ECONOMIC RECOVERY AND PEACEBUILDING[1]

Input Paper

I. Economic Recovery Matters for Successful Peacebuilding

Fragile states have limited resiliency and persistent vulnerability to internal and external shocks, resulting in a marked propensity to relapse into crisis. Walter (2004) calculates that as many as 40 percent of fragile states fall back into crisis within 10 years of a stabilization episode. A large body of research has pointed to failure to develop economically among the root causes of conflict (Collier et al., 2003). Blomberg and Hess (2002) find that links between internal and external violence and prosperity are strong and mutually reinforcing, with recessions increasing the probability of conflict. Low per capita income and slow economic growth are robustly linked to civil war (Blattman and Miguel 2010). While spawning a short-lived rebound of economic activity, the process of reconciliation does not breed permanent growth as micro and macro-insecurity continue at high levels after peace agreements are signed (Collier and Gunning 1995). Short-term peace-dividends appear to be small, and only a fuller recovery of the private sector confidence allows for later accessing a (delayed) peace-dividend (Collier 2005).
Elbadawi and Sambanis (2002) and Elbadawi (2003) show that economic development plays a critical role in reducing the risk of relapsing into conflict and violence. Collier (2009a) suggests that supporting growth in low income countries is the best strategy to reduce conflict risk, diversify the economy, promote long term stability, and ultimately bring peace and prosperity in Africa (Collier 2009a). He goes as far as calling economic development the "true exit strategy" for international peacekeeping (Collier 2009b).

Jobless recovery: A threat to peace and stability
In Liberia, youth unemployment is estimated at 85 percent. President Johnson Sirleaf considers it a threat to peace. WDR2011 researchers found that respondents to a survey indicated that 40 percent of young militia members joined such formations to escape unemployment, while only 13 percent did it for ideological reasons. In Afghanistan, the labor force increases by 400,000 every year, in South Sudan, by 220,000 every year, with little capacity of the economy to ensure a sustainable access to livelihoods to the new entrants. This worrisome trend will be stable until 2025. We will not outgrow the problem. The World Bank Youth Employment Report (2014) indicates that even taking a 5 percent annual growth rate in next 10 years, at best only one in four of Sub-Saharan Africa's youth will find a wage job, and only a small fraction of those jobs will be

[1] Nadia F. Piffaretti (npiffaretti@worldbank.org), Fragility, Conflict and Violence Group, The World Bank – March 2015

[2] Financing gaps are huge. As an example, in DRC, despite an investment by the World Bank of

"formal" jobs in modern enterprises. Most young people will work where their parents do—in family farms and household enterprises. The lack of prospects ('poverty of opportunity') may increase social tensions, foster migration and decrease resilience to shocks.

II. Current Practice

A Sequenced Approach

Current approaches to early economic recovery are anchored on a "sequenced approach" ("three tracks approach") based on the assumptions that i. in the immediate aftermath of crisis, lack of economic opportunities increases the risk of a return of conflict and violence; ii. sustained and shared growth are necessary underpinnings to long-term peaceful and prosperous societies; iii. in the medium term, political and social stability are necessary underpinnings to sustained growth. Accordingly activities supporting early economic recovery cluster around "three tracks" as immediate 'stop gaps', early recovery and longer term economic recovery.

Immediate 'stop gapping'

In the immediate aftermath of crisis and conflict, emergency employment program are targeted to high-risk and high-needs groups, such as displaced persons, combatants, and youth (De Vries and Specker 2009). The location of projects is oftentimes chosen strategically. While these activities fulfill the role of "stopgap" measures, they bear the risk of involuntarily crowding out local initiative, and increase the wage-rate. Short-term interventions have also been questioned for their sustainability.

Wide array of short-term activities aiming at income recovery, without a coherent growth strategy

Short-term measures to encourage early economic recovery span a very broad array of activities (some locally driven, some driven by donors and international agencies), covering multiple sectors, and broadly aiming at recovery of income generation capacity. The presence throughout the economy of multiple layers of (binding) constraints provides the rationale for the relevance of a variety of programs aimed at relieving some of the constraints. However, there are no mechanisms, to ensure overall coherence of sectoral programs, and overall growth strategy for the domestic economy is lacking.

Early development plans are rarely accompanied by a fully-fledged realistic growth strategy, as long-term development is not considered possible until after the political settlement has consolidated and an enabling environment has been created. Too often, governments are encouraged to elaborate – under the guidance of the international community - recovery plans that are overly ambitious in their timeline, not realistic, rely excessively on external funding, under-emphasize domestic-led recovery, and finally lack internal coherence.

The search for economy-wide reforms as "enablers" to growth

Inevitably this leads to an early focus on attempting to initiate economy-wide reforms, such as restoring macro-economic stability, improving state capacity, governance and overall business-climate conditions. Against the backdrop of heavy deficits in both "soft" and "hard" infrastructure in fragile states, early economic revitalization is heavily driven by the action of central governments and international donors, with rare systematic participation of the local private sector. Lack of implementation and financial capacities greatly hamper ability to readily implement economy-wide reforms and investment programs, resulting in lengthy reform processes that may incentivize predatory attitudes. The effectiveness of liberalization programs is hampered by bottlenecks that limit capacity increase. Difficulties are compounded by the dual nature of post-conflict economies, as liberalization can accelerate the demise of sectors that may have lost comparative advantage (due to obsolescence intervened during the conflict years, or due to their strong links to the war-economy), further reducing formal employment in the already fragile context.

Economy-wide policies for improving the overall business climate rarely relieve bottlenecks in the domestic economy, as constraints substantially differ among sectors and subsectors, and business climate reforms typically ignore bottle-necks due to the broken internal linkages among firms of different sectors, while power generation remains lacking in the early years after conflict. Major constraints (instability and political risk, access to electricity and transport, access to finance) are not addressed in the early phase of the recovery. A major funding gap remains in key infrastructure (IEG 2013)[2].

As a result, reforms aiming at creating an enabling environment are hitting against the reality on the ground of lengthy and frustrating processes. At the same time, the lack of transformational investments leaves the private sector unable to initiate vigorous supply responses.

An elusive path to sustained and shared growth

While the "three tracks approach" is a useful organizing framework encompassing different activities (oftentimes carried out by different agencies), it provides little insight on the right sequencing during the critical transition phase, from a vicious cycle, to a virtuous cycle.

In many cases, it proves to be difficult to sustain the economic recovery beyond the initial period of usually brisk economic rebound. While most post-conflict societies experience a post-conflict rebound of economic activities, often supported by early important inflows of aid and goods, countries do not necessarily enter a dynamic of sustained growth. As countries' paths out of conflict and violence differ, there is still limited understanding of which fundamentals such as indigenous state capacity, societal processes and role of the

[2] Financing gaps are huge. As an example, in DRC, despite an investment by the World Bank of USD1 billion dollars in power generation over the 2000-2012 period, domestic access to power is below 10 percent.

private sector better expressed dynamics of past successes and failures in transitions, and how external engagement influences variation of outcomes.

III. Areas for Policy Development

Stronger emphasis on path dependency, and home grown dynamics

In many cases, either by necessity or design, recovery efforts rely more on external partners than on home-grown dynamics. A stronger focus on domestic recovery may shed a different light on the sequencing of the recovery.

Donor-led efforts bring a set of priorities that may disrupt home grown dynamics, determining focus on macro-economic stability, the speed of its attainment, and emphasizing use of donor systems versus country systems. While external intervention has focused on enhancing state capacity, there is a growing body of research that has called attention on the structural weaknesses and strong path dependence in state capacity (Acemoglu and Robinson 2011).

There is an ever-stronger realization that trajectories out of conflict and violence will differ, and that transition from early recovery to sustained development is highly *context-specific and path dependent.*

Framing interventions with earlier growth strategies aimed at domestic markets

In the absence of domestic dynamism, medium term recovery efforts by governments are often strongly focused on rent-based sectors (mining, and export-crops), and aimed at increasing the availability of fiscal resources and hard-currency, with less emphasis on increasing productivity in the agricultural sector, and in building linkages between primary production and light manufacturing. A fuller understanding of the potential for recovery in key domestic subsectors can inform a policy reforms aimed at shared growth.

An important share of fragile states economies present comparative advantage in primary products, and the larger share of natural resources in exports determines a negative effect of structural change on overall productivity growth, unless resources from the mineral sector are put into productive uses, supporting a process of shift of labor and capital from low-productivity to high productivity activities.

Overall, there is scope for expanding the emphasis on investment in infrastructure supporting broader manufacturing and rural development. As a result, growth is rarely happening in labor-intensive sectors, increasing the risk of non-inclusive growth. Job creation is concentrated around the public sector, and not enough to absorb new entrants[3]**.** This points to the need of elaborating early on growth strategies based on revitalization of domestic demand and domestic markets.

On the other hand, the limited consistency between short-term interventions, and longer-term development, could be improved through an earlier focus on increasing access (to markets and to assets). Developing linkages between rural and urban markets could be an

---

[3] As an example, in Iraq, between 2007 and 2012, job creation has progressed at 2.2 percent per annum, while population has been increasing at 3 percent a year. Job creation has been particularly limited in some regions.

earlier area of focus.

IV. Research Gaps

Employment creation and stability

Employment creation in fragile states is assumed to engender poverty reduction and improved stability. However, the empirical literature on employment creation in fragile states and post-conflict situations remains limited, and the research gaps are significant. Although it is well established that job creation reduces poverty in general, (see e.g. Islam 2004), it is not clear that the lessons from “stable” developing countries are transferable to the fragile context. Similarly, although unemployment and underemployment are higher in unstable and fragile environments (e.g. Collier 2006), it is not clear that employment creation promotes stability (ODI 2013). World Bank (2005) analysis suggests that not all jobs have the same impact on stability (see also World Bank 2013). Recent literature has devoted attention to emergency employment of high-risk and high-needs groups in the short term, income-generating activities for communities, and the creation of an enabling environment (De Vries and Specker 2009). Data limitations have hampered rigorous evaluations of most public work programs (McCord 2010) and of the labor impacts of investments in other sectors.

Legacies of civil war and violence

There are more gaps than solid conclusions on the understanding of postwar recovery (Blattmann and Miguel 2010). Most of the economic research on civil war focused on searching explanations for their onset. War’s economic legacies have been much less researched. In particular, there are especially wide gaps in understanding the legacies of war on institutions, human capital, and culture, and their persistency.

Conflict prevention and aid

Reforms to the design of foreign aid have recently been suggested by authors (Miguel 2007) to help address income shocks and support local economic conditions when the risk of political violence is high. However, very little is known about micro-dynamics and their link with poverty, and further empirical research is necessary. A systematic application of impact evaluation of programs, and the organization of follow up surveys, would greatly bolster the understanding of the real potential of targeted cash injections to prevent violence and conflict.

REFERENCES

Acemoglu, D. and J. Robinson (2011). Why Nations Fail.

Andrews, M., L. Pritchett, and M. Woolcock (2012). Escaping Capability Traps through Problem-Driven Iterative Adaptation (PDIA), Center for Global Development Working Paper 299.

Chandy, L. (2011). Ten Years of Fragile States: What Have We Learned?, The Brookings Institutions, Policy Paper 2011-2012.

Mansuri, G and V. Rao (2012). Localizing Development: Does Participation Work?, Policy Research Report, The World Bank.

Beasley, K. (2006), "Job creation in post-conflict societies." Issue Paper No. 9, Washington DC, US Agency for International Development.

Blattman, C. and E. Miguel (2010). Civil War, Journal of Economic Literature, 48-1:3-57.

Collier, P. (2009a). Wars, Guns and Votes, Democracy in Dangerous Places, Harper Perennial.

Collier, P. (2009b) The Political Economy of Fragile States and Implications for European Development Policy, Oxford University, mimeo.

Collier P., A. Hoeffler, and D. Rohner (2006). Beyond greed and grievance: feasibility and civil war. CSAE Working Paper Series, Oxford, Centre for the Study of African Economies.

Collier, P., et al. (2003). Breaking the Conflict Trap: Civil War and Development Policy, Oxford University Press.

De Vries H. and L. Specker (2009). "Early economic recovery in fragile states priority areas and operational challenges." The Hague: Clingendael Institute.

Ellis K., P. Harvey, A. Lemma, and K. Higgins (2010), "Job creation in fragile states," Overseas Development Institute.

Independent Evaluation Group (2013), World Bank Group Assistance to Low-Income Fragile and Conflict Affected States, An Independent Evaluation, Main Report, December 2013.

Islam, R. (2004), "The nexus of economic growth, employment and poverty reduction: an empirical analysis." Issues in Employment and Poverty Discussion Paper, No. 14. International Labour Organization.

Kharas, H. and A. Rogerson (2012). "Horizons 2025: Creative destruction in the aid industry." ODI and Brookings Institutions.

Miguel, E. (2007). "Poverty and Violence: An Overview of Recent Research and Implications for Foreign Aid", in Brainard L. (ed) "Too Poor for Peace?", Brookings Institutions.

Overseas Development Institute (2013). "What is the evidence on the impact of employment creation on stability and poverty reduction in fragile states?"

Walter, B. (2004). "Does Conflict Beget Conflict? Explaining Recurrent Civil War." Journal of Peace Research 41(3): 371-388.

World Bank (2005), "Afghanistan: state building, sustaining growth, and reducing poverty, Country Study."

World Bank (2013). World Development Report 2013, *Jobs*.

World Bank (2011). World Development Report 2011, *Conflict, Security and Development.*