WORLD DEVELOPMENT REPORT 2011

BACKGROUND PAPER

THE ROLE OF THE PRIVATE SECTOR IN FRAGILE AND CONFLICT-AFFECTED STATES

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July 2010 (updated April 2011)

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I. Introduction[*]

This paper explores how the private sector can positively contribute to peace-building and conflict prevention, and how that positive private sector role can be supported and enhanced. The starting premise recognizes that the private sector exists in all conflict situations and has the potential to both exacerbate and ameliorate conflict, the outcome of which can be greatly affected by appropriate support from external partners. It argues that private sector development in fragile and conflict-affected states requires special policies and instruments, given the backdrop of the distortions caused by conflict and the high potential of a return to violence. It also posits that a thriving, legal, private sector is essential to development and peace, as it provides livelihoods and growth, while delivering revenue streams in the form of taxes so governments can provide services to their citizens.[1]

This paper discusses and analyzes the role of the private sector (including local formal, informal, and illegal actors; diasporas; and regional and multinational players) in fragile and conflict-affected states, beginning with its role in the conflicts themselves, and in the immediate peace-building and longer-term reconstruction and development phases. The paper acknowledges that the topic of private sector development cuts across political, governance, and security dimensions, as well as a broad range of development themes. It also considers international efforts to support the private sector in fragile and conflict-affected settings to date, identifying gaps and making recommendations to address them. The paper does not focus on detailed operational issues or the use of various reform tools. Rather, it concentrates on key strategic issues, challenges, and solutions.

With respect to the conflict stage, the paper argues that, far from disappearing, the private sector continues to operate even during the most violent situations. However, distortions occur, with a focus on short-term, often illicit, gains and the fusion of actors (such as warlords or military officers who become "businessmen"). Other distortions result from the destruction of physical infrastructure and the flight of local human and financial capital.

In the immediate peace-building period, the paper emphasizes short-term measures that contribute to peace and to politically important confidence-building in private sector investments, such as: a) creating jobs, with a particular view to demobilized military and paramilitary forces; b) harnessing immediate business opportunities related to relief and reconstruction (for example, procurement from the local private sector); c) building key skills needed throughout the relief to development continuum; d) facilitating access to finance (e.g., microfinance, remittances); and e) building or strengthening government and community institutions and processes. In all cases, these initiatives should be undertaken in ways that acknowledge the primacy of local actors, are sensitive to the complex context, help build trust and confidence, and have a longer-term view.

In terms of longer-term development, the paper explicitly recognizes that conflict also creates a unique opportunity for reform. It reviews the performance of private sector development-related policies and reforms at the national and local levels, and analyzes the extent to which

[*] A special thank you to the following for good discussion, shared insights and editorial comments, during the preparation of this paper: David Bridgman, Michael Carnahan, Laurence Carter, Pierre A. Guislain, Ines Gutierrez, Melissa Johns, Karim Khoja, Samuel Maimbo, Catherine Masinde, Alan Andrew Moody, Borany Penh, Stephen Rimmer, Marc Roex, Sunita Saligram, and Jorge Wong-Valle.

[1] Service delivery is a critical demonstration of the state's commitment to its citizens.

"imported" reform models have been effective and reflect local capacity constraints. It also examines the critical issue of whether the international community is actually making the long-term support commitment, through the first post-conflict decade and beyond, to ensure that the reforms can be successfully implemented and sustained.

International mechanisms to support investments and private sector growth in fragile and conflict-affected states are examined, including existing risk-sharing mechanisms.

Beyond looking at key issues in private sector development in conflict-affected settings, the annexes to the paper highlight cross-cutting examples that illustrate broader points about the challenges and opportunities in these situations. Examples include extractive industries, mobile telecommunications, financial services, the diaspora and remittances, and a country case study on development and foreign investment in Mozambique.

II. The Private Sector during Conflict

Since the beginning of commerce and trade, the private sector has played a crucial role in conflict – as a cause and catalyst of strife, and as an integral part of restoring and maintaining peace. Ancient civilizations, from China, Persia, Egypt, Greece and Phoenicia to the Maya and the Inca, have fought battles over access to resources and trade routes. The very origins of the modern insurance market in the seventeenth century are directly tied to insuring ships against, among other risks, "men of warr… enemyies and piratts."[2] Insurance companies, in turn, started developing better sources of information on conflict and funding means of protecting ships, to minimize their losses.

More recently, since the end of the Cold War, many conflicts have focused on internal or regional grievances. While most of these conflicts had ethnic or religious overtones, they often were spurred on by competition over natural resources (see Annex A), exacerbated by the illegal trade in arms and drugs, which increases corruption and weakens state institutions, and driven by economic grievances among certain groups in the country or region. These trends are reinforced by the globalization of information flows, technology, and commerce. The result is an increasingly complex web of relationships between local, regional, and global economic actors, involved in multiple conflict situations, along with a mingling of military or paramilitary forces, government and private sector roles. Examples include rebel groups operating mines in Africa and the partial funding of the Tamil Tigers in Sri Lanka through a "tax" on remittances from Tamils abroad.

Over the past decade, there has been considerable debate regarding the specific role of the private sector in conflict and links between some private businesses and organized crime. Much of this debate has focused on the harmful effects of certain private sector activities—such as mining and logging—on certain countries and regions. However, there also is a clear parallel to private sector participation in organized criminal activity such as drugs and arms trading and trade in endangered species. Such activities cause or reinforce conflict and further weaken fragile institutions. Often, these activities occur with the active support of parts of the military and/or government in the country, eroding the integrity of these institutions. Furthermore, since these activities are focused on control over export and trade

[2] From the earliest available English marine insurance policy, of 1613; *The History of Lloyd's and of Marine Insurance in Great Britain*, Frederick Martin, p. 47, MacMillan, 2004.

with other countries, they are directly supported by outside actors, including neighboring countries, multinational businesses, or global criminal cartels. In the drug trade, for example, there is a clear domino effect in the Sahel/West Africa region, with drugs that originate in Latin America and are mostly destined for European consumers. Guinea-Bissau was the first direct victim. It became a trans-shipment point, which contributed to the internal strife affecting the country over the past two years.[3] The detrimental impacts of the illegal drug trade also have spread to Guinea and Mali, among others.[4]

The impact of conflict, violence, and prolonged fragility is particularly pervasive on the legitimate formal private sector. Foreign and local investors alike flee the country, taking with them longer-term capital, skills, jobs, and technology and further undermining local private sector support institutions (such as chambers of commerce) that could help prevent the slide into full-scale conflict. The businesspeople who do stay face difficulty in accessing finance, are often harassed or co-opted by increasingly corrupt government and military and/or by militias, and may find it harder to import necessary goods or export their products. Of course, there is a segment that also might benefit in the short term, by selling to armed groups or by hedging themselves against the usual inflationary pressures and currency depreciation that accompany a movement into conflict.

As the conflict deepens, new players emerge in the gray or black markets. These players often are directly related to military officers or leading government officials. In many cases, they are leading officers and officials themselves. As a result, the momentum of private sector-related activities can shift, ultimately reinforcing trends toward conflict, such as corruption and flight of human and financial capital. Still, there is nothing inevitable about this shift.

As institutions grow weaker and conflicts intensify, the resulting arms trade further distorts normal private sector activity. Unfortunately, the international community's response is usually not effective. The typical response does not help support the government and legitimate private sector activities, which could help prevent a fall into conflict; nor does it help suppress illegal trade. Where action is taken, the focus is often on interdiction and working with existing government, police, and military structures. There is little or no emphasis on alternative livelihoods or on the already-corrosive effects of the illicit trade on the very institutions that are now being supported. For example, in Tajikistan, initial efforts in the late 1990s focused on better equipment and training for the border guards, as these guards—in theory— represented a first line of defense against the heroin trade from Afghanistan on its way to Europe. However, regional experts pointed out that the border guards constituted one of the most corrupt institutions in the country. Thus, enhanced

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[3] Guinea-Bissau emerged in 2005-2006 as "Africa's first narco-state," with estimated monthly cocaine trans-shipments worth more than 10 times the country's gross annual national earnings. http://www.independent.co.uk/news/world/africa/drug-barons-turn-bissau-into-africas-first-narcostate-457690.html

[4] Antonio Maria Costa, head of the UNDCP, warned of the danger of West Africa, particularly Guinea-Bissau, becoming a trafficking hub, with money potentially going to "terrorists and anti-government forces," after 10 tons of cocaine were found in Mali in November 2009 on a Boeing 727 from Venezuela. UN Secretary-General Ban Ki-moon said drug trafficking was also affecting peacekeeping efforts in Afghanistan, Haiti, Guinea-Bissau and elsewhere. "So far, co-operation between governments is lagging behind co-operation between organised crime networks." *BBC News Online, 9 December 2009.*

training and provision of additional equipment may have improved their ability to profit from the trade, instead of stopping it.[5]
Even though prevention would be a far more cost-effective solution for all sides involved, avoiding the loss of many lives and livelihoods, regional and global actors often do not act until a full-blown war or civil conflict has erupted and directly threatens broader stability within a country and beyond.[6] In part, this is due to a concern over interference in the domestic affairs of a given state (governments in question rarely seek outside help in clamping down on a trade in which they may be implicated). It also could be because of business interests in neighboring states and elsewhere that feed on the illicit trade and the conflict, such as arms manufacturers and dealers from Europe, the republics of the former Soviet Union, China, and the United States.[7]

When the international community tries to resolve conflict, there often is little direct emphasis on strengthening and diversifying legitimate private sector activity. Notable exceptions to this occur sometimes in natural resource-rich countries, with a narrow focus on the natural resource sector. This focus can come at significant cost, including the "Dutch disease" effect, which can cause a decline in potential growth sectors of the economy (see Annex A).

Countercyclical support from international financial institutions, bilateral donors and other actors can make a significant contribution at this stage, by ensuring ongoing access to finance, imports, and exports. However, these efforts make sense only if they are coupled with a concerted international effort to (re-) establish or strengthen transparency, trust, effectiveness, and legitimacy in the government institutions, which provide the overall framework within which the private sector operates.

Where full-scale conflict has broken out, the private sector can become more skewed to the provision of goods and services to the armed combatants and to illegal activities related to the conflict[8] as the population seeks to cope. There is higher degree of informality,[9] and more

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[5]According to Nancy Lubin of JNA Associates and member of the Council on Foreign Relations, who has worked extensively on Central Asia, particularly reviewing the effectiveness of aid and development programs.
[6] Chavet and Collier (2005) point to the steep price of conflict, estimating that the cost of an average fragile state to be double the annual global aid budget (2005). Nevertheless, as fragile states slide into conflict, their descent is often not impeded by the international community. Somalia, Bosnia and Rwanda are all frequently cited as examples of countries where interventions by the international community came too little too late. It was after genocide in Rwanda and ethnic cleansing in the Balkans and Kosovo in the 1990s that the international community really began to debate how to "react effectively when citizens' human rights are grossly and systematically violated." At the heart of the discussion, is whether "States have unconditional sovereignty over their affairs or whether the international community has the right to intervene militarily in a country for humanitarian purposes." *Lessons from Rwanda: The United Nations and the Prevention of Genocide* accessed from www.un.org on 3 April 2011
[7] In October 2009, for the first time, 153 UN member states agreed in principle to a global arms trade treaty, to be negotiated by 2012, www.controlarms.org. For an analysis on the global arms trade, highlighting the fact that spending on arms now exceeds such spending during the Cold War era, with much of it going directly to conflict areas (and with assembly of weapons becoming increasingly diversified), see *Arms Without Borders*, Control Arms Campaign, October 2006.
[8] See Mark Shaw's Drug Trafficking and the Development of Organized Crime in Post-Taliban Afghanistan (accessed April 3, 2011 www.sitesources.worldbank.org) for discussion of the vulnerability of post-conflict countries to the growth of organized crime and its challenge to state consolidation. Countries frequently transition from conflict to democracy and market economies in the context of weak government institutions, lack of transparency, and lack of legislation; consequently, they are more vulnerable to corruption and criminality. He examines Afghanistan, where he notes that "the link between war and illicit activities became

focus on subsistence trade and farming. In many cases, with the absence of nearly all foreign investors and traders,[10] domestic firms closely tied to the government, military and/or militias are the only ones able to import increasingly scarce goods, since the military will have tightened control on borders and established monopolies (frequently on access to hard currency). Where the military is in control, officers may become directly involved in previously private sector activities, such as mining and trade. By contrast, in places like Somalia, Sudan, and Afghanistan, the lack of any effective central government presence may lead the local private sector to provide services normally expected from the government.[11] Within the country, beyond local short-term traditional lending markets based on family or kinship, credit tends to be at either usurious rates or confined to those best-connected to officials controlling state-owned banks.

Conflict also can cause economic relations to revert to pre-modern patterns, focused more extensively on kinship or ethnic identity and reflecting the broader roots of the conflict.[12] Depending on the nature of the conflict, the economic elites of entire ethnic communities may flee the country, often to places where clusters of their kin are already living. For example, many elites from Sri Lanka's Tamil community fled, particularly to London and Toronto, and continued to support their brethren from abroad.[13] Beyond this, a more generalized brain drain affects the government and the private economy as well – particularly the most advanced sectors and those tied to the outside world. In severe situations, or where hyperinflation renders the currency worthless, such as Darfur and Zimbabwe, economic activity may revert to bartering.[14]

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progressively stronger over the long conflict of the country. Both a cause and a consequence of this is that a weak central state in Kabul has been unable to govern the country's borderlands..." Also see Local Business. Local Peace: the Peacebuilding Potential of the Domestic Private Sector. International Alert, pp. 477-478 for discussion on Somalia case, where the private sector adapted and "developed coping mechanisms, such as filling the regulatory void themselves, maintaining close ties with warlords or in some cases by assuming warlord-like roles themselves, effectively blurring the boundary between the two."

[9] During conflict, informality arises from the disruption of social networks and formal structures and can lead to a "grey" economy, where private sector activity is irregular, largely opportunistic and operates without regulation. Private Sector Development in Post-Conflict Countries: A Review of Current Literature and Practice. Naoise MacSweeney. DCED. p. 21

[10] Interestingly, Lebanese traders have long remained active in West Africa even throughout conflict.

[11] Somali businessmen have leveraged their cultural networks "to take the place of the non-existent state in providing services and infrastructure...Business is one of the few sources of stability in Somalia." International Alert, p. 28

[12] It is important to note that kinship and ethnicity cannot always explain divisions. In Central America, for example, kinship and ethnicity play different roles depending on the conflict in explaining private sector survival.. The civil war in Guatemala fits more the case of division along ethnic lines: indigenous (approximately 70 percent of the population) versus mestizo/European descendants. Economic relations ran along those lines as well: indigenous populations working on the rural/agri economy, crafts, and smaller businesses or as laborers in farms owned by landowners. In Nicaragua, families were divided between t supporters of the Sandinistas/revolution (backed by the USSR via Cuba) and those that did not. The political division cut across all segments of society (wealthy/middle class and poorer socio-economic groups). The two sons of Violeta Chamorro (president 1990-1995) during the 1980s were fighting in opposite sides – Carlos Fernando was a Sandinista leader and Pedro Joaquin was a Contra leader. Discussion with Jorge Wong-Valle, IFC LAC department, April 3, 2011.

[13] "Diaspora Circulation and Transnationalism as Agents for Change in the Post-Conflict Zones of Sri Lanka," R. Cheran, York University, Sept. 2003, pp. 9-10

[14] In Zimbabwe, chickens became a sort of ersatz currency, as a result of hyperinflation and lack of access to hard currency in rural areas. See the Zimbabwe Telegraph, Dec. 23, 2009.
http://www.zimtelegraph.com/?p=5019

Of importance, however, is that throughout these mutations, the private sector continues to operate in one form or another. For example, using informal networks based on trust and kinship, remittances[15] sent from family members abroad often reach remote areas even during the worst of conflict. As Annex B illustrates, these remittances are a vital and relatively efficient lifeline to millions of families, particularly when foreign direct investment and official development assistance cannot reach them. In addition, this money often funds services such as health care, education, and sanitation, which government institutions may no longer be able to provide.

In sum, while the private sector is not destroyed by conflict, like other segments of society, it is deeply traumatized and damaged. For this reason, the steps taken in the immediate post-conflict period are crucial to shaping the future of the private sector and to restoring it to the legitimate driver of economic activity that it can and should be.

It should be noted that in addition to facing direct impacts from conflict, the private sector faces difficulties in periods of prolonged fragility, often accompanied by violence. The potential interventions to address the private sector development constraints during a conflict are similar to the interventions that could be used during a period of prolonged fragility.

The next section of the paper addresses the private sector's role in the relief and reconstruction period and the constraints to productive private sector development.

III. The Private Sector Role in Peace-building, Relief and Reconstruction

In the aftermath of conflict, the private sector's role can extend beyond its narrow impact in providing jobs and generating income. The private sector can lift some burden from government and help lend legitimacy to the state. The private sector can deliver tangible dividends to the wider population through investments that not only create jobs but also provide basic and new services, introduce innovative approaches to development, and generate tax revenues for reconstruction efforts.[16] To help the private sector meet these challenges, build peace and secure development, it is important to understand more clearly the interrelationships it can have to politics, security, institutions and development.

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[15] Remittances are private transfers, though typically used for consumption purposes, which have been used for wider purposes in fragile and conflict-affected states. Remittances from the diaspora frequently sustain businesses and individuals in places such as Somalia and Darfur, and are used to pay for key services such as health care and education, where the authorities are absent or unable to operate adequately.

[16] According to the World Bank Group's 2005 World Development Report, *A Better Investment Climate for Everyone*, "Private firm – from farmers and microentrepreneurs to local manufacturing companies and multinational enterprises – are at the heart of the development process...They provide more than 90 percent of jobs, creating opportunities for people to apply their talents and improve their situations...They are also the main source of tax revenues, contributing to public funding for health, education and other services."

Also, consider the case of the Aga Khan Network's Roshan telecommunications company in Afghanistan: it is the country's most significant investor, employing 1,100 people directly and over 30,000 people indirectly (selling top up vouchers, running retail stores or public call offices) and paying taxes (at the end of 2008, it had paid 146 million in taxes, which accounted for 6 percent of the government's overall domestic revenue). Source: "Mobile Marvels," The Economist, 8 March 2007. Statistics also cited in discussions (late 2009 and early 2010) between Karim Khoja, CEO of Roshan and Mary Porter Peschka.

Private Sector Contributions to Securing Peace, Building the State and Keeping the Peace

There are many instances of the private sector playing a key role in building and sustaining peace after a period of conflict. Businesses can make strong strategic partners in peace-building efforts, they can participate directly in peace negotiations or talks to prevent conflict, and they can engage indirectly by undertaking activities to influence the negotiations. South Africa, Sri Lanka, and Northern Ireland offer illustrations of the positive contributions the private sector can make to peace processes.

- In South Africa, businesses helped the country transition from the apartheid days to a multiracial state. For example, Consolidated Goldfields organized and financed meetings between the African National Congress and the Afrikaners leadership during the final years of the apartheid regime. This dialogue was widely credited with laying the groundwork for the eventual negotiations that brought end to apartheid.[17]
- In Sri Lanka, a group of local trade associations sponsored a public campaign to mobilize citizens to speak out on the importance of peace in 2001.[18]
- In Northern Ireland, the Confederation of Business Industry advocated for the peace process, highlighting the benefits of a peace dividend. CBI and a number of other business associations formed the "Group of Seven" to encourage a settlement to the conflict by using media and public campaigns at critical points in the peace process. Throughout, they also interacted directly with all the parties to the conflict.[19]

The private sector and economic considerations more generally are rarely taken into account during the development of peace treaties.[20] Although there is no single best way to engage the private sector in the peace process, the engagement itself— either by informal means or by means of a formal parallel track focused on private sector-led economic development—is critical. Without this, the private sector could become a deterrent to peace, rather than a key partner in the peace process.

The private sector can also help address some of the key security issues in fragile and conflict-affected countries through the provision of jobs to unemployed youths and former combatants, either related to national disarmament, demobilization and resettlement initiatives or over the course of a normal business trajectory.[21] But the relationship between security, justice, and the private sector is complicated. In the absence of basic security and legal transparency—for example, unclear property rights—businesses are reluctant to make the long-term investments that spur economic growth and generate the jobs so desperately needed in these challenging contexts. In some cases private sector economic activity can be

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[17] Allan Gerson, 2001. "Peace Building: The Private Sector's Role," *The American Journal of International Law*, p.108

[18] Guidance on Responsible Investment in Conflict-affected and High Risk Areas, draft 19 February 2010, UN Global Compact, p.10

[19] Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector, 2006. International Alert, p. 4

[20] Astri Suhrke, Torunn Wimplemann and Marcia Dawes, 2007. Peace Processes and Statebuilding: Economic and Institutional Provisions of Peace Agreements, CHR. Michelsen Institute

[21] Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector, 2006. International Alert, p. 7

dominated by a handful of large, often family-owned businesses, which can impede healthy competition and the development of competitive markets.

Political settlements and processes lay the groundwork for future stability, long-term growth and security, but early economic development is what most readily translates into tangible differences in people's lives. These positive changes are vital in the course of peace consolidation, where the successful implementation of peace agreements is "often contingent on swift materialization of peace dividends."[22]

By generating jobs and income opportunities and filling gaps in delivering basic services, the private sector can help the state shift expectations in the country, because concrete dividends instill hope in people, and give them a reason to buy into peace. As Gerson asserts, "Conflict settlement requires the injection of optimism and hope born of employment and economic opportunity. Otherwise, fragile peace arrangements can rarely be sustained. And, over the long term, only the private sector is capable of growing new enterprises, opening investment opportunities, and providing employment and enduring economic security."[23]

By supporting the state's peace-building efforts, the private sector helps strengthen the state's legitimacy through registering and paying taxes, providing services on contract to the public sector, and others.[24] Through the private sector's provision of essential services, a weak government in a fragile or conflict-affected context can strengthen its social contract and build credibility with its citizens.

Finally, the private sector cuts across all socioeconomic strata. So, it also plays a role in helping to "mitigate the socioeconomic exclusion that lies at the root of many conflicts."[25] This is important because social exclusion can lead to significant economic and political grievances. Coupled with cultural affinities, such grievances can spur groups to challenge authority using violence. This situation has occurred numerous times in the recent years: the Muslim rebellions in the Philippines, Catholic insurrection in Northern Ireland, the Sendero Luminoso movement in Peru, and the Tamil rebellion in Sri Lanka among others.[26]

The private sector can help bridge these gaps. In Sri Lanka, for example, a group of members from regional chambers of commerce from across the country promoted joint initiatives between Muslim, Sinhalese and Tamil businesses, as well as policy advocacy. In the Philippines, La Frutera Inc. and Pglas Corporation established a banana plantation in a marginalized area, creating jobs for Christians and Muslims—including ex-combatants—thus helping to promote religious tolerance and facilitate reconciliation in the workplace.[27]

Constraints facing the Private Sector

While there are clear gains from developing a vibrant private sector in fragile states, there is little that is easy about doing business in such economies. According to the World Bank's

[22] International Alert, p. 42
[23] Gerson, p. 103
[24] OECD Concepts and Dilemma of State Building in Fragile Situations: From Fragility to Resilience, 2008
[25] International Alert, p. 6
[26] Social Exclusion and Conflict: Analysis and Policy Implications. Frances Stewart. CRISE Policy Paper. January 2005 (updated April 2006). PP. 6-7
[27] International Alert, Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector. 2006. P. 5

Doing Business database, fragile states represent the world's most challenging business environments, often with the most bureaucratic hurdles and the fewest property protections for entrepreneurs. The *Doing Business* indicators reveal that fragile states, on average, rank 144th out of 183 economies for ease of doing business. The average rank for non-fragile states is 78th.[28] Among the bottom 25 economies in the *Doing Business* rankings, 20 are fragile states. These countries tend to implement fewer reforms as well: during the period 2005-2009, fragile states contributed only 14.4 percent (186 in total) to the total 1,290 reforms documented by the database, even though these states comprised 22.5 percent of the dataset.

Businesses operating in fragile states face numerous obstacles. While anecdotal evidence of the difficulties abound, the World Bank Group's Enterprise Surveys quantify these constraints to business operations. An examination of the survey data reveals that the number one environment constraint faced by firms working in conflict areas is lack of access to electricity.[29] The second biggest challenge is obtaining access to finance.[30] Other major issues cited by firm managers include political instability, practices of the informal sector, and corruption.[31]

Conditions in conflict-affected countries create additional dimensions of difficulty for businesses, beyond the standard barriers captured by the surveys and the *Doing Business* data.[32] Indeed, just because the conflict has ended, it does not mean that the business operating environment has changed. So, businesses may continue to face many of the same difficulties they faced in the midst of the conflict.[33]

A country's ability to achieve sustained and permanent growth in the aftermath of conflict has proven to be a particularly difficult and lengthy process.[34] The poor state in which the overall economy and institutions are left poses a difficult environment for recovery. By understanding these difficulties, the private sector will be better equipped in dealing with them, for a more efficient private sector development strategy.

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[28] Melissa Johns, Conflict Affected Countries: Reform Trends from the Doing Business Data Set, May 2010. The ease of doing business index is the simple average of the economy's percentile rankings on each of the 10 topics covered in Doing Business, minus the pilot "getting electricity" data. The ranking on each topic is the simple average of the percentile rankings on its component indicators. See www.doingbusiness.org.

[29] In total, 22 of the 181 countries included in the Enterprise Surveys are fragile and conflict-affected states. 10 out of these 22 countries have electricity as the number one environment constraint facing firms (and usually electricity is much higher than any of the other issues). It is also in the top 3 issues for 17 out of the 22 countries assessed. Only two countries, Cote d'Ivoire and Tonga, do not list electricity in their top six environment constraints. http://www.enterprisesurveys.org/Custom/

[30] Access to finance is in the top three issues for 17 out of the 22 countries, and the number one issue in four countries (Cote d'Ivoire, Liberia, Nepal, and Georgia). http://www.enterprisesurveys.org/Custom/

[31] Political instability (occurs in the top 5 issues for 14 of the 22 countries assessed, and in the top 6 issues for 15 of the 22 countries assessed); informal sector practices (occurs in the top 5 issues for 13 of the 22 countries assessed, and in the top 6 issues for 16 of the 22 countries assessed); corruption (occurs in the top 5 issues for 11 of the 22 countries, and in the top 6 issues for 15 of the 22 countries assessed) http://www.enterprisesurveys.org/Custom/

[32] Karen Ballentine in Bray, John. The Role of Private Sector Development in Post-Conflict Economic Recovery. UNDP 2007. p 3.

[33] Ibid. p 4.

[34] Piaretti, Nadia F. From Rent-seeking to Profit-creation: Private Sector Development and Economic Turnaround in Fragile States. World Bank. November 2010. p 3.

Asset Destruction. The loss of assets is one of several economic constraints to the private sector in post-conflict environments. Such losses make it harder for enterprises to resume economic activity, and affect a significant part of the population – which in turn creates shrinkage in purchasing power and markets.[35]

Macroeconomic instability. Conflict also creates inflation, macroeconomic instability and uncertainty, currency weakness, limited access to credit and financial services, and distorted regulation of economic activity. These factors result in a high proportion of informal economic activity. An economic environment with these constraints increases both the costs and the risks of engaging in commercial activity and investing.[36]

Poor Public Institutions. Post-conflict governments and institutions are fragile primarily because of: reduced levels of authority following the conflict; absence of the most capable officials, many of whom have fled the nation; and, in some cases, lack of support from locals.[37] Added to this are the financial constraints and limited capacity in terms of human resources and skilled staff. These factors also have an impact on governability, many times limiting institutional capacity to bring about change, ensure security, and guarantee the provision of basic services.[38]

Corruption. In the majority of cases, a natural consequence of a conflict is widespread corruption. As Bray explains, "post-conflict environments are notorious for high levels of corruption, among other reasons because of the "state of exception" – the idea that exceptional circumstances place the main imperative on rapid spending, with accounting controls as a secondary consideration."[39] This state of exception can pose serious obstacles to private sector development. As USAID's Guide to Economic Growth in Post-Conflict Countries points out, "increased corruption can lead to disparate and unpredictable enforcement of business and trade regulations, enabling some businesses to evade taxes, licensing restrictions, or customs duties that others must pay. Frequently, the rules themselves may be in flux, with unexpected decrees or fluctuating enforcement policies, making it difficult to pursue a rational business plan."[40]

Security. Another constraint to private sector development is the insecurity that conflict creates in the aftermath of war. Naoise MacSweeney's research makes a clear reference to this issue:

> "Due to its fragility, the post-conflict state is unlikely to be able to guarantee the complete rule of law – comprising basic security and a properly-functioning judicial system. If there are residual pockets of violence, or continuing security threats, these place major limits on the form that the private sector can take, and the kinds of activities it can engage in. Restrictions are also placed on private-sector activity by the judicial system. Not only are property rights unclear in a post-conflict context, but

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[35] MacSweeney, Naoise. Private Sector Development In Post-Conflict Countries. A Review Of Current Literature And Practice. Cambridge, UK. p 17.
[36] Ibid., and U.S. Agency for International Development (USAID). A Guide to Economic Growth in Post-Conflict Countries. Office of Economic Growth. Bureau for Economic Growth, Agriculture and Trade. January 2009. p 4.
[37] MacSweeney, Naoise. Op. Cit. 19 and USAID Op. Cit. 5
[38] Ibid. and USAID Op. Cit. 4
[39] Bray, John. The Role of Private Sector Development in Post-Conflict Economic Recovery. UNDP 2007. p 4.
[40] USAID Op. Cit. 51.

there may not be clear channels of dispute resolution. Both of these are important to allow the private sector to grow and develop."[41]

Moreover, as Rob Mills and Qimiao Fan explain, the lack of physical security changes the nature of business life itself, becoming "less transparent, less competitive and demands greater reliance on personal contacts. Individual business transactions are fewer in number and smaller in size. With fewer opportunities to benefit from economies of scale, private sector activity becomes less efficient."[42]

Access to finance. Conflicts put a halt to the normal operations of banking services, and financial institutions do not usually go back to business-as-usual in the early stages of post-conflict. Consequently, the lack of access to credit is likely to be a particularly severe problem for private firms.[43]

MacSweeney's study describes this situation, in which central and commercial banks do not operate normally during conflict and post-conflict environments. Even if they were operational, these banks are not equipped to serve the most vulnerable people. Extending financial services to micro- and small entrepreneurs is essential to kick-start economic activity in the immediate post-conflict period, and to allow enterprises to grow in the medium to long term.[44]

Mills and Fan further explain that "without a functioning banking and payment system, business transactions must rely on cash and cannot access formal credit. Businesses that need credit for working capital (for example, to purchase inputs or goods for on-selling) have to rely more than usual on informal financial services, which are more expensive, unregulated, and limited in range."[45]

Labor. Conflict also causes unemployment and under-employment. In the post-conflict period there is a sudden influx of workers into the labor market, many of who will be young, unskilled, and inexperienced ex-combatants who will further depress the already low price of labor and complicate their absorption into the post-conflict economy.[46]

Land Ownership. As mentioned before, the resulting weakened institutions in the post-conflict context can create a breakdown of the legal system (even if laws and regulations are still in place), creating instability for private sector development. Another consequence of this disruption of the judicial system is the "informal" expropriation of property and disputes over rightful land ownership.[47] The private sector suffers the direct effects of this impact, since individuals and firms will be unsure of their assets, limiting their opportunity to construct on them.[48] With no security over land ownership and without institutions that can help one recover "stolen" land, individuals will not be motivated to securitize land to raise finance.

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[41] MacSweeney, Naoise. P. 19
[42] Mills, Rob and Qimiao Fan. Op. Cit. p 7.
[43] Bray, John. Op. Cit. p22.
[44] MacSweeney, Naoise. Op. Cit. p56
[45] Mills, Rob and Qimiao Fan. Op. Cit. p 9.
[46] MacSweeney, Naoise. Op. Cit. p21 and MILLS, Rob and Qimiao Fan Op. Cit. p 11.
[47] Mills, Rob and Qimiao Fan. Op. Cit. p 9.
[48] MacSweeney, Naoise. Op. Cit. p17

Infrastructure. Armed conflict inevitably damages or destroys infrastructure, including basic transport and communications structure, as well as utilities such as electricity and water.[49] Therefore, fragile states will be in severe need of rehabilitation and replacement of physical infrastructure if reconstruction is to occur in general, and if private sector development is to take place in particular.[50] More specifically, the impact of poor or lacking infrastructure on the private sector prevents diversification and specialization of production, and the expansion of trade. Without the rehabilitation of infrastructure, economic growth potential will be limited.[51]

Market distortions. The private sector is in competition with other development interventions, as numerous agencies try to help war-affected people. Grants and subsidies usually abound in such situations. These grants and subsidies are critical to easing the burdens of a fragile state, but there could be different rules associated with this aid. This can cause confusion and frustration in the local population. It also has the side effect of distorting private sector markets. In addition, many relief programs ignore locally available goods and services, making the problem worse.[52]

Poor tax enforcement and collection. Another result of war is a severely depleted national fiscal base, with a small number of enterprises remaining in the formal sector. A vicious cycle is created that feeds informality: as "economic activity declines and fewer firms remain in the formal sector, revenues from indirect taxes and VAT fall and governments become more dependent on import duties and other trade taxes…In many cases, the temptation has been to tax business activities too heavily, which strengthens the incentives for firms to remain in the informal sector.[53]

There is no template for how these challenges are best addressed or for the optimal way to carry out private sector development in fragile and conflict-affected situations. Still, it is clear that initiatives need to be grounded in a field-based understanding of a country's history, culture, resources and capacities. When thinking about the best ways to harness the power of the private sector to contribute to securing development, it is important to consider the context and to be pragmatic.

The Role of Foreign Direct Investment

Foreign investment can be a key driver of growth and employment generation. However, there is a reluctance to make long-term investments and "private portfolios are made up of a considerably greater amount of liquid assets than in *normal* conditions."[54] Moreover, there are only a few sectors in which where foreign firms are willing to enter fragile/conflict situations, including mining,[55] telecommunications, construction. These sectors are of interest

[49] Bray, John. Op. Cit. p4.
[50] USAID Op. Cit. 5-6.
[51] Mills, Rob and Qimiao Fan. Op. Cit. p 10.
[52] Bagwitz, Daniel et al. Private Sector Development in (Post-) Conflict Situations Guidebook. Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH. Eschborn, 2008. P60-61, and USAID Op. Cit. 58-59.
[53] Mills, Rob and Qimiao Fan. Op. Cit. p 14-15
[54] Measuring the Business Environment for Entrepreneurship in Fragile States. UNU-WIDER. Chiara Guglielmetti. March 2010. P. 3
[55] FDI to 42 fragile and conflict-affected states more than quadrupled from $5 billion in 2000 to $21 billion in 2006; however, over 70 percent of all FDI to these challenging countries went to a handful of natural resource-rich countries (Angola, Chad, Equatorial Guinea, Nigeria, Pakistan and Sudan – Pakistan being the only non-

to foreign firms for various reasons, ranging from extreme rewards in the case of mining, to relatively quick returns in the case of telecommunications,[56] to the certainty of payment for donor-funded construction.[57]

But overall, foreign investors are extremely selective when considering engagements in highly risky environments.[58] Thus, the best approach is to facilitate the willing while ensuring these early mover investments are channeled for the benefit of the country, rather than just for a handful of people.

Knowing the characteristics of conflict environments and the precursors to violence, international business can be proactively engaged to help stabilize the environment. The UN Global Compact's Guidance on Responsible Business and Investment[59]helps companies work constructively in these challenging contexts, ensuring that their operations minimize risk of doing harm and maximize positive contributions to peace and development. For example, recognizing that investments in natural resources generate significant revenues for the government, which could exacerbate tensions between conflicting parties, the compact notes the importance of encouraging stakeholders to conduct financial transactions in transparent ways, and to ensure that payments are earmarked to support infrastructure and capacity-building projects that benefit the local area.[60]

Furthermore, international companies can make strategic social investments alongside their core business activities in a country, as is recommended in the Global Compact guidelines.[61] Such investment offers a win-win for the investor and the local community. For example, when Aga Khan's Roshan invested in the telecommunications sector of Afghanistan, the firm engaged extensively with local communities, implementing corporate social responsibility initiatives[62] and hiring villagers to guard its towers. These activities brought jobs and general development to the local population and resulted in fewer tower attacks by the Taliban. It also resulted in lower security costs when switching from international to local security providers. Roshan also made a positive impact on significant development issues such as improving health through telemedicine, and battling corruption through mobile banking (see Annex C).

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natural resource producer). Source: Resource Flows to Fragile and Conflict-affected States Annual Report. 2008. OECD.

[56] The telecommunications sector offers relatively quick returns (payment comes as soon as people start calling) and fragile and conflict-affected countries represent new markets, yet to have been saturated (unlike those of the developed world). In Afghanistan, Somalia and DRC, the average mobile penetration growth rate was 111 percent between 2001 and 2006. Source: Konkel and Heeks, p. 415

[57] Construction opportunities abound in post-conflict countries, where sizable amounts of money are available from the donor community. For example, in the first decade after conflict ended in Lebanon, the country received about $10 billion. , Even a smaller economy like Bosnia and Herzegovina has received $5.4 billion since 1995. And since these reconstruction activities are typically funded by the donor community, there is little risk of non-payment. Bray, p. 23 www.international-alert.org/pdf/international_companies_post-conflict_WBank.pdf

[58] In 2008, total foreign direct investment into fragile states was $13 billion, compared to the $586 billion total net FDI to developing countries, of which $320 billion went to the large emerging markets of Brazil, Russia, India and China. Source: MIGA, *Conflict Affected and Fragile States Facility*, Presentation, May 2010.

[59]Guidance on Responsible Business and Investment in Conflict-affected and High Risk Areas, draft February 19, 2010, UN Global Compact

[60] Ibid, p. 13

[61] Guidance on Responsible Business and Investment in Conflict-affected and High Risk Areas, draft 19 February 2010, UN Global Compact Global Conflict, p. 17

[62] For example, Roshan supports initiatives to provide clean water and solar power at the village level.

Still, given the limited nature of foreign investment in fragile and conflict-affected countries, it is important to broaden the discussion of mobilizing investment in these challenging contexts beyond foreign direct investment to include potential local and diaspora sources of investment. Post-conflict efforts also should be focused on stimulating recovery by resuscitating "markets, livelihoods and services, and the state capacities necessary to foster them."[63]

The Role of the Financial Sector

The financial sector plays a key role in private sector development, and in contributing to broader economic development and growth. Financial services are essential to jumpstarting activity and enabling medium- and long-term business growth (see Annex D). The financial sector is the main source of capital financing for the domestic private sector, including for large firms, smaller businesses, microenterprises, and individuals. It plays a key role in broadening positive economic impact beyond what foreign direct investment creates.

The effect of prolonged periods of conflict and violence can be devastating for the financial sector. Following prolonged conflict or periods of severe fragility, normal operations of public and private financial institutions—their capacity and their performance—can be decimated.

In extreme cases, looting of banks—including the central bank—can take place, records can be destroyed, and assets can be impaired because of widespread negative impacts throughout the economy. In the recent conflict in Côte d'Ivoire, for example, banks were embroiled in the conflict as competing factions tried to secure financial assets and means of payments while foreign banks were closing and domestic banks were subject to seizures.[64]

Banks that survive such conditions often find themselves with a weak capital base, a highly risky environment for extending credit, and—often—a legacy of poor governance and sector management that can get in the way of a return to normalcy. In addition, the asset preferences of bank clients are affected by conflict, instability, and violence. Many clients opt to move liquid assets overseas or convert assets to foreign currencies. In some cases they convert to non-financial assets or holding cash outside the banking system. [65]

Restoration of routine banking operations is an important first step in rebuilding a financial sector. This step enables the provision of credit and other financial services needed by the private sector, such as trade finance, working capital, and other forms of short-term credit that banks do not provide during periods of conflict and instability. Such activities also rebuild banks' deposit base.[66]

Even though restoration of commercial bank operations are important for businesses, it is unlikely to improve access to finance immediately for large numbers of individuals or

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[63] Recovering from War: Gaps in Early Action, NYU Center for International Cooperation

[64] edition.cnn.com/2011/WORLD/africa/02/15/ivory.coast.**crisis**/

[65] Fragile and conflict-affected countries tend to be extremely poor, with significant unemployment. Micro, small and medium enterprises tend to be the only vehicle to provide jobs and income opportunities to sizable portions of the population.

[66] Addison, Tony, "Conflict and Financial Reconstruction," Finance and Development Briefing Papers, March, 2002.

micro/small enterprises. These smaller businesses are the market focus for microfinance institutions. Microfinance banks can operate more effectively than traditional commercial banks in the absence of a strong regulatory environment, as long as there is strong management capacity and a robust business model to manage risk and ensure adequate income.

Here, it is important to distinguish between small scale, donor-supported, cash grant or loan programs and sustainable microfinance. Immediate post-conflict "microfinance" from nongovernmental organizations has often been a misnomer for grants. The lack of distinction between grants and loans has caused confusion and significant difficulties for future microfinance providers. In fact, it is difficult for microfinance institutions s to create a fee-for-service, business client mentality in the midst of an environment dominated by relief operations and handouts.

Using microfinance as a means to achieve non-financial objectives is costly and serves to blur the lines between microfinance services and NGO relief. For example, in Rwanda, small grants were called microfinance, although there was no supervision or repayment discipline, and microfinance programs re-opened solely to issue new grants from donor sources.[67] Most of these programs do not survive to become sustainable institutions.

IV. Short Term Interventions to Enhance the Private Sector's Impact

In the short term, external partners can support the local private sector in three main areas to address fundamental constraints and begin to shift the direction of private sector activity in ways which will support peace, stability, and longer term development:

- Harnessing immediate business opportunities
- Building key skills that can be used along the relief to development continuum
- Facilitating access to finance

Each of these three areas will be addressed in turn.

Harnessing immediate business opportunities related to relief and reconstruction

Relief and reconstruction efforts mean the arrival of international militaries, bilateral and multilateral development agencies, and NGOs, among others. As these multiple players enter the country and as basic security is restored, there is a rapid rise in economic activity, in the form of procurement by the various institutions, spending by their international staff and spending by their local staff. These funds are not negligible. In Afghanistan, the British military has more than eight thousand staff and spends around 1.2 billion pounds each year. It is estimated that over one thousand sustainable jobs and $10 million in additional income could be generated for the local population, at no extra cost to UK taxpayers.[68]

[67] Tamsin Wilson, *Microfinance During and After Armed Conflict: Lessons from Angola, Cambodia, Mozambique and Rwanda,* The Springfield Centre for Business in Development, 2002.
[68] Chris Bold, "The Importance of Private Sector in Conflict-affected Countries," IFC Smart Lessons, 2009, p. 2

Globally, UN peacekeeping missions spend about $5 billion each year.[69] In 2006, a study looked at 10 UN peacekeeping missions and estimated how much of each mission's budget was spent on locally-produced goods and services. With only one exception (Kosovo), research showed that just under 10 percent of mission spending went directly into the local economy. Even at this low level, there was a considerable boost in GDP, of 4- 8 percent.[70]

Such missions procure a variety of goods and services, potentially bringing immediate benefits to the local populace; but, they also bring international staff (with allowances), who want to make personal purchases, eat at restaurants and stay at local hotels. Expenditures in these areas can provide near-term employment for local people and serve as a catalyst for longer-term development, since often these establishments do not go out of business when the mission ends. They may have to curtail operations and shift towards different markets. Still, the 2006 study revealed that business leaders and government officials alike viewed these businesses as a good way to lay the groundwork and establish the infrastructure for other sectors, especially tourism.[71]

So, a good place to start with local economic recovery efforts is with the early influx of international players. The "Afghan First" policy is an example of how such efforts can encourage local economic growth, a policy endorsed by most donors and the UN.

Afghan First is a non-binding commitment by donors to buy local goods and use local suppliers whenever possible as they undertake project work, in keeping with the Paris Declaration on Aid Effectiveness and the Afghanistan Compact. To date, this initiative has translated into well over $1 billion in new spending in the local economy, "creating tens of thousands of jobs."[72]

Following on the heels of this success, efforts are underway to promote a "Haiti First" policy, as a way to, in effect, spend the development dollar twice. This is the concept: a donor can invest development dollars to construct a hospital, using imported goods and services, and leave a hospital behind in a single spend of the money. Or, the donor can use local suppliers to build a hospital and simultaneously restore livelihoods, develop the local marketplace and generate tax revenues, making the same dollars work double.[73]

Building skills needed throughout the relief to development continuum

While the small percentage of UN peacekeeping budgets spent in the local economy usually results in a significant boost to GDP, there is considerable room to enhance its local economic impact. Peacekeeping operations and the donor community can be more purposeful in their programming. They should work to ensure the local community has the tools it needs to take advantage of the opportunities generated by the entry of international actors in the immediate post-conflict period. And they also must to help the local business community progress along the development continuum, including when the peacekeeping operations and other international players depart.

[69] Michael Carnahan, William Durch and Scott Gilmore. Economic Impact of Peacekeeping, Peace Dividend Trust, March 2006
[70] Ibid, pp. 1-2
[71] Michael Carnahan, William Durch and Scott Gilmore. Economic Impact of Peacekeeping, Peace Dividend Trust, March 2006, p. 21
[72] Scott Gilmore, Peace Dividend Trust, email exchange of 12 February 2010
[73] Ibid.

International actors know what they need when they enter post-conflict contexts; by having such a sizable presence of international peacekeeping, relief, and development communities, there is—in effect—a captive market. Even thought local businesses may not initially have the requisite skills to take advantage of these early opportunities , such operations typically last some years. So, there is time to build local capacity to meet the needs of the international presence on the ground. Unfortunately, this local capacity-building is not happening in many cases. The UN's Special Representative of the Secretary-General for Afghanistan made a compelling point in June 2009 at a local procurement conference in Kabul, when he highlighted the fact that it was no longer 2002, when the international community first returned to Afghanistan and could not find suitable local suppliers. Seven years and multiple millions of dollars worth of private sector development efforts later, and the international community was still not procuring local goods and services on a sufficient level.[74]

There are certain sectors, such as agribusiness and construction that are important following any conflict situation. These sectors could form the basis for concentrated, local development focus. Collier specifically points to the decline of agricultural production for export that takes place during conflict, as farmers tend to move significantly into subsistence. He also discusses construction booms that characterize post-conflict recoveries. The inflow of foreign aid and associated large reconstruction contracts will grow the demand for construction services; however, it is all too likely that local construction skill sets will be decimated during the conflict.

According to Collier, "A construction boom will follow the arrival of peace as night follows day and so right from the start of the peace a shortage of construction skills can be anticipated. A priority is thus at an early stage to establish training facilities for basic construction skills and target training on precisely the young men who might otherwise be recruits into the reversion to violence."[75]

In addition to these sector specific skills, local entrepreneurs will be in great need of general business skills and in particular, training on how to bid successfully for on construction-related contracts.

In an effort to address these issues, the Dutch defense ministry and the Dutch employers association have partnered to help promote economic reconstruction in places where conflict is still underway. The International Labour Organization supports the initiative, called IDEA—I ntegrated Development of Entrepreneurial Ideas. The ILO is providing training materials for small businesses, and training Dutch businessmen who are deployed to Afghanistan as reserve officers to help illiterate would-be entrepreneurs.[76]

Other efforts include IFC's small business management training program, called Business Edge. The program provides locally-adapted and translated adult-learning materials, trains local trainers, builds capacity of local training companies—often smaller businesses themselves—and establishes quality assurance mechanisms so that local firms can train the local population. To date, Business Edge has engaged in some particularly challenging markets, including Afghanistan, Democratic Republic of Congo, Haiti, Iraq, Liberia, Papua

[74] Speech by Kai Eide, UNAMA, Local Procurement Conference, Kabul, 10 June 2009
[75] Paul Collier, Post-conflict Recovery: How Should Policies be Distinctive?, Oxford University, May 2007
[76] War Zone Entrepreneurs, Radio Netherlands Worldwide – downloaded 3/14/2010

New Guinea, West Bank and Gaza, and Yemen. In such markets , the local companies' knowledge of the environment allows them to navigate the complex terrain more readily.[77]

With the arrival of development institutions, comes large contracts, which are typically awarded to international companies. There must be more focus on helping local enterprises learn how to effectively bid for these contracts. More realistically, given that the international companies will have better access to financial and other resources, efforts can be made to prepare local firms as sub-contractors to the larger international companies.

Experience in many post-conflict countries suggests that local labor and materials can be used to help build required infrastructure. In some cases, use of local sources for employment-intensive and labor-based technologies can represent a more astute development strategy than relying on expensive equipment and foreign labor.

For post-conflict countries with low wages and high unemployment and under-employment, comparative studies of the two approaches have demonstrated certain advantages of the employment-intensive approach, such as increased local employment through the building and maintaining of infrastructure, as well as associated skills development. Employment-intensive investment also can assist in the process of self-sustaining development, distribution and reinvestment of wealth in local regions. Additional business start-ups, healthier people, technical innovation, human and labor rights and standards, loan repayments, higher school attendance, and increased tax receipts are just some of the value added through such labor-based infrastructure programs.[78]

Disarmament, demobilization, and reintegration programs are inevitable in these contexts. Donors spend millions of dollars on DDR initiatives, and yet rarely are these efforts linked to the international community on the ground. For example, the UNDP spent some $6 million in Afghanistan to support small businesses of former combatants including efforts to help ex-combatants with vocational and on-the-job training as well as finance agricultural and other opportunities for ex-combatants who wanted to work for themselves. Their beneficiaries represented nearly 83 percent of the DDR population and 50,000 new businesses. If such efforts had proactively paired the international community's expenditures with local suppliers and producers to develop their capacity, they may have been able to significantly boost the Afghan economy over the longer term.

If managed properly, taking care not to encourage an over-reliance by the local companies on the international community, the captive market could have provided a safe space for the

[77] Thus far, 135,000 Business Edge training seats have been delivered globally. 65 percent of trainees apply new skills on the job. In Yemen, nearly 30,000 participants were trained from 2006 to 2010. An independent evaluation found that the program has had a lasting impact on the country. There was no management or business skills training on offer in the market – only English language and IT training. Today, even after subsidies have been withdrawn there is an active management training market. In Pakistan, an assessment of the program found that the number of smaller businesses preparing cash flow statements after training increased by 20 percent and that 71 percent of participants with irregular credit histories had cleared or decreased their outstanding amounts 6 months after the training. Source: IFC Business Edge team in the Middle East, June 2010. Also, review of independent consultant Mark Latowsky's report on Business Edge in Yemen.

[78] Discussion with Stephen RImmer, Senior Private Sector Development Specialist, World Bank, Iraq.

local supply chain to develop. It could have catalyzed development of locally-produced goods, as part of a wider "Buy Afghan" marketing initiative aimed at reducing imports.[79]

Understanding the needs of both the international community and the local private sector in the early days after a conflict can allow different actors to be more purposeful in the structuring of their approaches, which can yield not only immediate benefits in the form of income opportunities for the local population but also longer term opportunities in the form of skills development and launch of new businesses and activity.

Facilitating access to finance

Stabilization of money markets soon after a conflict is critical for controlling inflationary trends and giving further confidence to investors.[80] This was the case in Afghanistan, where efforts to stabilize the central bank and the financial sector soon after the end of war were key. Following the fall of the Taliban in 2001, the IMF and SIDA set up a fund to stabilize the financial sector by funding the Central Bank of Afghanistan.[81] Subsequent reforms in microfinance were enabled as a result.

Other countries have achieved similar results. In Liberia, Sierra Leone, southern Sudan, and Yemen, licensing foreign banks to enter the market early provided the much needed platform for remittances to flow legally into the country[82] and encouraged cross-border trade in basic goods and services.

The introduction of semi-formal and formal microfinance institutions can significantly alter the terms and conditions of competing services, in favor of the borrower. In Cambodia, informal lenders charged 30 percent interest or more per month until competition from semiformal institutions arrived, offering 5-7 percent interest.[83] The result is that these microfinance institutions displace predatory finance to individuals and small firms and bring strong benefits.

There is a significant track record of microfinance in conflict-affected and fragile countries, including Afghanistan, Bosnia, Cambodia, Kosovo, Mozambique, DRC, Liberia, Sierra Leone, and Rwanda.[84] In Cambodia and Mozambique, many microfinance institutions collapsed when donors shifted from relief to development. Funding requirements from development donors were more rigorous, and the microfinance institutions Is that emerged

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[79] Richard Scarth, PostConflict Reforms Afghanistan Fact Sheet, Micro contracting: capacity building a viable future, March 2006, www.ddrafg.com

[80] Maimbo, S, Ratha, D eds (2005). *Remittances: Development impact and Future Prospects.* The World Bank, Washington DC.

[81] Sida/IMF. (2004) *Framework Administered Account for Technical Assistance Activities – Sweden Technical Assistance Subaccount*. Kabul: Sida/IMF.

[82] Maimbo, S, Ratha, D eds (2005). *Remittances: Development impact and Future Prospects.* The World Bank, Washington DC.

[83] Ibid.

[84] Afghanistan and Bosnia and Herzegovina are frequently cited as successes. In 2002, when hostilities ended, hardly any formal financial services were available in Afghanistan. Five years later, there were 15 formal institutions and outreach to more than 400,000 clients, as well as interest from several banks to scale down into this market. In Bosnia and Herzegovina, the industry went from nascent to consolidation in under a decade. Source: Synthesis Report: AMAP KG Economic Recovery and Conflict Case Studies. USAID. September 2008. P. 4

after conflict were not prepared.[85] In Afghanistan, a centrally-coordinated microfinance program has received strong support from donors who committed more than $25 million to this program.[86] Within this framework, IFC supported the establishment of a greenfield commercial microfinance institution– the country's first post-war licensed commercial financial institution – which has prospered and grown more rapidly than expected.[87]

Similarly, in DRC, a new commercial microfinance institution has grown quickly to generate more individual accounts than the rest of the banking system combined.[88]

Mobile banking, or the extension of banking services over mobile phone networks, shows significant promise in further expanding access to low-income borrowers in the challenging settings of fragile states (see Annex C). In DRC, mobile banking has grown rapidly, even in the absence of enabling regulation, led by Celpay Holdings. Customers have confidence in the services provided by the mobile operator. Of note, mobile banking services are expanding more quickly in DRC than in neighboring Zambia, where customers view mobile banking as a luxury service rather than as a primary form of baking. Celpay Holdings has been particularly successful in extending banking services to smaller businesses that are part of larger networks, such as supplier/distributors of products like beer and soft drinks.[89]

Typically, microfinance banks expand most rapidly in financial services such as deposit accounts for individuals and cash management services for smaller businesses, using traditional banking methods and, increasingly, via mobile banking.[90] There are risks in encouraging microfinance banks to lend more than they would otherwise. However, in post-conflict situations capturing cash and other assets back into the banking system is a crucial part of an evolution in post-conflict risk management by individuals and firms, and microfinance institutions can be a key contributor to this at the low-income end of the market.

Successful financial sector initiatives in post-conflict countries address shortcomings in basic financial sector regulation and infrastructure: central bank supervision capacity, reform of banking regulations, restoration of inter-bank payments and clearing mechanisms, introduction of ATMs and other technology, among others. Often, such initiatives involve development partner assistance for governments and central banks. Among the financial sector activities supported by international financial institutions and development banks are

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[85] Tamsin Wilson, *Microfinance During and After Armed Conflict: Lessons from Angola, Cambodia, Mozambique and Rwanda,* The Springfield Centre for Business in Development, 2002.

[86] According to Banyan Global's assessment of microfinance in Afghanistan, clients of the Afghan microfinance apex organization, MISFA's partners, are better off than non-clients, economically and socially. Business revenue is higher for clients than non-clients. Profit is more likely to have increased for clients than for non-clients. Profit drawn from business is higher for clients than for non-clients (avg. $886 vs. $263). Profit reinvested in business is higher for clients than non-clients (avg. $1,201 vs. $361). Expenditures on clothing, education and medical expenses decreased and expenditures on food grew for non-clients, thus demonstrating greater hardship. Finally, clients were more likely to hire a tutor for their children. Moreover, clients do not come from any specific income or ethnic groups or areas, thus demonstrating the potential inclusiveness of microfinance.

[87] Banyan Global, "Evaluation Report: First Microfinance Bank of Afghanistan," October 10, 2008

[88] According to an evaluation of IFC's microfinance program in Afghanistan by Banyan Global, ,the I

[89] Rosenberg, Jim, "Lazarus Muchenje: An African View on Mobile Phone Banking." CGAP, August 30, 2007.

[90] Banyan Global, "Evaluation Report: First Microfinance Bank of Afghanistan," October 10, 2008; International Finance Corporation, "Expanded Project Supervision Report, ProCredit Bank, Democratic Republic of Congo," March 2010.

direct programs with banks to provide equity and long-term funding to strengthen balance sheets and risk management products to encourage expanded private sector lending, beginning with short- term instruments such as trade finance, and moving into credit facilities to expand medium-term investment lending.

Remittances

Another significant (and resilient) form of finance in fragile and conflict-affected countries comes from the diaspora, which represents key actors in all phases of the cycle of conflict. Although much of the remittance flows go to support current consumption, many of these countries turn to their diaspora for much-needed investment capital.[91] The funds the diaspora represents are often significant. In fact, the funds rival FDI as the main source of capital inflows into developing countries, and dwarf official development assistance. For example, in Haiti, financial remittances from the diaspora exceeded $1billion in 2006.[92] (see Annex B)

In some instances, the diaspora is the major investor in a country. These expatriates become significant contributors to economic recovery.

The Somali diaspora, at least one million strong, is a good example. In 2004, remittance flows were estimated at up to $1 billion, but they may have been as high as $1.6 billion to Somalia and $700 million to Somaliland.[93] Somalis living abroad have made significant investments in the local economy, providing 80 percent of the start-up capital for small and medium businesses.[94]

Typically, individuals or groups from the diaspora set up new businesses in Somalia or invest in existing enterprises. Most of the major companies in the country fall into one of these categories. One manager at a major telecommunications company in the country indicated that 30-40 percent of the firm's shareholders came from the diaspora.[95] These citizens living overseas have engaged in Somalia in the context of a risky investment climate, generating jobs for many and providing revenue for the government.

Remittances also reach poor, isolated communities even during periods of conflict, where they are a vital lifeline to survival.[96] Diaspora communities increase their remittances back to their families in times of exceptional need, such as during conflict or natural disasters, when the funds can be the key means to survival.[97] Surveys have shown that the majority of

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[91] Tjai M. Nielsen and Liesl Riddle, Investing in Peace: the Motivational Dynamics of Diaspora Investment in Post-Conflict Economies, January 2010

[92] USIP 2006

[93] Somalia's Missing Middle: The Somali Diaspora and its Role in Development, UNDP Somalia, March 2009, p.8

[94] Ibid

[95] Ibid, p. 21

[96] Studies have shown that, even in Darfur and Somalia, money reaches families in the midst of conflict, often through ancient hawallah systems that are based on clan or ethnic identity and trust. Lindley, ibid.; "Livelihoods, migration and remittance flows in times of crisis and conflict: case studies for Darfur, Sudan", Helen Young, HPG Background Paper, September 2006

[97] Lindley, ibid., p. 16; "Remittances in Crises: A Haiti Case Study", Patricia Fagen, HPG Background Paper, September 2006, p. 15

remittances in these cases are used for basic household expenses, particularly food, education, health care/medicines and construction.

It is important to note that this money is destined almost entirely for purchases in the private sector. So, remittances play a fundamental role in sustaining the private sector during conflict, including provision of basic services (such as health care and education) which the public sector may be unable to furnish as a result of the conflict.[98] In these cases, informal networks are often the safest and surest means of remitting money back home; however, this creates problems with the systems and institutions that also could be funneling money directly to combatants to sustain conflicts.

External partners can support the flow of remittances through initiatives to decrease their cost, including providing help in complying with anti-money laundering regulations. Efforts to support the establishment of mainstream commercial banking also will likely lead to more competition in the remittance market and, hence, lower costs.

Ensuring appropriately designed interventions

Early support to the private sector must keep in mind the primacy of local actors, the need for sensitivity, and the importance of having a longer-term and case-by-case view.

Until recently, most research and policy has concentrated on the role of external players such as foreign governments and international NGOs in post-conflict reconstruction and state-building, rather than on the role of "domestic players in fashioning their own institutional capacities for economic recovery."[99] Today, however, there is almost unanimous agreement that the "primary burden in building local peace lies with local actors."[100] Therefore, international organizations and donors should place greater emphasis on empowering local players to develop a better business-enabling environment. Local businesspeople have the potential to be good partners in peace-building, because they have a strong interest in ending the conflict, and are often willing to engage in community dialogue and partnerships to champion reforms in the broader community interest.

Still, post-conflict countries are highly complex environments. So, early interventions to support peace-building must be done carefully, in a manner that does not reinforce tensions or make things more difficult for longer-term private sector development efforts. "Peace-building interventions must be market-sensitive, and market development must be conflict-sensitive."[101] Relief efforts should reinforce and assist the legal private sector – not distort it or crowd it out. Otherwise, the relief efforts could actually exacerbate conflict.

What happens early on in a post-conflict environment lays groundwork for the future. The literature on peace-building acknowledges that the movement from relief to development happens along a continuum, rather than in clearly delineated stages. The agendas of early relief, economic recovery and reconstruction, and longer-term development tend to overlap and thus should be cognizant of and complement one another. This way relief can serve a

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[98] Lindley, ibid., pp. 12-3, "Understanding the Remittance Economy," Manuel Orozco, Inter-American Dialogue, March 2006, p. 13

[99] UNDP Post Conflict Economic Recovery: Enabling Local Engenuity, New York, 2008, p. 146

[100] International Alert, p. 31

[101] Chris Bold, "The Importance of Private Sector Development in Conflict-affected Countries," IFC SmartLesson, November 2009

developmental role "and longer-term development thinking can inform humanitarian policy."[102]

It is essential for all involved to understand that the policies and choices of the international community can affect the longer-term development of the countries where they engage. Significant opportunities are missed and significant problems can be generated when players plan and act in isolation, not recognizing the interconnectedness of different issues and initiatives.

Infrastructure is one sector where the disconnect between vision and policy has been particularly apparent. In many post-conflict situations a large number of international players try to help. However, the capacity of post-conflict countries to engage effectively is often very limited. Therefore, it is up to international organization and donors to cooperate and coordinate effectively to maximize long term development impacts and outcomes.[103] International organizations and donors should collaborate based on their capacities and areas of comparative advantage.

Rebuilding infrastructure is vital to the recovery of a country and is a priority for government and donors. As noted above, electricity supply was cited as the most important constraint to business expansion in conflict-affected countries. Since donor programming tends to target shorter-term spending in such nations, funding construction or reconstruction of essential infrastructure allows for quick disbursement of funds and ministerial announcements of peace dividends in the form of roads, ports, power plants and the like. The problem is that governments in these countries typically do not manage or maintain the asset well, leading to deterioration. In some cases, the asset is not used at all: a hospital remaining unused because there are not enough doctors or nurses, or power generators not used because of connection problems.[104]

These gaps can have far-reaching consequences. In 2001 in Timor-Leste, the UN peacekeeping mission found a destroyed national electrical grid. The mission's budget, which was oriented towards the short-term, would not cover anything that could be regarded as fixed infrastructure investment, so a decision was made to use large portable generators to provide power to UNTAET facilities and to major Timorese population centers. Unfortunately, the new Timorese government inherited this network and did not have the budget to reverse the decision and build a power plant. The result is that today, Timor-Leste has the most expensive power generation system in Asia. And in Timor-Leste, the cost of power is repeatedly identified as "the single biggest deterrent to attracting investment."[105]

This discussion has focused primarily on relatively immediate engagements to support the private sector in a country recovering from conflict. But it is important to note that they

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[102] Joanna MacRae reference in www.peacebuildinginitiative.org
[103] Discussion with Stephen Rimmer, Senior Private Sector Development Specialist, World Bank, Iraq.
[104] Virtual discussion with Laurence Carter (IFC Infrastructure), Edgar Saravia (IFC East Asia) and Edith Bowles (World Bank Country Manager, Solomon Islands), 19 March 2010
[105] Michael Carnahan, William Durch and Scott Gilmore. Economic Impact of Peacekeeping, Peace Dividend Trust, March 2006, p. 43 - It is worth noting that some practitioners in the field disagree that electricity is the most significant issue. One colleague on the ground cited the overlapping land claims that can exist under four different legal regimes (traditional, Portuguese, Indonesian and UNTAET), where there is no functional avenue to resolve either these disputes or more general commercial matters, as the big issue (discussion between IFC's Alan Andrew Moody and Mary Porter Peschka).

should be carried out in the context of a longer term vision and in parallel to reforms that will re-establish a legal and regulatory framework and key institutions for investment. These actions, taken together, can help signal the end of a conflict and that the country is open for business and investment, beyond just a handful of sectors.

As Collier noted, "Bad politics destroy an economy with great speed but even the best politics can only facilitate a gradual recovery. This can rapidly lead to disillusionment and skepticism by the population....The best the government can do is to articulate a credible medium term growth strategy – what the economy would look like after one or two decades."[106]

V. Reforming the Business Environment in Fragile States

The most important longer-term reforms needed to power economic recovery and build stability directly focus on improving the operating environment for the private sector. Such reforms can include new or improved investment laws, clear property rights, land registries, business-friendly taxation, anti-corruption institutions and processes, transparency, and access to finance programs. They also include work to expand access to important services such as electricity and water, judicial reform (particularly in the area of commercial courts and land disputes), small and medium business promotion, rural development, and regional trade. Implementing such reforms takes time and requires long term support and commitment from international organizations and donors.

As should be clear from the discussion above, the need for private sector-related reforms in post-conflict states is also cross-cutting and acute. Such a task would be daunting for any developing country, but in a post-conflict context – where institutions have been destroyed or severely weakened, trained specialists have left the country, and other priorities, such as security and infrastructure continue to dominate – it is even more difficult. In this section, rather than exploring individual private sector development-related reforms, four crucial questions are considered:

- To what extent should PSD-related reforms be sequenced?
- Do the reforms in these countries need to be distinctive?
- How can these reforms be designed to take into account local realities while learning from other examples, particularly in the region?
- How can local actors and the international community sustain, coordinate and sequence the PSD reform effort over the long term?

Sequencing private sector development-related reforms

After a conflict, a nation's highest priorities are often peace-building, stability, and jumpstarting economic growth for job creation and income generation. One school of thought suggests that the first-generation response following the end of a conflict should be to secure peace through demobilization and other strategies, provide humanitarian assistance, and perhaps re-build institutions to provide social services such as health and education. Under this approach, investment would follow after these early imperatives.

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[106] Paul Collier, Post Conflict Economic Recovery, International Peace Academy, April 2006

Yet, it is increasingly clear that incomes, employment, and access to services are needed early as instruments to deliver peace dividends to the population. A consensus is growing that an early focus on economic growth as a mechanism to promote stability and recovery through jobs and improvements in the standard of living for both sides is a key first priority. Early private sector development interventions can, therefore, provide opportunities for such needed outcomes.

Despite the strong case for early private sector development efforts, finding empirical impact data to support this case is a challenge. One study looked at time frame for the introduction of private sector development activities in five post-conflict countries where the World Bank Group implemented programs with significant private sector development components (Afghanistan, Haiti, Rwanda, Sierra Leone, and Timor-Leste). In three of the five countries – Rwanda, Sierra Leone, Timor-Leste – private sector development activities were introduced later in the recovery process, seven-to-nine years after the signing of peace agreements. In Haiti and Afghanistan, where the World Bank has more recent engagement, these activities were introduced earlier, within three years following peace.[107]

The findings do not indicate whether early engagement resulted in a better or worse recovery record; however, they demonstrate that the World Bank has started to introduce private sector development activities as part of first-generation reforms when governments are eager to consolidate the peace-building agenda.

Results thus far suggest that this earlier than conventional prioritization of private sector development-related reforms is making a difference in a variety of contexts and is delivering multiple dividends. "Reforms of government institutions that regulate the business environment can inculcate transparency, honesty, professionalism, and client service – all key to restoring government legitimacy."[108] Encouraging investment by eliminating unnecessary regulatory risks generates a wide range of benefits such as additional jobs, provision of a greater range of goods and services, innovation, and reduced prices. It can also encourage businesses to migrate from the informal to the formal sector, improving further compliance with regulations, generating additional tax revenues, and reducing potential for corruption. Successful investments in a post-conflict environment increase business confidence, thus generating further investment and creating a self-sustaining cycle of new private sector investment and activity. They also can enhance confidence in regulatory institutions and processes, resulting in greater legitimacy, confidence and trust.[109]

A good example of this positive impact is in Liberia, where the World Bank Group and the Swedish International Development Cooperation Agency teamed up to rebuild the private sector and attract investors. Launched in 2006, the investment climate program has generated $13 million in private sector investments for the 2008-2010 period; created more than 20,000 jobs for the 2008-1010 period; generated private sector savings totaling $4.7 million; and moved Liberia up from 177 to 149 in the annual *Doing Business* ranking. In 2010, the World Bank recognized Liberia as one of the *Doing Business* top 10 global

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[107] Mills, R., and Fan, Q. (2006) *The Investment Climate in Post-Conflict Situations*. Washington: World Bank Institute.
[108] A Rough Guide to Investment Climate Reform in Conflict-affected Countries (2009). IFC. USAID
[109] Discussion with Stephen Rimmer, Senior Private Sector Development Specialist, World Bank, Iraq.

reformers. Such results were obtained by supporting the Liberian government in its business regulatory changes.[110]

In places such as Liberia, Rwanda, Sierra Leone, southern Sudan, and Uganda, simplifying business registration after conflict signaled openness and security. And the formalization of businesses enhanced government revenue streams through increased taxes, providing more resources for peace-building. In Kosovo, for example, more than 90,000 businesses have been registered since the opening of the business registry in 1999. While as many as 56 percent of these businesses are small or micro in nature, they contribute significantly to employment in Kosovo, and provide opportunities for value chain development in some sectors.[111]

Another positive example of the value of early private sector development-related interventions is Rwanda. In the wake of the genocide in 1994, Rwanda focused on opening up the economy for investment and providing hope for its citizens on both sides of the conflict through job creation. The goal was to reduce the risk of sliding back into war and to encourage service delivery, stability and peace building. In 2001, with World Bank support provided through the Competitiveness and Enterprise Development Project, Rwanda began the process of building an enabling environment for private sector-led development. One of the early interventions focused on overhauling the contract enforcement regime in the country.[112] Although these interventions came more than three years after the end of the genocide, they arrived quite early in the peace-building effort. Due to the prioritization of private sector development-related interventions, the formal sector economic activity grew 6-7 percent in real terms during 2003 and 2004. Domestic business registrations increased at a rate of 10 percent per year from 2001-2004. [113]

Distinctiveness of reforms related to the private sector

As related in the previous sections, one of the many consequences of conflict is that it severely disrupts and reshapes the private sector with the flight of foreign and local capital, the lack of longer-term financing, the fusion of private and public roles (with military and government officials becoming "businessmen"), and the strong role of illegal and parallel economic activities.

Additionally, the conflict itself has often resulted from weak or absent institutions, including those regulating the private sector. In Afghanistan, for example, the decade of Mujahedeen and Taliban rule was marked by the collapse of private sector-related institutions, such as chambers of commerce. The limited local experience after the Taliban's fall was gained under Soviet control – and, not surprisingly, those officials were not terribly helpful in understanding the needs of the "bourgeois" private sector.[114]

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[110] Investment Climate in Africa Program: Four-Country Impact Assessment. Report #4 – Liberia Country Report. Economisti Associati srl. October 24, 2010

[111] Email exchange between Catherine Masinde, IFC and Mary Porter Peschka

[112] USAID's BizCLIR Project (March 2007): *Best Practices for the Business Environment*; Issue 17 *Overhauling Contract Enforcement: Lessons from Rwanda*

[113] Stern, 2005

[114] One of the contributors, while working at MIGA, met several times with the Minister of Light Industry and his senior officials in 2004 and 2005. They were mid-level technocrats in the Najibullah government and had received their education in Soviet technical universities in Moscow and Tashkent. These senior Afghan officials gave discourses on the proletariat, dialectic materialism and the efficiency of the Soviet system.

In other cases, such as in many African countries, decades of strong man rulers following the colonial era have left a legacy of weak private sector institutions. Where such institutions— like chambers of commerce— exist at all, they are tied directly to the government, and are under government control, rather than being independent associations.[115]

One of the strongest arguments for distinctive policies is the high risk of a return to conflict.[116] Economic policies, including those related to developing a legitimate private sector to power the economy and build the tax base the government needs, are crucial to creating momentum toward stability. However, it is clear that these policies are only successful in the medium to long term, which speaks to both the importance of maintaining the commitment (see below) and to viewing economic policies as a complement to sustained reform efforts in other areas, such as governance, public financial management, anti-corruption, security, and infrastructure.

How can distinctive pro-private sector development reforms help reduce the risk of a return to conflict?

While space does not permit an exhaustive list here, there is one area that deserves mention, because of its importance in reducing the risk of a return to conflict, and in the immediate post-conflict period: the private sector alone is in a position to generate large-scale, sustainable employment opportunities, especially for young men, who are at highest risk of becoming fodder for potential future conflicts.[117] So post-conflict governments and donors might consider prioritizing reforms that liberalize labor markets and offer incentives for the private sector, such as more permissive labor laws and incentives for vocational training of adolescents and young adults, so that businesses would be willing to hire those at highest risk of becoming combatants. This is but one example of many.

Another reason to establish distinct private sector development reforms is that the economic and political consequences of conflict create an environment that is uniquely conducive to broad, fundamental institutional reform (including in areas directly related to the private sector) but also poses clear challenges that make such reforms both more urgent and more difficult to implement.

As Collier and others have argued, conflict shatters or greatly weakens existing government institutions, changes the macroeconomic context due to a lack of a tax base, a focus on military spending, and the like, and creates a rupture in the elites who controlled the country pre-conflict.[118] On the other hand, the negotiation of peace agreements, the focused, large-scale inflow of outside development experts and aid, and the return of key diaspora figures provide a unique window of opportunity for the country to strengthen its institutions – and particularly the private sector – in ways that contribute to long-term peace and stability. For

[115]"Businesspersons have become enmeshed in the patronage networks of incumbent regimes which, together with the extensive governmental intrusions in the affairs of private sector organizations, have ensured that organized business has supported rather than challenged the political status quo and accepted rather than shaped major economic policy decisions." "Politics, Capital and the State in Sub-Saharan Africa," p. 114, by Roger Tanri, in *Civil Society and Democracy in Africa: Critical Perspectives*, 1998, Cass & Co.

[116] Likelihood of a post-conflict country falling back into conflict is 40 percent within decade following end of violence (Collier, Hoeffler and Rohner 2006)

[117] Collier, p. 4-5

[118] Ibid. pp. 5-7.

example, riots in Tonga in 2006 resulted in the destruction of most paper-based records of business registration and licensing. However, this provided a catalyst for international organizations and donors to work with the Tongan government to establish a more efficient electronic business registry as well as to review and improve existing business licenses.[119]

Indeed, much has been made of the "clean slate" argument, in which a post-conflict environment offers the opportunity for a fresh start. In this scenario, state-of-the-art private sector development-related (and other) reforms, reflecting best global standards, can be introduced to help the conflict-affected country become a leader in areas such as investments and trade. Such efforts, often supported by key donors, government officials and diaspora leaders, while well-intentioned, are doomed to failure if they do not account for the local reality on the ground. While this is explored in greater detail below, it is worth noting here that there is no such thing as a clean slate. It simply does not exist, with respect to the private sector or any other institution or segment of society. Even in places of extreme rupture, such as East Timor and Iraq,[120] the past lives on and must be considered in the design and the implementation of private sector development-related reform efforts.

Post-conflict private sector development reforms also need to take into account a country's clear economic needs, which would create an environment that is conducive to change. For example, the lack of private investment during and immediately after the conflict requires reforms that will promote the return of capital. The physical rebuilding required in a post-conflict country, with increases in construction and infrastructure activity can create significant opportunities for local and international investors. Distinctive pro-private sector development reforms need to ensure that wherever possible, these opportunities are awarded to the private sector and that investment reforms focus on allowing the local private sector to learn from, grow, and compete with foreign investors. Far too often, the push toward opening the post-conflict country to foreign trade and investment can devastate domestic producers. A prime example is Haiti, where "free trade" with the United States virtually destroyed local rice producers, with a devastating effect on a mainstay of the country's rural economy and labor market.[121]

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[119] Discussion between Mary Porter Peschka and Stephen RImmer, Senior Private Sector Development Specialist, World Bank, Iraq.

[120] In the case of East Timor, Indonesian colonization heavily affected economic development, particularly limiting the development of large investment projects, such as the current explorations of petroleum and natural gas. However, as witnessed by the ongoing conflicts among the Timorese, the conflict – and different perspectives on the roles of different groups, including the diaspora, during the resistance – continue to overshadow efforts to create a viable local economy. See "Diminishing Conflict in Timor-Leste", Susan Harris Rimmer, 14 October 2008 (presentation). In the case of Iraq, the Saddamist model of economic development, which borrowed heavily from socialist models of state control over key industry and strategic sectors, was used to reinforce Baath Party control – and, hence, the perception of Sunni dominance – despite the simultaneous presence of a flourishing black market under the embargo. As a result, the economic reforms focused on private sector-led growth are also seen through the lenses of this complex past. See "The War Economy of Iraq", by Christopher Parker and Pete W. Moore, *Middle East Report*, 243, Summer 2007.

[121] Under trade liberalization, after the end of the Duvalier era, rice import tariffs in Haiti dropped to 3 percent, among the lowest in the region, leading to a massive increase of rice imports from the United States. Haitian rice production dropped from 163,296 tons in 1985 to an all-time low of 89,000 tons in 1995. Meanwhile, with a growing population, demand for rice continued to grow – and with it, the rice imports. Imports from the United States, which were 7,337 tons in 1985, rose to a staggering 350,000 tons in 2000. "Trade and the Disappearance of Haitian Rice", Josiane Georges, Ted Case Studies, Number 725, June 2004, p. 3.

Long-term economic reform in the post-conflict country also must focus on rebuilding the tax base, employment, and productive legal sectors of the country – against a backdrop in which institutions, particularly the civil service, are severely impaired. From a private sector perspective, this opens up numerous opportunities for reform that can help grow the economy and can take into account longer-term drivers of conflict. Examples include reducing spending on military expenditures while increasing money for infrastructure and education (leading to a better-qualified labor force), such as in Mozambique and Uganda.[122] Efforts to streamline government can include focus on more efficient, effective, and transparent regulations and a smaller, smarter, and directed administration that targets provision of critical services and oversight. Such reforms help overcome the problem of a civil service with limited capacities and results in a stronger business enabling environment.

For countries such as Afghanistan, the Democratic Republic of Congo, and Sierra Leone, where illegal trade fueled conflict, longer-term private sector development reforms need to focus on strengthening alternative livelihoods and creating conditions in which parallel gray markets transform into the legitimate private sector, even as there is a crack down on truly illegal activities. This means concentrating more resources on microfinance, rural reforms, and improving land registries. It also means making it easier to register legitimate businesses. Of course, as with other reforms, this will only work in the long term if they are sustained – and if they are accompanied by broader reforms that promote governance and security.

Global and regional models – adapted for local realities

In designing private sector development-related reforms for post-conflict countries, the international community has, until recently, relied heavily on certain established, off-the-shelf models. These models tend to reflect the priorities of donors and multilaterals and the belief in their universal relevance. Post-conflict governments have little choice but to adopt these measures and to initiate reforms specifically targeting certain popular common benchmarks, like the *Doing Business* scores. Tailoring reforms for local realities often is hampered by a lack of local capacity, either because of the overall low level of development or as a legacy of the conflict.

In Afghanistan, for example, the initial reform efforts were divided by donor country, with the United States taking the lead on investment reform. The new investment law was drafted in English by USAID contractors. After the fact, it was translated into Dari and Pashtu for a limited scope of local Afghan input. This local input was heavily skewed toward government officials, and included minimal consultation with actual private sector representatives from Kabul. This increased frustration among the private sector representatives, many of whom felt the reforms did not take into account Afghan realities – particularly in the context of weak and/or allegedly corrupt government institutions.[123]

While localizing the reform effort is important in any context, it is particularly vital in the post-conflict setting. Aside from the fact that imposing reforms from outside may be ineffective, it can be dangerous in situations where peace is fragile and various groups within the country are competing for resources that will allow them to "win" – or will help them prepare for the next conflict. In the Afghan context, for example, the initial deals that

[122] Collier, pp. 4 (Mozambique) and 7 (Uganda).
[123] Based on Keith Martin's interviews with subcontractors and representatives of the Afghan Chamber of Commerce in 2004-05.

allowed regional warlords to reap benefits from the federal government – in many cases, even becoming federal ministers – gave them access to resources that they used to strengthen their militias and weaken local foes.[124]

Increasingly in recent years, the international community has recognized this shortcoming and has started to focus more on developing or adapting solutions to local conditions. This new, local focus begins with broader, more effective stakeholder consultations, and takes into account the challenges of weakened or absent institutions. And, where they do rely on outside models, they are looking more toward what has worked in the region or in other similar contexts. For example, the German government has developed a strong set of guidelines within its Ministry of Economic Cooperation and Development for conflict-sensitive development efforts. These guidelines include analyzing the relevant actors within the local setting (peace and conflict analysis) and evaluating the risks to ministry officials and others who are acting on their behalf in implementing reform programs.[125]

However, the challenge is great, given the backdrop of weak institutional capacity, especially in the private sector development arena. Therefore, it is important to highlight the role that diaspora representatives can play, particularly those who are returning after conflict. On the one hand, their role is critical, providing a bridge between the international community and local realities. In many cases, key diaspora leaders have worked in development institutions, such as the World Bank and regional development banks.[126] Many were business leaders in their countries before the conflict, and have a keen understanding of the types of private sector development-related reforms that are needed and how they might be best implemented. A key reason that a higher percentage of the UN peacekeeping mission budget for Kosovo was spent locally was because the diaspora – with both access to capital and business experience – returned in greater numbers than in other mission countries.[127]

While citizens who are returning from a diaspora can play a powerful role, it is important to note that many diaspora representatives were not neutral during the conflict. So, their involvement must take into account the role they might have played in creating or perpetuating the upheaval in their homeland. Furthermore, in long-term conflict situations, such as Afghanistan and Iraq (including the Saddam years), many diaspora representatives

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[124] Regional warlords who have held ministerial positions post-Taliban include General Dostum, from the northern Uzbek regions, Qasim Fahim, from the Tajik areas; many others benefited through patronage positions, governships, and the like. Kai Ede, then leader of the UN mission in Afghanistan, was quoted as saying "I expect an understanding of the fact that we need fewer warlords and more competent ministers". "Afghan Leader Courts the Warlord Vote," New York Times, August 7, 2009.

[125] *Sustainable Economic Development in Conflict-Affected Environments*, GTZ, 2009, p. 37.

[126] Recent examples include Ellen Johnson Sirleaf, Liberia's current President, who worked at Citibank, Equator Bank, and the World Bank; and Kabine Komara, a former Africa Eximbank administrator, who was briefly Guinea's prime minister in 2009. Perhaps the most famous example, in terms of diaspora businessman-cum-political leader, however, is Rafiq Hariri, who controversially implemented major reforms as Prime Minister of Lebanon – in particular the revitalization of Beirut, undertaken by Solidere, a private sector company of which he was majority owner, which was given special eminent domain rights of large parts of the downtown area and made huge profits. For Johnson Sirleaf, see "Liberia's Iron Lady" (http://news.bbc.co.uk/2/hi/world/africa/4395978.stm); regarding Komara, http://www.mg.co.za/article/2008-12-31-guinea-coup-leader-names-civilian-prime-minister, and on Hariri and the Solidere controversy, see "Solidere – Vigilantism under color of law", http://www.cggl.org/scripts/new.asp?id=862

[127] Michael Carnahan, William Durch and Scott Gilmore. Economic Impact of Peacekeeping, Peace Dividend Trust, March 2006, p. 24

from the business community left the country many years earlier. The country to which they are returning is now completely different – socially, politically, and economically. They may have a skewed vision of their homeland, making it more difficult for them to help promote the reform agenda. [128]

In this section, we have shown that externally-imposed private sector development reforms are ineffective. This approach also can increase the risk of a return to conflict. To sustain the reforms over the long term, a cooperative partnership between the national government, local businesspeople, and the international community is required.

Sustaining the commitment

One of the most difficult yet critical elements to ensuring that a country does not return to conflict is the long-term commitment of the international community and regional actors to coordinate and sustain the reform efforts. At a bare minimum, this requires ongoing funding for the reforms. In many cases, international aid is designed to help in the relatively short term – the first three-to-five years post-conflict. Even then, aid commitments often do not translate into actual expenditures, especially when there is an impression that peace has been established.[129] For private sector development-related reforms, which are likely to bear fruit only after five or more years, it is even more important to cooperate, coordinate, and sustain funding and support. In addition, there is a strong case to be made for building sustainability and indigenization into the initial reform design.

On the national level, helping the private sector also may be an argument for stronger reliance on aid flows in the short term, rather than trying to increase the tax base – and using the aid flows to induce private sector investments that, in the longer term, will create both employment and taxes.[130] Too often, the government (frequently under pressure from donors and international institutions to be fiscally responsible) decides too early to rebuild its tax base, which can result in a multiple taxes, fees and charges that can restrict the private sector's ability to invest. In addition, the tax administration in many countries is among the most corrupt institutions. Until it is reformed, there is a good chance that increased economic activity may not generate commensurate additional tax revenues.

That said, in resource-rich, post-conflict countries such as Iraq, where governments can access significant but often volatile revenues, the strengthening and reform of public finances should also be a high priority in the short, medium and longer terms. If public finance institutions and processes are not established, the significant revenue streams can become a

[128] While Rwanda is one of the good examples cited of returnees significantly contributing to development, in the Sudan the returnees were viewed as traitors who failed to carry their fair share during the conflict, instead living in safety as refugees outside of the country, where they could access education and other advantages. Thus, they would be more likely to obtain jobs after the war ended. Source: e-mail from Pierre Guislain to WDR core team on 12/16/2009.

[129] Lack of disbursement can be attributed to various factors, ranging from poor project design to lack of implementation capacity locally. A recent estimate showed that in Afghanistan, from 2002 to 2008, the African Development Bank and India had only disbursed about one third of the aid committed, while the United States and the World Bank had disbursed about half their committed amounts. "Falling Short – Aid Effectiveness in Afghanistan", Matt Waldman, ACBAR, 2008, P. 1.

[130] Collier, pp.16-18.

source of corruption and nepotism, impeding economic and social development and in some cases facilitating renewed conflict.[131]

Beyond this minimum, in the context of private sector development, sustainable reforms must include three additional elements. First, they must focus on developing local capacity – both within the private sector itself and within the government administration that oversees private sector development-related regulations and reforms. This includes incentives for employers to implement vocational programs, a strong focus on training teachers and prioritizing education, building the capacity of regulators and judges (since there is usually almost no local expertise on issues such as mobile telephony and commercial law), and courses and training on basic accounting, finance, and trade, among other topics.[132] For extractive industries, there may be a transitional period during which international institutions can help the government negotiate and re-negotiate long-term concessions[133] – since local expertise post-conflict may not be a match for the legal representation of large mining, oil and gas companies. However, even in such cases, the emphasis should be on having local lawyers and officials shadow the negotiations in order to develop a new generation of professionals who can represent national interests. Still, none of these pro-market reforms will make a difference if they are not accompanied by the development of local expertise so they can actually work on the ground. In fact, there is a risk that without such efforts to train local professionals, these reforms could lead to market dislocations.

Second, sustainable reforms must extend to rural areas and regional urban centers away from the capital.[134] Experience in Afghanistan, Liberia, and Mozambique has shown that this is a massive long-term challenge, particularly in the areas of land reform and access to finance. Given that most conflict countries, especially in Africa, are still largely rural, this has several damaging effects. Most important, it compounds the misery that conflict has already inflicted on rural areas, and can be another factor that increases the risk of a return to violence. In addition, in the absence of meaningful rural development and continued poverty , the usual patterns of migration to cities might be reinforced, leading to a massive influx of poor, unemployed people into urban areas – again reinforcing the likelihood of conflict. Moreover, in certain conflict settings, like Afghanistan and Sudan, rural areas are actually at the heart of

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[131] Discussion between Mary Porter Peschka and Stephen Rimmer, Senior Private Sector Development Specialist, World Bank, Iraq.

[132] The aforementioned IFC Business Edge management training program has been used in Iraq to build the capacity of government officials working for line ministries, on such key topics.

[133] In numerous conflict and fragile state settings, such as Guinea, DRC, Chad and Timor-Leste, the World Bank has provided advice on sector reform aimed at promoting sustainable private (usually foreign) investment. Interestingly, in the DRC, the Bank has taken strong issue with the re-reading of existing contracts – which went counter to Bank advice. An entire Bank Web page is dedicated to the issue, in Q&A form. One example: To the question, "What risks does this ongoing review in DR Congo expose parties/stakeholders to?", the Bank's answer, in part, is "The commission's re-reading of the contracts has already had a destabilizing effect on the international markets where companies raise capital for investments in DR Congo." http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/CONGODEMOCRATICEXTN/0,,contentMDK:21552574~menuPK:349485~pagePK:2865066~piPK:2865079~theSitePK:349466,00.html

[134] It is worth noting that an increasing number of articles are being published (IPS, The New York Times) about a potential resurgence of Sendero Luminoso in Peru, pointing to the guerilla group's attempts to recruit in *campesino* areas, by offering help and providing services in the absence of government in these neglected rural communities. "Shining Path Resurgence?", Lisa Skeen, NACLA, 25 June 2009. Further to this point, at the IISS Bahrain Global Forum (May 2010), attended by the author, there was some discussion around Peru. Consensus was that the jury is still out on whether the country will sustain the peace. There has been economic growth in Peru but it has not been inclusive.

the conflict itself: without adequate development here, the likelihood that armed factions will be able to capitalize on poverty and unemployment is great.

Finally, promoting foreign trade and investment is a relatively inexpensive but effective way to sustain long-term reform and private sector development. The issue of access to well functioning, transparent and competitive markets is also a key issue for the local business community.

As infrastructure needs are overcome and the country becomes reconnected to the global markets, it will often still face a variety of barriers – from being a higher-cost producer (due to higher risk premiums and capital costs) to tariffs in key import and export markets. Hence, developed countries (and, in certain cases, regional markets – such as SADC for Mozambique and Zimbabwe) can play a key role in promoting longer-term development simply by providing longer-term trade incentives and market access. In the case of Africa, this has already been achieved to a significant extent under agreements with the United States and Europe.[135]

Transitional arrangements facilitating preferential market access, for the first 10-15 years, with a gradual phase-out period, can further incentivize fragile and conflict-affected countries' exporters. Given the experience of Haiti and some other countries,[136] these arrangements should not require reciprocity and should also recognize the importance of programs to rebuild capacity of local producers in the conflict-affected countries. If not, such arrangements may harm more than they help, particularly in the crucial area of agriculture. Of course, such arrangements also must take into account the impact they will have on the country's neighbors and their trade – helping avoid conflict in one country through measures that might encourage it in others obviously is not a desirable outcome.

With respect to regional trade, measures taken by the country's neighbors to increase access to markets (including the labor market) would clearly be helpful to sustaining reform. Successful examples include South Africa's support for Mozambique[137] (see Annex E) and Russia's aid for the post-conflict Tajik regime, which has included both openness for trade and particularly a high tolerance for Tajik migrant workers, whose remittances have proved crucial for the country's fragile recovery.[138] Obviously, nations typically base these

[135] The two most relevant current agreements for Africa – the United States' Africa Growth and Opportunity Act (AGOA), initiated in 2000, and the EU's Cotonou Agreements – have had a positive, if precarious, effect on the countries concerned. AGOA has led to significantly increased textile exports to the U.S., but efforts require further government reform and support for trade. The Cotonou Agreements between the EU and its African, Caribbean and Pacific partners, implemented in 2003, allow *non-reciprocal* trade advantages for least developed ACP countries. Critics charge that it does not focus its attention on the most urgent problems, particularly in rural Africa. On AGOA, see http://www.wilsoncenter.org/index.cfm?event_id=143669&fuseaction=events.event_summary. The Cotonou agreements are summarized at http://www.acp-eu-trade.org/index.php?loc=faq/ACP-Secretariat-FAQ.php, while a critical view of their impact is at http://practicalaction.org/african-voices/about

[136] Georges, ibid., p. 4

[137] For a treatment of trade and investment relationships between South Africa and Mozambique, in the context of domestic policy priorities in both states, see "What is the Experience and Impact of South African Trade and Investment on the Growth and Development of Host Economies? A View from Mozambique", Carlos Nuno Castel-Branco, SARPN, 2004.

[138] It is estimated that over 650,000 Tajiks live and work in Russia, mostly illegally – representing 18 percent of Tajikistan's adult population and as much as 80 percent of all Tajiks abroad. Remittances are said to account

measures on their own (shorter-term) economic needs, and will often eliminate them when economic conditions change. Furthermore, such efforts usually occur when the economies of the countries are complementary, rather than being competitors on the world stage.

Unfortunately, many conflict countries and their neighbors are heavily reliant on the export of the same raw materials, so cooperation is unlikely. Even so, regional cooperation can be helpful in areas such as developing efficient trade logistics and customs, which can reduce business costs and facilitate the exchange of skills and new ways of doing business, thus increasing international competitiveness.

VI. International Risk-Sharing Mechanisms for the Private Sector in Fragile and Conflict-affected States

Since the end of World War II, many developed countries (and a growing number of developing countries) have introduced approaches to mitigate the risks their investors may face when making investments abroad, given the relative scarcity of a private insurance market for riskier investments. The initial focus was on national government-related bodies, particularly the export credit agencies, which supported investments in post-war Europe, protecting investors and exporters against risks such as the collapse of the new currencies and the possibility of a Soviet invasion. Over time, the agencies refocused their support on investments into emerging markets.

Multilateral programs – both global and regional –also were created, most often associated with existing institutions. Within the World Bank Group, the creation of IFC and later of MIGA were founded on the notion that finance and investments into emerging markets were hampered by the higher perceived risk in such countries, particularly in countries affected by conflict.

Over these last decades, there has not been a program or institution created to focus specifically on mitigating private sector risk across all fragile and conflict-affected states. And despite some noteworthy success stories, the eligibility rules, structure, and mandates of the existing institutions strongly limit their ability to play a larger role in such situations.

In the section that follows, we explore this issue through the prism of political risk insurance, which is the most direct mechanism to mitigate investors' and lenders' risks in conflict-affected situations.

Political Risk Insurance

Political risk insurance is designed to protect investors and lenders against a range of risks they may encounter: war, civil war, riots and terrorism (*political violence*); the inability or unwillingness of the host government to allow the exchange of an investor's local currency into dollars or Euros and the repatriation of profits back to the home country of the investor (*inconvertibility and transfer*); the seizing of the investors' assets by the host government (*expropriation*); and the host government's non-honoring of contractual obligations it or sub-sovereign entities may have with the investor (*breach of contract*). By providing insurance against these risks, it is hoped that more investors will venture into more complex emerging

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for around 50 percent of GDP – one of the highest figures in the world. "The Macroeconomics of Remittances: The Case Study of Tajikistan", Alexei Kireyev, January 2006, IMF Working Paper, pp. 3, 7.

markets and will be able to secure funding from commercial banks at better rates and for longer tenors. This insurance is offered for both investments and exports. In the case of export credit insurance, short-term coverage (of less than one year) usually covers both political and commercial risks.[139]

While political violence is the most obvious risk that investors face in fragile and conflict-affected countries, one of the characteristics of these countries is that they, almost by definition, are considered to be fertile ground for a perfect storm of all four political risks, as well as for increased commercial perils. Government finances are usually in disastrous shape, increasing the risk of inconvertibility. Due to the conflict, the authorities often have limited capacity to negotiate long-term deals with investors, making it more likely that there will be attempts at revisions in the future – which may take the form of expropriation or breach of contract. Furthermore, the judicial system typically is weak (particularly in the area of commercial law) or perceived to be corrupt and dependent on the government, further enhancing the risk that breaches of contract will not be adjudicated in favor of the investor. Meantime, precarious infrastructure and the accumulation of other factors augment the likelihood of commercial default on the part of importers and exporters based in these countries.

For all of these reasons, private sector providers of political risk and export credit insurance are, understandably, very restrictive in offering cover for risks in such environments, since their mandate is to maximize their profits and minimize their losses. Where private sector coverage does exist, it is usually for very short tenors (6 months or a year) and at very high premiums (as much as 10 percent of the investment amount per year). In addition, insurers might seek to carve out some of the highest risks or require a high deductible, further reducing the attractiveness of coverage for the investor.[140]

Public providers, including the U.S. Overseas Private Investment Corporation , France's COFACE and China's Sinosure, as well as multilateral organizations such as MIGA, have a developmental mandate. In theory, they are in a better position to offer longer-term protection, even in higher-risk environments such as Iraq, Afghanistan and Liberia. Their counter-cyclical role is often heralded as a reason for their existence – and this role includes activity in difficult environments.

Indeed, these agencies can point to a number of important successes in supporting private sector activity in fragile and conflict-affected countries. MIGA, for example, supported six SME investments into Bosnia and Herzegovina after the civil war, backed by a $12 million EU trust fund. Similar MIGA funds, supported by donors, exist for Afghanistan (where the agency has insured five projects) and West Bank and Gaza, through which only one guarantee has been issued.[141] OPIC, for its part, has issued insurance for NGOs working in

[139] The US Ex-Im Bank, for example, provides insurance that covers "the risk of buyer nonpayment for commercial risks (e.g., bankruptcy) and certain political risks (e.g., war or the inconvertibility of currency)." http://www.exim.gov/products/insurance/index.cfm

77 On a MIGA mission to Lebanon two weeks after the assassination of Prime Minister Hariri, in February 2005, the MIGA representative was told by Omar Razzaz, then World Bank's Country Manager, that Lebanese businessmen had come to him, pleading for World Bank Group help in obtaining insurance coverage against terrorism. Private insurers had offered them 6-month coverage for 10 percent of the cost of investment, which would have made their businesses unviable. For reasons explained in the text above, the World Bank Group was not able to provide such assistance.

141 http://www.miga.org/documents/conflict09.pdf; http://www.miga.org/documents/post_conflict.pdf

conflict countries. For example, it is insuring the International Rescue Committee in 17 countries and has already paid four claims for losses the IRC suffered in DRC, Afghanistan and Chad.[142] And numerous ECAs are able to make exceptions to support investments in extractive industries in fragile and conflict-affected states that are rich in minerals or oil. Interestingly, and contradicting the notion that investing (or insuring investments) in conflict-affected countries is particularly risky, both MIGA and OPIC have only paid out relatively small amounts of claims in fragile and conflict-affected countries. Of the $428.5 million in claims that OPIC paid between 1999 and 2009, only $18.9 million were for projects in conflict-affected countries – about 4.4 percent. In MIGA's case, although three of the five claims it has paid in its history were in fragile and conflict-affected countries (Nepal, Kenya and Madagascar), the total amount of those claims came to $465,000 – less than 3 percent of total claims payments.[143]

Still, it is clear that the existing political risk insurance options are not adequate to truly mobilize large amounts of investment in these countries.[144] There are several reasons for this. First, the rules and eligibility requirements for coverage eliminate one of the most important target groups: local investors. MIGA and other public and private providers generally only cover *cross-border* investments and loans. For inconvertibility, expropriation and breach of contract, local investors cannot step outside the bounds of their own country to protect themselves from actions of their own government – if an event of this type arises, those investors can and should take recourse in the local courts. (It is also unlikely that governments would be happy with the idea of their own investors going abroad for protection.) However, acts of political violence (and loss of income resulting them) could be covered by insurance, and since this is the most urgent concern of local investors in the immediate post-conflict period, this could be critical for them – and to those financing these investments.

These same requirements make it difficult or impossible to cover existing investments. While the logic against covering existing investments is the lack of development benefit from such coverage (since the investment has already taken place), there is a strong argument for the other side: in pre-conflict situations in particular, there is a serious risk of *disinvestment*, as investors become increasingly nervous. Such disinvestment may add fuel to the fire by increasing unemployment, harming the country's fiscal base, among other destabilizing effects. Without political risk insurance coverage, one potential tool to assuage the concerns of existing investors is taken off the table.

Another risk facing investors and exporters in conflict zones that is generally not covered by political risk agencies involves losses due to short-term business interruption caused by violence, border closures and the like.

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[142] http://opic.gov/news/press-releases/2005/pr020405, http://opic.gov/sites/default/files/docs/2009_claims_history_report.PDF

[143] OPIC's historical claims data, going back to the 1960s, is generally considered to be the best statistical tool in this area. Private insurers do not publish such data, and some public insurers only began divulging partial data to the public in recent years. http://opic.gov/sites/default/files/docs/2009_claims_history_report.PDF, http://www.miga.org/documents/09ar_MDNA.pdf,

[144] More businesses are interested in investing in fragile and conflict-affected countries than are currently engaging in these countries, but are dissuaded by high risk and limited risk mitigating options. 95 preliminary applications in the last year, on a total of 550. MIGA presentation delivered at the World Bank Group Donor Forum in Paris, May 2010.

The needs of the two likeliest sources of cross-border investment in the immediate post-conflict period are not always addressed by existing sources of political risk insurance: the diaspora and regional investors. Diaspora investors often make small investments. They also are widely disbursed across many countries, making it difficult to target them through information campaigns. As a result, it would seem that few of them know about the existence of such insurance. Similarly, regional investors in emerging and developing countries are generally not served by a national agency, such as OPIC or COFACE. MIGA and other multilateral agencies are not widely known outside the developed world.[145]
National investment promotion agencies in conflict-affected states can play a key role in supporting foreign and diaspora investments into conflict-affected countries, as well as informing potential investors about risk mitigation options. These agencies can use a range of tools, such as sector benchmarking studies and information on local security conditions to make investors more aware of the investment opportunities as well as to dispel some of the legacy of negative stereotypes caused by the conflict. The World Bank Group's FIAS has focused extensively on helping IPAs in conflict-affected countries in this regard, for example in Colombia.[146]

In general, though, IPAs are reluctant to directly acknowledge investors' potential political risk concerns head-on or mention the possibility of using political risk mitigation options. On one level, this is understandable, since the job of an IPA is to promote its country. Still, this approach may inadvertently damage the agency's effectiveness and limit potential FDI inflows (as well as the use of political risk and export credit insurance).

Perhaps the biggest obstacle to expanded coverage is that public political risk insurers frequently are mandated to be self-sustaining (on a portfolio-wide basis, not per project). Because of this, they may be reluctant to expose their own balance sheets to projects or countries perceived as particularly risky, despite the evidence from their own claims history that such countries are not, on the whole, likely to lead to larger claims than other countries. While MIGA has made efforts to provide coverage backed by other donors, these programs had limited scope and impact. And they do not benefit the many other fragile and conflict-affected countries around the world.

In December 2009, MIGA announced that it would seek $100 million in donor funding and $400 million in private insurance coverage for a "Conflict-Affected and Fragile States" facility, specifically designed to address some of the shortcomings in the political risk and export credit insurance market mentioned above, such as the exclusion of domestic investment. By MIGA's own estimates, if fully utilized, the $500 million facility could generate $2 billion in new investments into eligible countries – compared with total FDI inflows into fragile and conflict-affected countries of $13 billion in 2008.[147] In creating a

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[145] Notable exceptions are China, India and South Africa, all of which have active ECAs. MIGA currently only has offices in Washington, D.C. and Tokyo, so its outreach to emerging market investors is hampered; increased cooperation with the IFC, which has a broad field presence, could help in this regard. Regional products offered by the Inter-American Development Bank, Asian Development Bank and Inter-Arab Investment Guarantee Agency, as well as by the Islamic Corporation for the Insurance of Investments and Export Credits, are also not yet being applied on a wide scale to fragile and conflict-affected countries.
[146] See FIAS News, June 2008, p. 3. Interestingly, Colombia has become one of the few post-conflict countries to directly address security concerns, when it began its ongoing campaign to attract investors and tourists, using the slogan, "Colombia. The only risk is wanting to stay."
[147] "Conflict Affected and Fragile States Facility", MIGA PowerPoint presentation, May 2010; FDI statistics, slide 11.

private-public partnership, where donors assume the first risk, the facility is modeled on the World Bank-originated Caribbean Catastrophe Risk Insurance Facility, created in 2007 to help the region find stable, affordable coverage against hurricanes and earthquakes.[148] It also takes into account the specific needs of fragile and conflict-affected countries by allowing coverage to be extended to export credit and domestic risks.

Several critical concerns remain for the implementation of the program. First, for the facility to be successful and truly support investment into fragile and conflict-affected countries, information must be communicated to local and diaspora investors and exporters, who are widely distributed and hard to reach. Second, to be effectively mainstreamed into other bilateral and multilateral efforts at private sector development in these challenging countries, there must be effective World Bank Group ownership – within the Bank and IFC country and regional offices – of the facility. Also, the current list of countries for which MIGA is considering applying the facility excludes a number of important nations, such as Iraq, Ethiopia and Fiji. The agency might consider including such countries to make the facility more effective.

Finally, and perhaps most important, while this facility has the potential to make a significant contribution to promoting FDI into, and trade with, fragile and conflict-affected countries, it still needs to be complemented by additional risk mitigation instruments at the national, regional and multilateral levels. MIGA, for example, is not putting any of its own capital at risk for the facility – and this pattern continues to hold for all the major export credit and investment insurers. Ultimately, the solution must come in the form of rethinking risk thresholds within these institutions – consistent with data indicating that fragile and conflict-affected countries, while presenting a manifestly higher risk of political violence claims, on the whole actually account for a small percentage of overall claims (which are much more likely to come from large expropriations and breaches of contract in other emerging markets).[149]

VIII. Going Forward: Reinforcing the Private Sector Contribution to Securing Development

There is a positive trend in terms of level of bilateral and multilateral commitments to fragile and conflict-affected countries[150] and specifically, in terms of greater recognition of the role the private sector can play in helping secure peace and development.

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[148] See http://www.ccrif.org/

[149] Precisely because of the ongoing involvement of the World Bank, and bilateral donors, post-conflict settings actually might present a lower-than-average risk for expropriation and breach of contract, since such actions by the host government could lead to direct conflict with the very foreign governments and multilaterals on which they most depend.

[150] Last summer, the British government announced that half of British aid would go to fragile countries and that creating economic opportunities in these challenging countries would be a priority. The World Bank Group has indicated that fragile situations are one of its strategic priorities. IFC has ramped up its efforts in these places, tripling its investment commitments and growing its advisory activities by more than 10 times over last four years. MIGA, as mentioned, is on the verge of launching a dedicated facility for fragile and conflict-affected countries. Still, these are the early days of such increased efforts. IFC investments in fragile and conflict-affected countries constitute 6 percent of its total investments. These challenging countries make up about 9 percent of MIGA's portfolio (over 60 percent of MIGA's exposure to fragile and conflict-affected countries is with one project in Djibouti). Here it is important to note that definitions are an issue, making it difficult to understand true trends. The World Bank Group does not consider Iraq a fragile and conflict-

The private sector exists throughout the cycle of conflict and cuts across the dimensions of politics, security and development. It can, in certain situations—such as informal sector involvement in illegal activity—exacerbate tensions in a fragile situation. However, if properly channeled, the legitimate private sector can make huge contributions to capacity building and reconstruction in the aftermath of conflict. It can even help prevent a fall into conflict in the first place. We are not arguing that supporting the private sector is a cure. Rather, private sector development efforts should be considered as a significant contributor to peace, recovery, reconstruction and development. As such, it is important to move away from any argument under which sequencing would imply that security comes first, while private sector development-related reforms come later.

Simply put, there are appropriate reforms related to the private sector at each step of the way. So, the issue should be less about when to pursue such efforts, and more about how to pursue these reforms in parallel to broader reforms.

Going forward, focus should be on identifying the best ways to strengthen the private sector in these challenging contexts, including the determination of the optimal roles of government and business throughout the continuum. In the absence of stable, local enterprises, ex-combatants will be unable to secure alternative livelihoods, so the processes of peace-building and state-building could be subverted. Below, we recommend possible starting points, to help ensure that the positive momentum of peace-building and state-building can continue.

Recommendations on Intervention Design and Links to Security Concerns

- Focus more on conflict prevention in particular on supporting the legitimate private sector and those government institutions which support the private sector in the period when conflict is already on the horizon.

- Provide early and consistent countercyclical financing and risk-sharing, including for farmers and small traders, during the pre-conflict period (as part of a conflict prevention strategy, including a focus on alternative livelihoods).

- Explicitly recognize potential detrimental effects on the legitimate domestic private sector from actions taken by global and regional actors to contain conflicts (border closures, embargos).

- Take early and effective action against illegal trade, particularly cross-shipment of drugs, and against those military and government officials supporting and benefiting from it – but with a careful calibration so that these instruments do not cause collateral damage on the already weakened legitimate private sector and on remittances.

- Impose early and effective arms embargos on all combatants, supported by Western, East Asian and other arms producers and regional and global arms dealers – with a

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affected country, and investments in Iraq by IFC and others are not counted, even though a number of institutions are active there, providing both investment and technical assistance to the country under extreme circumstances.

careful consideration of the respective roles of the official military, militias and rebels in the conflict.

- Study recent examples of post-conflict countries that have prioritized investment climate reform and implemented ambitious reform programs, in order to help develop a better understanding of the early sequencing of private sector development-related interventions. This group includes Bosnia,[151] Georgia and Sierra Leone as three leading reformers, with Liberia emerging as a significant reformer in 2008-2009.

- Increase knowledge-sharing efforts on the private sector's role (both positive and negative) in urban violence in countries such as Brazil, Colombia, and South Africa that have commonalities with conflict-affected states. Though the conflict in Central America ended in the 1990s, violence has continued to grow, with some of the highest rates of murder now found in the sub-region. Such violence, which is predominantly urban, is serving as the main hurdle to sustainable development.[152]

Recommendations on Reducing Remittance Costs

- Increase direct support for family-to-family remittances from the diaspora, particularly during the most active phase of conflict.

- Initiate further study of remittances, particularly during active conflict (in areas such as legitimate transactions and purchases of armaments), with special focus on informal channels, south-south remittance flows and how the funds are used for private sector activity.

- Recalibrate remittance restrictions by the U.S. and other countries, to avoid collateral damage and additional transactions costs for those sending remittances to their families.

- Add measures to lower transaction costs and ensure that the maximum amount reaches family and relatives (including lowering taxes on transactions, and improving transfer access through cell phones).

- Look into the possibility of pooling remittances through microfinance institutions, for example, and the potential for leveraging these remittance pools for larger investments in local communities.

Recommendations on Support for Foreign Investment Flows to Benefit Local Communities

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[151] In 2004, IEG carried out a review of the Bosnia and Herzegovina reconstruction program and cited it as an example of the "Bank at its best." IDA commitments totaled $1.27 billion, IFC investments were $230 million and MIGA guarantees were around $310 million, constituting one of the most significant per capita assistance programs for any post-conflict country. Source: Melissa Johns, Conflict Affected Countries: Reform Trends from the Doing Business Data Set. May 2010.

[152] The Gangs of Central America: Major Players and Scapegoats. Number 317, December 2007, Revista Envio.

- Add mechanisms through which the positive impact of FDI can be guided and strengthened. For example, in some countries, where IFC is investing in natural resources, IFC advisory services efforts promote social development from royalties.[153] In conjunction with investment clients, IFC collaborates with local/national authorities and representatives to promote the adoption of tools and practices to improve investment management as well as with civil society on monitoring receipts and investments, and allowing citizens' voices to be heard.

Recommendations on Expanding Local Procurement

- Strengthen links between the operational needs of the international community and the local private sector. For example, in 2006, Canadian NGO Peace Dividend Trust launched "Peace Dividend Marketplace," a procurement brokerage pilot project[154] in Kabul. Thus far, $52 million in local economic impact has been generated. Replication is being considered for Haiti and local Afghan staff of the project has travelled to Port-au-Prince to share lessons.

- Set aside some amount of donor contracting to stimulate local enterprise capacity development over the medium to long term. Even a modest contracting percentage could reap big benefits and indirectly boost the country's GDP.

- Be forward thinking in developing specific skills in the post-conflict context. In the immediate term, the international community procures everything from cleaning and security services, engineering and construction services, office supplies and equipment, to basic products like oil and lubricants. In Afghanistan, even agricultural products like tomatoes and essentials such as bottled water were being procured from abroad until only very recently.[155]

Recommendations on Building Capacity in the Local Private Sector

- Establish facilities to train young men and ex-combatants in basic construction early to increase local capacity, stimulate construction activity (a sure need following any conflict situation), and avoid a return to violence. Consideration should be given to labor-intensive construction that draws heavily on local populations and materials.

- Focus on typically excluded groups, particularly rural populations and women, ensuring they have adequate access to key skills and finance.
    - Seventy percent of Sierra Leone's population is in the agribusiness sector. Most are subsistence farmers lacking sustainable employment. In early 2010,

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[153] In Colombia, IFC is currently assisting the municipality of California to manage and invest royalty revenue from Greystar's Angostura gold-silver project. The municipality intends to use the royalties to strengthen the skills of local municipal managers to implement projects, which provide key services to citizens.

[154] Essentially, in partnership with the Government of Afghanistan, PDT developed a website to match the international community's needs – from tomatoes to building materials to consultancy services – with Afghan suppliers. There is information about more than three thousand Afghan companies on the site. http://www.peacedividendtrust.org/en/index.php?sv=&category=PDT%20Afghanistan

[155] IFC and several bilateral aid agencies work with firms in promising sectors in fragile states, using a value chain approach, to enable them to develop or regain sustainable market opportunities. To achieve this, local companies are assisted to improve their quality standards and productivity.

MIGA signed contracts with two private equity funds that are raising money to invest in small-scale local companies, especially agribusinesses. These master contracts of guarantee reserve MIGA's capacity to provide political risk insurance for up to a dozen of the fund's individual investments, totaling an estimated $16.2 million. MIGA's commitment to underwrite the political risks for the planned investments is facilitating the investors fundraising efforts in the private market and providing assurance to limited partners that MIGA is making a strong commitment to the funds.[156]

  - Women are significant contributors to economic growth in a post-conflict context. Encouraging policy changes based on the needs of female entrepreneurs (especially land and inheritance rights), such as legal changes in status can help them obtain credit.[157]

- Pay more attention to the diaspora phenomenon and its catalytic role in the post-conflict period. National tax and other policies should encourage early repatriation of capital from the diaspora into reconstruction efforts – and the international community should seek new mechanisms to support those flows (which is difficult, given the often diffuse and closed nature of the diaspora communities).[158]

Recommendations on Increased Donor Flexibility

- Make donor funding and programming more flexible so that opportunities to transition from conflict to peace and development are not lost. For example, if donor funding horizons could be addressed through creative mechanisms, significant development could be facilitated or, at the very least, de-development could be avoided.

- Make donor funding for infrastructure more flexible. Donors often finance large infrastructure projects in the early days but without any consideration for the future. If donors could go beyond construction to support the delivery of services for a longer period—ten years or more—significant benefits could be yielded. Donor funds could be structured to support a stream of payments over a concession period to a private constructor/manager of the services. This would bring in private contractors and be private managers, since management is often a crucial missing skill in these environments. This way, donor funds are allocated to support a stream of infrastructure services over a longer period. If necessary, the funds could be disbursed into an escrow account to support the services rather than provided as budget support to the government. The government would be the contracting party (and get credit for in facilitating services to the wider population), but the funds would be pre-allocated.

- Strengthen public finance institutions to better manage the often volatile but significant revenues generated in post-conflict countries with significant and valuable

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[156] "MIGA to Support Investments into Small Businesses in Sierra Leone." Press Release. January 15, 2010. www.miga.org

[157] Rebuilding Nations: Women Entrepreneurs in Post-Conflict Societies. IFC Quick Note. Accessed 3 April 20100 from www.ifc.org

[158] One approach is demonstrated by Sri Lanka's diaspora investments in government securities. Financial Times, February 8, 2010

resource endowments such as oil, gas, diamonds and minerals. This reduces the scope for corruption and nepotism, facilitates stronger public investment in critical areas such as health, education and public institutions. It also helps ensure that the significant revenues from resources do not become a source of further conflict.[159]

- Encourage further study into private sector development-related interventions in various stages of conflict to quantify the contributions of first generation reforms to sustainable recovery and development.

Recommendations on Funding Direct and Indirect Mechanisms to Finance Private Investment

- Institute a large global fund that would insure investors in fragile situations. (See Annex F).

- Support the development of commercial banking systems.

- Support the establishment of sustainable microfinance institutions.

[159] It is worth considering experiences such as the establishment of the Petroleum Fund for Timor-Leste. Understanding that the country's natural resource wealth will not last forever, this fund was set up in 2005 to collect revenue generated by Timor-Leste's petroleum resources, and ensure that it is translated into sustainable income (through investment) to benefit current and future generations of Timorese. Money from the fund is used to finance official government programs. The amount in the fund is public knowledge, published quarterly. Source: The Petroleum Fund and Timor-Leste's Revenue Outlook. World Bank. 2008.

ANNEXES

Annex A – Natural Resource Investments and Conflict

Natural Resources have long played a role in conflict. However, recently, debate has become more directly focused on that role – and the part played by foreign investment – as a result of two events: the 1973-74 Arab oil embargo, targeting the US (and its Western European and Japanese allies) for supporting Israel in the 1973 war;[160] and the end of the Cold War, which opened up opportunities for many new actors to join the race for oil, gas, minerals and other resources. The rapid growth of several emerging markets, particularly China and Russia, has made that race more complex, since firms from those countries (often tied directly to the government) are accused of "not caring about democracy or conflict" as they invest in countries with poor governance records such as Sudan, the Democratic Republic of Congo and Myanmar, among others.[161] Furthermore, global information flows and increased NGO activism have put focused international attention on the myriad problems of natural resources investments, particularly in fragile and conflict-affected countries or areas. This, in turn, has led to efforts on the part of international institutions, governments, and investors to improve the broader socio-political (and environmental) impacts of investments into the sector. Thus far, though, the record on such efforts is mixed.

Two specific multi-stakeholder initiatives – the Extractive Industries Transparency Initiative [162] and the Voluntary Principles on Security and Human Rights[163] – have been set up since 2000 to address several of the main issues in the sector, including corruption, safety and security in unstable environments, and human rights. While not specifically targeting fragile and conflict-affected states, EITI and VP clearly recognize the role that the extractive industries can play in either fomenting or preventing conflict.

While there are no independent evaluations to date of the overall effectiveness of these two initiatives, it is clear that they depend on the political good will of the parties to implement

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[160] Yergin, Daniel H., *The Prize: The Epic Quest for Oil, Money, and Power* (New York: Simon and Shuster, 2008), p. 589.

[161] Numerous studies have shown that Chinese investments in Africa's natural resources, for example, have actually been relatively small to date – in March 2010, Foreign Minister Yang Jiechi claimed that China's investment in Africa's oil sector was only 6 percent of the global total investment into the sector; http://www.chinadaily.com.cn/china/2010-03/07/content_9550417.htm . On the other hand, many Western governments and NGOs continue to have concerns about China's perceived unwillingness to take conflict and fragility into account when choosing investment locations. A good example is the $7 billion infrastructure for mining and oil deal announced in October 2009 between China and Guinea's military rulers – questioned by many for coming just 2 weeks after the killing of at least 157 demonstrators at the Conakry stadium, followed by widespread, and apparently ethnically-motivated, rapes and attacks on women. http://news.bbc.co.uk/2/hi/8304418.stm

[162] Announced in 2002 at the World Summit on Sustainable Development by the UK's Prime Minister, Tony Blair, EITI has a formal organization, headquartered in Norway, which has been joined by 30 resource-rich countries, including numerous conflict-affected ones, such as DRC, Guinea and Sierra Leone. However, only 2 of the 30 countries – Liberia and Azerbaijan – are "compliant"; the other countries are still considered "candidates". EITI "supporters" include over 40 companies, as well as NGOs and civil society organizations. EITI plans to issue a first evaluation of its work in 2010. http://eitransparency.org/

[163] The Voluntary Principles, initially created as a multi-stakeholder initiative by the US and UK governments in 2000, is now driven by its 20 corporate members. The focus of the VPs is on security (risk assessments, and the interaction with public and private security forces) and on human rights (especially within the local communities impacted directly by the companies). So far, there has been no evaluation of the VPs' effectiveness. http://www.voluntaryprinciples.org/

them fully – there are no sanctions for non-compliance, for example. Furthermore, many key emerging market companies are not participating in these efforts; there are no Russian or Chinese companies among the more than 40 corporations supporting EITI.[164] More transparency and an increased focus on local security also should not obscure the fact that many countries subscribing to these initiatives continue to use a significant part of their revenues from natural resources to expand their military; examples include Chad and Azerbaijan – one of only two "EITI compliant" countries.

Although not an EITI member, Chad signed specific undertakings with the World Bank Group in 2000 as part of the WBG's support for the project, in particular with respect to managing oil revenue and improving public expenditure – in large measure because the Bank explicitly recognized the risk that the revenues could aggravate institutional weaknesses and lead to more conflict.[165] Less than two years after the pipeline began operating and Chad started to receive oil revenues, the government unilaterally scrapped the deal, after initially trying to renegotiate it with the Bank. As a result, Chad repaid the Bank loans in 2008, and the Bank is no longer supporting the Chadian oil sector.[166] Government revenues increased from $112 million in 2000 to $2 billion in 2008, with 90 percent coming from oil.[167] The IEG report on the project's impact on the non-oil sectors[168] reflects the fact that – despite Bank Group involvement – Chad is not escaping the resource curse. This also means that the vast new revenues may well cause increased conflict, both domestically and with neighboring countries, especially Sudan/Darfur.

The lessons of the project continue to be debated, both within the World Bank Group and in the broader development and extractive industries communities. (It should be noted that over 90 percent of the financing for the project came from a consortium of oil companies, led by ExxonMobil, and from commercial banks – as the IEG report found, it is likely that the project would have gone forward even without World Bank support.[169]) IEG also notes that "no alternative program design or closer supervision would have allowed to achieve the program's development objectives in the absence of government commitment."[170] At the heart of the matter is the fact that sovereign governments, once revenues begin to flow, will have a very different perspective on revenue allocation than they did when financing was needed. Furthermore, the suggestion that government institutions should first be strengthened before the inflows begin, while theoretically correct, often ignores the realities of the market, where governments may have the luxury of multiple offers from US, UK, Chinese and Russian companies to develop deposits. It also would require a greater up-front commitment of resources from the development community – rather than waiting for the revenues to pay for such programs.

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[164] http://eitransparency.org/supporters/companies

[165] World Bank Group Independent Evaluation Group, *The World Bank Group Program of Support for the Chad Cameroon Petroleum Development and Pipeline Constructio*n, Washington, DC, Nov. 20, 2009, p. x.

[166] It should be noted that the IFC continues to provide advisory services to Chadian companies in the oil sector and continues to monitor the environmental and social aspects of the private sector investments in the pipeline. Ibid, p. xi.

[167] Ibid, p. xii

[168] Ibid., pp. xii-xiii

[169] "With the rapid increase in oil prices, the oil would most likely have been extracted and the pipeline constructed even without WBG involvement. This weakens the criticism by some NGOs that the WBG should have waited until capacity was in place and governance improved." IEG Website.

[170] Ibid, p. viii

An interesting example of how natural resources can play a constructive short-term role in forging peace and yet also continue to contribute to conflict is the case of oil in southern Sudan. Long at the heart of the conflict, control over the oil also lay at the center of the peace process which led to the 2005 Comprehensive Peace Agreement. With both the government of Sudan and the authorities in southern Sudan recognizing that foreign investors would not make large-scale investments in many of the most promising oil fields in southern Sudan as long as conflict continued, but unable to agree over ultimate ownership of the resource, international mediators forged a win-win solution.[171] It allowed both sides to benefit financially, through joint wealth distribution and resource management, while bracketing the question of ownership itself for a later date. So far, this agreement has held. But even here, the short-term solution may bear the seeds of its own demise – the governments in Khartoum and Juba are both using the resources to strengthen their position (militarily and politically) ahead of a potential referendum in 2011 or later.[172] As a result, the current oil revenues may again lead to further conflict. In addition, while the deal satisfied the two main warring parties, it left out the local communities, which are not significantly benefitting from the revenue-sharing. Furthermore, allegations have surfaced that both the peace deal itself and the revenues from the oil have fueled the Darfur conflict, since the government is no longer as preoccupied with the south.[173]

Another trend in the area of extractive industries related to conflict lies with a new group of actors – institutional investors and consumers. Where companies are perceived to be complicit with conflict, corruption or human rights abuses, investors are voting with their feet – causing companies to rethink their behavior. Norway's state pension fund, for example, has withdrawn from several mining companies (including Norils Nickel, Barrick Gold, Freeport and Rio Tinto); in the case of Rio Tinto, it accused the company of "grossly unethical conduct" and environmental damage in the company's Indonesian mines.[174] Australia's Anvil share prices temporarily fell sharply after it was accused of providing trucks to the DRC military from its Dikulushi mine. The trucks were used in the military's effort to put down a local rebellion, resulting in a massacre that may have killed up to 100 people. As part of its response to shareholders and other stakeholders, Anvil – which had MIGA insurance – joined the Voluntary Principles mentioned above[175] and pioneered a comprehensive toolkit for applying the principles in the field.[176]

One of the strongest examples in this area has come from the diamond industry – with both governments and industry recognizing a shared interest in avoiding consumers' wrath over

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[171] Economic Issues in Sudan's North-South Peace Process, CCDP Working Paper, Geneva, Switzerland, 2009, pp. 13-19.

[172] Ibid., p. 21

[173] Ibid., p. 21

[174] CSR News, 10 Sept. 2008

[175] At the request of then-World Bank President Paul Wolfowitz, the Bank's Compliance Advisor Ombudsman undertook a review of MIGA's due diligence on the project. He found, among other issues, that "Regarding the Voluntary Principles on Security and Human Rights, CAO finds that MIGA did not fully understand the implications for its client of implementing the principles nor assess whether its client had the capacity to do so. Neither MIGA nor Anvil recognized the critical distinction between conventional security, which deals with securing the safety and well-being of personnel and assets, and the Voluntary Principles, which recognize that conventional security provision can, in and of itself, present risks to the well-being of communities." *CAO Audit of MIGA's Due Diligence of the Dikulushi Copper-Silver Mining Project in the Democratic Republic of Congo*, November 2005, p. ii

[176] The Voluntary Principles on Security and Human Rights – An Implementation Toolkit for Major Project Sites. Washington, DC, July 2008.

"blood diamonds." The Kimberley Process, begun in 2000 with UN support, has resulted in a specific certification program designed to ensure that certified rough diamonds are conflict-free. Participants include the diamond industry, governments and NGOs such as Global Witness. Under the program, "participating states must meet 'minimum requirements' and must put in place national legislation and institutions; export, import and internal controls; and also commit to transparency... Participants can only legally trade with other participants who have also met the minimum requirements of the scheme, and international shipments of rough diamonds must be accompanied by a KP certificate guaranteeing that they are conflict-free."[177] While the program is voluntary, it was seen at the outset as a strong self-regulatory body. It removed the Republic of Congo in 2004 over allegations of non-compliant trade in diamonds from DRC, and suspended certification Cote d'Ivoire in 2005 as a result of the civil war. However, the KP Plenary Group's inability to achieve consensus on removing Zimbabwe in 2008 caused criticism from Global Witness and the resignation of Ian Smillie, one of the Process's architects.[178] While imperfect, it is considered one of the most effective initiatives of its kind, particularly with respect to countries like Sierra Leone.

Investment in natural resources does not have to catalyze or reinforce conflict. By starting off with a solid understanding of potential danger points, a country's resources can be used as a force for good and significant contributor to development. Resources can be managed purposefully so that investment benefits a broader swathe of people, in a fair and transparent manner. National governments can be assisted to ensure sustainable income from natural resources (Timor-Leste Petroleum Fund); local governments can be helped to spend natural resource royalties on education and key infrastructure (IFC Revenue Management initiative); multinational corporations can facilitate local community development alongside their investments (UN Global Compact); and on a more macro level, foreign governments can exert pressure on responsible corporate behavior (Publish what you Pay), government behavior (KP, EITI) and consumption ("blood diamonds").

[177] http://www.kimberleyprocess.com/background/index_en.html

[178] Daily Telegraph, 5 November 2009. According to Smillie, "The whole thing is farcical, irresponsible and a disgrace. Here we have a government that has lied repeatedly to the KP - clearly stated in the KP report - has a tenuous grip on its diamond industry - and that courtesy of gross human rights violations - and the regulatory body that is supposed to assure consumers that the diamonds its certifies are clean ignores its responsibility and sets up an open-ended tea party. It will turn the KP into a laughing stock and give Zimbabwe more or less carte blanche for business as usual." Global Witness, a campaign group, said the decision cast doubt on the credibility of the Kimberley Process. Annie Dunnebacke, from the organization, said the scheme had "failed to enforce its own minimum requirements."

Annex B – Remittances

Even now, it is a relatively little-known fact that official remittances rival FDI as the main source of capital inflows into developing countries – and dwarf official development assistance. In 2004, official remittances totaled $160 billion, compared to $166 billion in FDI and $79 billion in official development assistance, known as ODA.-[179] If unofficial remittances, using informal or parallel networks of money transfer, such as *hawallah*, are considered, the total likely far exceeds FDI.[180]

In conflict situations, the relative importance of remittances increases even more dramatically. FDI will have generally evaporated, and ODA may not yet be able to reach many affected communities. In countries as varied as Tajikistan, Somalia and Haiti, remittances rival or exceed exports as the main source of hard currency, and represent a significant proportion of GDP.[181] The role that these inflows play in conflict is complex, cross-cutting and understudied. In some conflict areas, they can empower women, who often are the direct recipients of the money sent home from sons and brothers working abroad. However, while they are a lifeline for many, they are also frequently used to fund conflict – including allegations of being a source of financing for international terrorism. Additionally, the money is often used to fund further migration, with all the incumbent social consequences in the home country and abroad. These complexities and their ramifications for conflict and peace are only now beginning to be understood, and a lack of reliable cross-country data means that, currently, research relies heavily on case studies.

Remittances have the unique advantage that they are able to reach remote areas of conflict-affected countries, even during the darkest days of conflict.[182] Furthermore, evidence has shown that diaspora communities increase their remittances back to their families in times of exceptional need, be it due to conflict or natural disasters.[183] In those cases, they may be the only source of income for the families, literally keeping them from starvation. Surveys have shown that the majority of remittances are used for basic household expenses, particularly food, education, health care/medicines and construction. <u>It is important to note that this money is destined almost entirely for purchases in the private sector – so remittances play a fundamental role in sustaining the private sector during conflict,</u> including provision of basic services (such as health care and education) which the public sector may be unable to furnish as a result of the conflict.[184]

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[179] "Remittances in Fragile Settings: a Somali Case Study", Anne Lindley, HiCN Working Paper 27, March 2007, p. 2

[180] For example, no official remittance statistics exist for Somalia, but estimates are that remittances total $700 million to $1 billion. Somalia's official GDP in 2008, by contrast, was only $2.8 billion. Lindley, p. 5; https://www.cia.gov/library/publications/the-world-factbook/geos/so.html

[181] Tajikistan may represent the most extreme case. Remittances are believed to account for approximately 50% of GDP. "The Macroeconomics of Remittances: The Case of Tajikistan", Alexei Kireyev, IMF Background Paper, January 2007, p. 3.

[182] Studies have shown that, even in Darfur and Somalia, money reaches families in the midst of conflict, often through ancient hawallah systems that are based on clan or ethnic identity and trust. Lindley, ibid.; "Livelihoods, migration and remittance flows in times of crisis and conflict: case studies for Darfur, Sudan", Helen Young, HPG Background Paper, September 2006

[183] Lindley, ibid., p. 16; "Remittances in Crises: A Haiti Case Study", Patricia Fagen, HPG Background Paper, September 2006, p. 15

[184] Lindley, ibid., pp. 12-3, "Understanding the Remittance Economy," Manuel Orozco, Inter-American Dialogue, March 2006, p. 13

An added result of remittances, at least in certain countries where case studies have taken place, is the potential to empower women, who often become the family bankers in conflict situations. In Haiti and Somalia, for example, studies have shown that the migrants who are sending money home often prefer to send the money directly to a female relative. This is apparently related to the belief that women will be more likely to respect the remitters' wishes on how the money should be spent and avoid using it frivolously, for example for alcohol (in Haiti) or *qat'* (in Somalia). [185] However, there is not yet any clear evidence that financial control is translating into a stronger voice in broader family or political matters.

Unfortunately, the flow of funds also fuels conflict. Remittances have been used to sustain civil conflicts in countries such as Somalia, Lebanon, and most notably Sri Lanka, where many Tamils around the world contributed (willingly or not) to funding the LTTE "liberation movement."[186] It should be noted, however, that it is the conflict itself that has often forced weaker or marginalized groups to leave their home country – hence the fact that these groups, once abroad, send money back to fund the defense of their brethren must be understood in the wider context of the origins of the conflict.

Furthermore, after the attacks of September, 11, 2001, the U.S. and other governments began to scrutinize more closely the funds being sent from Muslim communities in Western Europe and the U.S. to places tied to Al-Qaeda and other "terrorist" groups, particularly Afghanistan, Yemen, Sudan and Somalia. As a result, Western countries put in place strict new rules on money transfers and are trying to force more of the transfers into official, transparent channels (as opposed to the unofficial *hawallah* network). The result of these blunt instruments was to shut down some remittance companies, including El Barakat, the largest such firm in Somalia, as a result of which "tens of thousands of Somali families essentially lost their life lines."[187]

While alternatives are generally found, the temporary losses can be devastating in the context of ongoing conflict, and the long-term consequences are both counterproductive (forcing transfers back into the informal, opaque systems) and costly (increasing transaction costs for remitters). The measures also ignore the fact that vast numbers of rural recipients in developing countries simply do not have access to official channels, particularly banks. The World Bank has argued that "the challenge is how to target illegal acts perpetrated through IFT [informal financial transfer systems] without affecting the numerous innocent customers who remit honest money back home…and without unduly disrupting trade or harming legitimate enterprises. It is important to minimize 'collateral damage' caused by unfocused or unfounded control actions."[188]

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[185] Orozco, ibid., p. 27; Lindley, ibid., p. 11 – in Somaliland, according to the survey, about 60% of recipients are women.

[186] Lindley, p. 18; "Diaspora Circulation and Transnationalism as Agents for Change in the Post-Conflict Zones of Sri Lanka," R. Cheran, York University, Sept. 2003, p. 10. The Sri Lankan government accused overseas Tamils of funneling $80 million to the LTTE, a figure disputed by Tamil representatives.

[187] Fagen and Bump, p. i, p. 16

[188] Mambo and Passas, 2005, p. 217, as quoted in Fagen and Bump, p. 11.

Annex C – Telecommunications

In countries like Somalia, DRC, and Afghanistan – some of the most unstable and unbearably violent countries in the world – the telecommunications industry has been able to thrive. While governmental services and basic infrastructure are lacking, cell phones have become a part of daily life. The telecom industry has even been able to provide services such as banking and tele-medicine as tools for development. The Earth Institute's Jeffrey Sachs once called mobile phones "the single most transformative tool for development," and Nobel laureate and former Grameen Bank executive Mohammed Yunus has said, "When you get a mobile phone it is almost like having a card to get out of poverty in a couple of years."[189]

The telecom industry is an example of how the private sector can help alleviate rather than exacerbate conflict, and investment in this field has proven to yield positive results towards peace-building, reconstruction, and development while turning a profit. [190]

The telecom industry is unique in the sense that companies are able to start initiatives during the conflict and do not have to wait until stability and peace have been fully achieved. In contrast to other industries, "mobile phone companies make smaller investments, and start getting a return as soon as the first subscriber makes a call."[191] The initial investment is usually quite low compared to other industries, and companies are able to start recovering the investment almost immediately. In developing countries with cash societies, the business model most widely used by telecom companies is pre-paid cards which have no collection problems.[192]

In looking at Afghanistan, Somalia, and DRC, the average mobile-penetration growth rate was 111 percent between 2001 and 2006.[193] The Middle East Times called mobile telephony in Afghanistan its "most impressive economic success," as it has the third highest growth rate in the world, next to Iraq and Liberia, both conflict-affected countries as well.[194]

The ability to enter during conflict, the low initial investment required, and the enormous growth potential all help facilitate telecom investment into fragile and conflict-affected countries.

A Quick Look at Somalia

With no real government since 1991, Somalia has been in a state of chaos for two decades, and the Somali people have endured severe violence with no clear end in sight. Despite the lack of any basic infrastructure, governance, rule of law, or financial systems, Somalia's private sector has been relatively successful. Three of the largest telecom companies in country, Hormuud Telecom, Telecom Somalia, and National Link, have a combined total of around 1.8 million mobile subscribers.[195] The products and services manager of Telecom Somalia (set up during the violence in 1994) says that "warlords realize that if they cause

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[189] "Mobile Marvels," The Economist, The Economist Newspaper Limited, 24 Sep. 2009.

[190] Konkel, Agnieszka and Heeks, Richard(2009) 'Challenging conventional views on mobile telecommunications investment: evidence from conflict zones', Development in Practice, 19: 3, 414 — 420

[191] "International Companies and Post-Conflict Reconstruction: Cross-Sectoral Comparisons," John Bray, Feb. 2005.

[192] Ibid. p. 13

[193] Konkel and Heeks, p. 415

[194] Ibid. p. 415

[195] "Mobile-Phone Firms Thrive in Somalia Despite Turmoil," The Daily Star, 04 Nov. 2009.

trouble for the phone companies the phones will stop working again, which nobody wants."[196]

Private firms act in line with the following steps to ensure the security of their investments and to make up for the lack of government regulation: "First, 'importing governance' by relying on foreign institutions…Second, using clans and other local networks of trust to help with contract enforcement, payment, and transmission of funds. Third, simplifying transactions until they can be carried out with help from neither the clan nor the international economy."[197]

In Somalia, the lack of government might actually make operations easier to set up. Licenses are not necessary, no taxes must be paid, and there is no state run monopoly to block competition.[198] However, a functioning government would certainly aid the current telecom operations and would be able to provide a central bank and infrastructure so staff could be trained locally rather than abroad. Moving forward, the Secretary General of the Somali Telecom Association (set up in 1998 as an informal regulator of the Somali telecom industry) says, "We need a government to regulate and provide necessary legislation as well as ensure security and peace which would attract much needed foreign investment to the sector."[199] Finally, despite all the setbacks and risks involved, current operations have managed to find success, but Somalia is a very unique case: in addition to the lack of government, Somalia has one of the largest diasporas (1-3 million compared to the 7 million people in Somalia)[200] who are motivated to stay connected and keep in touch.

Telecom Companies Working in Conflict-affected Countries

Celtel, founded in 2004 by Dr. Mo Ibrahim, an African native and visionary, is currently operating in 13 African countries and reported a 63 percent increase in customer numbers after 6 months and a 47 percent increase in revenue to $296.5 million.[201] Dr. Ibrahim says that setting up operations in Africa is a wise business move because "its poorly developed communications infrastructure means that – albeit from a small base – it is the world's fastest growing mobile phone market."[202] Already, in Africa, the largest conflict-affected region in the world, four in ten people have a mobile phone.[203]

Other examples of companies operating in conflict-affected countries include Millicom in 16 emerging markets such as DRC and Sierra Leone, Mobitel in Sudan and Sri Lanka among others, MTN in Afghanistan, Rwanda, Cameroon and Eastern DRC, Orascom in places like Algeria, Congo, DRC, and Iraq, and Vodacom in DRC.[204] In 2002, Vodacom invested $94 million into DRC's mobile phone network. While understanding the risks involved, Vodacom chose to move into DRC as there was very little competition and the potential for

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[196] "Telecoms Thriving in Lawless Somalia," Joseph Winter, BBC News, 19 Nov. 2004.

[197] "Anarchy and Invention," Tatiana Nevona and Tim Harford, Nov. 2004, Public Policy Journal, The World Bank.

[198] "Telecoms Thriving in Lawless Somalia," Joseph Winter, BBC News, 19 Nov. 2004.

[199] "Somali Telecoms Boom Without Governments," Nita Bhalla, Reuters, 22 July 2004.

[200] "Telecoms Thriving in Lawless Somalia," Joseph Winter, BBC News, 19 Nov. 2004.

[201] "Celtel to List on London Stock Exchange," Robert Budden, Financial Times, 19 Oct. 2004.

[202] Bray, 2005, p. 20

[203] "The Power of Mobile Money," The Economist, The Economist Newspaper Limited, 24 Sep. 2009.

[204] Bray, 2005, p. 14

profit was significant. Vodacom Congo increased their customer base by over 50,000 within its first three weeks and expected to quadruple this base by March of that year.[205]

Many of these companies have incorporated corporate social responsibility schemes into their telecom projects. For example, Celtel developed an initiative with Search for Common Ground to help bring together people of different ethnic and linguistic backgrounds in Sierra Leone.[206] Companies are also able to encourage political legitimacy and good governance practices. FrontlineSMS allows people to communicate through text message to report human rights violations and coordinate aid and conservation projects. A website called Ushahidi was created in Kenya during the post-election violence in 2008 to allow mobile phones to be used for crisis and disaster management. In India's election, voters could use their phones to find out information on the candidates running. Moreover, mobile phones can be used for election monitoring as has been done in Nigeria, Kenya, and Sierra Leone.[207]

Mobile technology has also started innovative initiatives far beyond the traditional role of a phone. Farmer's Friend, created by MTN, Google, and the Grameen Foundation's Application Laboratory, is an agricultural-information service that allows farmers to send a text message asking about weather and expected rainfall as well as advice on farming tips. The operation includes another application, The Clinic Finder, which gives information about the nearest clinics and symptoms of common diseases. Additionally, there is Google Trader, a system that matches buyers and sellers of agricultural products.[208] Many other companies have similar services that have the potential to change the developing world dramatically.

There are many obvious benefits for citizens that come along with the arrival of telecommunications. Iraqis describe phones (banned under Saddam Hussein) as the biggest benefit of America's invasion[209] because phones represent freedom. Dr. Mo Ibrahim said, "There is a massive need for mobile telephony in Africa. Where you have good telecommunications you usually have democracy. If you have a phone in your hand, then you have a voice."[210] While empowering individuals, telecommunications also helps bring families and a country together.

Beyond the social capital benefits, telecommunications also help individuals in their business life and make markets more efficient. People are able to run successful businesses and communicate with others in different locations. In 2006, an entrepreneur with a roadside kiosk increased his income by 70 percent in six months through use of a phone, "because basic activities such as stock handling and negotiating prices with suppliers become much more efficient with a mobile phone."[211] Or, a phone can be the core of the business. For example, Mary Wokhwale from Uganda makes her living as a "village phone" operator. She received a microfinance loan, bought a phone, and made her money by selling calls at a small profit to other villagers. She was able to pay back her loan as well as set up a "business selling beer, open a music and video shop and help members of her family pay their children's school fees."[212] According to a recent study, the addition of ten mobile phones per

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[205] "The Hotspots of African Investment," Briony Hale, BBC News, 29 Aug. 2002.
[206] Bray, 2005, p. 22
[207] "Mobile Marvels," The Economist, The Economist Newspaper Limited, 24 Sep. 2009.
[208] Ibid.
[209] "Better than Freedom?" The Economist, The Economist Newspaper Limited, 12 Nov. 2009.
[210] Bray, 2005, p. 21
[211] "Mobile Marvels," The Economist, The Economist Newspaper Limited, 24 Sep. 2009.
[212] Ibid.

100 people in a typical developing country leads to an increase in GDP per person of 0.8 percentage points.[213]

One of the best examples of a telecom company using their business to significantly aid development is Roshan in Afghanistan.

Roshan Case Study

Roshan, the telecom company of Aga Khan, is a true example of how the telecom industry can be used to engage society and help bring about peace in a country while running a successful and sound business. Not deterred by instability and lack of infrastructure, Roshan entered Afghanistan in 2003 when there were only 20,000 telephone lines and no international calling capabilities in the country.[214] After six long, hard years of work, there are over 3.5 million subscribers to Roshan telephones (up from over a million in 2007).[215] Roshan has a unique business philosophy of staying committed to non-profit and for-profit work simultaneously. For every $2 billion put towards the company, Roshan invests $1 billion into projects aiding Afghanistan because the company believes in the value of devoting time and resources to both non-profit and for-profit activities as investment alone will not lead to success in conflict-affected countries.

Roshan contributes to development in seven ways:

1 Improving public sector legitimacy. The private sector provides tax revenues that the government can use to provide basic services to citizens. Roshan is Afghanistan's largest taxpayer and at the end of 2008 had paid $146 million in taxes, which accounted for 6 percent of the government's overall domestic revenue. In addition to taxes, businesses can add value to the state in other fields. For example, Aga Khan is the largest private generator of electricity in Afghanistan illustrating how the private sector can step in to provide services that the public sector cannot in times of crisis. Infrastructure needs are too high for the public sector alone, and in post-conflict situations, the public sector can leverage the more efficient private sector, to benefit citizens and in turn help legitimize the public sector.

2 - Creating jobs. Roshan is Afghanistan's biggest employer and indirectly employs a network of 30,000 people who sell top up vouchers and run retail stores or public call offices. 93 percent of employees are Afghan locals, most of whom only have a high school degree and average 23 years of age. In addition to the great social value hiring locals has on a community, it also cuts costs for companies. In conflict countries, companies face high security costs, and Roshan has saved at least $1 million by employing locals to guard the telephone masts.[216] "By generating taxes, creating jobs that are not related to opium production and promoting prosperity, the telecoms industry provides 'a bubble of hope for Afghanistan," says Mr. Khoja, CEO of Roshan.[217]

3 - Empowering women. Roshan directly employs 1,100 people, 20 percent of whom are women. Of the 10 percent of the Afghan population that has a Roshan phone, 20-25 percent

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[213] Ibid.
[214] "Dial M for Mujahideen," The Economist, The Economist Newspaper Limited, 18 May 2006.
[215] "Shining a Light," The Economist, The Economist Newspaper Limited, 08 Mar. 2007.
[216] "The Importance of Private Sector Development in Conflict-Affected Countries", Chris Bold, Nov. 2009, IFC SmartLessons.
[217] "Mobile Marvels," The Economist, The Economist Newspaper Limited, 24 Sep. 2009.

are women, who become more active members of society because of this connectivity. The mobile technology also provides more opportunities for work. Roshan employs the Grameen village phone model, and "telephone ladies" take around eight months to pay off their microloan and then start making $50-100 a month.[218]

4 - Empowering rural populations. Unlike many other telecom companies, Roshan has prioritized the extension of services to the rural population. Roshan employs a unique model, in which tribes are paid a bonus if booster stations in remote areas stay functional for one year.219 Usually, the risk of renewed fighting is highest in rural areas, and with the increase of telecom coverage throughout the country, this risk is reduced.

5– Introduction of mobile banking. Vodafone and Roshan teamed up to form Afghanistan's first mobile money transfer system, called M-PAISA. The service provides financial services for people who cannot access a bank and ultimately stimulates economic activity throughout the country with no transaction costs. Launched in 2007, the system now has 1.6 million subscribers.220 Capabilities include microfinance institutions' loan disbursement and repayments, as well as salary disbursements and airtime distribution. Individuals withdraw and pay money through Roshan retail outlets that are able to provide banking services without real banks in place. The system also includes interactive voice recognition, presenting new opportunities for the extensive illiterate population in Afghanistan. Hatem Dowidar, CEO of Vodafone Partner Markets said, "…our trialing of an interactive voice recognition system means that financial services can be brought to people across the world regardless of their social circumstances."[221] M-PAISA is based on a similar and successful program in Kenya, M-PESA. M-PESA was launched in 2007 by Safaricom of Kenya, and by 2009, the program had 7 million users.[222] Originally, the most popular users of the program were male, urban migrants sending money home to their rural families, but now the program has expanded into sending tuition and even paying taxes.[223] In total, around 130 billion Kenya shillings ($1.7 billion) has been transferred, and around 150 million Ksh ($1.96 million) is transferred daily. Since the start of the program, the income of rural recipients has increased by 30 percent. [224] Conflict countries tend to have poor roads and services and traveling from place to place can be dangerous. Therefore, mobile money is very pertinent for those who need to send money from one place to another. Mobile remittances have even empowered women, because women are usually the rural recipients who now have access to funds from their family. Clearly, mobile banking has the potential to change the livelihoods of individuals, despite the lack of essential services like a central bank. M-PAISA is becoming as successful as M-PESA and has already resulted in savings of $250 million.

Using M-PAISA to battle corruption:
Police in Wardak province were used to earning 1,500 afghanis per month as their salary; however, once the police started picking up their salaries from M-PAISA Roshan dealers,

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[218] Ibid.
[219] "The Importance of Private Sector Development in Conflict-Affected Countries", Chris Bold, Nov. 2009, IFC SmartLessons.
[220] "Vodafone and Roshan Launch First Mobile Money Transfer Service in Afghanistan," Vodafone Group Press Release, 10 Feb. 2008
[221] Ibid.
[222] "The Power of Mobile Money," The Economist, The Economist Newspaper Limited, 24 Sep. 2009.
[223] Ibid.
[224] "Poor People Using Mobile Financial Services: Observations on Customer Usage and Impact from M-PESA," Olga Morawczynski and Mark Pickens, Aug. 2009, CGAP Brief.

they started receiving 3,500 afs. Due to the skimming off the top, police did not know what their true salary was. In the beginning, the police were being followed when they went to pick up their paychecks from Roshan dealers, but because there are Roshan cash points throughout the country, they began to travel to more remote locations where they could not be followed. So, they avoided confrontation and received their actual salaries.[225]

6 - Community empowerment/CSR initiatives. The Aga Khan Network, of which Roshan is a part, never works in countries commercially without engaging on the social side. It very much sees complementary benefits between for-profit and not-for-profit activities. In Afghanistan, they have used a 2:1 split, giving away $2 billion for every $1 billion invested. Examples of socially-oriented efforts include initiatives related to education, local infrastructure and basic services (e.g., digging wells, making available clean water in villages, installing solar panels to power mosques, opening clinics), connectivity (the idea being that free connectivity now will lead to profits in the future).

7 - Improving access to information. Mobile technology is immensely important to the media world in terms of immediate access to accurate information. Phones allow citizens to communicate with the outside world the moment something newsworthy occurs, and people can take pictures or videos on their camera phones to send to media sources and help spread information faster. When a woman and her baby died during childbirth in Kandahar because her family was unable to call medical help due to a ban by the Taliban on mobile phone usage after 10pm, there was a public backlash against the Taliban, as news of the tragedy spread.[226]

Risks/Challenges:
Obviously, security risks for companies exist; and furthermore, rebel groups can use phones to coordinate violent attacks. Additionally, poor infrastructure makes operations more difficult to run. For example, the lack of good roads makes transportation difficult or poor electricity can make setting up operations a challenge. Moreover, Roshan is constantly battling the Taliban's corrupt business practices, and the company's staunch refusal to pay bribes has made operations more difficult to run in Afghanistan.

However, despite the challenges involved, Roshan believes that its model is replicable and scalable. Of course, results have taken time and effort to achieve, but Roshan shows that models for successful, positive private investment in fragile and conflict-affected countries do exist.

In sum, while there are many risks involved in entering conflict-affected countries, positive private investment into the telecom field should be encouraged as it can be a sound business venture, yield revenue, and has tremendous growth potential. Additionally, new initiatives such as M-PAISA and others have shown that mobile technology can lead to development effects that can contribute to peace-building and reconstruction. It is clear that the telecom industry empowers individuals, brings societies together, and improves business environments resulting in a beneficial outcome for citizens and private companies alike.

[225] Based on fall 2009 discussion between Karim Khoja, CEO of Roshan, and Mary Porter Peschka.
[226] Based on fall 2009 discussion between Karim Khoja, CEO of Roshan, and Mary Porter Peschka.

Annex D – Financial Services Development in Fragile Situations

The financial sector plays a key role in private sector development, and in contributing to broader economic development and growth. Following prolonged conflict or periods of severe fragility, normal operations of financial institutions, both private and public, can be decimated in terms of their capacity and performance. Yet even following episodes of fragility and conflict, financial institutions and their normal functioning can be interrupted, amplifying broader economic dislocation. This annex will focus on the impact of prolonged periods of conflict in particular, as this appears to pose the greatest development challenge; however the analysis and conclusions are broadly relevant for prolonged periods of fragility, and to varying degrees to shorter episodic periods of fragility and conflict.

Impact of Prolonged Conflict

The increased risks stemming from active and prolonged conflict directly affect financial institutions and individual/household/corporate behavior concerning financial assets. The following are typical observations from post-conflict situations:

- Conflict can have consequences for the governance of financial institutions
    - Looting of banking systems by managers, regulators and political elites can occur during conflict
    - High or hyper-inflation can undermine confidence in the currency, and in financial assets in general
- Conflict promotes capital flight, but also alters individual and business preferences for different types of assets
    - Conversions of bank deposits for precious metals
    - Choice of foreign over domestic currency
- Banking assets may deteriorate significantly with increases in non-performing loans; correspondingly banks also adapt to higher risk and may cease lending altogether
- Countries show considerable variation in outcomes with policy responses being an important determinant of how badly the financial sector is affected. Some states resort to the monetization of deficits to finance war and effectively dissolve the banking system and its regulation (Mobutu's Zaire); whereas others manage to maintain wartime economy and maintain public confidence in currency and financial system (Eritrea/Ethiopia, Sri Lanka).
- Microfinance institutions can meet a broad array of financial needs and have proven resilient and able to expand financial services in unsettled post-conflict environments.

Individual/household and business banking needs shift. Households are not keen to liquidate assets during or after conflict but often do so to be able to cope with the unpredictable environment. There is the fear that liquid assets are at risk from theft, flooding, fire or further conflict. For many households, only the minimum amounts are kept as cash.[227] In Rwanda, individuals reported wanting to save and put money out of reach, but there was a distrust of banks. In rural areas, people prefer to save in productive assets in the immediate post-conflict situation. Liquid assets are only useful and desirable to a limited point – a balance is sought between the need for liquidity and safety.[228]

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[227] Tamsin Wilson, *Microfinance During and After Armed Conflict: Lessons from Angola, Cambodia, Mozambique and Rwanda,* The Springfield Centre for Business in Development, 2002.

[228] Ibid.

There appears to be potential for savings services immediately post-conflict, if people are convinced that the bank is safe and trustworthy. Liquidity is important for households during periods of high insecurity. Banks must be prepared for high savings withdrawals from banking institutions with the resurgence of conflict. In contrast, as soon as the security situation improves, the situation reverses and there is a strong preference for removing the risk associated with having portable and easily stolen assets in the house.[229]

Rebuilding shattered financial systems. Looting of financial institutions, including Central Bank assets, has been common in conflict in places like Afghanistan, Iraq, and Rwanda. There is often extensive physical damage and loss of human capital, compounding expected capital flight and loss of assets. The protracted civil wars in Mozambique and Angola damaged entire rural banking systems, but the central banks remained intact. The reconstruction of central banks and restoration of their capacity and regulatory functions is often an early donor-supported intervention, as strengthening the prudential supervision and regulatory capacity of central banks is essential for building a stable financial system. There has been a range of experiences of these efforts, for example:

- Rwanda's central bank reopened within a year of the genocide, performing reasonably well a short time after it had been looted.
- Somalia's central bank remains closed after its looting in 1991.
- The Central Bank of Liberia was created in 1999 (3 years after the end of the war) through the IMF, but shut down again when conflict intensified (2002-2003).
- In Angola and Eritrea-Ethiopia, central banks continued to function (with varying degrees of effectiveness) during conflict.

Currency Reform. Currency reform can take a variety of forms: introducing new currencies for new states; introducing a new version of the national currency; legalizing the parallel circulation of foreign currencies; replacing the national currency with foreign currency. In many prolonged conflict situations, effective dollarization or switch to foreign currencies is common; this is a rational response both for stressed governments and private individuals and businesses. During conflict periods, smooth functioning (i.e. acceptance of foreign currency in official transactions) of dollarization can ease the instability created by hyper-inflation during exaggerated conflict/fragility (Zimbabwe). Currency reform may be undertaken by states during conflict, and is essential to programs of post-conflict recovery in those situations where confidence has completely vanished. Introduction of a new currency is a complex operation, often not easily accomplished by weak states. When Angola's government chose to introduce a new currency in the early 1990s, the confusing and chaotic manner in which it was carried out destroyed much of the country's monetary savings, particularly those of poor households – many of whom were unable to convert their old currency before the deadline. Currency boards are a potential remedy, but in reality have been scarcely utilized; Bosnia and Herzegovina is the only contemporary example of currency board implementation.[230]

Sequencing of reform with capacity. In many post-conflict countries, institution building of regulatory institutions and more broadly among financial institutions, takes time and often lags behind reforms geared towards market liberalization. The result can be a perverse sequencing whereby "visible aspects of reform, such as interest rate deregulation, bank recapitalization or even the creation of stock exchanges have been pursued before basic

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[229] Ibid.

[230] Addison, Geda, Le Billon and Murshed, "Reconstructing and Reforming the Financial System in Conflict and 'Post-Conflict' Economies." The Journal of Development Studies, Vol. 41, No. 4, May 2005.

infrastructure in finance – auditing, accounting, legal systems and basic regulations – have been addressed."[231] In conflict-affected countries, the application of the developed-country model of prudential regulation – with its emphasis on capital adequacy and loan loss provisions – is severely constrained by often gross inaccuracies in asset valuations and chaotic recording of loans and payments. Private commercial banks may also outpace their regulators in terms of restoration of operations following conflicts, so that central banks are constantly in catch-up mode. The private financial sector typically has greater resources than public authorities, and the state faces other priorities. In a situation of scarce professional capacity, the private sector can use its resources to bid skills away from the authorities, reinforcing the need for considerable technical assistance. The IMF and donor countries have provided this technical assistance to central banks, for example in Afghanistan, Mozambique and Sierra Leone, among others.

Commercial banks. Commercial banks are the main element of most financial systems, and are indeed the dominant financial institutions in low income countries in general. Addressing their institutional needs in a post-conflict setting is a key component of any private sector development strategy. Banks may be coming from severe dislocations: in Rwanda the *Caisse Hypothecaire de Rwanda* was plundered; the *Union des banques populaires du Rwanda* lost most of its liquid assets and 80 percent of its staff. A conflict environment typically creates large numbers of distressed borrowers among previously sound enterprises due to loss of markets, destruction of equipment, dislocation, etc. Uncertainties in ownership of collateral, delays in the restitution of property and collapse of insurance markets impede resumption of a functioning market in bank credit in particular. As a result, banks may be undercapitalized due to conflict-related losses. Given the large infusions of private capital and technical skills needed to resuscitate banks, most conflict-affected countries have sought foreign investment through both privatization and licensing new banks, such as in Afghanistan, Bosnia and Herzegovina, Timor-Leste, and Mozambique. Increasingly, regional banks have been early investors in high risk post-conflict markets, consistent with their strategies to grow their regional footprint. For example, the expansion of Nigerian banks into neighboring countries has now extended into Sierra Leone and Liberia.

State-owned banks, in particular, often pose severe problems. Recapitalizing state-owned financial institutions entirely from public funds runs into the objection that there are many competing and higher priorities for the use of public money. This may lead to strong pressures for introduction of private capital or full privatization of state-owned banks, as in Bosnia and Herzegovina and Mozambique. The process of privatization and the licensing of private banks in order to recapitalize the system has sometimes been highly non-transparent, especially when it begins during war. In the former Yugoslavia, this process resulted in large asset transfers to war criminals. However, with a lag of several years following the cessation of the civil war, Mozambique privatized its commercial banks, bringing in foreign partners.

Programs to encourage and share the risk of bank lending to the private sector can be important stimuli to restoring credit into the financial system at scale and on reasonable terms. However, measures which move too quickly to push credit will undoubtedly stretch the capacity of banks beyond what they can reasonably accomplish. IFC, for example, has adapted SME finance programs for post-conflict countries to combine advisory assistance/capacity building with funding and risk management support. These have proven effective where a certain readiness and strong credit demand is present, but cannot by

[231] Ibid.; Caprio, 1996

themselves be expected to miraculously jump start significant provision of credit to the private sector.

Microfinance. The establishment or other support for microfinance banks in post-conflict situations has been a successful strategy for many development partners; support for commercial microfinance institutions is a cornerstone of IFC's strategy. Commercial bank operations, while important, are unlikely to improve access to finance immediately for large numbers of individuals or micro/small enterprises, the market focus for microfinance institutions.

It is important to distinguish between small scale donor-supported cash grant or loan programs, and sustainable microfinance. Immediate post-conflict microfinance from NGOs has often been a misnomer for grants. The lack of clarity between grants and loans has caused confusion and significant difficulties for future microfinance providers. It is difficult for MFIs to create a client mentality in the midst of an environment dominated by relief operations and handouts. Using microfinance as a means to achieve non-financial objectives is costly and serves to blur the lines between microfinance services and NGO relief. For example, in Rwanda small grants were called microfinance, although there was no supervision or repayment discipline, and microfinance programs re-opened solely to issue new grants from donor sources.[232] Most of these programs do not survive to become sustainable institutions.

The introduction of semi-formal and formal MFIs can significantly alter the terms and conditions of competing services, in favor of the borrower. In Cambodia, informal lenders charged 30 percent interest or more per month until competition from semiformal institutions arrived, offering 5-7 percent interest.[233] As such, microfinance institutions may be displacing more predatory forms of finance to individuals and small firms as well as providing strong benefits.

There has been significant experience with microfinance in a number of countries, such as Afghanistan, Bosnia, Cambodia, Kosovo, Mozambique, the Democratic Republic of Congo, Liberia, Sierra Leone, and Rwanda. In Cambodia and Mozambique, many microfinance institutions collapsed when donors shifted from relief to development. Funding requirements from development donors were more rigorous and the microfinance institutions that opened post-conflict were not prepared.[234] In Afghanistan, a centrally coordinated microfinance program has received strong support from donors; more than$25 million committed by donors to this program. Within this framework, IFC supported the establishment of a greenfield commercial microfinance institution that has prospered, growing more rapidly than expected.[235] Similarly, in DRC, a new commercial microfinance institution has grown quickly, generating more individual accounts than the rest of the banking system combined.

Mobile banking, or the extension of banking services over mobile phone networks, shows significant promise in further expanding access to low income borrowers in otherwise challenging settings of fragile states. In DRC, use of mobile banking is expanding rapidly, even in the absence of enabling regulation. The leader in this sector is Celpay Holdings.

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[232] Tamsin Wilson, *Microfinance During and After Armed Conflict: Lessons from Angola, Cambodia, Mozambique and Rwanda,* The Springfield Centre for Business in Development, 2002.
[233] Ibid.
[234] Ibid.
[235] Banyan Global, "Evaluation Report: First Microfinance Bank of Afghanistan," October 10, 2008

Customers have confidence in the services provided by the mobile operator, which have grown much more rapidly than in neighboring Zambia, where it is perceived as more of a luxury service than a primary form of banking as in DRC. They have been particularly successful in extending banking services to smaller businesses that are part of larger networks, typically among suppliers/distributors in products like beer and soft drinks. Smaller businesses have been perhaps more adept at adopting payment agreements among their commercial networks.[236]

Microfinance banks have typically expanded most rapidly in providing deposit accounts to individuals and cash management services to smaller businesses, either traditionally or increasingly via mobile banking.[237] Pushing microfinance banks to lend more than they either may be ready for in terms of their own systems, or in terms of the market, has risks, although credit is often perceived as more valuable than deposit services. However, in post-conflict situations, as noted above, capturing cash and other assets back into the banking system is a crucial part of an evolution in post-conflict risk management by individuals and firms, and microfinance institutions can be a key contributor to this at the low income end of the market.

[236] Rosenberg, Jim, "Lazarus Muchenje: An African View on Mobile Phone Banking." CGAP, August 30, 2007.
[237] Banyan Global, "Evaluation Report: First Microfinance Bank of Afghanistan," October 10, 2008; International Finance Corporation, "Expanded Project Supervision Report, ProCredit Bank, Democratic Republic of Congo," March 2010.

Annex E – Development and Foreign Investment – The Case of Mozambique and Mozal

Mozambique is often heralded as one of the success stories among post-conflict countries, having succeeded – against the odds of its civil conflict, colonial past and half-hearted attempts at a socialist economy – in building a fairly strong, stable country. Economic growth has averaged about 8 percent over the past 15 years; per capita GDP rose from $120 in the 1980s to $956 in 2008; more than 1200 state-owned enterprises have been privatized; and the country enjoys a trade surplus and relatively low inflation.[238]

Within this context, the massive Mozal project is often cited as being the anchor foreign investment that not only spurred the country's growth but also had a significant demonstration effect for other foreign investors – with the message being that Mozambique is open for business and a safe place to invest. The project is an interesting example of both the ability and limitations of foreign mega-investments to transform an economy.

Commissioned in 1997, five years after the end of Mozambique's civil war, Mozal was specifically designed by investors and politicians in South Africa and Mozambique, as well as the international community, to help cement Mozambique's economic recovery. Led by mining giant BHP, other investors in the nearly $2 billion dollar aluminum smelter (phases 1 and 2) included South Africa's Industrial Development Corporation and Japan's Mitsubishi, as well as energy from by Eskom, South Africa's state-owned utility. The World Bank Group contributed $255 million in direct support, through IFC financing ($145 million) and MIGA guarantees ($110 million), as well as various IDA credits for infrastructure improvements related to the project. [239]

There is little doubt that Mozal itself has had a significant, generally positive impact on Mozambique's economy. The project tripled the country's exports and added more than 7 percent to GDP in its initial years of operation and an estimated 10 percent in 2001. Its impact on the trade balance has been a positive$173 million per year. In its first five years of operation, the project generated more than $300 million in foreign exchange earnings for Mozambique, and about $70 m in fiscal receipts for the government. Roads, ports, power generation, telecommunications, water supply, and drainage systems were built or upgraded in order to build Mozal. Through special trust funds—the Mozal Community Development Trust and the SME Empowerment Linkage Program , Mozal supports communities living around the smelter with activities in community infrastructure, education and training, health (AIDS prevention, malaria, and others), environment, small business development, sports and culture.[240] The project also has been criticized for being an "island investment," using energy from South Africa and exporting its final product, as well as for its limited employment impact (about 1000 direct jobs created), generous tax breaks received, and the relative lack of a broader direct impact on the Mozambican economy through upstream and downstream investments.[241]

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[238] http://www.state.gov/r/pa/ei/bgn/7035.htm
[239] http://www.miga.org/news/index_sv.cfm?aid=154, http://www.ifc.org/ifcext/pressroom/ifcpressroom.nsf/PressRelease?openform&52F1B14F925E6B8785256A7D00646470 , "IDA at Work: Private Sector Development – Encouraging Investments and Economic Growth in Mozambique"
[240] Ibid.
[241] "Impacts of the Mozal Aluminum Smelter on the Mozambican Economy," Carlos Nuno Castel-Branco and Nicole Goldin, September 2003, p. 22.

Among the most powerful results of the project is the significant evidence that Mozal has had an important, if immeasurable, demonstration effect for foreign investors. Investors in other large projects, such as the Sasol natural gas project, have stated that the Mozal example gave them greater confidence to invest in the country. Furthermore, the project increased the government's ability to deal with mega-projects, easing the way for additional investors.[242] The relative success of the project and its high visibility has helped attract additional investors to Mozambique, exploring opportunities in a range of sectors, from tourism to mining. Many of these investments will have a greater direct impact on the local economy, including in employment, use of local resources, etc. In addition, the World Bank Group's early and significant commitment of resources to the project was key. It allowed investors in other projects to have confidence that international institutions were backing the Mozambican economy, its reform process, and its quest for foreign investment.[243]

Is the Mozal example exportable to other countries emerging from conflict?

On the one hand, certain aspects of the project – particularly the early and consistent support from international financial institutions – can be replicated. On the other hand, the project itself was contingent on several factors that are independent of Mozal and would need to come together for a similar outcome to occur. First, the Mozambican government embraced the reform moment after conflict and had already embarked on a broad economic reform process. Mozal took advantage of these changes. The international community, particularly through the HIPC process, contributed to the government's reform aim, illustrating how effective multilateral cooperation, coupled with local intentions, can increase the chances of success for the reforms – when they are sustained over the long term.

Additionally, South Africa's role cannot be underestimated, and this is more difficult to replicate in other circumstances. Enlightened self-interest in South Africa allowed the government to encourage IDC and Eskom to enable the project – which would not have happened were it not for their involvement. As such, South African authorities saw an opportunity to strengthen their neighbor, bilateral trade, and their own economy all at the same time (as well as helping to potentially reduce the influx of Mozambican migrant workers into the country). Not all conflict-afflicted states have an economic powerhouse as a neighbor – and where they do exist, those countries often have a history of conflict and competition, which did not exist in the case of Mozambique and post-apartheid South Africa. Last but not least, geography itself helped enable the project, due to the proximity to both South Africa and to a large port, providing relatively rapid access to Asian and European markets.

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[242] Ibid, pp. 22-23.

[243] "James Bond, Director of the joint World Bank/IFC Mining Department, said, 'The investment demonstrates IFC's continued confidence in Mozambique and will provide reassurance to potential investors in other large private sector projects that are currently being considered.' He added, 'IFC's involvement will support Mozambique's image as a country with a healthy and fast-reforming investment climate, encouraging foreign direct investment in industry as well as overall private sector development.'
http://www.ifc.org/ifcext/pressroom/ifcpressroom.nsf/PressRelease?openform&52F1B14F925E6B8785256A7D00646470

Annex F – Insuring Investors in Fragile Situations Globally

On the one hand, a large global fund (of perhaps $1-2 billion) for insuring investors in fragile situations would appear to be the best solution, particularly if it could leverage additional $6-8 billion in coverage and lead to $10-20 billion in new investments. However, success of such a plan will depend on a number of critical factors, such as use of underwriting and eligibility standards other than those currently used by ECAs in general. In particular, the program would need to:

- Cover existing investments in pre-crisis countries, in order to help prevent disinvestment
- Cover local investors, at least against the risk of political violence, including business interruption[244]
- Be marketed and distributed through a decentralized system that could reach diaspora investors (e.g., in partnership with Western Union, *hawallah* dealers, local banks,) and investors in neighboring countries
- Be endorsed and supported by local governments
- Have a relatively low cost for covered investors and lenders
- Have a quick, un-bureaucratic and simple application, approval and claims process (which also could mean the potential relaxation of current rules on assessing development and environmental impact, and relying instead on warranties from the investor), benefitting investors and lowering administration costs
- Require some level of self-participation in order to deter fraudulent or frivolous claims

There is a possibility that such a fund would not be self-sustaining and would need to be replenished from time to time. However, given historic data from OPIC and MIGA, the likelihood is that claims, while frequent, will likely be small – reinforcing the need for efficient claims processing. If executed properly, the fund could make a significant contribution to strengthening the private sector before conflict and helping rebuild it soon after the violence ends.

[244] An argument can be made that it would be inappropriate to cover local investors against government-created risks, such as expropriation and transfer/inconvertibility