

## Stabilisation Issues Note

### Economic Regeneration and Private Sector Development

#### Purpose

Stabilisation Issues Notes provide a short summary of what the Stabilisation Unit has learned to date. They have been developed on the basis of experience and are aimed at improving the effectiveness of our practical engagement in various aspects of stabilisation. They are aimed primarily at the Stabilisation Unit's own practitioners and consultants, and those of other HMG departments. They are not a formal statement of HMG policy.

#### Key messages

- Private sector development (PSD) is an important tool for stabilisation and an essential component of economic recovery. The private sector is defined as *any person who sells something with the aim to make profit*. It includes micro businesses such as small farmers and market traders as well as large, medium, and small businesses and multinationals.
- Efforts to regenerate economic activity need to be based upon the specificities of any given context. This requires initial investment in a good enough analysis of local conflict dynamics, the political and regulatory environment, security and viable economic opportunities. Promoting economic regeneration can however undermine stability by unintentionally enabling the monopolisations of benefits or maintenance of exclusion. In order to mitigate this risk, economic analysis must be accompanied by conflict and political analyses.
- PSD has the potential to reduce tensions between opposing groups (ethnic, political factions, religious) when economic actors are brought together to pursue common goals of increasing business revenues and boosting local economies. Building trust through the economic interaction between groups can encourage social and political reconciliation.
- The regeneration of the private sector is an important indicator of a return to normality, which helps consolidate support for peace. Stabilisation benefits and benefits from the revitalisation of local markets, reduction of costs of basic food items, improved and less expensive transportation, more job opportunities, increased tax revenues, improvements in basic infrastructure and improved services. Reducing insecurity and restoring infrastructure helps to reduce the costs of doing business in hostile environments.
- PSD provides the necessary pre-condition for the successful economic reintegration of ex-combatants. Where ex-combatants can engage in profitable, economically sustainable economic activity, the risk of return to violence is reduced.
- However, some economic actors benefit from the instability of conflict: those who profit from illegal activities, unregulated exploitation of natural resources or illegal extortion may resist attempts to normalise economic activity. These risks must be understood and managed.

## Introduction

Conflict undermines productive economic activity. It destroys workplaces, weakens labour markets and other economic institutions. It reduces the availability of productive land due to anti-personnel landmines and unexploded ordnance. Systems of land ownership become destabilised, and productive assets are stolen or destroyed. Conflict causes considerable damage to physical and economic infrastructure (marketplaces, warehouses, water, communication, energy facilities and transport networks). In addition, trading networks, vital for marketing goods and supplying businesses, are disrupted, and public and private sector investment declines. As employment opportunities become scarcer, working conditions tend to deteriorate, and it becomes easier to exploit workers and violate their rights. The macroeconomic instability that characterizes conflict and post-conflict contexts further limits the opportunities for licit economic activity. In some countries these effects are compounded by natural disasters.

## PSD and Stabilisation

Economic recovery, especially the creation of sustainable employment has been shown to significantly reduce the risk of future conflict<sup>1</sup>. A vibrant private sector which benefits from peace can be a powerful partner in efforts to reduce the risk of renewed conflict.

Sustainable, long term economic recovery involves a complex set of interventions at macro and micro levels. However, this Issues Note concentrates on local level Private Sector Development (PSD) and will only briefly touch upon more macro-economic issues such as the regulatory environment, fiscal policies and monetary policy. International agencies, such as the International Monetary Fund (IMF), would lead on the reform of these macro-economic stabilisation processes.

### **Roots of Conflict: Youth Unemployment**

It is crucial to understand the roots of conflict in order to maximise the efficiency of interventions. Poverty, unemployment and unequal access to economic opportunities are among the underlying structures of most conflicts. According to the study of the United Nations Office for West Africa (UNOWA), analysing youth unemployment in West Africa and its links to conflicts in the region, the lack of opportunities for youth is a strong contributing factor to the escalation and continuation of armed conflict and violence. According to former Ambassador Ahmedou Ould Abdallah, UN Special Representative of the Secretary General for West Africa:

*There are 3 major challenges to peace and security in the West Africa region today. The first is the increasing consolidation of an arc of instability, comprising large zones of lawlessness in the region. The second is the ever-growing criminalization of armed conflict, in which conflict has now become a business-oriented venture, whether the profit is for diamonds, timber or the trafficking of arms. The third is increasing youth unemployment across the region, which represents a great threat to peace and security. Today, 43.5% of the population in West Africa is under-15 years of age. This group numbers in the millions and faces acute unemployment. One could conclude that armed conflict may be the biggest employer of young people in the region.*

Youth are also important potential agents of change: the "only hope for the future", "the vulnerable" as well as the "biggest potential source of instability" and war.<sup>1</sup>

*Youth Unemployment and Regional Insecurity in West Africa. UNOWA, 2005 Dakar*

<sup>1</sup> Collier, Paul. 2007. "Post conflict recovery: How should the strategies of the African Development Bank be distinctive".

It is well understood that improved stabilisation encourages the private sector to expand and grow and thus stabilisation has a direct impact on PSD. It is also understood that economic instability is a conflict driver and that without economic recovery and job creation, stability will not be effective or sustained. A study<sup>2</sup> in eight countries on the linkages between youth unemployment and conflict clearly shows that massive youth unemployment creates the grounds for violent conflict and that violent conflict furthermore aggravates youth unemployment, dragging countries such as Liberia and Sierra Leone into a negative spiral of conflicts.

Private sector development fosters stabilisation by creating jobs, increasing the purchasing power of the population, facilitating the establishment of business networks across ethnic and “enemy” borders, re-establishing trust in government and delivering a critical ‘peace dividend’. The public sector can also be a critical partner for peace.

Where war has been the main employer and where the capacity of the state to provide public sector employment is weak, the private sector is the biggest potential employer.

The crucial elements for increasing stabilisation through PSD are:

- Improving security and freedom of movement.
- Improving the business regulatory environment.
- Improving access to finance (including micro-finance).
- Improving skills, in line with labour market demands.
- Creating short term opportunities in advance of more sustainable economic conditions.
- Ensuring equity – support must be informed by understanding of local political/ conflict dynamics and be deliberately targeted at reducing the risk of renewed conflict.

### **Private Sector Actors as Peace Initiators**

The private sector has played a very dynamic, proactive role in peace building initiatives in South Africa and Northern Ireland. The Business for Peace Initiative encourages greater participation by business in efforts to promote peace at both formal and informal levels. This initiative helped reduce unemployment and created forum for increasing the contribution of business to peace and stability.

*Case Study: FCCISL BPI team for South Africa, Northern Ireland to study private sector involvement in peace building*

## **Improving Security and Freedom of Movement**

Improving security and freedom of movement is a critical pre-requisite to protect businesses, assets and personnel and to reduce the costs of business development and expansion. The protection of roads, markets, businesses should be recognised as critical to stabilisation. In order to direct the provision of enhanced security, peacekeepers and other security services should consult with local economic actors in order to identify choke

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<sup>2</sup> Youth Unemployment and Regional Insecurity in West Africa, UNOWA, 2005 Dakar

points and areas of increased vulnerability. The protection of economic assets also helps create trust and will enhance popular participation in efforts to maintain overall security.

## **Improving the Business Regulatory Environment**

- *Macroeconomic and Fiscal Policies:* National macro-economic stability is a prerequisite to private sector development and macro economic instability will impede the contribution that PSD can make to stability. Ensuring that the international community recognises the importance of macro-economic stability as a key aspect of political stability is essential. The International Finance Institutions (World Bank, International Monetary Fund) will need to engage to establish monetary stability and control inflation. Fiscal policies are key – both to the generation of necessary revenues, but also to the creation of inter-dependence between state and economic actors. Tax-payers have increased interest in ‘holding government to account’ and can thereby become important partners for peace. New policies should be subject to examination of their impact on fiscal stability – but also their impact on political stability.
- *Property Rights:* An urgent issue in many stabilisation contexts is uncertainty around land and property rights. This uncertainty impedes investments and is often a cause of ongoing or renewed conflict – especially where the cessation of hostilities entails the return of refugees and IDPs. Even small scale, local disputes over property rights can escalate – and feed into larger scale political or ideological conflicts. Land and other physical assets are often the only form of collateral acceptable to lenders. Where formal legal resolution of property rights may be a (very) long term process, the adoption of more informal mediation of property disputes can reduce the risk that uncertainties feed into the risk of renewed violence. In Afghanistan, encouraging traditional shuras to engage in the mediation of disputes over land between incumbents and returnees helped restore stability and enabled returnees and receiving communities to engage in productive use of land – rather than disputes.
- *Business Regulation:* Many fragile states retain a complex array of regulatory impediments to PSD: business registration, employment of others and the acquisition of necessary permissions, licences and paperwork can require compliance with a bewildering array of state organisations and institutions. This complexity provides ample opportunities for corruption – which both impedes establishment of licit businesses and maintains a de-stabilising distrust between citizens and state. Efforts to streamline the regulatory environment are critical. A ‘one stop shop’ combined with a one off flat rate fee for the establishment of a small business can help stimulate the local economy and reduce rent seeking.
- *Labour Market Information:* Restoring labour market information flows helps facilitate employment by matching job seekers to job opportunities. The establishment of local labour offices also provides an opportunity to identify any mismatch between supply and demand. This in turn helps ensure that investments in skills are properly targeted.

## Quick Impact Projects

Quick Impact Projects (QIPs) are short-term, small-scale initiatives that are designed to have an immediate impact contributing to stabilisation and early recovery. They may also have an impact on longer-term development, and this should be taken into account in the planning stages. Cash for work, small scale infrastructure projects can both absorb local labour and inject cash into the local economy. There are a number of risks which can be mitigated by attention to the following:

- *Infrastructure and service delivery:* QIPs which rebuild the infrastructure required for delivery of services (e.g. health and education) must ensure that the finance and systems for delivering the service are in place: a new - but empty - school building or clinic where no services are delivered compounds the sense of grievance and exclusion. People resent the waste of scarce resources and will be less willing to engage in subsequent activities.
- *Process is as Important as Product:* experience indicates that the process of consultation, bringing a broad range of local actors together to decide on priorities, oversee implementation and participate in exploitation is as important as the project itself. Joint activities help create trust and inter-dependence and start to recreate the social capital essential to long term stability. Lots of small scale projects provide more opportunity for joint consultation and cooperation – and may therefore be preferable to single large scale projects.
- *Equity:* In conflict affected environments, there is a high risk that non-participants in a particular project or programme will assume deliberate exclusion – which in turn fuels the sense of grievance and vulnerability to instability. Attention must be paid to equity. Substantial and ongoing investments in communications to explain decision-making criteria, sequencing and future plans is critical to reduce this risk.
- *Procurement and Transparency:* where QIPs are to be contracted out, it is absolutely critical to ensure that tendering processes are more than usually fair, transparent, equitable – and seen to be so. Again there is a high risk of perception of unfair contract award – and this risk must be pro-actively managed, lest the QIP exacerbates rather than alleviates local tensions. Explaining tendering processes and broad inclusion in ‘open’ (even public) tender assessment helps reduce this risk. The provision of support to potential contractors – e.g. training in how to put together a tender – is also helpful.
- *Skills development:* QIPs provide a useful opportunity to build local skills – be these in construction, project management or asset/resource management. It can be preferable for completion to be slower – but build local skills.

## Improving Access to Finance (including Micro-Finance)

Lack of access to finance is frequently cited as a severe constraint to business growth in developing countries in general – and is of course more difficult in unstable conflict affected environments. Where efforts should of course be invested in the re-establishment of a functioning banking sector, this may take time – especially in an uncertain legal and regulatory environment. In the interim, providing accessible credit to small entrepreneurs

can help kick-start local economic recovery. There is substantial experience of micro-finance in the development community which can be exploited. Group lending can reduce risks and the need for individual credit risk assessment; it can also help foster the growth of social capital, cooperation and trust. Simple micro-finance schemes enable people to exploit small market opportunities, and help develop the business skills important for more substantial enterprise when conditions permit. Development-oriented micro-finance schemes are often directed to specific vulnerable communities or excluded groups (e.g. women), in order to reduce poverty. In a stabilisation environment, there needs to be more weight given to equitable access to finance (including micro-finance), in order to ensure that otherwise 'at risk' groups (e.g. ex-combatants) can benefit. Any perception of unfairness – however well intentioned – can feed the sense of exclusion and grievance which increases risk of renewed conflict.

### **Improving Skills, in line with Labour Market Demands**

Conflict is likely to have caused a serious loss of skilled people by death, population movement and emigration. Little or no training will have occurred during the conflict, leaving behind a generation of youth without skills. Investing in training facilities, training trainers, and redrafting curricula is an urgent requirement in all stabilisation contexts. However, this must be informed by analysis of the demands of the local labour market. Too often training programmes produce armies of carpenters or bicycle repair mechanics, who are then unable to sell their new found skills. This is demoralising and can increase the risk of reversion to violence.

Engagement in e.g. rebel movements often gives participants not only the means of economic survival, but also a sense of purpose and belonging, respect and opportunities to 'excel'. Attention to these non-economic needs of e.g. ex-combatants is also critical. Similarly, engagement in war often endows participants with a range of skills and abilities, which can be exploited in peaceful activities: logistics, planning, management of human resources, financial management. Recognising and building on these skills is often more effective than trying to turn a 'general' into a mechanic.

#### **Local Procurement**

The local procurement of goods and services by international actors can support recovery by injecting cash into the local economy and creating jobs. There are however risks, which must be carefully assessed. Local procurement has the potential to distort local markets and prices, possibly pushing up the price of local foodstuffs and making them unaffordable to local communities. International agencies' appetite for local labour, especially at the more skilled (and English speaking) end of the spectrum can draw essential and scarce skills away from engagement in local recovery. Paying (English speaking) doctors ten times the local salary to drive our cars is unhelpful.

### **Spoilers**

In spite of the apparent coincidence of interest between stability and economic recovery, stability may not be in the interest of some – often powerful – economic actors. These may actively impede efforts to establish peace and stability – and this resistance must be factored into plans. Those likely to impede stabilisation and re-establishment of licit economic activity include:

- *Combatants whose initial 'political' aims have transformed into a continued interest in the 'easy' revenue flows enabled by armed violence.* Why work when greater revenues can be gained by violent extortion of others?
- *Those engaged in illegal economic activity:* illegal production and trade in narcotics, illegal smuggling and trafficking of people and arms, or exploitation of natural resources. Stabilisation and the establishment of rule of law are not in the interests of those engaged in illegal economic activity. Conflict and instability reduce the costs and risks usually associated with illegal economic activity, making continued instability in the interest of these often powerful actors.
- *Those whose power enables them to distort local markets:* excluding others (be they opposing groups, other ethnic groups, the poor and vulnerable) helps maintain monopolisation of revenues streams for those able to control market access.
- *Rent-seeking local officials and/or security forces* may have an interest in the retention of an over-regulated environment, and the opportunities for corruption. Efforts to rationalise the regulatory environment will reduce these opportunities and may be fiercely resisted by formally 'legitimate' state authorities.

These risks cannot be addressed solely by efforts to create licit economic opportunities and broad-based economic recovery. The risks associated with ongoing illegal violent extortion, smuggling or exploitation of natural resources must be increased – and this often requires cooperation with local security services (if possible and effective), peace keepers or other (external) security actors. Ongoing violence or engagement in illegal economic activity must have real and perceived risks, if the attractions of easy money are to be reduced.

Where the state or local security forces are implicated, a more robust political engagement may be required. Creating mechanisms whereby the population can (safely) report official extortion and rent-seeking can help increase risk – or at least the perception of risk.

Creating collective incentives for changed behaviour can also be effective: enhanced salaries or other rewards for groups popularly agreed to be less predatory may be an option if carefully managed.

## Conclusions

- There are a range of mechanisms which can help promote economic recovery – and economic recovery can make an important contribution to stabilisation.
- The more familiar developmental approaches to economic development must be adapted to the specific political and conflict dynamics of a stabilisation environment.
- The political impact of interventions must be assessed and risks identified and mitigated.
- Equity, transparency, consultative processes and communication are more than usually important.
- Speed and quick visible impacts are more important – but must not undermine the potential for longer term, more sustainable development.
- There will be often powerful spoilers, who may actively impede efforts to establish stability and broad based economic recovery. The incentives which motivate these actors must be changed: the risks associated with ongoing engagement in illegal activity or violence must be genuinely increased – and this usually involves cooperation with local or international security actors.

## Resources and Further Information

### General Reading

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## Other Documents

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