THE RECONSTRUCTION OF WAR-TORN ECONOMIES

Technical Paper

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EXECUTIVE SUMMARY

The Issue to be Addressed

This study, requested by USAID under CAER Task Order Number 6, asks *what policies are needed, and in what order, to move a war-torn economy from devastation to a path of sustainable economic recovery*. The paper develops a framework for analyzing war-torn economies, applies it to the Democratic Republic of Congo, suggests directions for further research with a view to developing a larger, comparative study, and draws a number of practical conclusions.

Background on War-Torn Economies

Since 1970, 42 countries have been seriously damaged by war. Together these countries represent 44 percent of world population. Wars in these countries have claimed 11.9 million lives since 1970. By the end of 1994 there were 15 million international refugees, and 20 million people displaced within their home countries, as a result of war.

These recent wars have several characteristics, including the following:

- They have tended to be long and drawn out, without a clear beginning or end;
- They were hard to predict, at least from the vantage point of five years before they erupted;
- In about half of all cases, government broke down completely;
- All the wars in Africa have had a strong ethnic dimension, but this was less common elsewhere;
- In half of the wars, meddling by outsiders, both the great powers as well as regional powers, exacerbated and prolonged the conflict.

The Need for Early Economic Development, and Institution-Building

The traditional working assumption of donors, in post-conflict environments, is that peacebuilding must precede development. The current study makes the case that *economic development is complementary to the political and security elements of peacebuilding*, and so measures to promote economic development must begin as soon as there is even a prospect of peace.

As conflict draws to an end, donors have typically focused their attention on political reconstruction including the organization of early elections, on supporting measures to establish internal security, on providing humanitarian relief, and on rebuilding the physical infrastructure. We argue that these are not sufficient, and that *donors and countries must also pay attention to rebuilding the institutional infrastructure*, in effect enhancing the capacity of countries to help themselves.

Issues Raised by Earlier Writings on Recovery from War

Existing writings on what needs to be done in war-torn economies raise a number of important, and controversial, questions. Among the most important are the following, along with our responses:

Should the government role be large and active (Stewart) or small and selective (Collier)? Our answer is that the role should be small, because post-war governments lack the financial and skill bases for a dominant role in the economy, and so need to concentrate their limited resources on doing well those things that others cannot do successfully.

Should macroeconomic reforms be introduced rapidly (Collier and Pradhan) or gently (Kumar), or are they not central to the reconstruction effort (Lake, by omission)? Our answer is that such reforms must be undertaken rapidly, because sustainable growth does not occur in economies that have not been stabilized.

Should the exchange rate be deliberately undervalued for a while, to attract back investors (Collier) or moved from an overvalued position only with circumspection (Kumar)? Our answer is neither. Restrictions on trade should be reduced and the exchange rate allowed to find its appropriate level.

Can and should émigrés be encouraged to return at an early date (Lake, Collier)? Our response is that they are a difficult group to lure back, and so should be neither encouraged nor discouraged.

Does land reform need to be an early priority (Lake)? Our belief is that other reforms are typically more pressing, and that good land reform cannot be done quickly.

Is a separate international fund, targeted at reconstructing war-torn economies, needed? Our answer is no. A new bureaucracy is not needed, but existing donor organizations need to build further flexibility into their lending procedures in order to respond rapidly when peace breaks out.

Should the donors attach conditions to the granting of aid? Our response is that initially any conditions should be minimal and credible; later than can be stiffened, but they should remain parsimonious.

Do governments need to signal explicitly their commitment to reform by undertaking difficult reforms early on (Collier and Gunning)? Our answer is no. If governments make good decisions, they will be seen as credible. If they do not, smoke and mirrors will not help.

The main problem with the current literature on reconstructing war-torn economies is that it does not give a good sense of what the priorities should be. Everything seems to be urgent, essential, crucial. Yet in practice donors and decision-makers need to know what to do first.

Features of War-Torn Economies

There are many common features to war-torn economies. The negatives dominate. In all cases GDP/capita falls; the population moves, driven elsewhere by the fighting; even with peace, security may be fragile, particularly in the countryside; the infrastructure is typically in poor shape, more through years of neglect that because of war-related destruction; inflation is generally high and the exchange rate overvalued, and the financial system is very weak; the fiscal system is also weak, but the peace dividend that might accompany lower military spending is usually illusory; the industrial sector tends to be abnormally small; social indicators are weak; and institutions, such as property rights, trust, and statistical services, tend to have been undermined.

There are some assets too. Donors are typically keen to help with reconstruction; there may be a pool of émigrés ready to return with their skills and capital; and "the extreme void … in a way makes [institution building] easier."

Sequencing Reforms

How are reforms to be sequenced? The study devotes a good deal of attention to this issue, and the main points are summarized in Table S1.

Issues for Future Research

Current knowledge about how to approach the redevelopment of war-torn economies is a mile wide and an inch deep. There is a need for a series of focused cross-country studies which would fill this gap, much as is done by the recent study of demobilization by Colletta et al. Among the (partly) unanswered questions are the following:

Are disbursements fast and flexible enough? The procedures followed by most donors tend to be rigid and cumbersome.

How does one measure success in recovering from war? A benchmark is needed, both to help assess which policies work, and also to guide donors as to when they may revert to more conventional types of assistance.

What institutional capacity needs to be built urgently? The study suggests that countries need to develop an ability to appraise and oversee projects, to coordinate donor efforts, to draft and implement investment-friendly laws, and to put in place a system of prudential bank regulation. The list needs to be made more complete, and to be illustrated with examples of what countries have actually done.

How can property rights be defined and secured? This is a problem in many, but not all, post-war societies. Part of the issue is whether donors should promote, and finance, substantial land reform, and if so, where and how.

How can a country achieve instant fiscal health? This is an essential component of macroeconomic adjustment, but begs the question of which taxes need to be raised (excises?), and which expenditures compressed. Case studies would be particularly useful here.

How can the war-time decline in social indicators be reversed? Economic growth will lead to an eventual improvement in literacy and mortality rates, but are there policies that might speed the process?

What should be done about the banking sector? Post-war reconstruction requires finance, but what role the feeble banking sector should play, and how if at all donors should support it, remains unanswered.

Does dollarization matter? Most post-conflict economics use dollars, as a hedge against inflation and exchange rate inconvertibility. Many governments take measures to suppress the use of foreign currencies, but should they?

How much donor support is needed, and what form should it take? In some countries donor support appears to be excessive; in other cases it is inadequate and late. It would be helpful to develop a clearer idea of how much aid is useful.

How quickly do markets recover, and could this recovery be speeded up? Some (e.g. Kyle) have argued that markets are slow to recover after a war ends, but does this argue for a direct government role, or for measures to support the more rapid re-emergence of markets? And if the latter, what measures are effective?

What conditions should donors apply to their aid? There is a need to examine situations where conditions have worked well, what sorts of conditions are needed, and which ones are superfluous.

Should counterpart funds be required? Many donors require a local contribution to match their aid, but this can be a particular strain for cash-strapped post-war economies.

In addition to these thematic studies, it would be desirable to apply the framework of this paper in a few country studies.

Concluding Themes

Table S1
Key Policy Measures in Speeding the Reconstruction of War-Torn Economies

	Early measures (years 1-2)	Later measures (years 3-5)
Population	Return and settle refugees.	
Security	Demobilize. Professionalize police, army.	 Professionalize police, army.
Infrastructure	Open and secure main ports, roads, rail, airports. Develop capacity to appraise & manage projects.	Plan long-term investment and maintenance.
Macroeconomics	Cut inflation below 20%. Restrain lending by state-owned banks. Liberate exchange rate. Establish exchange rate convertibility.	 Develop banking rules and oversight capacity.
Fiscal System	Introduce cash budgeting. Set up payments system. Suspend debt servicing. Seek foreign aid to support budget.	Increase revenue mobilization. Develop data collection. Renegotiate debt. Civil service reform. Fiscal decentralization.
Economic Structure	Provide seeds and tools. Food aid, briefly.	Foreign investment law. Investor roadmap. Encourage development of markets.
Social Infrastructure	Maintain health in remaining camps. Support orphans, war cripples.	Restore public health measures in towns. Target primary health care. Build primary education.
Property Rights	Land for ex-combatants.	Land reform. Asset restitution. Privatize small companies.
Role of donors	Budget support. Indiscriminate project aid. Technical training in key areas. Select aid coordinator and establish guidelines. Apply few conditions to aid.	Reduce budget support. More selectivity in project aid. Broader educational support. Institutional coordination within government. Tighter, but still few, conditions attached to aid..

Source: Table 8.

The report ends with an emphasis on a few themes. Economic institutions need serious attention in post-war economies. Yet donors must be patient, because war-torn economies typically take a generation to recover to their pre-war level of affluence. Donors can, and should, get involved as early as possible, at a minimum gathering information which allows them to act swiftly when peace is more secure. It is important to build local decision-making and administrative capacity as quickly as possible, because this is a major bottleneck to recovery. Donors also need to be flexible, far more so than they would be normally. This message is being heard, as USAID, the World Bank, and others have put in place more supple procedures for disbursing funds in post-conflict societies.

0. PREFACE

This report was written at the request of USAID under CAER Task Order Number 6. Its aim is to

(i) "improve both economists' and noneconomists' understanding of those sequences of action that move an economy from devastation by war to the taking of first steps towards sustainable economic recovery;" and

(ii) "design a larger, comprehensive study that would form a set of guidelines or a manual for those implementing economic recovery program."

Among the specific objectives of the research are that:

- "using economic principles, it will formulate an analytical framework for assessing the impact of specific policy measures on economic recovery ...
- it will assemble instructive histories and case studies of recovery programs ...
- the previously-prepared, analytical framework will be brought to bear on the gathered histories, case studies and first-hand experience."

The research "will draw on secondary sources of information including studies, reports, and other relevant literature. It will also involve interview with selected specialists and participants. The output ... will be a report 75-100 pages in length."

The author would like to thank the many people who helped us with the report; a partial list is given in appendix 1. The comments of participants at the USAID conference on economic growth (October 1997) and the Conference of the All-UC Working Group in Economic History (April 1997) were very helpful. The study grew out of Elaine Grigsby's interest in the issues, and more particularly in what USAID and other donors might do in Bosnia to speed up economic development there. Orest Koropecky has been a strong supporter of the project and has provided encouragement on several occasions, which was much appreciated.

I. INTRODUCTION

"You look at the bombed out buildings but not at the bombed out institutions"

Robert Burke, USAID

Most recent wars have been civil wars, and so the focus of this study is countries which have just gone through a civil war. It asks a very basic question: ***what policies are needed, and in what order, to move a war-torn economy from devastation to a path of sustainable economic recovery?***

Until very recently, remarkably little had been written on this important question. Perhaps donors and governments were too busy working on the transition from war to peace to have the time to organize their thoughts on paper. Yet this lack of attention is surprising, for two reasons. First, when peace breaks out the international community typically shows great generosity; for instance, Bangladesh received more external assistance during 1972-74, after the war in which it broke away from West Pakistan, than during the entire previous 24 years as East Pakistan (Boyce 1995a, p.2076). And second, civil wars are both frequent and seriously set back economic development. In a recent report the World Bank (April 1997, p.iii) noted that "fifteen of the world's twenty poorest countries have experienced major conflict during the past decade." The same report estimated that more that 50 countries were either currently engaged in civil or cross-border conflict, or had been so in the recent past.

There is however a growing recognition that more attention needs to be paid both to preventing conflicts and to re-igniting economic development in their wake. One reflection of this is the rapid recent increase in written material on the subject; an up-to-date listing is given in the references at the end of this report.

Traditionally the generosity of government and other donors has largely been directed into four areas:

- political reconstruction such as moving to elections,
- support for security such as retraining the police force,
- humanitarian relief, and the
- reconstruction of physical infrastructure.

Implicit in these priorities is the idea that "peacebuilding activities are a critical precondition for development in post-conflict environments" so "a return to traditional development activities in the near term in post-conflict environments is neither possible nor desirable" (Ball 1996 p.104). This traditional view is widespread. Summarizing the dominant sentiment at an international colloquium on *Post-Conflict Reconstruction Strategies* which brought together representatives of almost all the main United Nations agencies and units in June 1995, former UN Under-Secretary-General Margaret Anstee (1995, p.4) wrote that "once peace has been restored to a war-torn society ... the overriding goal of the international community should be to assist in national efforts to ensure that conflict and chaos will not recur. This goal must be met over and above needs for relief, rehabilitation and resumption of development."

We take a different view, which is based on the idea *that economic development is complementary to the political and security elements of peacebuilding*. As UNDP Administrator James Speth (1996, p.9) puts it, "insecurity can frustrate development, and development is necessary to achieve and sustain security." Or in the words of Anthony Lake (1990, p.19) "economists, diplomats, and political leaders must think in each other's terms ... - as the diplomats fashion the political arrangements that could end the fighting, and as the economists plan the first stages of economic recovery." Katherine Marshall (1997, p.2) also sees a tension between "competing frames of reference: diplomacy or development" and argues that in practice the political and socioeconomic solutions "are so intertwined that the classic 'phased' approach, peace first, economics second, would at best leave an impossible legacy for those who inherited the peace" (p.3).

It follows that as soon as there is even a *prospect* of peace, substantial attention must be given to putting in place the elements required for rapid and sustained economic development. An interesting case where this occurred is in El Salvador. In 1989, even before an end of the civil war was in sight, the government of newly-elected President Alfredo Cristiani introduced a stabilization and adjustment program. The program successfully lowered inflation and ushered in a period of solid economic growth of about 5% annually, which in turn helped secure continued peace (Wood and Segovia 1995, p.2080).

Moreover, humanitarian relief and the reconstruction of physical infrastructure, important as these are, do not constitute a complete program for economic recovery. In the words of a recent study by Krishna Kumar (1996, p.22), "rebuilding *institutional* infrastructure shattered during conflict is as important, if not more important, as physical infrastructure ... this is an area that has largely been overlooked by the international community in the past."

Almost all of the countries moving from civil war to sustained economic development are going through a *triple transition*: from war to peace, from authoritarian to more democratic government, and from a state-directed to a market-directed economy. Many countries, particularly in Eastern Europe and Latin America, are currently going through the latter two transitions, which means that there is a wealth of experience on which to draw. But the lessons of transition in these countries have to be modified to take into account the special characteristics of war-torn economies. Much of this report is spent identifying these special characteristics and tracing their implications for the best path of economic development.

But what do we mean by "best path?" Put another way, how might one judge the success of post-war recovery? We suggest that a recovery will have been successful if, within a decade of the end of the conflict:

- Per capita consumption has returned to its pre-war high level. We will show below that this is a very stringent criterion, which has almost never been achieved.
- Economic growth reaches at least 5% p.a. and is sustainable. By sustainable we mean that the growth is based on the creation of assets rather than on, say, simply cutting down forests or just providing services to a growing number of aid-supported projects.

- The prospect of further civil war is remote.
- The recovery and growth are accompanied by an acceptable level of individual liberties.

The list is of course arbitrary, but a yardstick is needed if one is to be able to distinguish the more successful from the less successful cases of post-war economic recovery.

The central purpose of this report is to make a first pass at indicating what economic policies are needed to reconstruct war-torn economies, and to provide some pointers for the appropriate sequencing and speed of the necessary reforms. The emphasis throughout is on economic policies, not because other dimensions of reconstruction are unimportant, but because there is a gap in understanding which needs to be filled. In a similar vein, this report does not address the issue of how civil conflict might be avoided; for a somewhat depressing overview of this complex topic see Marshall (1997).

We proceed as follows. The next two sections build foundations: first we identify which economies are war-torn, and then we are more precise about the time-frame under consideration. The relevant literature is reviewed in section 4, after which we set out the characteristics of war-torn economies, before, during and after their wars, in some detail. There follows a discussion of the theory and evidence of sequencing economic reform, and in section 7 we present our framework for developing economic policy for moving from war to peace. The framework is then applied briefly to the case of the Democratic Republic of Congo (ex-Zaire); fuller details are available in a companion report. Throughout this report we shall frequently refer to six countries - Cambodia, Bosnia, Ethiopia/Eritrea, Mozambique, Uganda and Nicaragua. These countries were chosen because of their geographic variety as well as their intrinsic interest, and we have begun the process of developing short case histories for each of them.

This report is necessarily tentative. A fuller program of study and research is needed, to test and refine the main ideas more thoroughly. Such a program is set out in section 9 and is followed by a some concluding thoughts and recommendations.

II. WHICH ECONOMIES ARE WAR-TORN?

Between countries like Cambodia that have been ravaged by war, and countries like Switzerland that have known decades of peace and tranquility, there is a whole spectrum. The point at which one considers an economy to be war-torn is thus arbitrary.

Table 1 lists all the countries which we consider war-torn, for the period since 1970. To be included a country had to satisfy at least one of the following conditions:

a. at least 20,000 people died as a direct or indirect result of war or civil disturbance since 1970;
b. at least 100,000 people had left the country as refugees, as of the end of 1994;
c. at least 1,000,000 people were internally displaced, as of the end of 1994.

The purpose of these necessarily arbitrary criteria is to identify those countries where there was serious turmoil. Measuring the number of homicides is not enough; almost 300,000 people have been murdered in the United States since 1970, but the country is not generally thought of as war-torn. For the war-torn countries, Table 1 gives the estimated numbers of deaths, refugees and internally displaced persons and indicates the main periods of war.

The numbers are striking. For the 42 countries listed, encompassing 44% of the world's population, an estimated 11.9 million people have died as a result of war since 1970, including as many as 7 million civilians; one source estimates that two fifths of those killed are children (Tessitore and Woolfson, 1996). As of the end of 1994 these countries had created 15 million refugees and displaced over 20 million people within their borders.

Our interest is in countries recovering from *civil* war, and countries where war exacted a heavy toll. So we have extracted a subset of the countries listed in Table 1, to include only those countries where the war was a civil war and where at least 0.5% of the population was killed in conflict since 1970. Frances Stewart (1993, p.364) used a similar 0.5% threshold in her recent study of the economic costs of war.

This leaves 20 countries which suffered substantial devastation from civil war over the past generation. Even these countries had very different experiences. Figure 1 is designed to emphasize this point by graphing the proportion of the population that was killed for the countries in question. In nine countries at least 5% of the population died as a consequence of civil war.

Generalizations

Not all civil wars are the same, and in Table 2 we have arranged countries according to a number of different dimensions. This permits us to hazard several generalizations:

a. *Most of the civil wars were long and drawn out, without a very clear beginning, middle or even end* (see too Collier (1995) p.1). The wars symptomize underlying divisions which are likely to be slow to mend, or reflect

Table 1 Death and Displacement in War-Torn Economies

		Population (mid 1993) (millions)	Deaths, military and civilian 1970s '000	1980s '000	1990s '000	Total '000	Tot as % of pop.	Military fatalities TIme period	Total 000	Internally displaced End 1994 '000	Refugees (by source) End 1994 '000
AFRICA											
Angola		10				750	**7.3%**			2,000	344
1975-95	Civil war		204	341	205			11/75-5/91	346		
Burundi		6				280	**4.7%**			400	330
1972	Hutus vs govt		110					4/72-5/72	50		
1988-95	Tutsis massac. Hutus			20	150			8/88-8/88	5		
Eritrea											385
1974-92	Revolt, famine							1/74-5/91	150		
Ethiopia		52				614	**1.2%**			400	191
1974-92	Eritrea revolt, famine		188	320	101			3/78-5/91	15		
1976-83	Ogaden, vs Somalia		20	19				7/76-3/83	36		
Liberia		3				155	**5.5%**			1,100	784
1985-88	Reprisals (coup attpt)			5							
1990-95	Civil war				150						
Mali		10									115
1991-1994	Tuareg Rebellion										
Mozambique		15				1,050	**7.0%**			500	325
1981-94	Civil war & famine			1,050				10/79-12/92	201		
Rwanda		8				502	**6.6%**			1,200	1,715
1992	Tutsi vs Hutus				2			9/90-12/92	2		
1994-95	Genocide vs. Tutsis				500						
Sierra Leone		5				30	**0.7%**			700	260
1991-95	Civil war				30						
Somalia		9				500	**5.6%**			500	457
1988-95	Civil war			125	375			4/82-12/92	58		
Sudan		27				1,500	**5.6%**			4,000	510
1984-95	Civil war			500	1,000						
Togo		4								100	140
1993-94	Political violence										
Uganda		18				611	**3.4%**				15
1979-78	Idi Amin killings		300								
1978-79	Tanzania intervn.		3								
1981-87	Civil war			308				10/80-4/88	102		
EUROPE & FSU											
Armenia		4								150	229
1989-95	War vs Azerbaijan										
Azerbaijan		7				20	**0.3%**			346	374
1989-95	War vs Armenia				20						
Bosnia		4				263	**6.9%**			1,300	863
1992-95	Civil war, massacres				263			3/92-12/92	150		
Croatia		5				25	**0.6%**			290	137
1991-92	Civil war				25						
Georgia		5				6	**0.1%**			260	107
1992-95	Ossetia, Abkhazia				6						
Russia		149				30	**0.0%**			450	75
1994-95	Chechenya				30						
Tajikistan		6				50	**0.9%**				165
1992-95	Civil war				50						
Turkey		60				13	**0.0%**			2,000	13
1985-95	Kurd rebellion			8	5						
MIDDLE EAST/N. AFRICA											
Algeria		27				50	**0.2%**				
1992-95	Islamic revolt vs govt.				50						
Gaza/West Bank											3,137
1982-95	Palestinian nationalism				2						
Iran		64				338	**0.5%**				54
1978-89	Shah overthrow, Kurds		40	48							
1980-88	War with Iraq			250				9/80-8/88*	1,250		
Iraq		20				472	**2.4%**			1,000	636
1980-88	War with Iran			250				9/80-8/88*			
1988-95	Kurd killing, rebellion			10	32						
1990-91	Invasion of Kuwait				180			8/90-4/91*	101		
Kuwait		2				20	**1.1%**				
1990-91	Invasion by Iraq				20			8/90-4/91			

Table 1   Death and Displacement in War-Torn Economies

		Population (mid 1993) (millions)	Deaths, military and civilian 1970s '000	1980s '000	1990s '000	Total '000	Tot as % of pop.	Military fatalities TIme period	Total 000	Internally displaced End 1994 '000	Refugees (by source) End 1994 '000
Lebanon		4				163	**4.2%**			600	
1975-76	Civil war; Syria enters		100					4/75-10/90	170		
1982-90	Israel invades, aftermath			63							
ASIA											
Afghanistan		18				1,550	**8.8%**			1,000	2,835
1978-92	USSR in civil war			1,500				6/78-12/92	1,055		
1991-95	Civil war				50						
Bangladesh		115				1,000	**0.9%**				
1971	India intervention; famine		1,000					3/71-12/71	500		
Bhutan		1									132
1990-92	Ethnic tension (vs Nepalis)										
Cambodia		10				1,221	**12.6%**			113	30
1970-75	Civil war, US intervention		156					3/70-3/75	156		
1975-78	Killings, Famine. Khmer R		1,000								
1978-89	Vietnam intervention			65				1/79-10/91	42		
China		1,178				8	**0.0%**				139
1983-90	Govt. executions				8						
Indonesia		187				150	**0.1%**				
1975-82	E. Timor: famine, killing		130	20				12/74-8/75	30		
Myanmar		45				13	**0.0%**			750	203
1980	Communist revolt		5								
1985-95	Rebellions		4	4							
Philippines		65				75	**0.1%**				
1972-95	Communist, Muslim revolts		25	31	19			1/72-12/92	75		
Sri Lanka		18				60	**0.3%**			525	104
1971	Communist revolt		10								
1984-95	Tamil uprising			25	25			7/83-12/92	51		
Vietnam		71				36	**0.1%**				295
1979	War with China			35				2/79-3/79	21		
1987	Border dispute, China				1						
LATIN AMERICA & CARIBBEAN											
Colombia		36				45	**0.1%**				
1986-95	Domestic rebellions			18	27			3/84-12/92	22		
El Salvador		6				75	**1.4%**				16
1979-91	Civil war			75				7/79-2/89	25		
Guatemala		10				119	**1.2%**			200	45
1966-95	Killing of Native Amns.		47	47	25			3/78-4/84	73		
Nicaragua		4				80	**2.0%**				23
1978-79	Sandinista uprising		50					10/78-7/79	35		
1981-88	Contra rebellion			30				3/82-4/90	43		
Peru		23				35	**0.2%**			600	
1980-95	Shining Path rebellion			25	10			3/82-12/92	23		
TOTAL		2,307	3,392	5,167	3,351	11,909	**0.5%**		4,787	20,484	15,183

Notes:

Countries included if, in any decade since 1970, more than 20,000 dead of war-related causes, and/or at least 100,000 refugees, and/or at least 1,000,000 internally displaced persons. Authors' estimates of deaths by decade.

* Fatalities given under first listing of conflict.

Sources:

Ruth Leger Sivard, *World Military and Social Expenditures 1996*, pp. 18-19.

Duyvestyn, *Peace Economics*, Summer 1996, xxx for military deaths, through 12/92.

U.S. Committee for Refugees, *World Refugee Survey 1995*, Tables 1-4 and text.

World Bank, *World Development Report 1995*, Tables 1 and 1a.

the weakness of some post-war governments.

The case of Uganda serves to illustrate the point. Idi Amin came to power in January 1971 in a coup d'état. He was ousted when Tanzanian troops intervened in April 1979. Milton Obote was installed in December 1980, but this marked the beginning of an even more savage period of violence, which only ended when Yoweri Museveni took over in January 1986 and consolidated his hold over the country during the ensuing months. Even now (1997) there are pockets of resistance to the regime in the north of the country, although they no longer pose a serious military threat.

b. *Looking at the war-torn economies five years before civil war began, one would not have noticed unduly great political instability*. This makes it difficult to predict where the world's next civil wars will break out; indeed the considerable efforts by academics and others to predict where war will break out next have been largely futile (see Marshall (1997) for a review). Only in a very few cases can the civil wars since 1970 be characterized as post-independence power struggles.

c. *In more than half of the cases covered in Table 2 the pre-war government suppressed the domestic opposition.* This is not a feature unique to war-torn economies, but does suggest a hardening of differences within the countries concerned which may help precipitate the outbreak of overt conflict; this may also provide an early warning signal of impending conflict.

d. *Almost all of the civil wars in Africa have a strong ethnic dimension, while most of the civil wars outside Africa do not.* On the other hand religious and cultural divisions played a role in about half of the non-African wars. The most plausible explanation is that warring factions emphasize ethnic and other divisions in their efforts to rally support.

e. *In half of the civil wars in question the government broke down almost completely,* and this is particularly true of the most severe wars. But in a number of cases (e.g. Ethiopia, El Salvador) an adequately functioning government retained control through most of the war period.

f. *About half of the serious civil wars since 1970 were exacerbated by the significant involvement of outside powers*, typically but not always the United States and the Soviet Union. With the ending of the cold war, outside involvement is more likely to come from smaller regional powers (e.g. Iran, Israel and Syria in Lebanon, South Africa in Mozambique and Angola, Rwanda and Uganda in former Zaire).

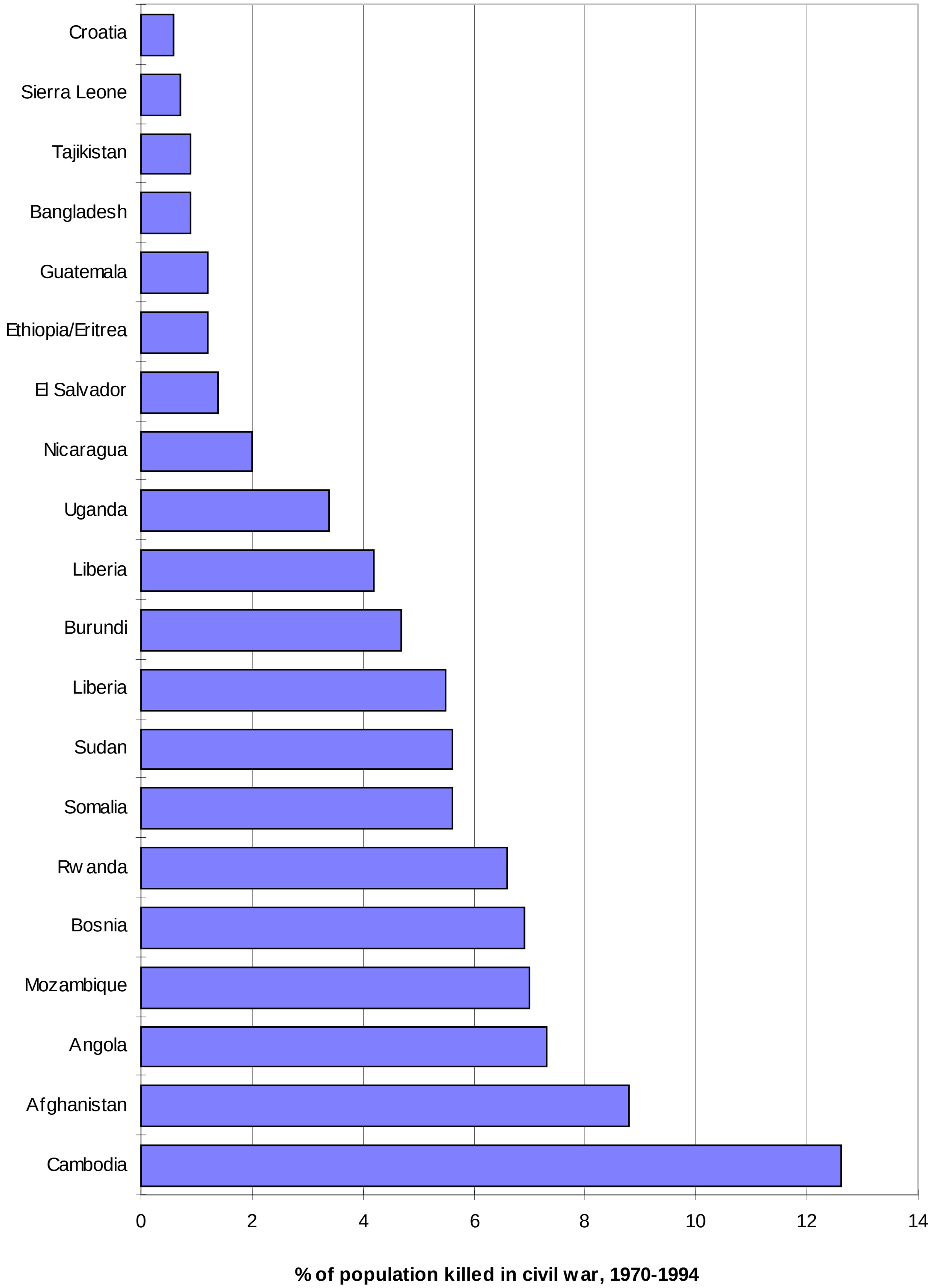
g. *In a few cases civil war followed independence.* There is a long history of post-independence civil wars, and there was a rash of such cases in the countries which emerged from the wreckage of the Soviet Union. However these are becoming the exception rather than the rule simply because most countries are independent already.

Implications

Table 2
Typology/Dimensions of Civil Wars

	Yes	No
Was the conflict short and intense?	**Rwanda,** Bosnia, Croatia, Tajikistan, Bangladesh	**Angola, Burundi, Ethiopia/Eritrea, Liberia, Mozambique, Sierra Leone, Somalia, Sudan, Uganda,** Lebanon, Afghanistan, Cambodia, El Salvador, Guatemala, Nicaragua
Was there a pre-war tradition of domestic political instability?	Afghanistan, Cambodia	**Angola, Burundi, Ethiopia, Liberia, Mozambique, Rwanda, Sierra Leone, Somalia, Sudan, Uganda,** Bosnia, Croatia, Tajikistan, Lebanon, Bangladesh, El Salvador, Guatemala, Nicaragua.
Prior to the war did the government suppress the domestic opposition?	**Ethiopia/Eritrea, (Liberia?), Mozambique, (Rwanda?), Sierra Leone, Somalia, Sudan, Uganda,** Tajikistan, Afghanistan, Cambodia, Guatemala, Nicaragua	**Angola, (Burundi?),** Bosnia, Croatia, Lebanon, Bangladesh, (El Salvador?)
Did the war have a strong ethnic or religious dimension?	**Angola, Burundi, Ethiopia/Eritrea, Liberia, Rwanda, Sierra Leone, Somalia, Sudan, (Uganda?),** Bosnia, (Tajikistan?), Croatia, Lebanon, (Afghanistan?)	**Mozambique,** Bangladesh, Cambodia, El Salvador, Guatemala, Nicaragua
During the war, did the government disintegrate?	**Liberia, Sierra Leone, Somalia, Uganda,** Bosnia, Croatia, (Tajikistan?), Lebanon, Cambodia, (Nicaragua)	**Angola, Burundi, Ethiopia/Eritrea, Mozambique, (Rwanda?), Sudan,** (Afghanistan?), Bangladesh, El Salvador, Guatemala
Did inteference by outside powers prolong the war?	**Angola, Mozambique**, Bosnia, Croatia, Lebanon, Afghanistan, Cambodia, El Salvador, Nicaragua	**Burundi, Ethiopia/Eritreal, Liberia, Rwanda, Sierra Leone, Somalia, Sudan, Uganda,** Tajikistan, Bangladesh, Guatemala
Is the war part of a post-independence struggle?	**Angola, Mozambique**, Bosnia, Croatia, Tajikistan	**Burundi, Ethiopia/Eritrea, Liberia, Rwanda, Sierra Leone, Sudan, Uganda**, Lebanon, Afghanistan, Bangladesh, Cambodia, El Salvador, Guatemala, Nicaragua

Figure 1: Death Rates in the Most Severely War-Torn Countries: 1970-1994



This diversity of experience makes it harder to arrive at generalizations about how to prevent or end civil wars. It also suggests that it may be difficult to make sweeping statements about how to get a country back on its economic feet. There are nonetheless a few immediate lessons.

The first is that the governments of war-torn economies typically lack clear authority; good examples of this are the current regime in Bosnia, or the Chamorro government in Nicaragua (1990-96). It follows that post-war governments will need to delegate many of the functions that stronger governments could shoulder. Post-war governments must recognize their limitations and restrict their attention to essential activities - in a way outlined in more detail below. *Post-war economies must rely more on market mechanisms, not less*.

There may be another implication. There are almost no cases of war-torn economies, where the government lacks clear authority, and which have achieved substantial economic growth. For instance, the Ethiopian problem was not solved until Eritrea was allowed to secede. If this general observation is correct, then the priority of aid and diplomacy should be to create a clear winner, probably by encouraging political skills so that the losers can be co-opted successfully; good examples of this process are Uganda (where Museveni has made a point of bringing a wide variety of viewpoints into his cabinets), and El Salvador (where the Chapultepec peace accords gave political role to the ex-guerillas). Where an inclusive government, or an evident winner, is not on the horizon, aid may be futile. Thus Bosnia is misbegotten and should be allowed to divide; ditto Sudan.

The second conclusion is that economic policy must aim to be inclusive - to give all ethnic and religious groups a stake in the success of the post-war economy. This point is stressed by Azam (1995), who contrasts the success of the (inclusive) Museveni regime with the failure of its disastrous and divisive predecessors. He notes that the Cote D'Ivoire has been one of the most stable and peaceful countries in Africa, despite considerable ethnic diversity, in part because President Houphouet-Boigny was flexible enough to accommodate and co-opt opponents. In the same vein one might note the considerable expense of the demobilization in El Salvador; while these funds could probably have been used more equitably and productively in other areas, the payments made to ex-combatants from both sides should probably be viewed as part of the price of peace.

And third, the reconstruction of war-torn economies will have only limited success until the meddling by outside powers is ended, a process which calls for considerable diplomatic efforts by the international community. Increasingly the outside powers in question are not the great powers, but local and regional powers, such as Syria in Lebanon, Libya in Chad, Vietnam in Cambodia, Serbia in Bosnia, or Uganda and Rwanda in the Democratic Republic of the Congo.

III. WHAT TIME FRAME?

Our concern is with moving an economy "from devastation by war to the taking of first steps towards sustainable economic recovery." It is helpful to review the time frame involved, and the sometimes-confusing vocabulary applied to the steps in this process. A schematic and idealized time line is set out in Table 3, although the path from war to sustainable development rarely follows such a clear, predictable and linear path as the one indicated here.

Except in cases where there is an outright victor (e.g. Uganda in 1986; Bangladesh in 1971), the first phase in ending a civil war is one of *conflict resolution*. Ball (1996) separates this into a negotiation stage, where there is enough

Table 3
Moving From War to Sustainable Development: The Phases

Phase	Sub-phase	Duration of phase (years)
Peacemaking	Conflict Resolution	?
	Peace Negotiations	
	Cessation of Hostilities	
Peacekeeping	Maintenance of Peace Accords	?
Peace building	Transition	1-2
	Consolidation	1-2
	Rehabilitation	
	Peace Stabilization	
	Restoration	
	(Re)construction and Recovery	5-10+
Sustainable Development		

agreement to stop the fighting, and a more permanent cessation of hostilities where the two parties cement the cease-fire, sign peace accords, and separate their forces.

Even at this early stage thought needs to be given to economic policy. In the words of Fagen (1994, p.5), the "groundwork for longer term development must be laid during the emergency phase." This might include training programs, in refugee camps and elsewhere; drumming up aid commitments from donors; and logistical planning for demobilization and other early measures.

Following conflict resolution comes the *peacebuilding* phase, which Ball subdivides into transition and consolidation periods. The transition period is typically comparatively short, of the order of perhaps a year. During this time an interim government is in charge, until a more permanent government may be established with adequate legitimacy, typically after elections. Ball divides the tasks of the transition period into three: the strengthening of political institutions, the consolidation of internal and external security, and the promotion of economic and social revitalization. She argues that this period is demanding, both on donors and the country, and is often compressed into too short a period (p.108).

Once a more permanent government has been established, more attention can be paid to economic recovery. Terminology differs from author to author, but it is reasonable to think of a consolidation period which starts with *restoration* (Ball uses the term rehabilitation), which returns individuals and communities to some degree of self-sufficiency. Ball argues that the initial emphasis, during rehabilitation, should be on reintegrating the war-affected groups such as soldiers, refugees and the internally displaced, back into the economy. She argues that this may require an early emphasis on mine clearance, to make way for people to return home.

Following rehabilitation and restoration, one may move on to *reconstruction*, through structural reforms and institution building. The titles of two of the World Bank reports on Cambodia tell the story; the 1994 report was subtitled *From Rehabilitation to Reconstruction* while in 1996 the title was *From Recovery to Sustained Development.* Christine Wallich of the World Bank refers to the latter phase as “the transition to sustainability.” In many impoverished countries, or in war-torn areas, the need is more properly for construction than reconstruction (Lake et al. 1990, chapter 1). In part this is because it may not necessarily make sense to rebuild all of what has been destroyed; and in part it is due to the need to provide some basic services and infrastructure in destitute areas, often for the first time ever.

At some point the war-related features of the economies become so attenuated that there is not much to distinguish them from any other developing economy. At that point the consolidation and reconstruction periods are over, and the literature on how to achieve sustainable development anywhere now applies.

In this report we focus on the economic measures that are appropriate during the peacebuilding phase, when the country is going through the periods of transition, rehabilitation and (re)construction.

After the initial euphoria and optimism which follows the end of conflict, it is essential to recognize that the building of a durable peace is slow. The transition period may last a year or so, but rehabilitation and reconstruction are likely to require up to a decade. Even this may be optimistic. With the exception of Ethiopia, no country, hit by a significant civil war in recent times, has achieved its pre-war peak level of GDP/capita within a decade after the emergence of peace. This is evident in Figure 2, which graphs real GDP per capita since 1970 for the 15 war-torn economies for which data were available; in every case the war was associated with a drop in per capita production, and a slow rebound. Counting the period of conflict, the civil wars on our list set back economic development for a generation - a period during which incomes in a well-run economy can quadruple.

The slowness of recovery can be a frustration to some donors, who may be prone to aid fatigue after just a few years of helping any given country. Donor fatigue should not be overstated, however, because even when one donor pulls back, there are often others ready to step in. The multilateral lending agencies such as the IMF and World Bank are also less fickle. And even when aid commitments falter, disbursements tend to continue for several years because of the large lags involved. The case of Uganda illustrates the extent of aid inertia; ODA disbursements were as follows:

	1973-79	1980-85	1986-90	1991-93
ODA disbursements ($m p.a.)	27.2	144.8	403.3	650.6

By the 1990s these sums were large, accounting for over 10% of GDP, and they were also relatively predictable from one year to the next.

Governments also want quick results, to help consolidate their position. That said, almost all post-war governments (not counting interim administrations) have in practice had a window of at least five years in which they remain in power, and this is certainly long enough to set the foundations for rapid subsequent growth. Transition arrangements aside, governments in our focus countries have been quite persistent:

Bosnia	Government elected in 1996.
Cambodia	Coalition in power since 1993 election with a strengthening of the Hun Sen group in the wake of the de facto coup d'etat in July 1997.
Eritrea	Isaias Afworke in power since 1991; formal independence proclaimed in 1993.
Ethiopia	Government came to power in 1991. Meles Zenawi formalized as Prime Minister after 1995 elections.
Mozambique	Joaquim Alberto Chissano in power since 1986; most recently elected in 1994.
Nicaragua	Violeta Chamorro served as President from 1990 through 1996. Constitutionally prohibited from serving a second term, she was replaced by Arnold Aleman who won a hotly contested presidential election.
Uganda	Yoweri Museveni in power since 1986; handily won Presidential election in 1996.

We are particularly interested in these first few years of post-war consolidation - in effect the term of the first post-war government - and pay most attention to the conduct and needs of economic policy during this period.

Figure 2: Real GDP (PPP terms) for selected war-torn economies

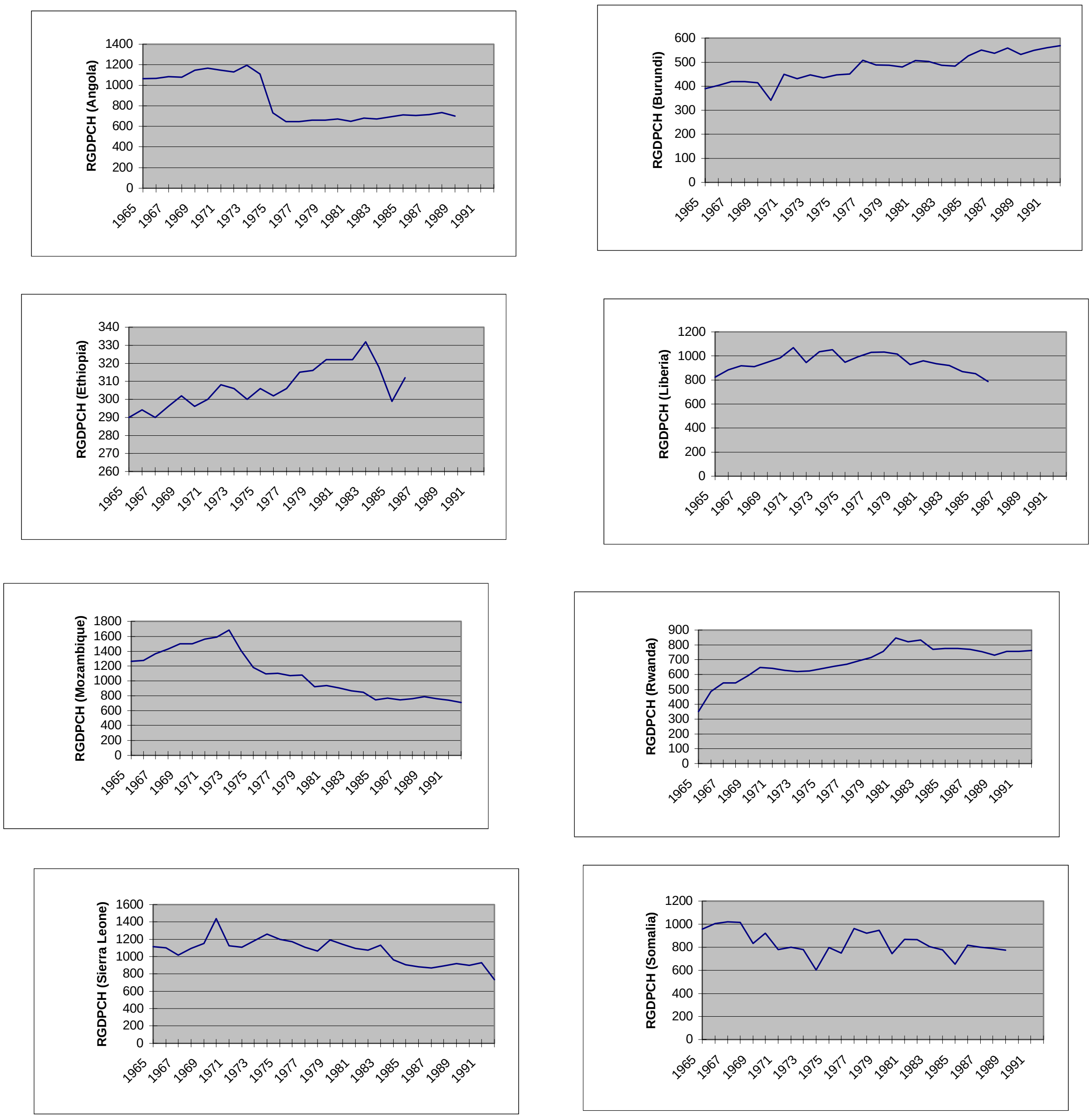
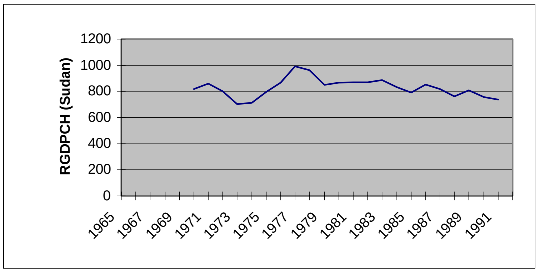
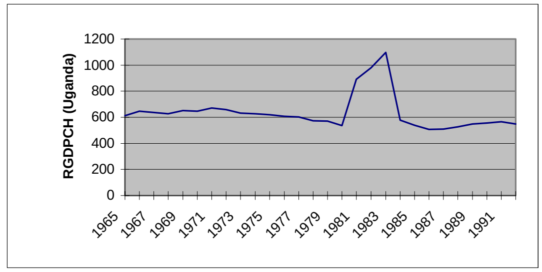
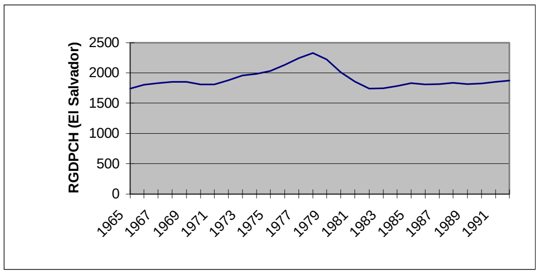
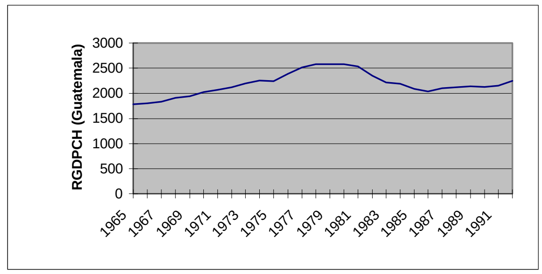


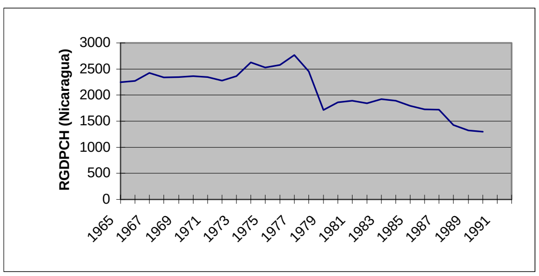
Figure 2 (Cont.): Real GDP (PPP terms) for selected war-torn economies

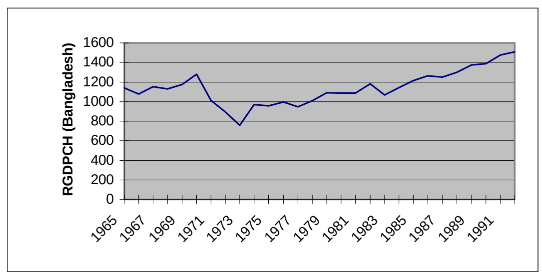


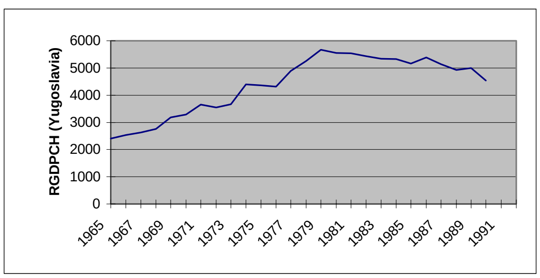












IV. THE LITERATURE ON ECONOMIC RECOVERY

"The period of the transition to peace is a particularly suitable time for radical policy reform."

Paul Collier and Sanjay Pradhan (1994, p.133).

Although there are a number of studies about particular countries, little has been written about the economic recovery of countries emerging from civil wars in general. In this section we review the most important themes of the available literature, in the hope of extracting some lessons, or at least of raising the right questions to address.

Advice to the donor community

Donor money and advice is at the heart of facilitating rapid post-war recovery, and so most of the published literature is addressed to donors. There is an audience for this advice, because donors want to know how best to proceed.

One of the first recent efforts to provide guidance came in a volume edited by Anthony Lake entitled *After the Wars*, published by the Overseas Development Council in 1990. A series of authors were asked to reflect on the problems of immediate post-war reconstruction in Afghanistan, Indochina, Central America, Southern Africa and the Horn of Africa. Lake summarizes the recommendations, which have almost become the conventional wisdom on post-war recovery, as follows:

a. Donors need to enhance the absorptive capacity of war-torn economies, by training personnel whose managerial and technical skills will be needed (pp.17-18). An effort should be made to encourage skilled émigrés to return, and to dissuade talent from leaving. Meanwhile transportation systems need to be made functional as early as possible.
b. Refugees and the internally displaced need to be resettled (p.18).
c. Rural reconstruction is needed, with attention to mine clearance, restoring rural public health, and agricultural development including land reform (pp. 18-19).
d. Donors need to provide plenty of aid, including debt relief (pp. 22-23).
e. An International Fund for Reconstruction should be established, to provide rapid and flexible funding for training and other projects (pp. 23-25).
f. Donors should not shy away from setting performance criteria as conditions for loans (pp. 25-26), including those applied to G-24 assistance in Eastern Europe which cover "adherence to the rule of law; respect for human rights; introduction of multi-party systems; the holding of free and fair elections; and the development of market-oriented economies" (p.26).
g. Donors should be pragmatic (p.12).

Not all of the items on this list are equally convincing, as will become evident from our later discussion. For instance, the experience at encouraging skilled émigrés to return has essentially failed in Cambodia; land reform is particularly intractable, and requires sustained effort over a long time horizon; and the problem of the appropriate degree of conditionality is not easy to resolve.

Conspicuously absent is any mention of the need to achieve macroeconomic stability at an early stage, or of the role of the exchange rate or trade policy, or of how the tax system needs to be constituted or the Central Bank established, or generally how economic institutions are to be reconstituted.

Some of these gaps are filled by Krishna Kumar's 1996 essay on "The Nature and Focus of International Assistance for Rebuilding War-torn Societies." His first concern is with political rehabilitation - restoring a capacity for governance, supporting elections, monitoring and promoting human rights, demobilizing and reintegrating soldiers, and reforming the security sector. He then discusses social rehabilitation, which includes the repatriation and resettlement of internal and external refugees, reviving and reforming education and health, assisting war-stricken children, and assisting women who have been victims of war.

And when he turns to economic rehabilitation he stresses the need to remove landmines, to revive agriculture, to restore the physical infrastructure, and to institute macroeconomic policy reforms, asserting that "introducing macroeconomic stability remains perhaps the most important element of any rehabilitation endeavor." (p.26). His view is that the international community "has emphasized a set of interrelated reforms" which typically begin with economic stabilization, currency devaluation, the liberalization of controls and regulations on the economy, and the privatization of state-owned enterprises.

He then argues that while changes such as these "are necessary for sustainable economic growth, many might not be optimal solutions in the short run." He expresses concern about the social costs of reduced government spending, the unemployment resulting from privatization, and the balance-of-payments effects of liberalized trade.

We make the case below *against* such a go-slow approach, and argue that economic stabilization and liberalization (although not necessarily privatization) can and should be achieved early in the process of rehabilitation, in order to create soil fertile enough for subsequent economic development to take root. Starting with the transition period, the immediate post-war years provide a good opportunity for radical policy changes: few benefited from the wartime regime and so there are few losers to block rapid change; little investment has been locked in to unprofitable or protected activities; and in many cases the war "breaks up the domestic coalitions which normally block policy change" (Collier and Pradhan 1994, p.133). Furthermore speedy reform, "far from increasing uncertainty, ... will reduce it" (p.133). It is also easier to count on donor support during a shortened transition period, before key donor personnel get rotated elsewhere. For a recent example, when some USAID personnel were transferred out of Nicaragua the system of tracking the credits of the state-owned banks fell apart, as did some donor support for these banks.

Nicole Ball has put together a longer checklist, reproduced in Table 4, of the types of assistance, geared toward economic and social recovery, which she believes donors need to provide during the period of transition immediately after peace has been restored. The list omits most macroeconomic policies, but includes such worthy items as "reactivate smallholder agriculture" and "upgrade skills." The problem with this, or any other, list is that it does not give a sense of priorities, of what governments simply must deal with immediately and what can wait. We return to the central issue of sequencing below.

Advice to the governments of war-torn economies

Paul Collier and his collaborators are less interested in guiding the donor community than in making "some general economic inferences about economic policy in the aftermath of civil war" (1994a, p.1). Presumably these

Table 4
Post-Conflict Transition Assistance (from Ball and Halevy)

Objective	• Promote economic and social revitalization
Problems to be Addressed	• Extensive damage to economic and social infrastructure • High level of debt • Unsustainably high military budgets • Landmines that hamper the resumption of economic activities • Highly skewed distribution of income, wealth and assets • Multiple claims to land and assets • Need to reintegrate severely war-affected populations (refugees, internally displaced persons, former combatants, child soldiers, disabled persons, women, orphans) • Environmental degradation due to over-exploitation of natural resources, wartime movement of population, destruction of physical infrastructure • Severely weakened social fabric (destruction of communities, creation of culture c violence, fostering a sense of impermanence and mistrust) • Social disruptions created by the influx of returnees • Abysmal indicators of human well-being
Mechanisms	• Assess damage to economic and social infrastructure • Provide technical assistance for rehabilitation and reconstruction • Rehabilitate and reconstruct infrastructure • Reactivate smallholder agriculture • Rehabilitate export agriculture • Rehabilitate key industries • Undertake community revitalization • Resettle the most severely war-affected groups • Upgrade skills • Generate employment, including credit, vocational training, management training, apprenticeships, microenterprise assistance • Clear mines • Strengthen local capacity to address problems • Support regional economic initiatives

Source: Ball with Halevy (1996), p.54.

inferences might then serve to guide policy makers from the war-torn countries themselves.

The key idea in this analysis is that post-war recovery requires “a return to the market” (p.5), which in turn calls for a “restoration of confidence” which will encourage investment. Based on the experience of Uganda and Ethiopia, Collier sees this investment as coming, at least initially, from the repatriation of human and financial capital; these resources are substantial, and have accrued, in part at least, to war profiteers who in turn keep their assets in highly liquid form.

The return to the market can be fostered by the rehabilitation of the transport infrastructure, which appears to have a very high rate of return (Collier and Pradhan 1994). It also requires a low rate of inflation, so as to keep the implicit tax on (money-using) transactions at a modest level.

More challenging is the restoration of confidence, as a prelude to boosting private investment. The problem here is that “private agents are fearful both of each other and of the government” and this suspicion, “perhaps even more than physical damage to infrastructure, is the obstacle to a private-led recovery as irreversible investment is delayed despite being financable.” (p.8).

But how is one to restore confidence? One measure is to resolve disputes over property rights as quickly as possible. Another is to sequence investment-sensitive reforms, such as the introduction of a foreign investment law, early in the process. A third is to introduce difficult reforms at an early stage, to provide a signal of the government’s credibility (Collier and Gunning). Collier also proposes that the exchange rate be deliberately undervalued for a while. The idea is to tempt foreign capital back into the country, by in effect creating a windfall for those who repatriate their assets and sink their capital into domestic fixed assets.

He also argues that the lack of private confidence in the government of a post-war economy makes the cost of borrowing, for the government, exorbitant. The implication is that the government needs to get its deficit under control at an early stage. Yet governments cannot suddenly increase their tax effort, for fear of scaring away jittery private investors. Government spending may need to be curtailed, but at least initially there is essentially no peace dividend, because demobilization tends to be expensive. Although Collier does not spell out the ramification, it clearly is that the international community should finance a large part of government spending through most of the period of rehabilitation.

Kyle (1991) argues that grain markets have been very slow to re-emerge in post-war Mozambique. Based on this observation he cautions against pursuing market-based solutions where markets are weak. However Dercon (1994) finds that the liberalization of trade within Ethiopia has helped integrate the market for grain, albeit not very rapidly. Traders need capital, experience and expertise, and networks for buying and selling, which take time to develop. There is of course a chicken-and-egg problem here: if markets are not allowed a role, then they certainly will not develop.

Advice to belligerents.

Frances Stewart (1993) asks whether economic analysis can help make wars themselves less painful. Based on the economic and social indicators from the 16 worst-affected countries, she was surprised to find that the negative macroeconomic effects expected in wartime - falling incomes, lower food production, and less trade, with high budget deficits and inflation - did not invariably occur. Nor did public spending on health, education and food subsidies necessarily fall as a fraction of GNP. Indeed she found that governments that spent heavily on the military tended also to be the ones that spent heavily on health and education. She concludes, admittedly tentatively, that "strong government structures, with sufficient revenue to support provision of essential social services and the guaranteeing of food entitlements, are essential if the massive indirect deaths associated with war are to be avoided" (p.378).

In many cases advising governments to be strong is like advising an adult to be tall. But at a broader level, her emphasis on a large government role is at odds with the Collier view that government needs to stand back in order to get out of the way of the wary private sector. We return to this issue below, making the case that *governments need to be highly focused, in order effectively to undertake a relatively small number of important tasks.*

What have we learned?

There is a surprising amount of disagreement over what governments and donors need to emphasize as they tackle the task of economic reconstruction. Here are some of the main areas of contention, with the answers which we give and which we justify more fully below:

1. Should the government role be large and active (Stewart) or small and selective (Collier)?

   Our answer: A small role, because post-war governments lack the financial and skill bases for a dominant role in the economy. Even where markets develop slowly, this may still be better than involving an overstretched or ineffective government in such activities as marketing.

2. Should macroeconomic reforms be introduced rapidly (Collier and Pradhan) or gently (Kumar), or are they not central to the reconstruction effort (Lake, by omission)?

   Our answer: Rapidly, because sustainable growth does not occur in economies that have not been stabilized. And as is clear from the case of El Salvador, growth in turn reinforces the peace process, because one goes beyond a zero-sum society.

3. Should the exchange rate be deliberately undervalued (Collier) or moved from an overvalued position only with circumspection (Kumar)?

   Our answer: Neither. Restrictions on trade should be reduced and the exchange rate allowed to find its appropriate level.

4. Can and should émigrés be encouraged to return at an early date (Lake, Collier)?

   Our answer: They should be neither encouraged nor discouraged. Émigrés can be a difficult group to lure back.

5. Does land reform need to be an early priority (Lake)?

   Our answer: Land reform is a slow process which has never been successfully completed in a year or two. Thus it can wait.

6. Is a separate international fund, targeted at reconstructing war-torn economies, needed?

   Our answer: No. A new bureaucracy is not needed. But changes may be needed to permit development funds to be lent or given under more flexible conditions in the context of war-torn economies.

7. Should the donors insist on conditions for the granting of aid, and if so should these conditions be extensive?

   Our answer: Initially the conditions should be minimal and credible. As governments gain sophistication, the conditions can be stiffened, but they should remain parsimonious.

8. Is privatization needed early in the reform process?

   Our answer: If small state-owned enterprises can be privatized quickly, then this should be done. The privatization of large enterprises is more complex, and can be tackled a few years after the more urgent reforms have been completed. The government should, at an early state, state its intention to privatize.

9. Do governments need to signal explicitly their commitment to reform by undertaking difficult reforms early on (Collier and Gunning)?

Our answer: No. If governments make good decisions, they will be seen as credible. If they do not, smoke and mirrors will not help.

Apart from shedding light on the areas of contention, the weakest aspect of the literature on economic recovery after war is that it does not give a good sense of what the priorities should be. Everything seems to be urgent, essential, crucial. Of course in practice some decisions will be made before others, and one of the more useful things that one could do is to try to give a sense of what sequence the reforms should follow. We return to the issue in sections VI and VII below.

V. THE CHARACTERISTICS OF ECONOMIES DURING AND AFTER CIVIL WAR

"The extreme void ... in a way makes [institution building] easier."

World Bank commentator, 1996.

Countries that emerge from civil war typically have heavily regulated economies, and are usually faced with macroeconomic imbalances. In these respects they have a great deal in common with many Less Developed Countries, and also with formerly-planned economies which are moving to a market-driven system.

But in this section we want to focus on the features that make war-torn economies unique. An understanding of these characteristics is required before one can make any recommendations about the feasible and appropriate scope and sequence of reform. The generalizations discussed below are tested by referring to the experience of six focus countries: Nicaragua, Uganda, Ethiopia/Eritrea, Mozambique, Bosnia and Cambodia. Table 5 indicates whether the features are found in the focus countries, and Table 6 provides some numbers to support the conclusions.

Even when the fighting stops, war-torn economies typically face a formidable array of handicaps: low incomes which may still be falling, large numbers of refugees, a lack of skilled personnel because of emigration, some continuing civil disorder, run-down infrastructure, high inflation, an overvalued exchange rate, a weak banking system, a distorted tax structure, high foreign debt, small industrial and service sectors, worsening social indicators in health and education, low investment, an erosion of property rights and of trust, and very poor information. We now consider these in more detail.

a. GDP falls

Economic output falls with the onset of war, and sustained economic growth is impossible as long as the war continues. To illustrate: According to the *World Development Report 1995* (World Bank 1995), during the period 1980-93 nine less-developed economies were war-torn, and eight of these had negative growth in GDP/capita (the exception being El Salvador). Of the 107 non-war-torn LDCs, just 43 had negative growth in GDP/capita. Among the specific examples one might note that GDP per capita in Bosnia fell by 75% as a result of the civil war; or that in Nicaragua per capita GNP fell by 40% during the war-torn 1980s.

The poor economic performance of war-torn economies is evident in Figure 2, which graphs real per capita GDP for 1965-1992 for the war-torn economies (fifteen in all, out of the 20 listed in Table 2) for which data were available. In all cases, the onset of war halts economic growth (per capita), and generally ushers in a period of stagnation or decline; in almost all cases GDP falls absolutely.

The explanation is straightforward. For output to expand, an economy needs more capital, labor, and human capital. But in wartime, productive investment shrivels up, particularly private investment. Savings are typically channeled into dollars or gold, which are not directly productive. The infrastructure is typically neglected and so deteriorates, and may also be damaged as a direct result of the war itself. Frances Stewart (1993, p.367) cautions however that “the negative [macroeconomic] effects expected to be associated with war did occur - notably falling incomes, food production, exports and imports and high budget deficits and high inflation - but they did not invariably occur, and their magnitude varied considerably.”

Although population usually continues to grow, educational and skill levels tend to fall during war as school enrollments fall. Restrictions on trade and on the exchange rate act as further deterrents to enterprise.

b. Population Movement

All wars create refugees, often in huge numbers, as Table 1 shows. For instance when the war ended in Mozambique there were between five and six million displaced persons, or a third of the population, including 1.5 million refugees outside the country supported by the UNHCR. The war in Liberia, which began in 1989, has left 150,000 dead, forced 750,000 people into exile (a third of the population), and displaced a further 800,000 within the country. The recent conflict in Somalia killed 300,000 people and led to an exodus of a million refugees.

With peace there is typically a large and spontaneous return of refugees - illustrated most recently by the massive return of refugees to Rwanda from Tanzania and Zaire in late 1996, and earlier by the return home in April 1992 of 1.5 million Afghans who had been living in Pakistan. The United Nations High Commissioner for Refugees (UNHCR) is effective at mobilizing resources for supporting refugees in camps, but is not particularly successful at organizing their rapid repatriation; an exception may be the early repatriation of 375,000 Cambodian refugees from camps in Thailand after 1989.

The initial re-integration of large inflows of refugees may require considerable resources, including food aid, seeds and tools, and public health measures. It is also a process which occurs early on, and is typically complete by the time work begins on economic rehabilitation.

In serious conflicts a country loses most of its policy makers, intelligentsia and entrepreneurs. This was evident in Nicaragua (where these groups emigrated), Cambodia (where these groups were slaughtered) and in Uganda (where both occurred), but not in El Salvador (where the male members of the business class, but not their families, left; professionals also remained). Recovery is likely to be more rapid if this skilled and experienced group stays, as was the case of post-war Europe or post-war El Salvador. It is difficult and expensive to induce skilled émigrés to return, because they quickly put down roots elsewhere.

Cambodia has pursued an active policy of trying to lure back some of its most skilled expatriates, but has had to pay world-level salaries, which in turn creates resentment among equivalently competent (but poorly paid) local hires. On the other hand Uganda has had a measure of success in attracting some if its Asian entrepreneurs by agreeing to restore their assets, and this has been a key ingredient in the country’s recent robust economic recovery.

One of the most valuable roles of an expatriate community may be as a source of remittances; in the case of El

Table 5
Selected Features of War-torn Economies

	Non war torn LDCs	War-torn ecs.	Nicar-agua	Uganda	Ethiopia/ Eritrea	Moza m-bique	Bosnia	Camb-odia
Many refugees	—	✓	✓	✓	✓	✓	✓	✓
Many internally displaced	—	✓	✓	✓	✓	✓	✓	✓
Brain drain	—	✓	✓	✓	?	✓	—	✓
Overurbanization	—	✓	?	—	✓	✓	✓	✓
Large army	—	✓	✓	—?	✓	✓	✓	✓
Unprofessional police	—	✓	✓	✓	?	✓	✓	✓
External threat	—	—	—	—	—	—	✓	—
Landmines widespread	—	✓	✓	✓	✓	✓	✓	✓
Infrastructure: damaged	—	(✓)	(✓)	✓	—	(✓)	✓	✓
Infrastructure: worn out	✓	✓	✓	✓	✓	✓	✓	✓
Project appraisal ability	(✓)	—	—	—	—	—	?	—
GDP/capita falls	(—)	✓	✓	✓	✓	✓	✓	✓
GDP shrinking	?	✓	(✓)	✓	—	✓	✓	✓
Exports down > 50%	—	(✓)	✓	—	✓	✓		✓
High inflation	—	✓	✓	✓	—	✓	✓	✓
Dollarization	—	✓	✓	✓	—	?	✓	✓
State-owned banks dominate	✓	✓	✓	✓	✓	✓	✓	✓
Budget deficit > 5% GDP	(✓)	✓	✓		✓	✓?	✓?	✓?
Govt. tax revenue < 15% GDP	—	✓	✓	✓	—	✓	✓	✓
Foreign debt > 100% GDP			✓	—	—	✓		✓
Gov. health sp. < 2% GDP				✓	✓	✓		✓
Gov. ed. sp. < 2% GDP				✓	—	—		✓
ODA ? 10% GDP p.a.?			—	—	—	✓		—
Investment < 10% GDP	—		—	✓	—	—		✓
Many orphans	—	✓	✓	✓	✓	✓	✓	✓
Land reform an issue	—	✓	✓	—	—	—	✓	—
Many assets confiscated	—	✓	✓	✓	✓	?	✓	✓
Adequate budget info	✓	—?	✓	—	✓	?	—	—
Adequate NIPA	✓	—?	✓	—	✓	?	—	—

Key: ✓ = yes; (✓) = qualified yes; ? = uncertain; — = no; blank = insufficient information.

Salvador the flow is large - equivalent to 8.6% of GDP annually during 1992-1994 (Wood and Segovia 1995, p.2082) - and tends to flow disproportionately to the poorer parts of the country. The flow of remittances into Uganda is now about $120-130m annually, or about 3% of GDP; this may be compared to coffee exports of $200m and total exports of around $550m (EIU World Outlook 1996, p.53). So, in the words of one diplomat, “we are not really encouraging them [émigrés] to go back too quickly.” While there has been some concern that remittance inflows cause “Dutch disease,” i.e. an appreciation of the exchange rate which in turn inhibits the growth of exports and reduces employment in import-competing industries (e.g. Wood and Segovia 1995), there is some evidence that the alleged damage from this effect is overblown (Paus 1995).

War usually creates overurbanization, as people seek security in the towns and cities; a good case of this is Mozambique. A partial exception is Uganda, where much of the fighting was over the control of Kampala. In some respects the war-time urbanization is surprising, because food surpluses produced and marketed within the country tend to decline, which would normally prompt people to return to the agricultural areas. What appears to be happening is that food aid and imports are available to feed urban populations, so that paradoxically there is greater food security in the cities.

Migrants to the cities tend to be slow to return to the countryside unless they have some family members who have stayed behind and can provide a support structure for them if they go back. In Mozambique whole areas were depopulated, which made it very difficult for anyone to return.

c. Security

Paul Collier (1994a) argues that civil wars tend to peter out rather than end abruptly. Thus civil disorder continues, at both a micro-level (individuals are robbed) and a macro-level (groups such as the losers are discriminated against). Small flare-ups are common, and sometimes re-ignite, as may be occurring currently in Burundi, although in other cases even an ongoing minor war need not derail the drive for economic development (e.g. the Lord's Resistance Army which continues to operate in Uganda).

It is imperative that internal security be achieved and maintained quickly, both as a pre-requisite for sustained economic development, and also because greater personal security is the most evident and immediate benefit of the emergence of peace.

It used to be believed that *demobilization* would create disorder. The fear was that young men, whose only experience in life was fighting, would have difficulty adapting to civilian life, both psychologically and because they lacked the necessary skills for farming or other work. Collier's study of demobilization in Uganda (1994b) shows that this result is not inevitable; demobilization was not associated with an increase in crime there, at least where the demobilized soldiers gained access to land (as most of them did). One might note in passing that demobilization was not undertaken until 1992, or six years after Museveni came to power, because of the long time needed to establish security within the country. As in Uganda, crime did not rise in Vietnam after 1989, when the country withdrew its army from Cambodia and rapidly demobilized at least half a million soldiers. On the other hand there is continuing concern about what will happen in Mozambique after the payments to ex-combatants end. While the post-war government in El Salvador was able to halve the number of military personnel and to sharply curtail the power of the army, the process of curbing the influence of the military was much slower and more problematic in neighboring Nicaragua.

Table 7
Economic Change during the Move from War to Peace

	Nicaragua	Uganda	Ethiopia	Eritrea	Mozambique	Bosnia	Cambodia	
Memo								
Pre-peace years	1987-89	1986-87	1987		1990-92	1993/94	1991	Dec. 1994
Post-peace years	1992-94	1993-94	1993	1991	1994	1996	1994	Dec. 1994
POPULATION MOVEMENT								
Refugees	23,000	15,000	191,000	385,000	325,000	863,000	30,000	
Internally displaced	Few	Few		400,000	500,000	1,300,000	113,000	
Skilled labor	Left	Killed/left	Stayed	?	Few, stayed	Some stayed	Killed/left	
SECURITY								
Demobilization	Rapid	Effective	?		Rapid	Not yet	Slow	
Professional police?								
External threat?	No	No	No	No	No	Some	No	
Internal threat?	Some	Little	Unclear	No	No	Yes	Yes	
Landmines	120,000							
INFRASTRUCTURE								
Damage?								
Deteriorated?								
MACROECONOMICS								
Real GDP growth p.a.								
Pre-peace	-4.5				1.7	-28.0		
Post-peace	0.7	5.5			5.0		5.7	
Inflation (GDP deflator)								
Pre-peace	3328.3	256.0	35.7		48.6		152.0	
Post-peace	16.6	6.5	3.5		50.8		0.1	
Real Effective Exchange Rate								
Pre-peace	92	191			1599			
Post-peace	90	73			5918			
M2/GDP								
Pre-peace	54	6			37		6	
Post-peace	23	9					4	
Cash/M2								
Pre-peace	35	54			27			
Post-peace	23	34						
Forn. curry. deposits/GDP								
Pre-peace	1.0	0.2			5.8		0.0	
Post-peace	8.8	0.9					4.8	
FISCAL SYSTEM								
Tax/GDP								
Pre-peace	21.8	7.9	18.4		18.9		2.3	
Post-peace	21.7	8.0	13.3		16.1		6.2	
Govt. investment/GDP								
Pre-peace		6.7	12.1		22.9		0.4	
Post-peace	22.2	11.2	8.9		24.4		6.8	
Budget deficit/GDP								
Pre-peace	13.1	4.3	6.6		-3.8			
Post-peace		4.7	13.0					
International debt/GDP								
Pre-peace								
Post-peace								

Continued on next page

Economic Change during the Move from War to Peace

	Nicaragua	Uganda	Ethiopia	Eritrea	Mozambique	Bosnia	Cambodia
ECONOMIC STRUCTURE							
Food imports/GDP							
Pre-peace					16.2		
Post-peace					8.5		
Exports/GDP							
Pre-peace	15.5				0.1		
Post-peace	11.8				0.1		
Manufacturing/GDP							
Pre-peace	28.0	2.9	4.4				7.0
Post-peace	19.0	4.0	6.0				7.4
Investment/GDP							
Pre-peace	23.4	8.5			49.2		8.2
Post-peace	18.3	13.9			60.2		15.5
Domestic savings/GDP							
Pre-peace	-1.6	-4.1			-1.5		1.8
Post-peace	-7.7	-3.8			5.4		7.8
SOCIAL INFRASTRUCTURE							
Govt. health expend./GDP							
Pre-peace		0.3	1.0		1.8		0.2
Post-peace			1.0		1.4		0.7
Infant Mortality Rate							
Pre-peace	62	120			173		181
Post-peace	51	114			146		110
Govt. educ. expend./GDP							
Pre-peace		1.3	3.3		3.8		1.1
Post-peace		1.9	3.1		2.9		1.1
Primary gross enrollment rate							
Pre-peace	98	73			62		42
Post-peace	102	71					53
Total Fertility Rate							
Pre-peace	5.6	7.0			6.3		
Post-peace	5.0	7.3			6.4		
Population Growth Rate							
Pre-peace	2.6	2.5			1.9		2.8
Post-peace	3.9	2.8			6.6		3.0
Population							
Most recent year (m)	4.3	18.6			16.6		9.8
ROLE OF DONORS							
ODA/GDP							
Pre-peace	12.0				86.4		0.4
Post-peace	26.8				80.3		11.8

The lesson is that demobilization can be successful, if done well. The practical steps which are needed for an effective demobilization have been studied in some detail and are well understood, although E.V.K. Jaycox of the World Bank, in the Foreword to a recent book on demobilization and reintegration programs (Coletta et al., p.v), overstates the case when he asserts that these programs "constitute the central element of the transition from war to peace."

Demobilization can be expensive, as the case in Uganda where the reduction of the armed forces from 80,000 to 43,000 soldiers initially caused military spending to rise, before reducing it from 35% to 25% of the national budget. Thus the emergence of a peace dividend for the government is typically delayed. Even when it arrives, the dividend may be modest: military spending in pre-war El Salvador was 0.7% of GDP, had risen to 3.7% of GDP by 1989, and fell back to 2.6% of GDP in 1991 and 1.7% in 1993 (Boyce 1995b, p. 2110).

While liberating 2% or 3% of GDP is no small matter, it does not justify Colletta's assertion that "continental demilitarization is a precondition for reviving civil society, reducing poverty, and sustaining development in Africa." Military spending ate up 3.1% of GDP in Africa in 1992, and this proportion has fallen since. While it is common to argue for a rapid reduction in military spending after the war is over (e.g. Boyce 1995b, p.2113), care must be taken not to revert to the military conditions which preceded the civil war.

Experience with demobilization varies widely however, and it is worth remembering that in some countries (for instance Nicaragua, and to some extent Mozambique) much of the demobilization occurred rapidly and spontaneously. Not all countries have a will to demobilize, as they use the armed forces to reward supporters or integrate resistance fighters into the mainstream. In some cases, such as Cambodia there remained until very recently a significant internal threat which made demobilization problematic. On the other hand almost no countries emerging from civil war face external threats to their security.

Civil order is easier to re-establish with a professional *police force*, but this is often lacking. The rare attempts by donors to forge a professional force (El Salvador, Haiti) appear to have been fairly successful (see below for more details), but require strong political will and substantial resources in the form of equipment, training and advice over a period of several years.

One threat to personal security is the presence of large numbers of *landmines* and other ordnance, which blow up somebody every 20 minutes. These are a feature of almost every conflict, and are a barrier to agricultural recovery in some areas. Demining is expensive and slow, and in some areas may not be worth doing in the foreseeable future; an expert can only de-mine about 30 square feet of land in a day, and it has been estimated that it costs up to $1,000 per landmine deactivated. An estimated 100 million landmines have been laid worldwide (The Economist, December 6, 1997, p.48). Belgium still digs up about 3,000 pieces of ordnance annually, mainly from World War II but also from World War I and occasionally from the Napoleonic wars.

d. *Infrastructure*

In many cases, the infrastructure has been seriously damaged by war, and this includes roads, rail, ports, airports, electricity, water supply, sewers and phones. Certainly these are tempting targets. The more serious problem is that during war there has typically been a dearth of spending on the creation and (especially) the maintenance of infrastructure, and it is this legacy of neglect which needs to be reversed. This is also a feature of many non war-torn LDCs, where the problem of inadequate spending on recurrent costs has been recognized for at least twenty years (see Heller 1978).

Donors like to fund infrastructure projects. There is a well worked-out list for Bosnia, for instance (World Bank 1996a, 1996b). Most infrastructure projects are large, complex and slow to get off the ground, which makes them poor candidates if one is looking for projects which will help get post-war economies off to a quick start (IRIS, 1997).

e. *Macroeconomics: Prices*

High *inflation* (of 20% p.a. or more) in wartime is almost a given, although hyperinflation (rates above 100%) is relatively rare, the recent exceptions being Cambodia, Nicaragua and Uganda. The explanation for the rapid inflation is straightforward: during war, governments print money to pay for their expenses, including the swollen armed forces, while simultaneously having difficulty raising tax and other revenue.

As a result of the high inflation, the public reduces its holdings of the local currency and turns to dollars, so most war-torn economies are dollarized (with the curious exception of Ethiopia, where inflation was relatively restrained, mainly because the public held increasingly large amounts of local currency). The low public reliance on local currency limits the government's scope for seigniorage. The demand for local currency is also highly unstable, because the potential for shifting into and out of the local currency is so great. Thus the inflation that does occur is purely monetary, with little or no inertial component. For instance Fischer (1996, p.366) estimates that the lag between issuing money and the resultant inflation is 18-24 months in the United States, but of the order of 3-4 months in Russia. Lags this short are normal when inflation is high; the positive side is that reductions in the money supply very quickly translate into lower inflation.

There is a useful corollary: the cost of reducing inflation is quite low. If the government can lower its unfunded budget deficit by a modest amount - perhaps by one or two percentage points of GDP - then it will not need to have recourse to monetary financing. With little increase in the money supply, prices (in local currency) will quickly cease to rise, and the public will shift back into local currency from dollars, further moderating inflation. A particularly clear example of this process at work is in the case of Vietnam where inflation fell from 487% in 1986 to 35% by 1989 when the government sharply curtailed its spending (Haughton 1997). Spectacular reductions have occurred elsewhere; for instance inflation in Nicaragua fell from an average annual rate of 3328% during 1987-89 to 17%

during 1992-94. In Cambodia inflation (as measured by the GDP deflator) plunged from 114.5% in 1993 to 0.5% in 1994. Most of this fall occurred in the course of just a few months, during the tenure of the provisional government. The ease with which inflation may be lowered helps explain the otherwise surprising fact that most newly-peaceful economies have succeeded in reducing inflation to very modest levels within a few years; further documentation is provided in Table 6.

In most war-torn economies the official *exchange rate* is seriously overvalued. This is the result of restrictions on imports and exchange rate controls. Exchange rate distortions create the potential for redistributing resources, and in particular favor those who have access to foreign exchange at the official exchange rate. During wartime, this system is often used to steer resources towards the armed forces.

After the wars the exchange rate needs to be freed up, and the currency made largely or completely convertible. Again surprisingly, this appears to occur fairly quickly in most cases, although more fundamental changes which would lower trade barriers tend to be slower in coming.

Even though the war may have ended, most people will not trust their money to a *bank*. There are understandable reasons for this. The banks, usually state-owned, which have survived the war almost always have large portfolios of non-performing loans and are not solvent; their loan officers are also likely to have limited experience at appraising risk. Private banks may have difficulty getting established, because it takes time to establish trust and prove one's competence. The ability of the central bank, or any other body, to regulate and oversee the banking system atrophies during wartime, if indeed it was there in the first place, yet without prudential oversight it is difficult to know which banks to trust. Informal credit networks, which of necessity are strengthened during times of uncertainty and war, continue to provide larger and surer returns than most bank deposits. Households with surplus funds may be reluctant to convert their assets into local currency, and may have excellent alternative ways to place their money (for instance in real estate, where the price is likely to rise rapidly when peace returns).

Without deposit mobilization, the banking system will continue to play, at most, a marginal role in financing economic recovery. This may not be a serious handicap in poor economies; both Vietnam and China have grown rapidly, despite weak banking systems. In more sophisticated economies, such as those of Thailand, Indonesia, South Korea or Bosnia, the collapse of the banking system is likely to leave a more serious void and is likely to call for serious and quick attention. This is one of the reasons why USAID is providing funds to the banking system in Bosnia, encouraging them to on-lend cheaply to small and medium enterprises. This is a strategy with high risks, in part because of general economic uncertainty in the region, and in part because banks are likely to be less prudent when the funds available to them are so easy to come by.

f. The Fiscal System

During wartime, governments scramble to increase revenue in order to finance the war effort. This occurs at a time when the economy, and hence most tax bases, typically shrinks. The usual response is to raise tax rates, which in turn leads to a narrowing of the tax base as evasion becomes rampant - as has occurred most recently in Mozambique. Squeezed by lower real wages and few resources for upgrading, administrative capacity tends to run down and opens the way for more widespread corruption. Coercive and arbitrary measures - such as army billeting in homes -may further weaken faith in any form of government. These are characteristics of many tax systems in LDCs, but occur with particular force in countries emerging from war.

While post-war use of excises and mining taxes may occasionally boost revenues significantly, it is generally true that without thorough tax reform, revenue mobilization (measured as a proportion of GDP) is unlikely to rise appreciably after the war ends; the only exception to this rule among the countries we studied was Cambodia (see Table 6), which emerged from civil war with an exceptionally low level of revenue mobilization. Ensuring adequate revenue mobilization is a "key second generation issue" in Eastern Europe, according to Stanley Fischer (1996, p.366). But it cannot be achieved rapidly, which is why the suggestion by Boyce (1995b, p.2113) that El Salvador raise its tax revenue from 9.3% of GDP in 1993 to 15% by 1998 is unrealistic.

War distorts the structure of government spending, with high military spending, low public investment, and a bloated but poorly paid administration. Stewart (1993) does not find that countries with higher military spending spent less on health and education, but this does not rule out the possibility of a tradeo ff.

Modest revenues and a high demand for government spending tends to create high budget deficits. In some cases a foreign government provided sufficient resources to prevent a run-up in national debt, but these are the exceptions. Most newly peaceful countries have a large foreign, and sometimes a large domestic, debt which creates a potential drag on recovery; Table 6 gives some additional information on this.

g. Economic Structure

War changes the structure of economic activity, with particularly large reductions in the industrial and construction sectors, and little reduction in subsistence agriculture. Collier sees the reduction in terms of transaction and asset intensity: war disproportionately hurts those sectors where transactions costs are high, or which are asset-intensive and so particularly vulnerable.

The disruption of trading links also leads to a relatively large drop in cash crops, and potentially to food shortages. It is reflected in high price differentials across space (high transport costs) and time (risky storage).

A reasonable implication is that with peace, the transaction- and asset-intensive sectors should be among the first to rebound, as increased security lowers transactions costs and newly-viable infrastructure reduces transport costs. Nonetheless the evidence suggests that post-war improvements come slowly, perhaps because of the difficulty involved in rebuilding other elements of the system of transport and distribution, including fleets of vehicles, trading centers, and working capital to finance the purchase of crops. In his study of agricultural markets in Mozambique, Kyle (1991) found that farmers respond vigorously to prices, but that physical and institutional constraints limited the development of a national market for agricultural products, thereby restraining the recovery of the agricultural sector.

h. Social infrastructure

In most war-torn countries all the key social indicators worsen during wartime, as life expectancy falls, infant mortality rates rise, the number of people per doctor or per nurse rises, and school enrollment rates decrease. This sets war-torn economies apart from other LDCs, even the poorest LDCs, where social indicators have generally continued to improve even when GDP per capita has stagnated. The lost lives, increased sickness, and lessened access to education count among the largest human costs of war.

The increase in mortality and morbidity has a number of causes. Governments engaging in a war tend to have less time and resources for public health measures such as anti-malarial spraying and vaccinations. Migration helps spread disease, as people flee the fighting and congregate in camps or at the edge of the towns and cities. The war may destroy houses and water supply systems. Health care personnel, particularly physicians, are likely to emigrate, and an already underfunded system of clinics and hospitals is likely to become even less effective.

Stewart (1993) also argues that in wartime, food entitlements fall for most people. In part this is a consequence of household disintegration, with able-bodied males conscripted for fighting. But it may also occur if crops are routinely raided or destroyed, and when the system of delivering seeds and fertilizers weakens and so jeopardizes food production.

The educational system is also disrupted. Teachers flee the countryside, being poorly paid or not paid at all. As a result illiteracy rises, particularly in the rural areas.

i. Demography

In most war-torn economies the population is still growing rapidly; in only a dozen cases since 1970 has war removed more than one year's increment in the population. Even in severely affected countries such as Angola, Mozambique, Rwanda and the Sudan, population growth has replaced, in just two to three years, the people killed as a consequence of war.

The most striking demographic effect of war may be that it leaves a disproportionate number of widows and orphans, who in turn may have limited resources for survival.

j. Weak Institutions

During war, many institutions become seriously weakened, through neglect, underfunding, and as a direct result of conflict. The distortions which characterize the tax system have been mentioned above; the system of agricultural extension often breaks down, as does agricultural research and development. Markets sometimes fail to thrive, even in basic commodities, because of the high risks involved; for an illustration of this see the discussion of Ethiopia by Dercon (1994).

Government statistical services are less effective during wartime, in part because this is not seen as a priority, and in part because of the difficulty of collecting data, especially in rebel areas. Very basic information may be lacking, such as data on the number of government employees, or the nature and extent of the foreign debt. The World Bank was hampered initially in Cambodia for lack of information, and made data gathering an early priority.

Social infrastructure may also be undermined. There is frequently a diminution of trust, certainly between the opposing camps. On the other hand the declining effectiveness of the central government during wartime may force local communities to develop coping mechanisms, including in some cases a greater reliance on interpersonal trust in the absence of a viable legal system. Commentators on Uganda have argued that the period of war led to the emergence of widespread corruption, and an associated erosion in the work ethic (because the path to riches was not necessarily through effort).

Property rights tend to be eroded by the insecurity of conflict, and by the appropriation of assets by soldiers or by authorities trying to mobilize resources to pursue the war effort. Secure property rights need to be established quickly. This occurred in El Salvador, where the disruption to ownership had anyway been minor. Nicaragua presents a contrasting case; it has been argued that in 1990 it needed to deal with land and property rights immediately, and that dithering prolonged the period of post-war uncertainty and deterred investment. The nub of the debate is whether the new Chamorro government had enough power to take the necessary steps; if it did not, this suggests a role for donors in bringing outside pressure to bear for change.

Some Antidotes

The litany of woes facing war-torn economies may seem depressing, but these countries also have some important assets.

- First, donors are typically interested in supporting rehabilitation and reconstruction, even if most of them hesitate to get involved until it is clear that the conflict is indeed over.
- Second, émigrés will have amassed wealth and skills overseas, and will begin to send back remittances, to invest, and even to return home.
- Third, there is typically a group of war-time entrepreneurs who have accumulated liquid assets and who have the ability to operate even in very difficult circumstances; under the right conditions they could be persuaded to use their talents and money productively in peacetime too.
- Fourth, resistance to reform is typically low, because there are few entrenched interests. In the words of one

commentator on Cambodia, "the extreme void ... in a way makes [institution building] easier." The potential for a new start, to put institutional development on fast forward, may be enough to vault some war-torn economies ahead of many countries that remain entrenched in old ways of doing things.

So the challenge, and it is not a modest one, is how to untie the Gordian knot and break out onto a path of sustainable development, because it is clear that this is indeed possible. The key is to be realistic about what government should and should not do, and then to set a clear set of priorities for what to do. We now turn to the question of the appropriate scope and sequence of government action.

VI. THE SEQUENCING AND SPEED OF POLICY MEASURES

"It is extremely difficult to rank areas to be addressed, although setting priorities is important."

Nicole Ball (1996, p.51)

"There is much controversy," writes the World Bank (1991, p.145) "about the theory, timing, scope, speed and sequencing of reforms." In this section we review the relevant literature on the sequencing of economic policy, and distil the lessons for war-torn economies. There are really two literatures of interest, one which addresses the issue of sequencing reforms in the context of countries in transition from a planned to a market economy, and another which considers the sequencing of reforms in the process of economic development in less-developed countries in general.

It is recognized that there is no single sequence of economic policies that is appropriate to all (war-torn) economies seeking to get onto a path of sustainable growth, that "a unified sequencing proposal ... can hardly be established" (Funke, p.359). Nonetheless it makes sense to try to delineate a preferred sequencing, and to put the onus on those who would argue for a different ordering; at a minimum one hopes to ignite an overdue debate on the subject.

In a few cases the sequence of economic policies is constrained by the terms of the peace accords. Certainly this was the case in Cambodia, where the agreements explicitly limited the extent to which the transition government would be permitted to initiate economic reforms (Ball, p.51). More commonly the peace accords are silent on the economic side, or couch any economic conditions in vague and flexible terms.

To some extent the speed and sequencing of reforms depends on the view one holds of the motivation and capacity of government (Funke 1993). Most common is the *orthodox approach,* which views government as essentially benevolent, working in the public interest; in this case one may concentrate on trying to find "the welfare-cost minimizing reform sequence" (Funke, p. 341). This in turn requires answers to economic questions of the type: will reform X work if reform Y is not yet in place? And to the technical question of whether the country has the institutional and human capacity to undertake the reform yet (World Bank 1991, p.145).

The *political economy view* regards government as self-interested; at its most benign, the government is seen as wanting to win the next election. Government is seen as trying to create "political rents" to help build up its constituency of support and enrich its practitioners, and is likely to postpone taking difficult or unpopular decisions (Roland 1990, p.22), lest opposition derail reform (World Bank 1991, p.145). Funke (1993) sets out a third perspective, the *credibility view*, which argues that governments, if they are to be effective, must establish and maintain credibility, and that this in turn affects the manner in which they approach policy formation.

The different implications of the three approaches are summarized in Table 7, which is based to a considerable extent on Funke (1993). Since Table 7 is somewhat cryptic, a few further comments are in order.

According to the orthodox approach, *fiscal and monetary stabilization* is needed at an early stage. By reducing inflation, prices become informative and can act as clearer guides to economic decisions about what to buy and where to invest; and the tax on holding cash is reduced. Monetary stabilization is only plausible when fiscal balances are manageable, which is why the two go hand in hand. The political economy approach argues that there may be high costs to achieving macroeconomic stabilization, and so it may have to occur gradually; Boyce (1995b) appears to argue this case in the context of reconstruction in El Salvador.

The *domestic financial market*, in the orthodox view, can only be liberalized once the fiscal deficit and inflation are controlled, thereby freeing up the banks to lend to other sectors of the economy. It may be necessary to clean up the balance sheets of the banking system first, before one can rely on low reserve requirements to help achieve positive real rates of interest on deposits. According to the political economy view, government should be reluctant to support any substantial reductions in bank loans to unprofitable enterprises, because of the risk of bankruptcy and the ensuing unemployment. Danby (1995) argues that premature financial liberalization, which leads to a surge of lending for poorly-conceived projects and is often financed (indirectly) by foreign aid, should be avoided, and that "efforts to lead with finance ... are likely to waste resources" (p. 2134). Certainly banking that is not subject to clear prudential rules, and that does not attempt to mobilize resources, is unlikely to prove durable.

Although there are some differences in opinion, most proponents of the orthodox view argue that *trade liberalization* should occur early, probably in parallel with macroeconomic stabilization. The argument is that this spurs competition, avoids the continued inefficiency associated with high trade barriers, and that the unemployment costs associated with trade liberalization are small in practice. Not all observers are so sanguine, with some believing that governments still need tariff revenues and so cannot afford to liberalize trade as fast as would otherwise be desirable (Cheasty). This is unconvincing, because a sales tax is superior to import tariffs on welfare grounds, and would in practice collect much of its revenue at the border. Those in the political economy tradition stress the costs of reform to important interest groups, including those who work in currently protected industries, and argue for slower liberalization - although it appears that political opposition to trade liberalization was weak in Mexico in the late 1980s and in Poland in 1990.

Trade liberalization also requires an appropriate *exchange rate*, and especially one which is not overvalued. In most war-torn economies, this probably calls for a three-step process: first allow the exchange rate to float, so that it finds its appropriate level; then peg it for a while, perhaps with a currency board arrangement, to give it credibility and to enforce domestic macroeconomic discipline; and then when credibility has been established, allow it to move a little in response to shocks, such as changes in the prices of major imports and exports (see Sachs 1996 for steps 2 and 3 in the context of economies moving from a planned to a market economy and Haughton and Riiel 1996 for an application to Estonia).

The prevalent, although not unanimous, view in the orthodox vein is that the *capital account* should be opened up at a late stage (e.g. McKinnon 1993). The argument is that a premature opening to capital movements is risky, in some cases facilitating capital flight, in others inducing capital inflows into still-protected sectors which in turn could be immiserizing. This argument is not entirely convincing, at least in the light of some political economy considerations. An open capital account may reduce capital flight, because businesses and individuals who know they can

Table 7
Sequencing of Reforms Under Alternative Views of the World

Area of reform	Orthodox view	Political economy view	Credibility view
Fiscal and Monetary Stability	Do early; prices need to be informative.	May need to do slowly if adjustment costs high.	Do fast; establish credibility by tying hands of Central Bank, cutting government spending, reforming taxes.
Liberalize Domestic Financial Market	Only possible when fiscal deficit controlled. Clean up bank balance sheets.	Cut privileged borrowers. Don't enforce bankruptcies, because they cause unemployment.	Do; signals commitment to continued stabilization. End lax credit and clean bank balance sheets.
Liberalize trade	Ambivalence; some argue tariff revenue needed; others argue for reform, to reduce inefficiency, spur competition.	Do after stabilization, because trade liberalization hits interest groups.	
Liberalize capital account	Do last, to stem capital flight, avoid Dutch disease, and avoid capital flowing in to inefficient projects.	Lal argues: do early, as helps smooth adjustment if accompanied by announcement of trade liberalization.	(Open to long-term capital early in reform process?)
Privatization	Ambivalence. Some argue do early to boost investment, especially small scale projects, banks. Others suggest postponing until after macroeconomic stability, institutional framework, alternative revenue sources.	Do small-scale privatization early on, but delay on large firms because of unemployment effects.	

Source: Loosely based on Funke (1993).

take their capital out of the country at any time are less likely actually to do so (Obstfeld 1993). It need not be inefficient, and could in fact smooth the process of adjustment if accompanied by an announced schedule of trade liberalization (Lal). An open capital account also provides discipline, forcing a country to maintain macroeconomic balance at the risk of being punished by rapid capital outflows.

The classic case of development with a relatively open capital account is Indonesia, which made the rupiah largely convertible as early as 1972. For instance in 1987 when capital began to flow out of the country because the exchange rate was seen as overvalued, the government did not hesitate to raise interest rates to pull capital back in, and later undertook a large surprise devaluation. Since the mid 1960s the budget has not been seriously out of balance, and except for the periods just after the oil price booms of 1974 and 1979, inflation has been kept in check.

How quickly should *privatization* occur? There is almost universal agreement that small-scale enterprises should be privatized early on. The disagreement arises in the case of large state-owned enterprises (including the major utilities), and state-owned banks. McKinnon (1993) argues that state-owned enterprises represent an important source of government revenue, and so should not be privatized until a robust tax system has been put in place; otherwise the loss of revenue would jeopardize macroeconomic stability. A more pragmatic problem is that it may take considerable time to evaluate the potential of the larger enterprises, and to develop an appropriate procedure for privatization. The political economy view stresses the need to go slowly because of the loss of jobs which is typically associated with privatization of over-staffed and inefficient companies. Roland (1994) argues that the firms which are most likely to be viable post-privatization should be disposed of first. One advantage is that this would create some success stories, thereby helping to weaken the political opposition to privatization.

There is a cost associated with slow privatization, which is that until the future of a firm is clear, investment in the sector maybe deterred. In some cases, privatization may simply forestall the theft of the assets of the firm by its managers and workers (The Economist 1997). In practice public enterprises tend to have too much access to credit, in large part because of the implicit government guarantee which they have. The risk here is that they will use this credit in inefficient or corrupt ways. For instance in China more than half of loans from the banking sector go to state-owned enterprises, and these same banks have non-performing loans equivalent to at least a fifth of their assets, largely owed by state-owned enterprises (The Economist 1997, p.29).

State-owned banks pose a special problem. In most cases they are insolvent, and so have a negative market value. Yet they survive because of their privileged access to credit, and because they are frequently too large to allow to fail. This in turn creates a problem of moral hazard; knowing they will be supported, state-owned banks may not hesitate to continue to make poor or unduly risky loans, and they may force the Central Bank to expand credit faster than would be desirable. It is to prevent such hemorrhaging that attention is needed to the state-owned banks, including their possible privatization, at a relatively early stage. A more radical view, suggested for instance by economic historian xxx of Rutgers University, would be to close down state banks completely, and let the sector start afresh.

Speed of Reform

How fast should reforms be introduced? In its more extreme form, this is the same debate as the one over whether to favor a “big bang” or gradualism. Gradualists argue that the capacity to manage change is limited, and so one has to hasten slowly, consolidating gains and building a constituency for further reform. It also helps guard against errors because, in the words of one diplomat, “if you rush you are bound to make serious mistakes.”

The fundamental problem with the more deliberate approach is that it also provides time for the forces opposed to reform to consolidate, so that the process of reform stalls. Moreover, if current arrangements are inefficient, then the sooner they are swept away the better, like burning grass to allow for new growth.

It has also been argued, for instance by Fischer (1996) that reforms need to be introduced rapidly, and need to tackle the difficult issues early on, if they are to be credible. Collier and Gunning (1995b) make a distinction between policies where there is a fundamental doubt as to whether they will be implemented, and policies where the only doubt is about when they will be implemented (timing doubt). Intuition suggests that governments should tackle the issues where there is fundamental doubt first, thereby establishing their credibility at an early stage. Collier and Gunning argue that this generalization may not be correct, because there are times when timing doubt may be more destructive than fundamental doubt; for instance, if it is not clear when the telecommunications monopoly will be privatized, this could create enough uncertainty seriously to deter some other investments.

There is only one area where there is consensus in the literature, which is *that institutional reforms should take priority in economies in transition* (see Funke 1993, p.340). Institutional reforms include establishing a properly functioning legal system, defining property rights, and developing company and contract law. Whether these should get such priority in war-torn economies is less clear; murky property rights and a weak legal system have not prevented very rapid economic growth in China and Vietnam, although as their economies become more complex and sophisticated the need for stronger institutions becomes greater. A more compelling case can be made for needing to establish clear property rights quickly, so that investors (including farmers) need not fear that their fixed investments will be taken away from them after they have been put in place.

What lessons can one draw from the literature on sequencing? Quite simply, move quickly, especially with the stroke-of-the-pen measures which include opening up to trade, getting an appropriate exchange rate, cutting inflation, bringing the budget deficit to a manageable level, and petty privatization. Most other issues simply cannot be resolved so quickly, and will need to wait; they include the privatization of large enterprises, and land reformWorld World War II the major cities of Western Europe were substantially emptied, because it was harder to feed and to defend city populations. Now the towns and cities fill with refugees - the cases of Afghanistan, Bosnia and Somalia are good examples of this. Part of the reason may be that the nature of most civil wars has changed, largely taking place in the countryside. Another difference is that food can more easily be imported, whether purchased or received as food aid. This food is more easily distributed in the cities, a mechanism which helps support the government which controls the cities, and creates a strong inducement for people to move to the urban areas. The overurbanization which wars typically create is difficult to undo, although it is probably still desirable to offer seeds and tools to urban dwellers who agree to return to their rural homes.

b. Security

VI. SEQUENCING RECOVERY IN WAR-TORN ECONOMIES

> *"If you keep thinking about the best sequence, you get nothing done."*
>
> Juan Belt, USAID

In Table 8 we propose a sequence of policies which we believe will speed the transition from war-torn economy to sustainable growth. While flexibility, creativity and judgement will always be needed in the context of any given country, the suggested sequence can usefully serve as a framework within which particular policies may be fitted.

a. Population movement

With the outbreak of peace, there will usually be a spontaneous return of refugees [e.g. Rwanda 1996, Afghanistan 1992], although sometimes they need to be encouraged [e.g. UNHCR in Cambodia 1989]. They need to be supported until the first harvest permits them to support themselves, and food aid will often be required for this purpose. The difficult challenge here is how to phase out food aid, - early enough so that farmers recognize that they must fend for themselves, but not so early as to cause suffering.

Resettlement often requires the provision of basic agricultural tools and seeds. Where detailed knowledge of local conditions is scarce, the distribution of these inputs may need to be made on a universal basis, as occurred in Rwanda in 1995 [Tardif-Douglin, 1996]. Here too it is important, after the first round of help, to be stingy with further seeds lest farmers come to rely on this source as a matter of course.

The outstanding claims, on land and other assets, by emigrés need to be resolved early on, but special efforts (such as a temporarily undervalued exchange rate to provide a windfall gain on buying local fixed assets) to attract this group back are not needed. The resolution of claims will typically be enough to attract back serious entrepreneurs, as the Uganda case shows. Where such claims are not sorted out, or are resolved slowly and imperfectly, as in the case of Nicaragua, investors will be slow to make commitments.

But returnees are expensive, and their high salaries create resentment among equivalently qualified local hires. Whether they really do bring in democratic ideas, as suggested by Kumar (1996) is not clear. On the other hand the remittances sent by émigrés are unquestionably useful, and the window which they provide on the outside world is likely to be valuable, so perhaps governments should content themselves with making it easy for them to return home to visit friends and relatives, and to dabble in local investments.

Mark Harrison notes that the swelling of towns and cities during civil war is a recent phenomenon. Even in

Table 8
Policy Timelines

<table>
<tr><th></th><th colspan="2">First generation issues</th><th colspan="3">Second generation issues</th></tr>
<tr><th></th><th>Year 1</th><th>Year 2</th><th>Year 3</th><th>Year 4</th><th>Year 5</th></tr>
<tr><td>POPULATION MOVEMENT</td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Economy in Transition</td><td colspan="5">Not applicable</td></tr>
<tr><td>War-torn economy:
a. Return of Refugees</td><td>Spontaneous</td><td></td><td></td><td></td><td></td></tr>
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<tr><td>c. Overurbanization</td><td colspan="5">Ignore</td></tr>
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<tr><td>b. Professionalize police, army</td><td colspan="2">Start early</td><td colspan="3">Continue the slow process</td></tr>
<tr><td>c. Clear landmines</td><td>In key spots</td><td colspan="4">Long slow job</td></tr>
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<tr><td>War-torn economy:
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<tr><td>b. Rehabilitate restorable structures</td><td colspan="4">Not all structures should be rebuilt</td><td></td></tr>
<tr><td>c. Long-term investment and maintenance</td><td></td><td></td><td>Plan</td><td colspan="2">Build and maintain</td></tr>
<tr><td>d. Develop appraisal and management capacity</td><td>Urgent</td><td colspan="4">Maintain strong capacity</td></tr>
</table>

Table 8 (continued)

	First generation issues		Second generation issues		
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
MACROECONOMICS (PRICES)					
Economy in transition	*Similar sequence to that in war-torn economies*				
War-torn economy:					
a. Cut inflation to below 20%	Restrain M				
b. Restrain lending by state-owned banks	Urgent	Complete the job			
c. Liberate exchange rate	Urgent				
d. Float or peg exchange rate					
e. Establish and maintain substantial e.r. convertiblity	Establish	Maintain			
f. Develop banking rules and oversight capacity			Develop	Operate	
g. Remove regulations restraining international trade					
FISCAL SYSTEM					
Economy in transition	*Similar to case of war-torn economy*				
War-torn economy:					
a. Introduce cash budgeting	Low deficit	Phase out slowly			
b. Set up payments system	Urgent				
c. Increase revenue mobilization	Quick fixes (excises, houses)		Reform taxes and administration		
d. Suspend debt servicing and quantify it	Suspend	Quantify			
e. Renegotiate debt			Public	Private	
f. Civil service pruning and reform		Cut numbers, raise salaries			
g. Fiscal decentralization			Especially health, schooling		
h. Seek foreign aid for general budegetary purposes	Urgent, substantial		Decreasing amounts		
I. Develop data collection:	Disasters, public health				
		government payroll, revenue, debt			
			NIPA, poverty		

Table 8 (continued)

	First generation issues		Second generation issues		
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
ECONOMIC STRUCTURE					
Economy in transition	*Many similarities to case of war-torn economies*				
War-torn economy:					
a. Ag: seeds and tools in hit areas and for migrants	One season				
b. Ag: Initial food aid	Relief	Phase out quickly			
c. Ind: Foreign Investment Law					
d. Ind: Simplify tax rules and incentives		Foundation for FDI			
e. Ind: Formal laws on contracts, bankruptcy					
f. Ind: Investor roadmap		Useful			
g. Ser: Encourage development of markets	Allow goods to move; keep rhetoric down				
SOCIAL INFRASTRUCTURE					
Economy in transition	*Attention to worsening of health, education provision*				
War-torn economy					
a. Maintain public health in remaining camps					
b. Restore public health measures	In cities and towns		In rural areas		
c. Target primary health care; allow private sector		Focus limited resources on poor			
d. Restore education, esp. primary as resources permit		Building to univerasl primary ed. takes a decade			
e. Support for orphans and some widows, crippled	May be able to rely on NGOs here				

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Ensuring security in both urban and rural areas is a sine qua non for a return to normal economic activity. The creation and maintenance of a safe and secure environment is typically helped by a substantial demobilization on both sides, despite the considerable expense that this may involve. A more professional police force is likely to be needed, although this typically takes several years to achieve, as the accompanying discussion of experience in El Salvador illustrates. The clearance of landmines is a process which will have to continue for decades, but in a few selected areas this may call for immediate attention.

Box 1. Reforming the Police Force in El Salvador

El Salvador is one of the few countries where a serious effort has been made completely to reform the police force. In what follows we summarize the discussion by Stanley and Call (1996) in which they outline what the reform sought to achieve and how well it succeeded.

Under the Chapultepec peace accords of January 16, 1992 the government of El Salvador and the Farabundo Martí National Liberation Front (FMNL) agreed to establish a new depoliticized National Civilian Police (PNC) force. Just 20% of the officers were to be drawn from each of the FMLN and the old national police force, with the remainder consisting of new recruits. All the commanders were to be civilian recruits. The peace accords also greatly reduced the powers of the armed forces, stipulating that half of all military personnel were to be demobilized. The old national police force was to be gradually eliminated as the PNC was to takeover during a two-year transition period. Substantial technical assistance, training, supervision and materials were expected to come from foreign donors, most notably the US and Spain.

The PNC got off to a slow start. The training center was poorly equipped and the teaching put too little emphasis on practice, although the 60 officers who trained in Puerto Rico fared better. There were initial problems in screening recruits. Government support was lukewarm; the UN observer mission (ONUSAL) in late 1993 called it "blatantly insufficient." As PNC officers were deployed they initially enjoyed strong support from the public, and were able to solve a number of high profile cases. But the goodwill tapered off as problems accumulated. Notable among these were:

- Reforms in the judicial system did not keep up with the reforms in the police force, so that there was often insufficient jail space for arrested suspects, and some judges were considered to be biased.
- Some appointments were politicized; former army Captain Peña was appointed sub-Director for operations, and brought political bias, militarism and a disregard for human rights to the post.
- ONUSAL, which had 277 international police officers on the ground, provided valuable support and on-the-job training during the first six months of the operation, but suspended their cooperation until Captain Peña was relieved of his post.
- The new police were too quick to use force, particularly in handling demonstrations.
- The government undermined the PNC by deploying the army in July 1993 as a "dissuasive presence."
- The donors did not provide nearly as much financial and other support as had been expected; donors argued (unrealistically) that savings from military cutbacks should suffice to fund the PNC.
- The political will to wind down the old police force, and to replace it with the non-ideological PNC, was weak.

Stanley and Call draw a number of other lessons from the experience. They argue that more attention is needed to managing the transition from the old to the new police force; that systems of accountability and popular control are needed from the beginning; and that it is much easier to teach techniques than to change attitudes.

c. *Infrastructure*

The main ports, roads, airports and railroads need to be opened and secured at an early date. Some of the more important, or more easily restorable structures, should then be brought back into operation.

It need not be assumed that just because some piece of infrastructure existed in the past, it therefore should be rehabilitated. Some railroads, ports and bridges may not deserve priority. The point here is that a program for the long-term investment and maintenance of infrastructure needs to be developed, so that within two or three years of the return to peace, donor and other monies are being channelled into a coherent set of investments.

The capability to appraise infrastructure projects, and to develop a sensible sequencing of government investment, needs to be developed very urgently; it is not a major expense, and is an area where donors are likely to be able to make an important contribution.

d. Macroeconomics: Prices

Macroeconomic stability both must and can be achieved very quickly, largely though a series of “stroke of the pen” measures. This is an area where the IMF and World Bank are seasoned and their advice carries weight.

First inflation must be stopped, or at least brought down to the 10% range or less, by a strong commitment to restrain the creation of new money; there is strong evidence that once inflation exceeds about 20% it serves as a brake on economic growth (Dornbusch). This requires fiscal restraint, so that the banking system does not face any pressure to create credit to finance a budget deficit. More difficult is that it also calls for restraints on credit to less productive uses, and particularly on credit by state-owned banks to state-owned enterprises. The early development of some technical supervisory and regulatory capacity, on the part of the Central Bank, is likely to make this job easier.

Meanwhile the exchange rate should be floated, and allowed to find its appropriate level. When the appropriate value of the currency is known, some countries will want to link their currency with one of the major international currencies - as Estonia did when it linked the kroon with the deutschmark - while others will be content to continue to see their currency float. Pegging a currency, perhaps through a currency board arrangement, can be a good way of submitting to external discipline, because it effectively gives up the possibility of autonomous monetary policy. Such a step is most likely to be useful for countries which are trying to establish their credibility in fighting inflation and which start from a position of low credibility (because they are newly independent, or because of a poor record of macroeconomic management in the past). After the worst of the civil war in Uganda ended in 1986, the country wrestled with a variety of exchange rate arrangements, none of them satisfactory until the system of auctioning foreign exchange which it set up in February 1992. The ensuing period of stability allowed the country to replace this system with a foreign exchange interbank market by November 1993, or almost eight years after the war ended.

No efforts should be made to suppress the use of foreign currencies, partly because such efforts are usually futile, and partly because over time a well-managed local currency will naturally displace the use of foreign cash and coin, especially if the domestic currency is required for paying taxes and is used by the government in paying its bills. When the local currency has to compete with foreign currency, there is a strong incentive to keep inflation in check, because only when users find the domestic currency attractive will the country be able to obtain any seigniorage from the issuance of currency.

Restrictions on trade should, as far as possible, be swept away. This is often easier than expected. El Salvador dismantled its trade monopolies in 1992. In neighboring Nicaragua some US observers believed that liberalizing trade would be difficult, when in fact it turned out to be quite straightforward; President Chamorro was elected in February 1990, the state's monopoly of foreign trade was ended in January 1991, most export taxes were abolished later that year, and in April 1993 the country joined the *Grupo America Central Cuatro*, a nascent regional free trade area. Indeed the growing number of regional integration arrangements, and a renewed belief in the efficacy of open trade in stimulating economic development, have both helped post-war economies to shed their trade barriers. Yet few countries have gone as far as Bolivia or Chile, where almost all import tariffs are set at a relatively low flat rate.

One other urgent requirement is to set up or restore a payments system, which permits the government to pay its workers and suppliers in a timely way throughout the country, and provides a conduit for the collection of taxes. This is not a trivial problem, particularly in a country like Mozambique where the provincial capitals are still not all accessible year-round overland, or in Bosnia, where three different domestic currencies are still current.

If the hemorrhaging of bank credit for low-productivity projects can be staunched, then further reform of the banking system can wait in most developing countries. This is because for the poorest countries, the formal banking system does not play a central role in financing investment. However early attention is needed to developing the regulatory framework, as the World Bank is doing in Cambodia; once banking rules are in place it is much easier to allow foreign banks to enter, and to have confidence that newly-established will be operated with prudence.

The main exception to this generalization may be Bosnia, where the banking system was once important, and may have a major role to play in jump-starting investment now that the civil war has ended. By the standards of other war-torn economies, pre-war Bosnia was the most economically sophisticated and already relied heavily on its banking system.

f. Fiscal System

Monetary restraint requires budgetary restraint. The first step is to move to a cash budget, as done fairly successfully in Uganda by 1988, where spending cannot be committed until the funds are available in the treasury. This does not eliminate budget deficits, but it does help to reduce monetization of those deficits.

Most war-torn economies need to increase revenue mobilization, although in a few cases such as Ethiopia this was not the case. Greater revenue mobilization, defined as the government collecting a higher fraction of GDP in the form of taxes and other forms of revenue, is difficult to achieve with any rapidity. Collier (1994a) goes further and argues that a rapid increase in revenue mobilization is also undesirable because it is likely to require additional highly-distortionary taxes which will surely turn off investors. As a practical matter, few countries have managed to increase the government's take of GDP by more than a percentage point annually. However early emphasis may be put on excises and perhaps mining taxes. In some cases the government may have substantial assets such as houses which it could sell quickly; Collier (1994a) has argued that the Ugandan government should have tapped this potential at an early stage.

The reform of taxes and of tax administration is usually an ongoing process, and calls for serious attention once the more urgent tasks have been completed. Uganda introduced a quasi-independent revenue board to collect taxes, a step which has been imitated by Kenya and Tanzania. El Salvador introduced a Value-Added Tax in 1992 and, in the words of one observer, "has purged revenue administration" quite thoroughly. The World Bank has given strong support to the development of the tax system and to budget management in Cambodia. Donors have argued that Bosnia should keep its substantial arrears off the budget, covering them by disposing of the considerable assets (such as houses and land) which the government still has.

With a move to a cash budget, and with limited scope for raising more revenue, spending is likely to be cut unless donors prove to be particularly generous. Eventually military spending will fall, but not during the demobilization phase and, in some countries, not for many years.

In practice, most war-torn economies have neither the ability nor the inclination to make more than a token effort at servicing their debt. Payments of interest and principal on foreign debt may well have to be suspended, pending a renegotiation of the debt. War-torn economies have more urgent claims on their meager resources than debt servicing, and most foreign lenders claim to recognize this. In practice this is not a radical suggestion, because most war-torn economies are making no more than a token effort to service their debt. Nonetheless the debt overhang poses a serious potential problem, especially when arrears to bodies such as the IMF preclude further borrowing from that organization. Indeed in the immediate post-war years debt tends to *rise*, sometimes sharply. Here is a sampler:

		Debt as % of GDP	Debt service ratio (i.e. actual debt servicing payments as % of exports of goods and services)
Nicaragua	Pre-peace: 1987-9	500%	9%
	Post-peace: 1992-4	600%	39%
Uganda	Pre-peace: 1986-7	33%	40%
	Post-peace: 1993-4	88%	29%
Ethiopia	Pre-peace: 1987	43% (1988)	40%
	Post-peace: 1993	78%	13%
Cambodia	Pre-peace: 1990	166%	0.5% (1991)
	Post-peace: 1993	81%	0.3%
Zaire/DR Congo	Pre-peace: 1994	185%	due: 113% paid: 1%
Mozambique	Pre-peace: 1990-92	351%	57%
	Post-peace: 1994	385%	73%

These debt servicing burdens are high, and certainly work to inhibit rapid economic recovery.

Debt renegotiation requires a country to have adequate information about the current status of its debt obligations, and donors are typically willing to help create debt information systems. Countries emerging from war would do well to seek early debt relief, particularly from commercial creditors, before their recovery is so successful that creditors stiffen the terms. For instance Vietnam was barely able to negotiate a 50% writedown (in real terms) of its commercial (London Club) debt in 1996, because it was becoming increasingly clear that the country could indeed service the debt fairly well if it had to.

Indonesia presents a striking case of the usefulness of serious debt relief. The hyperinflation of the early 1960s was associated with substantial foreign borrowing and a serious decline in GDP. After the 1965 coup which brought Suharto to power, the new government negotiated a five year moratorium on debt payments (starting in 1967) and some debt relief. During the period the economy recovered rapidly, and Indonesia was able to service its international debt successfully from 1972 onwards.

When revenue is insufficient to cover costs, the burden is often borne by civil servants, who see their real wages fall; this was certainly true in Vietnam between 1988 and 1992, when it trimmed its budget deficit in an effort, ultimately highly successful, to tame galloping inflation. It is ironic that the governments of war-torn economies are often very weak, but frequently have large civil services. The long-term solution is to trim the size of the bureaucracy; if this is not possible, allowing real wages to fall has a similar effect, provided there is a mechanism for adequately paying those employees that one wishes to retain such as tax collectors (using a Revenue Authority perhaps) and school teachers (with school fees?). The World Bank is supporting civil service reform in Cambodia, which has a large, poorly-paid civil service; at one time the country boasted 2,000 generals and 10,000 colonels.

Although it is difficult to achieve quickly, some decentralization of taxation and spending is likely to be desirable. The period of civil war often weakens faith in central government, and a degree of decentralization may help improve the effectiveness of such services as schooling and health care and, in the words of one observer of Mozambique, may "reach those you didn't reach before."

g. Economic Structure

Despite the shrinkage of the industrial sector during wartime, there is no compelling need to show particular favor to this sector in peacetime. At some point a clear set of tax rules, a foreign investment code, and laws on contracts and bankruptcy are required. Even without these last two, industry can grow very rapidly, as recently experience in China and Vietnam shows.

In most countries the need is for simplification, making it is straightforward to set up and register a business. Rules which served in wartime may need to be rescinded. It is often helpful to begin this process by putting together a "road map" (which donors will be glad to finance), such as those created recently for Ghana and Tanzania, which sets out in detail what forms and permits are needed for different types of business activity. Such an approach might have helped streamline the investment incentives in Uganda which were initially too tied up with red tape.

Box 2. Maintaining the Flow of Foreign Investment into Uganda

After coming to power in 1986, the Museveni regime sought to attract foreign investment into Uganda. It promulgated a foreign investment law, but this alone only represented an initial step. In 1992 the London-based East Africa Association highlighted some of the lingering problems facing would-be investors in Uganda, including the following:

- Some government departments did not fully support the Uganda Investment Authority's efforts to attract foreign investment
- Ambiguities remained in the investment code
- Dividends could not be sent abroad if the company had borrowed locally, which is unrealistic
- The Central Bank was reluctant to permit local borrowing
- Corporation income tax treated depreciation unfavorably
- Work permits take a long time to arrange
- The highest denomination banknote was worth about $1, which was inconvenient
- Corruption and bureaucracy at the lower and middle levels of the administration was deterring investors and causes delays. The point here is that efforts to attract foreign investment need to be ongoing, and must pay attention to details.

Source: Economist Intelligence Unit (1992).

h. Social Infrastructure

Attention must be paid from the very beginning to the public health issues in any remaining camps, and to preventing the spread or outbreak of disease when refugees and others return home.

As resources permit, public health measures - such as anti-malarial spraying and vaccination campaigns - should be rebuilt, because these are likely to have a very high payoff.

And as normality returns, the educational structure can also be rebuilt. While education is central to maintaining economic growth over the long term, it will be easier to finance and sustain its expansion once economic growth has resumed and government revenue is rising. El Salvador has had considerable success with community-managed schools, a model which neighboring Guatemala is now copying. To the extent that the causes of war are rooted in poverty, inequality and unfairness, then measures which emphasize community participation and which target the poor and the excluded will also help take away "the occasion for all war." In El Salvador the new Extended Structural Adjustment Facility (ESAF) puts the emphasis on basic health and education as well as community education; on the other hand agrarian reform has not gone very far. One might note in passing that the thesis that civil wars are rooted in poverty is difficult to defend even though it is widely believed (e.g. by Marshall (1997)); poverty was surely not behind the struggles in Angola or Mozambique, or the continued conflict in the Sudan or Afghanistan or Northern Ireland.

i. Demography

Orphans and some widows may need direct support. This is an area where NGOs excel, and where donor financing is likely to be essential.

j. Weak Institutions

The restitution of land and other assets which belonged to émigrés is likely to be necessary, if only to help ensure continued donor support from the United States. The major outstanding claims need to be resolved rapidly, so as not to deter other investors - particularly firms planning land-intensive projects such as new plantations.

The slowness with which Nicaragua dealt with land reform has certainly contributed to the country's slow recovery from civil war; total GDP grew by 1.5% annually during 1990-95, but rapid population growth meant that GDP per capita fell by 1.7% p.a. during this period. Under the Sandinista government, anyone who had left the country for at least six months was deemed to have forfeited his or her property. After the peace accords special courts were established to handle land issues, and in 1993 $100 million worth of government bonds were issued to compensate (former) landowners. Initially these bonds traded at just 5% of their face value, indicating that the market believed the government had little intention of honoring them; pressure from the United States and others forced the government to reassure bondholders that it would make good on its promises, and the bonds now trade for about 30% of their face value. By 1996, or six years after the war ended, only about two thirds of property claims had been dealt with.

Land may also be needed for demobilized soldiers, as in Uganda. Where unequal access to land was one of the key issues which helped motivate the war - as in El Salvador and Nicaragua - some mechanism is needed to redistribute land on a substantial scale. It is also important to recognize realities; the initial plan to undertake land redistribution in El Salvador in just six months was clearly unrealistic.

Where there are small, state-owned companies, these should be privatized rapidly. Larger enterprises can be tackled later - as is the case, for instance, of the telecommunications industry in El Salvador, which is due to be privatized now, or more than five years after the Chapultepec accords sealed the end of the civil war.

Sometimes privatization occurs almost spontaneously. It occurred rapidly in Cambodia, where the ministries sold off the firms under their control in a chaotic process, and in Nicaragua. Ideally the 250 or so state-owned enterprises in Nicaragua would have been tuned up and sold to strategic investors. In practice the "army clan" used the proceeds of arms sales to buy most of these enterprises cheaply, in what has come to be known as the piñata. The sales of the large and important state-owned enterprises in telecommunications, energy and cement are now under-way, and the hope is that they will attract buyers who will in turn bring foreign investment into these areas. The most serious failing is in the banking sector, where the losses of the state-owned banks have not been staunched and now amount to as much as 10% of GDP (Burke).

k. Role of Donors

Donors tend to be slow to swing into action when war ends, presumably because they want to be sure that the conflict has indeed ended. This hesitation can be dangerous because of the tenuous hold which post-war governments typically have on power. When donors do begin to intervene on a large scale they often find that hard information about the country's needs is lacking. So initially there is no real alternative to throwing money at almost any activity, at what one observer called "things you wouldn't need to projectize." In Cambodia, where most donors (belatedly) began to spend in 1993, money was spent on railroad cars, the floating port of Phnom Penh, school buildings, drugs and medical equipment, and electric generators.

At the early stage most economies also need budgetary support. This makes it possible to avoid monetizing the budget deficit, and so helps bring inflation down quickly and relatively painlessly; the slowness with which donors moved into Uganda helps explain why inflation there was not reduced sooner.

Beyond budget support, donors tend to look to project aid. It is sometimes argued that the serious job of project appraisal and evaluation which the World Bank requires is a waste of time, because countries will ask the World Bank to fund only the most obviously attractive projects, in effect freeing up resources for potentially bad projects elsewhere. However the true value of undertaking rigorous project appraisals is that it helps decisionmakers articulate their priorities, and it typically leads to improvements in the detailed design of the projects under consideration.

Donors are also needed to provide training, on as large a scale as possible. This rubric includes the training of the new police force in Nicaragua; the need for technical training in such areas as tax administration and analysis, bank regulation techniques, designing customs systems, legal drafting methods, approaches to privatization, and so on.

In principle the aid which donors give will be more effective if the efforts of donors are coordinated; at a minimum the idea should be to share information on each others projects and plans, and to avoid activities that might work at cross purposes. But coordination also absorbs time and effort, which is often scarce. A more promising approach is to develop the government's capacity to work with, and coordinate, aid donors at an early stage, so that the process becomes more genuinely collaborative.

Box 3: Is Uganda A Success Story?

Uganda is frequently touted as a successful case of post-war reconstruction. This is largely true, although per capita GDP is still 20% below its pre-war peak in 1970. However it is helpful to have a brief overview of the strife in Uganda, and how it has achieved steady and strong economic growth since the end of the war.

The recent conflict in Uganda is usually dated from January 25, 1971 when Idi Amin seized power. He expelled the Asians - the main business group - in September 1972. An incursion into Tanzania in 1978 was repulsed, and Tanzanian troops entered Uganda in April 1979, eventually paving the way for Milton Obote's return to the Presidency in December 1980. The Obote regime came under increasing pressure, particularly from guerillas led by former minister Yoweri Museveni, and Obote fled in July 1985.

After six months of uncertainty, Musoveni took power in January 1986. He has served as President since, easily winning the Presidential election held in 1996. Low level conflict continues in the north of the country, where the Lord's Resistance Army opposes the government. Estimates of casualties vary widely, but the most widely used figure is that 800,000 Ugandans were killed between 1971 and 1985, including between 100,000 and 500,000 during the Amin regime, and 200,000 in the Luwero triangle during the government's campaign there in 1983-5. By 1984 there were an estimated 290,000 Ugandans in exile and 400,000 displaced within the country.

Under Amin real GDP stagnated; given population growth of 3.3% p.a., GDP/capita fell by 18% between 1970 and 1977. The slow growth reflects a low investment rate, which fell from 14% of GDP in 1970/1 to 6% by 1976/7. Internal security worsened, and many educated Ugandans fled, along with all the Asian population. Government revenue fell from 12% of GDP in 1972 to 6% by 1977, and the government had difficulty borrowing, so public spending on education, health, infrastfucture and even the army fell sharply. When the deficits were monetized, inflation rose, averaging 28% annually between 1971 and 1977. The infant mortality rate did not change, and primary school enrollments appear to have risen.

The insecurity of the Amin period was followed by an even more chaotic two years. Where an index of real wages stood at 100 in 1972, it had fallen to 35 by 1976 and to 6 by 1980. By 1981 tax revenue yielded just 0.9% of GDP. The early years of the Obote regime saw a rebound, as GDP rose by 1984 to its previous peak level (of 1972), inflation fell, revenue mobilization rose, and educational expenditures were increased. The conflict that ended the Obote regime cut economic growth to zero. Over a decade of insecurity had cut GDP/capita by about 40%, although subsistence output per capita (such as foodgrains and tubers) remained essentially stable (Jamal).

Under the Museveni regime growth began again, with GDP rising by an average of 5.6% p.a. between 1986 and 1994, or by 2.0% per capita per year. This still leaves GDP per capita about 20% below its pre-war peak (seen in 1970), as rapid population growth limits the per capita income gains. Despite the growth, the first half dozen years of the new regime saw almost no improvement in school enrollments or in infant mortality rates. Donors were slow to support the Museveni regime, and aid amounted to less than 5% of GDP annually during 1984-1987.

Then inflows rose rapidly, peaking at 25% of GDP by 1992. Revenue mobilization has remained low, going from 9% of GDP in 1984 to 6% in 1986 and up to 10% in 1992/3. Investment rates have risen slowly, from about 10% in 1988 to 15% by 1992. Among the more salient features of the period of recovery are the following:

- Political leadership was consistent, inclusive, and consolidated its authority throughout the country.
- Foreign aid arrived slowly, but is now important and helpful. However Uganda's international debt has risen sharply to 88% of GDP by 1993-94 , and the debt service ratio (29% of export revenue went to debt service in 1993-94) is still high.
- Inflation has fallen, but this did not happen immediately after the war ended.
- Revenue mobilization by the government has remained low, and unduly reliant on export taxes on coffee.
- Demobilization was undertaken successfully after 1992, once the country had been largely pacified, and almost half of all soldiers returned to civilian life. When conflict flared up again in the north, military spending was increased again in the mid 1990s.
- There has been relatively limited success at export promotion, in part because of exchange rate uncertainty which lingered until the early 1990s.
- Investment has risen to about 15% of GDP, but domestic savings remains low at less than 5% of GDP.
- Social indicators, such as school enrollment rates and infant mortality rates have improved very slowly.
- Population growth remains rapid, with a fertility rate of close to 7.

In short, Uganda is still recovering, and will not reach pre-war levels of per capita GDP for several years yet, despite being one of the ten fastest-growing less-developed countries in the 1990s.

Sources: Various, including Europa Yearbook; Economist Intelligence Unit; World Bank; IMF.

VIII. CASE STUDY: DEMOCRATIC REPUBLIC OF THE CONGO

"Effective control of the economy has escaped the government since 1991."

Recent observer of Zaire/Congo

The Democratic Republic of the Congo (DRCongo), formerly Zaire, has emerged from a period of civil strife. One of the major challenges for the new regime is how to re-ignite economic growth as quickly as possible. In this section we apply our framework for thinking about war-torn economies to the current situation in the DRCongo; further details are given in a longer companion paper (Haughton 1997).

DRCongo barely qualifies as a war-torn economy. Since civil strife escalated in 1990, about 40,000 Congolese have fled the country, 400,000 have been internally displaced, and perhaps 10,000 have died. These figures do not include the roughly half a million refugees from neighboring countries (Angola, Burundi, Sudan, Angola) who currently reside in the country, or the thousands (as many as 200,000 by some estimates) of Rwandans who have been killed there over the past year. It is nonetheless true that DRCongo shares many of the traits of the prototypical war-torn economy.

Recent History

After independence from Belgium in 1960, the Congo experienced a period of serious turmoil, most notably the attempted succession of Katanga (now Shaba province). General Mobutu, then head of the army, seized power in November 1965 in a bloodless coup, with US backing. This ushered in a period of stability and, for several years, economic growth of 4-5% annually. Mobutu, the sole candidate, was elected President for 7-year terms in 1970, 1977 and 1984, and continued to rule after his mandate expired at the end of 1991.

In November 1971 he announced, in the *Manifeste de la Nsélé*, a program of *authenticité.* This included changing the name of the country to Zaire, an emphasis on large industrial projects, and the Zairianization of foreign companies. Most of the large projects failed; for instance the 250,000 ton/year SOSIDER steel mill no longer produces anything. About 2,000 foreign-owned companies were seized in November 1973, allocated to Zairians (including the President), and later nationalized; when the bulk of the companies began to fail, most were retroceded to the original owners after November 1975. Over time the government appears to have become increasingly corrupt, referred to variously as a kleptocracy (Korner in Tshishimbi. p.98) and patrimonialist (Willame in Tshishimbi, p.98).

In late 1989 and early 1990 opposition demonstrations in Kinshasa were violently suppressed. In April 1990 President Mobutu announced that a multi-party political system would be allowed, and that this would mark the beginning of the third republic. This ushered in a period of “non-consensual transition” as the ability of the government to run the country rapidly diminished and the economy collapsed.

Among the more important events was a riot on the university campus in Lubumbashi in May 1990 which turned deadly. When the government refused to investigate the incident, Belgium (easily the largest aid donor) froze its aid. A constitutional conference (the “National Conference”) was convened in August 1991, with 2,850 delegates including representatives from over 200 political parties. The opposition parties formed a loose umbrella organization, the *Union Sacrée*, but tension rose between them and the Mobutu regime.

In late September 1991 soldiers went on the rampage in Kinshasa, and then in other cities, ostensibly because they had not been paid their salaries and had not received salary increases. They were joined by civilian mobs. An estimated 1,400 enterprises were hit, and the damage has been estimated at about $700m (EIU, p.4). The government responded by promptly paying the soldiers, and hiring more civil servants, in an attempt to buy peace. When it also suspended the National Conference in January 1992, the ensuing riots left 12 dead. The European Community suspended most if its aid. The National Conference reconvened in April, declared itself sovereign, and elected Etienne Tshisekedi Prime Minister in August. On December 3 it installed the 453-member *Haut Conseil de la République* (HCR), which was suspended by President Mobutu on December 11. The constitutional confusion lasted for about a year, when the President and the HCR agreed in October 1993 to create *the Haut Conseil de la République-Parlement de la Transition* (HCR-PT) which convened in January 1994, and in April 1994 agreed on a 15-month transitional period, to be followed by a constitutional referendum and elections. An electoral law was adopted in May 1995 and elections were announced for May 1997 but were not held. Between 1990 and 1997 there were 13 changes of Prime Minister.

The political confusion in Kinshasa was accompanied by growing civil disorder elsewhere in Zaire. Unpaid soldiers rioted and looted in Kisangani, Goma and Kolwesi in December 1992. Serious riots in Kinshasa in January 1993 left at least 65 dead, as soldiers refused to accept payment in the form of the 5 million Zaire notes which had been issued the previous month. Ethnic violence in North Kivu province broke out in March, between the Hunde and Nyanga on the one hand and the Tutsi and Hutu on the other; by August an estimated 6,000 people had died and 150,000 were displaced. Starting in October 1992 there was ethnic tension in Shaba province, and by late 1993 about 100,000 Luba had been packed onto trains and sent back to Kasai province; many died en route.

The strife in Rwanda spilled over into Zaire after April 1994, as Hutu refugees streamed across the border, fleeing the new Tutsi-dominated regime in Kigali. Camps were established for the Rwandan Hutus in the Goma area from August onwards. Many of the refugees were former Rwandan soldiers, some of whom had participated in the earlier genocide against the Tutsis; there is evidence that they received some training from the Zairian army, with

French support. By August 1995 the welcome accorded to the refugees had worn thin, and the government initiated the forcible repatriation of Rwandan refugees; 15,000 were deported in the course of a few days.

The spark that ignited the civil war that ended the Mobutu era was the decision by Zairian troops and Rwandan Hutu militia (the Interahamwe) to expel the Tutsis of North Kivu (the Banyamulenge). The latter group, about 100,000 strong, had lived in the area for about two centuries. They joined with Laurent Kabila - a long-term opponent of the Mobutu regime - and drew support from seasoned (Tutsi) soldiers from Rwanda and Uganda. The Alliance of Democracy for the Liberation of Congo (ADLC) began to move in September 1996. They first pushed the ineffective Zairian army out of eastern Zaire; after they forced the Interahamwe out of the Muganga refugee camp, half a million Hutus walked home to Rwanda during November 15-19. They met little resistance as they took the main cities in Kasai and Shaba. This permitted them to sign lucrative contracts with foreign mining concerns, which in turn helped finance the final phase of the rebellion. In May 1997 they entered Kinshasa, and President Mobutu fled on May 16.

The Alliance is a coalition whose strongest glue is disaffection with the previous regime. Thus one weak government was replaced by another one which is only slightly stronger. To hold the coalition together will be a challenge, and its durability may rest on its ability to generate economic improvement rapidly. Many of its military leaders are anglophone Tutsis from Uganda and Rwanda, who are unpopular in the country. They have continued to hound the remaining Rwandan Hutu refugees, in the hope of destroying the Interahamwe. The resulting atrocities have rapidly eroded the goodwill of donors towards the new regime.

The economic orientation of the new government remains somewhat opaque. Laurent Kabila favors a “social market” economy. The contracts signed with foreign mining companies indicate a recognition of the realities of the marketplace, but the privatization of Gécamines (the main mining company) and MIBA (the large diamond concern) is not being considered (Reuters, June 4, 1997). The government is planning to introduce a Congolese Franc (at CF2.5/$) and hopes to apply to join the Southern Africa Development Community (SADC).

DRCongo as a War-Torn Economy

The recent economic history of DRCongo closely mirrors that of many war-torn economies. For Instance GDP per capita has certainly fallen, but this is part of a long process of economic decline. According to the IMF, GDP/capita fell by 3.4% p.a. between 1965 and 1994, leaving the average resident 63% poorer in 1994 than in 1965. By 1994 per capita income stood at about $125, making Zaire one of the poorest half dozen countries in the world.

The spectacular fall in measured GDP has occurred since 1990, with GDP per capita falling 9.5% p.a. between 1990 and 1994. The fall of GDP in the 1990s is partly the consequence of civil strife (“near war”) and partly the result of years of poor economic management. For instance, investment fell from 13% of GDP in 1990 to less than 3% in 1994 and 1995, in line with a parallel fall in domestic savings. Spending on construction fell by three quarters over the same period. The riots of 1991 and 1993 reduced the productive capacity of the manufacturing sector, whose output was halved between 1989 and 1992. Output of the mining sector fell from 12% of GDP in 1987 to 4% in 1994, with the collapse of Gécamines. Spending on public administration fell by two thirds between 1991 and 1994, as the government lost the ability to raise taxes and even to create seigniorage.

For such a poor country, DRCongo is surprisingly urbanized, with about 40% of the population living in towns and cities (up from 26% in 1966). This is not a result of war or conflict, but rather of the deteriorating state of the infrastructure, which has continued to isolate agricultural areas and made agricultural activity increasingly unprofitable. The country has come to rely increasingly on food imports, which reached over 400,000 tonnes by 1990 and then fell, making the food situation more precarious.

DRCongo does not currently face any external threats; indeed it has strong support from the governments of Angola, Rwanda and Uganda. In most areas there is more security than anytime over the past five years. This does not mean all is calm. When the Alliance arrived in Kinshasa, many official buildings were looted, including the National Museum. Revenge killings against Rwandan Hutu refugees have been widely documented, and continue despite strong condemnation from the international community. The Kabila government is either unwilling, or unable, to stop these atrocities. The old army is in disarray, and it is not how large the armed forces of the Alliance are, made up of a hastily-assembled mix of Tutsi militia, officers from Rwanda and Uganda, ex-soldiers, and Mobutu opponents of various stripes.

In war-torn economies, the infrastructure is typically in very poor state, damaged both by war and by a period of neglect. In the case of DRCongo the problem is one of neglect, dating back to independence in 1960. In 1987 Zaire had an estimated 145,000 km of roads, of which 2,400 km were paved. Officially the *Office des Routes* at that time was able to maintain about a quarter of the network, although one estimate suggests that only 12,000 km were truly usable (Leslie, p.103); this would amount to 1 km of usable road for every 3,000 people. There is no all-weather road connecting the eastern and western parts of the country, and the main road running north-south in the heavily populated eastern Kivu is not usable in the rainy season. The once-important *Voie Nationale* has almost collapsed and Gécamines is obliged to export most of its output via Tanzania and South Africa, both expensive routes.

The poor state of the transport network has been a major reason for the poor performance of the agricultural sector, which has difficulty getting output to markets (at home and abroad) cheaply and reliably. There is some evidence that farmers are not very responsive to increases in the price of crops, and this has been attributed to the high costs of transport.

War-torn economies typically experience high rates of inflation, overvalued exchange rates, a shrunken and fragile banking system, and weak central bank. Zaire fits this picture exactly, although the seeds were planted before the serious civil disorder of the 1990s.

Between October 1990 and December 1995, consumer prices in Zaire rose a total of 6.3 billion percent. This may be the longest hyperinflation in history (IMF p.32). There is no mystery about the immediate cause: too much money was printed. New money issue represented a remarkable 9% of GDP annually between 1990 and 1994 (IMF, p.10). With the rise in prices, the government tried to issue higher-denomination bank notes. The new 5 million zaire notes issued on December 1, 1992 were demonetized by the Prime Minister the next day; soldiers refused to accept them as salary payment in January 1993 and rampaged though Kinshasa. The new zaire was issued on October 22, 1993, at the rate of one for every 3 million (old) zaire, and was initially fixed at 3nz/$. The new notes were not accepted by residents of Kasai province, who continue to use only the old notes; inflation in the province is said to be negligible. As inflation accelerates, people move their assets into other forms. By 1993 "barter and dollar transactions became popular alternatives" (EIU p.34) and there is now "widespread use of foreign currency notes" (IMF p.32). There is also a switch to cash, so the proportion of M2 (broad money) held in the form of currency rose from 54% in 1990 to 88% by the end of September 1995.

The interesting question is of course why so much new money was printed. The straightforward answer is that the government was spending far more than it raised in tax and other revenue, and arranged for new money to be printed to pay its bills. From 1965 to 1974 the government never had a budget deficit. Ambitious spending plans led to rising deficits, which reached 10.5% of GDP by 1982. Under a structural adjustment program designed by the World Bank and IMF, Zaire reduced its budget deficit to 3.6% of GDP by 1984, and was touted as the IMF's "model pupil." In the late 1980s the deficit widened somewhat, but jumped to a spectacular and completely unsustainable 23.5% of GDP by 1993.

The budgetary collapse began in 1990. After the riots at the university in Lubumbashi Belgium suspended its aid to Zaire. The Kamoto copper mine caved in, and copper shipments fell by about 10,000 tonnes per month (a reduction of about a quarter). Together these significantly reduced government revenue. Unable to borrow, and unwilling to cut expenditures, the government turned to monetary financing, sparking an acceleration in inflation. The serious riots of September 1991 prompted the government to try to buy peace, by raising wage rates, paying soldiers and hiring an extra 50,000 civil servants. Again, the only way to do this was by printing money. Even this did not suffice. Unpaid soldiers rioted again in January 1993, and again the government tried to buy peace. But this became increasingly difficult, as the tax base continued to shrink, and the ability to gain seigniorage from printing more money was halved.

The contraction of the tax base was partly due to the collapse of Gécamines. The company's Kolwezi office was burned down in September 1991, the Likasi foundry destroyed in October, and most of the company's expatriate workers evacuated from the country by French and Belgian paratroopers. As a consequence Gécamines, which had provided a quarter of government revenue in the 1980s, made no contribution to the treasury from 1992 onwards, as its output shrunk to less than 10% of its pre-crisis level. The sharp fall in donor aid contributed to the economic shrinkage, and indirectly to the fall in tax revenues: where donors had provided $991.6m in 1991, this fell to $288.3m in 1992 and to negligible amounts thereafter. IDA lending was suspended in 1993 and the IMF and World Bank ceased all further activities in 1994. Government revenue, which averaged 11% of GDP from 1986-89, fell to 5% of GDP from 1990-94 and barely 2% of GDP by the end of 1994; in real terms, government revenue fell by 84% between 1989 and 1994 (IMF? p.10). Real government spending eventually had to fall; spending on public administration plunged from 7.2% of GDP in 1992 to an estimated 1.3% in 1995 (IMF).

Changes in the exchange rate did not keep up with domestic inflation, so that in recent years there has typically been a gap between the official and parallel exchange rates, even after the exchange rate reforms of August 1991. Hardest hit by this gap have been the two main state-owned exporters, Gécamines (copper, cobalt) and MIBA (diamonds), which were typically required to surrender a significant proportion (typically half or more) of their export earnings to the Bank of Zaire at the official exchange rate. The beneficiaries were those favored companies that received foreign exchange allocations at the official exchange rate.

Not surprisingly, the government has been unable to service its foreign debt. The country's Paris Club (bilateral, official) debt was rescheduled 10 times between 1976 and 1989, and its London Club (commercial) debt rescheduled 6 times between 1980 and 1989. When the country did not service its IMF borrowings, the IMF declared it ineligible for funds in 1991, and suspended its voting rights in 1994. The World Bank withdrew its resident mission in 1994.

As in most situations of high inflation, trust in the banking system erodes rapidly. There are said to be only 8,000 bank accounts nationally (Wrong 1997). The Bank of Zaire employs 3,000, compared to 2,000 in all the private banks (Wrong). Since 1990 the banks, including the development bank nurtured by the World Bank in the 1980s (SOFIDE), have played essentially no role in mobilizing deposits or extending credit to productive sectors of the economy outside of international trade.

The experience of war-torn economies shows that the key social indicators worsen during wartime, as life expectancy falls, infant mortality rates rise, medical services weaken, and school enrollment rates decrease. Food entitlements fall for most people, and malnutrition becomes more widespread. Most of these features apply to Zaire, but here too the main effect of the heightened civil strife since 1990 has been to accelerate the pre-existing downward trends.

School enrollment rates show a clear picture of decline. Where government devoted 15.1% of its spending to education in 1972, this proportion had fallen to 1.4% by 1990. The country's 200,000 teachers have received essentially no pay from the state in recent years, and schools have been obliged to charge tuition fees. The influence of the Roman Catholic church on education is strong, and as of the 1980s they ran 80% of primary and 60% of secondary schools. The relatively low illiteracy rate (if it is to be believed) is a legacy of the relatively high enrollment rates of the 1960s and 1970s.

Government spending on health, which took just 2.4% of its spending in 1972, fell to 0.7% by 1990. By 1992 only 23% of children had been immunized. An estimated 2 million citizens are HIV positive, or about 5% of the population. Polio and bubonic plague still occur, and there was a highly-publicized outbreak of the Ebola virus in Kikwit in 1995.

In war-time many institutions which are required for the proper functioning of the economy are seriously weakened. Civil disorder in DRCongo has certainly undermined many of the most important institutions in the country, but it must be recognized that most of these institutions were already very fragile. Even before the unrest began in 1990 this was obvious enough, with one observer noting that "the [World] Bank considers institution-building the most important objective of its operations in Zaire" (Leslie, p.91).

Many of these weaknesses have been noted above. They include:

- a tax system that collected just 2% of GDP for the government in 1994;
- no agricultural extension;
- a bloated civil service, swollen by hirings in 1992 but poorly paid and equipped;
- educational and health systems which have been de facto entirely privatized because they have been starved of public funds;
- markets, particularly for agricultural goods, which have been stunted by the poor state of the transport infrastructure;
- a banking system which does not mobilize deposits or extend loans;
- a central bank which has no independence of the government and is overstaffed;
- a tradition of pervasive corruption, at all levels;
- an army and police force which is poorly trained and poorly paid; and
- a very weak statistical service.

Despite the dismal economic record, the DRCongo does have some important assets. There is a new government, which recognizes the need to re-ignite economic growth. There is no external threat. Donor interest is high, although there is caution pending an improvement in the human rights record of the Kabila government. There is a vigorous and dynamic informal economy (De Herdt and Marysse, 1996), a moderately well-educated population, and considerable immediate potential for greater production in agriculture and natural resource extraction (minerals, timber).

From Economic Crisis to Sustainable Growth

What does DRCongo need to do to pick up the pieces and get onto a path of sustainable growth? Here are some of the suggestions for serious consideration which arise from the framework outlined above in section 7.

Population Movement. DRCongo is in the odd position of being a war-torn economy which harbors refugees, rather than having created an refugee outflow. As many as 250,000 Rwandan Hutu refugees remain in DRCongo, and many of them are fearful for their lives. There have been many documented cases of revenge killings and other atrocities by the Alliance forces against these refugees. The motive behind these killings is presumably to break the back of the Interahamwe (Rwandan Hutu militia) so that it will no longer pose a threat to Tutsis, or the Tutsi-dominated regime, in Rwanda.

The international community is trying to locate and repatriate the “lost” refugees, and wants to find the truth behind the massacres of Rwandan Hutu refugees. Until the problem is substantially resolved, the Kabila administration cannot count on substantial inflows of foreign aid. This, in addition to the humanitarian imperative, makes resolving the refugee problem the first priority for the new government.

Security. The extent to which demobilization is needed is not yet clear. It is likely that many of the old army and gendarmerie have simply left their jobs, and little reliable information is available about the size and nature of the Alliance forces. What is essential is that the remaining army and police constitute a disciplined and professional force. In part this requires training, and the United States has already offered aid for this. It is also necessary that the army be properly paid, in order to avoid the type of rampages by unpaid soldiers that the country has witnessed since 1990. This in turn calls for more budgetary resources for the armed forces and police than have conventionally been made available for this purpose . In DRCongo there is no peace dividend in the budget, because the country has historically spent too little on maintaining security.

Infrastructure. After most civil wars, it is necessary to open and secure the main roads, ports and railroads. In DRCongo these are now open and relatively secure. There is a real need to invest heavily in improving the transportation infrastructure. There are undoubtedly plenty of small and useful projects which could be initiated and financed by donors very quickly, but major projects will need to be properly appraised. A priority should be the development of local capacity to appraise and manage large projects.   Different donors will be interested in different projects, and there will be a need to ensure that donor efforts are channeled into a coherent set of infrastructural investments.

Macroeconomics (Prices). The most urgent macroeconomic task is to end the high inflation, bringing it down to no more than perhaps 20% per year. Hyperinflation can be ended with the “stroke of a pen” by restraining the creation of money and credit. This in turn requires measures to take away the need to print more money. It also requires an institutional framework which will resist printing too much money in the future.

One approach would be to set up a currency board arrangement, as done for example by Argentina and Estonia. The board would need to be insulated from political pressures, so that it would never issue bank notes which are not fully backed by foreign exchange, and would not change the exchange rate. The strength of the currency board is its predictability; the main weakness is its inflexibility.

A second possible solution would be for DRCongo to join the Central African Currency Area. The country would then used the CFA franc, along with (among others) Gabon, Cameroon, Congo (Brazzaville), the Central

African Republic. The CFA franc is linked to the French franc and managed by a single central bank to which member countries send delegates. The downside of this solution is that DRCongo's exports are mainly denominated in dollars, and so the franc (or perhaps, in the near future, the euro) may not be the best currency to which to peg.

The third solution would be to continue with a modified version of the current system. The main modification that would be needed is a strengthened Central Bank, which would be required (constitutionally or otherwise) to limit currency issue in order to keep inflation low. A new currency is not needed for this - the low inflation rate in Kasai province, where the old zaire is still used, proves this. The introduction of new currency does not guarantee monetary stability; the especially rapid hyperinflation that followed the introduction of the new zaire in October 1993 is clear testament to this. The biggest problem with a modified version of the current system is that it is likely to lack credibility. When the government badly needs money it is surely going to pressure the Central Bank to print money. The extreme weakness of the tax base makes this highly likely in the not-too-distant future.

By the standards of other war-torn economies, Zaire had a relatively liberal exchange rate regime. Nonetheless the official exchange rate was consistently overvalued. Whatever the monetary regime chosen, the exchange rate should be unified (i.e. the same for all buyers or sellers of foreign exchange) and convertible. Market restrictions, such as the requirement that Gécamines deposit 55% of its export earnings at the Bank of Zaire, should be removed.

In due course the Central Bank (or an equivalent agency) will need to develop banking rules and a capacity to oversee the private banks. This is not an immediate priority because the banking sector is expected to play a marginal role in lending over the next few years.

Fiscal System. It is imperative to gain enough control over the budget so that the government does not have recourse to monetary financing, and for this a system of cash budgeting should be instituted immediately. Government spending is currently too small relative to GDP - teachers are unpaid, soldiers are barely paid, roads not maintained, and public health largely ignored. The conclusion is inescapable: the government needs substantial amounts of revenue, and quickly. If it cannot pay its bills more successfully than the old regime then it will not survive for long. Donors could help greatly here - by immediately injecting funds into the budget. If donors wish to earmark their contributions (for their own political reasons) this is not a serious hurdle, since funds are largely fungible. If government current spending is to return to 14% of GDP (the 1986-89 average) from the current level of perhaps 4% of GDP, then it needs to rise by 10% of GDP. If donors were to provide half of this amount they would need to give about $300m annually - a large but not exorbitant amount for a country of 40 million people (the second most populous in Africa). As recently as 1991, donors were providing about $900m in aid (including loans) to Zaire.

It is equally urgent to raise revenue domestically, including reconstituting the tax base. This has not proved easy elsewhere. The most promising source of tax revenue is excises, on petroleum products, alcohol and tobacco. A tax of $1 per gallon on motor fuel would yield about $300m annually, or the equivalent of about 5% of GDP. This should be a straightforward tax to collect, and could be made more palatable by earmarking a fraction of the proceeds for improving and maintaining the road network (and, of course, actually improving the roads as a result). A flat rate of import duty, at a rate of about 15% (as in Bolivia), would help to reduce cheating and would raise revenue from this source. A simpler sales tax, targeted mainly at consumer items (cars, air conditioners, televisions, etc.), would also be useful. These changes could be implemented very quickly.

Over the past several years Zaire has made almost no contribution towards servicing its foreign debt. Although as a practical matter the new regime will not be expected to resume debt service immediately, it is possible that lenders will have to write off most of the current debt. At a minimum creditors should provide a grace period of five years, as was done in the case of Indonesia in 1966. It is simply not realistic for a country with exports of about $1.5bn annually to service an international debt of $14bn.

Economic Structure. Unlike most war-torn economies, the agricultural sector in DRCongo is not in immediate distress. Nor, apart from some refugees from Rwanda, is much of the population dependent on food aid. The sector is however suffering from three decades of neglect and an inadequate transport infrastructure, which cannot be rectified quickly. Perhaps the best that can be done in the short-run is to ensure that the roads are safe (from predatory soldiers as well as bandits) and that exporters are not harassed at the borders.

The DRCongo, like all the countries of Africa, needs more foreign investment. There has been no recorded foreign direct investment in the country since at least 1989. In the short term, foreign firms may be attracted by the country's natural resources; if these firms succeed, investments in other sectors (tourism, distribution, manufacturing) may follow. Realistic expectations are important, because most investors will steer clear of DRCongo until they are convinced that the country is politically stable and economically welcoming. An early step towards attracting foreign investment is the promulgation, within the next year or two, of a clear and straightforward foreign investment law.

Social Infrastructure. Again in contrast with most war-torn economies, DRCongo does not face an immediate public health crisis, such as the need to maintain adequate sanitation in large refugee camps. Nor is there a significant population of war-related widows and orphans requiring care and attention. On the other hand government spending on health care is effectively zero, and spending on education is not much higher. Both sectors need to be rehabilitated. Among the priorities are likely to be greater immunization of children, and salary payments to teachers with a view to at least restoring primary school enrollments to their near-universal level of the early 1970s.

Property Rights. In many war-torn economies there are pervasive conflicts about property rights - to land, to housing, and to businesses. These problems are far less severe in DRCongo, although there are likely to be disagreements about the ownership of assets such as the houses of the elite of the old regime, and the foreign assets of ex-President Mobutu. Most of the state-owned enterprises are very small and many barely function; these could be sold off relatively quickly. The privatization of the larger state-owned enterprises would free them to operate by commercial criteria, and would reduce the ability of a small group of well-placed leaders to bleed them dry.

The more pressing problem in DRCongo is to reconstruct viable institutions, such as the Central Bank, the tax collection system, and the statistical services; and to professionalize the police so that they do not erode the property of individuals and companies by requiring bribes and other payments.

Role of Donors. The DRCongo will not be able to make the transition from war-torn economy to sustainable growth without very substantial donor support. Provided the government can improve its human rights record, there is substantial goodwill towards the Kabila regime, and a recognition that the country needs help. The biggest question is where to start.

First, donors should provide substantial budgetary support. At first it needs to be largely unconditional, and to be disbursed rapidly. Soldiers and teachers need to be paid, without printing money to do this, and the tax system is simply not up to the task of providing enough revenue yet.

Second, donors should spend, quickly, on small projects throughout the country - school rehabilitation, road repair, the stocking of primary health care clinics, immunization drives. Almost anything will do, provided it has a visible effect on improving people's lives. This will help consolidate support for the new regime, and help establish its economic competence.

Third, the major donors should choose a lead organization (e.g. the World Bank) to put together a short-term action plan for economic rehabilitation, with donors committing to execute parts of the plan in a reasonably coordinated way. This was done very successfully by the World Bank in Cambodia. A committee of the major donors should meet regularly with their counterparts in government to help speed the implementation of the early efforts. Government coordination of donor efforts can be institutionalized in due course.

Donors should also move quickly with technical training. Here is a sampler of suggestions: support for project appraisal and management, for a small group involved in working with donors (who will inevitably be involved in all major projects); short-term experts in the Central Bank (or currency board) to help master the inflation problem; training and resident experts in the Ministry of Finance, to strengthen tax collection and (in due course) expenditure control and audit; technical and other support for those parts of Gécamines that could pay off rapidly in terms of higher output. It would also be valuable to bring key policy makers and administrators on short visits to successful countries, such as Taiwan, perhaps Vietnam, Mauritius, and Ghana, to get a clear sense both of what is possible on the economic front, and the sorts of policies needed to get there.

In conclusion

For the thirty years following independence in 1960 Congo/Zaire was badly led and its economy mismanaged. The slow economic decline so weakened the country that the government lost control of economic policy after 1990, and the economy shrunk by 40% over the next five years, pushing per capita income levels well below those prevailing at the time of independence. In this weakened state it is not surprising that the Mobutu regime easily succumbed to the rebels led by Laurent Kabila, after a short and (refugee massacres aside) relatively bloodless civil war.

The problems of reconstructing the economy of Zaire are only partly those of reconstructing a war-torn economy, although the lessons from the reconstruction of other war-torn economies remain useful. More fundamentally they are the problems, common to many African countries, of arresting a long period of decline. A turnaround is possible. For ten years after the unification of Vietnam in 1975, real incomes fell. After 1986 the government rapidly liberalized the economy, got inflation under control, improved the tax system, and attracted foreign investment; the reward was a doubling of GDP since then. And the GDP of Uganda has growth by 5.6% p.a. in the 1990s.

At least on the economic front, the way forward for DRCongo is clear. The budget needs to be mastered, so the government no longer had recourse to monetary financing and therefore inflation will fall. In the short run donors will need to provide budgetary resources, but then the tax system must be reconstructed. Once macroeconomic stability has been restored, infrastructure and institutions need to be rehabilitated - roads, rail and rivers, health services and school.

What is far less clear is whether the new political regime will be robust enough to introduce the changes which are needed to re-ignite economic growth. The international community must take the gamble: if it does not support the new regime then the regime will surely fail, yet there is no guarantee that support for the regime will achieve wonders.

IX. RESEARCH PROGRAM

As noted at the start, there has been relatively little research on how countries cope with post-war recovery, and what could be done to speed up the recovery process. One consequence is that there are many serious gaps in our knowledge. Many of the assertions and recommendations made in this report rest on fragile foundations, even when they are articulated with conviction.

What then still needs to be researched, and how? Probably the most fruitful direction would be to undertake cross-country research on particular topics. Here are some of the issues which could usefully be addressed, for a moderate cost, in this way,

a. Are disbursements fast and flexible enough?

Most donors are unable to disburse funds very quickly, although speed may be of the essence in trying to support a nascent peace process. It would be helpful to compile a list of the procedures followed by the major donors, assess the speed and flexibility with which they respond to funding needs in post-war economies, and suggest improvements. A special funding facility has been suggested, perhaps located within the World Bank family, and the pros and cons of such an arrangement need to be set out.

b. How does one measure success in recovering from war?

In order to compare how well different countries recover from conflict, one needs to have a yardstick against which to measure success. We have suggested four criteria (see page 4 above), but these conditions are arbitrary. Moreover information on economic and social indicators is difficult to get, particularly during the conflict itself. It would be very valuable to set out a list of the types of information which are typically available, or could be made available easily and cheaply, and to use these to help develop measures of success.

c. What institutional capacity needs to be built urgently?

We have argued that post-war economies need to move quickly to develop the ability to appraise and oversee projects, to coordinate donor efforts, to draft and implement investment-friendly laws, to put in place a system of prudential bank regulation, and to collect statistics. This list needs to be made more specific, and the experience of different countries compared in an effort to evaluate whether these are indeed important priorities and if so, how best to achieve them rapidly.

d. How can property rights be defined and secured?

In many, but not all, post-war societies there are significant disputes about property rights, although the nature of the questions differs widely from country to country. In El Salvador the problem was how to make good on the commitments to land reform enshrined in the peace accords. In Nicaragua the difficulty was satisfying the claims of those, mostly émigrés, whose property had been expropriated during the war, and of the contras who had fought against the government. In Uganda the challenge was one of providing access to land for demobilized soldiers. In Cambodia there was a need to define property rights more clearly. Despite these differences, it is widely believed that clear and secure property rights are necessary (if not sufficient) for durable economic growth. Research here needs to look at mechanisms for dealing with property claims, and should evaluate the policies taken by different countries. One question is of particular importance: should donors promote, and finance, substantial land reform, and if so, where and how.

e. How can a country achieve instant fiscal health?

There is no serious disagreement about the need for budget rectitude as one of the central components of healthy macroeconomic policy. But for most war-torn economies this means that revenues will have to rise and/or spending be cut. How can this best be achieved? On the revenue side, is our suggestion that emphasis should be put on excises, and then sales taxes, the right one? And if spending is to be cut, how should this be done - for instance by compressing the real wages of civil servants, or by layoffs? It is likely that donors will need to step into the breach and provide budgetary support, but how substantial should this support be? And at what point does donor support of this nature foster dependency rather than serious efforts to achieve budgetary self-reliance?

f. How can the war-time decline in social indicators be reversed?

The evidence suggests that social indicators - such as life expectancy at birth, nutritional levels, and literacy and school enrollment rates - usually worsen in war-time, bucking the worldwide trend for these indicators to improve, even in less-developed countries where GDP/capita may be falling. The coming of peace will bring some relief, but active efforts are likely to be needed to improve health and educational levels. What initial efforts will be most rewarding?

g. What should be done about the banking sector?

This report has argued that prudential regulations are needed at an early stage, and that state-owned banks need to be restrained from lending for poorly-conceived or even dishonest projects (although we are not sure how best to do this). The problem is more subtle than this; on the one hand one wants to move to a banking system that will mobilize resources and evaluate loans effectively; on the other hand one is often starting with a structure of insolvent and poorly-run banks. Few countries have made the transition to a modern banking system without at least one serious crisis, of which the recent problems in Thailand are but the latest in a distinguished line. The United States has tried to use the banking system in Bosnia as a conduit for loans to small businesses, but this risks creating half a banking system - skilled (perhaps) at lending but not at mobilizing resources. Could one do better, particularly in war-torn countries where rapid institutional change is still possible? This important issue clearly merits more attention.

h. Does dollarization matter?

Put another way, should a newly peaceful country try to push its firms and citizens away from using foreign currencies such as the dollar? We have argued that the presence of a dual currency provides competition to the domestic currency, and helps force the monetary authorities to limit the creation of credit in the local currency in order to keep inflation low and make the local currency attractive to hold. Few governments find this approach attractive, and there is a strong temptation to legislate against the use of foreign currencies. What policy guidance should one give to governments in this case? What have we learned from experience elsewhere?

i. How much donor support is needed, and what form should it take?

This is a wide-ranging question, but obviously an important one too. Can there be too much donor support, to the extent that a country (Mozambique, for instance?) becomes too heavily dependent on this aid and so has too strong an incentive to seek additional aid instead of using its resources in more productive ways? Conversely, is there a threshold, below which aid is insufficient to promote peace? And if there is such a threshold, how can it be calculated? Clearly the answers are highly country specific. It may have been necessary to spend $2 billion in Cambodia to establish a more or less viable political structure and to re-start economic growth; yet neighboring Vietnam's recent growth spurt began when Soviet aid shriveled at the end of the 1980s, and before aid from elsewhere began to flow; the aid drought forced the country to make radical reforms. Substantial and consistent donor support since 1965 has helped further economic growth in post-civil-war Indonesia, but proportionally much larger aid to Tanzania has probably done more harm than good in that it delayed structural reforms. The challenge here is to attempt to predict where aid is likely to help, and where is will probably be wasted.

As important as the amount of aid is the form which aid takes. For example, when should food aid be ended and other forms of aid take its place? How much weight should be put on debt forgiveness, on budgetary support, on training?

j. How quickly do markets recover, and could this recovery be speeded up?

Some writers (e.g. Kyle) believe that markets recover slowly after the war ends; perhaps there is still too much uncertainty, or too little cash to invest, or the necessary skills are no longer available. It is sometimes concluded that government would therefore do well to step in to fill the void, although this is almost certain to deter further market development, and assumes that governments have the capacity to act successfully as traders. A different conclusion would be that governments, or perhaps aid donors, might have a role to play in encouraging the resurrection of markets. The research questions here are whether there are interventions which would help restore markets more quickly, and if so, to which markets should these efforts be applied?

k. What conditions should donors apply to aid?

We have argued that the initial aid that donors provide should not carry conditions, because that would be both unrealistic and unnecessary. Over time it is reasonable for donors to expect recipient countries to meet certain conditions, such as budgetary restraint, provided these conditions are small in number, reasonable, and credible (i.e. if the government does not meet the conditions, aid will be reduced). The case for conditions rests partly on the need for donors to justify their efforts to their own citizens, and partly because there is a moral hazard problem - the recipients may change their behavior in undesirable ways (for instance by buying more luxury cars for ministers) precisely because the aid flow enables them to afford it.

Having too many conditions is equivalent to having no conditions, because some of them will inevitably not be met, and donors in such cases will almost as surely not cut back their aid. Hence the research issue: where have conditions worked well, what sort of conditions are needed and which ones are superfluous?

l. Should counterpart funds be required?

Many donors require the recipient country to provide some counterpart funds, to show that the country is serious about wanting the aid in the first place. The problem is that this may significantly slow down the inflow of aid during the initial period of post-war recovery, because this is when the government is likely to have the greatest difficult sparing the required local resources. Printing local currency to cover counterpart funds is not a solution either, since it conflicts with the important goal of maintaining macroeconomic stability (including low inflation).

Hence the questions. Under what conditions should counterpart funding be required? How can one judge whether the requirement of counterpart funding is slowing down the disbursement of aid? What are the implications of doing away with counterpart funding in most cases?

Country Studies

Apart from cross-country comparisons, there is a need for additional case studies of individual countries, with an emphasis on how they have tackled the problems of economic reconstruction. With the 20/20 vision of hindsight, it should be possible to determine both what was done well, and what mistakes were made. As part of this project we have made a modest first step with a study of the DRCongo, and we plan short studies of Uganda, Nicaragua and Cambodia. A volume of focused country case studies of this nature would be a welcome addition to the literature.

X. CONCLUDING THOUGHTS

This paper has proposed a structure for thinking about the reconstruction of war-torn economies, and has made some suggestions about the sequencing of reforms. But the idea is to suggest a framework, not to supply a detailed blueprint. This is because the process of crafting and implementing the policies required for economic recovery calls for imagination, creativity, and strong knowledge of local conditions.

That said, there is room for a series of volumes which would pull together best and worst practice in well-defined policy areas, along the lines suggested in the previous section. The study of demobilization by Coletta et al. is an excellent example of what might be achieved - a compendium which will serve to guide advisors, donors, policy makers and administrators. A set of country studies would also be valuable.

What few themes need to be stressed?

The first is that ***economic institutions need attention*** - from property and legal rights to banking rules, trade policy, and money issue. Along with security and political reform, the development of appropriate economic institutions is necessary for a successful peace, or at least for what Bush (1996) calls "peace nuturing." One immediate reason is that, as the UNDP (p.9) puts it, "relief and rehabilitation operations should be carried out within a macro-economic framework, failing which many activities risk being misplaced or ineffective."

The second theme is ***patience***. It took Western Europe at least a decade to recover economically from the effects of World War II, and there is no evidence that the recovery process has become any faster since then. Nicole Ball believes economic recovery could take a generation; certainly it has rarely taken less.

A third theme is that ***donors should start early***. At a minimum, donors should maintain what the World Bank calls a watching brief - gathering enough knowledge about local conditions that one can plunge in as soon as there is a break in the clouds. Then plunge in with aid and support; at an early stage almost any activity that aid could support will do some good. In Cambodia there was a substantial degree of peace from 1989, but substantial aid flows began only after May 1993, which was almost too late. Early intervention does carry a greater risk of failure, because if conflict flares up again the aid efforts could be entirely undone. But there is also a greater possibility of success, as a modicum of economic success may help ease the path to peace. Kumar (1996, p.6) argues that the international community should have gone into Rwanda earlier. The lesson has not been learned, as donors continue to shy away from the DRCongo; it appears that the need for the truth about the dead is more important than improving the prospects of the living.

The fourth important idea is that one ***typically needs to build local decision-making and administrative capacity as quickly as possible***. For example, through 1991 many World Bank loans to Uganda were undisbursed, because there was inadequate local capacity for project preparation and implementation. Improving administrative capacity is difficult and slow, and is an area to which more thought and attention need to be applied. Or consider the case of Cambodia. Germany provided money for the public investment program, but as usual did not give project support; after a year and a half Germany began to channel the funds through NGOs, because there was such a lack of appropriate local institutions. More generally, aid is much more likely to be effective if the recipients are persuaded of its value, and have a strong say in how it is spent.

When peace breaks out, donors typically rush in to help. Sometimes their efforts work at cross-purposes. For instance, Australia and France squabbled about whether French or English should be used at the University of Phnom Penh. Sometimes donor resources get channeled into activities which are a low priority, such as building hospitals rather than stressing disease prevention, in Cambodia. In principle the solution is some form of donor coordination, - sometimes done by a relatively neutral party like the World Bank, occasionally done by a well-placed bilateral donor. But coordination takes time and leadership, assumes that the coordinators have truth and wisdom on their side, and is not always to the taste of the coordinated. The eventual solution is to develop local capacity to coordinate aid. For example, initial complaints about NGOs in Mozambique, notably in education and health, were solved once the government was able to articulate a program.

Even without formal coordination, it often helps to develop guidelines at an early stage, as was done successfully by the IMF and World Bank in Cambodia. A short document set out the immediate priorities, and helped focus donors on the most important tasks.

A fifth theme is ***keep it simple***. Of course war-torn economies are complex places with subtle social structures. But the essential components of economic reconstruction are straightforward. It is important not to lose focus. When donors attach dozens of conditions to loans or grants, they are losing focus, and when projects become too complex they lose focus and become less effective.

Finally, there is a ***need for donors to be flexible***, far more so than they would be normally. Unfortunately the procedures for approving and disbursing aid monies are often cumbersome and bureaucratic. For instance the board of the World Bank had to be convinced that and economic rehabilitation credit to Cambodia (c. 1993) should have only a few conditions attached; board members pointed to the successful stabilization program as evidence of implementation capacity, without realizing that stabilization is relatively easy and that heavy conditionality would make the loan exceptionally onerous.

This has led some to suggest the establishment of a special office, in the World Bank perhaps, for war-torn economies, which would have the power to provide low-conditionality loans. However we are not convinced that establishing another bureaucracy is either necessary or desirable. A better route would be the creation of more flexible loan instruments - call them Post-war Rehabilitation Credits - which would then be administered within the usual World Bank channels. The World Bank has recently established a post-conflict unit, but its work will mainly consist of providing support and advice to other units within the wider organization.

The world is now seeing a new divide, between countries that have been at peace for a generation, and those that have experienced war. The latter group is large and still growing; where 13 million refugees were receiving aid by the end of 1987, the number had risen to 27 million by April 1996. As long as these wars exist there will be a need to help put war-torn economies back on their feet. We still do not know how to do that very well.

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Appendix 1 People to whom we talked (partial list)

Nicole Ball	Overseas Development Council
Juan Belt	USAID
Bob Burke	USAID
Juan Buttari	USAID
Rocio Castro	World Bank
Guy Darlan	World Bank
Elaine Grigsby	USAID
Stephen Holtzman	World Bank
Richard Kabonero	Embassy of Uganda
Orest Koropecky	USAID
Ms Michaela	Embassy of Mozambique
Christine Wallich	World Bank
Jorge Wong-Valle	Embassy of Nicaragua