



CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE

# **BUILDING DEMOCRACY AND THE MARKET ECONOMY IN POST-CONFLICT SOCIETIES**

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*CIPE is an affiliate of the U.S. Chamber of Commerce and one of the four core institutes of the National Endowment for Democracy*



# Post-conflict reconstruction

- Transition to peace through rebuilding socio-economic framework of society
- Reconstruction of enabling conditions for building democratic institutions, governance, and market economy
- Three-phase transition from emergency phase toward sustainable economic development
  - Emergency phase (peace onset) of 4 years + two other 4-year periods (capacity building)
  - The need for unique development assistance during those phases

# The importance of post-conflict reconstruction

- The increase of the volume of post-conflict aid
  - 20–25% of total lending of the World Bank (2003)
  - 17% of IDA grants (2003)
  - In order to reach the Millennium Development Goals (MDGs) post-conflict funds need to be increased from \$136 billion in 2006 to \$195 billion in 2015
- Humanitarian aspect: 90% of conflict casualties are civilians
  - Loss of human capital cripples the economy
  - Divided societies need both financial resources and policy advice

# The areas of post-emergency assistance

- Repairing and building new physical infrastructure
- Creating institutional infrastructure to support economic growth
- Managing the existing institutional gap
  - The need for sequencing policy reforms: social, structural, and macroeconomic
- Budget support for investment in infrastructure
- Aid to productive sectors (often neglected)

**It is crucial to set sound and realistic aid objectives.**

# Common challenges to reconstruction assistance

- Aid objectives and methods
  - Lack of clear definition and coordination
  - Exit strategy, local ownership, and local participation not well addressed
- Aid sequence and phasing
  - Aid comes too early and tapers off too soon, creating discordance with absorptive capacity
- Transparency and accountability
  - Inadequate monitoring and evaluation
  - Inadequate feedback and information flows

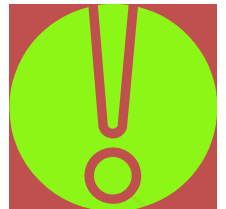
# Absorptive capacity and its constraints

- Absorptive capacity is the ability of a country to efficiently accept and apply outside assistance
  - Policy and institutions matter for the returns from aid in terms of economic growth
  - There are diminishing returns to aid
    - Saturation point equals 15–45% of GDP
    - Marginal benefits beyond that point become inexistent or even negative
- Absorptive capacity constraints
  - Macroeconomic, institutional & policy, technical & managerial, donor behavior

# Macroeconomic constraints

- Large inflows of aid and the “Dutch disease”
  - Dutch disease leads to appreciation of local currency
    - Same phenomenon as in the case of windfall cash flows from discovery or price hikes of natural resources
  - Dutch disease has negative effect on exchange rate and competitiveness of exports
- Debt sustainability and debt burden
- Rising inflation and high interest rates
- Labor market pressures (skills and wages)

Overvaluation of the local currency fueled by massive aid inflows during post-conflict reconstruction reduces catch-up growth.



## Capacity

- More capacity needed to formulate and implement credible strategies, policies, programs
- Challenges of transforming high levels of post-conflict aid and scarce public resources into positive development outcomes
  - Little job creation and income generation
- More transparency needed in budget systems
- Inadequate patterns of public expenditure



## Accountability and Responsibility

- The need for a degree of decentralization of reconstruction resources, efforts, and responsibilities
  - Mechanism for definition of policy priorities and accountability systems to hold governments responsible
- Insufficient institutional capacity of a recipient country increases aid dependency
  - Negative incentive for reforms
  - Shift of responsibility from local government to international actors

## Country Assessments

- Country Policy and Institutional Assessment (CPIA)
  - The World Bank’s diagnostic tool meant to capture the quality of policies and institutional arrangements
  - Rates 16 criteria within four clusters:
    - Economic management
    - Structural policies
    - Policies for social inclusion and equity
    - Public sector management and institutions
  - Scores are averaged on 1 (low) to 6 (high) scale
- Average CPIA scores during the three 4-year phases of post-conflict transition
  - Peace onset 2.50; I period 2.82; II period 3.05



# Technical and managerial constraints

- Low quality of human capital and education
  - Not enough human resources to accelerate development
- The need for technical assistance and training
  - Build upon what already exists on the ground
  - Support learning vs. training (match training needs)
  - Provide on-the-job training
- The need for a critical mass of people who understand the country's development challenges and can hold the government accountable
  - The government must be accountable for transforming public spending into improvements in the standard of living

# Donor behavior constraints

- Fragmentary donor interventions
- High transaction costs
- Lack of cooperation with local actors on needs assessments, setting objectives, and benchmarking
- Many small, dispersed projects that are uncoordinated and burdensome to administer
- Lack of certainty and predictability concerning the future volume of aid
- Lack of donor cooperation in ex-post evaluation of aid effectiveness
  - Hampers learning from feedback

# Ways to improve capacity

- Options to create better absorptive capacity
  - Build capacity (start early in the onset phase)
  - Buy capacity
  - Build temporary capacity
  - Bypass weak government capacity
- Local ownership of reform matters

**Building local capacity in post-conflict countries helps ensure local ownership in the reform process, which is crucial for the success of the reconstruction efforts.**



# The importance of local ownership of aid-sponsored projects

- Building domestic capacity for reform
  - Ensure local ownership
  - Avoid imposing institutional models from the outside
    - Distorts local initiatives for reforms
- State building / Institutional building
  - Balance the power of government
  - Bring civil society and business into the reform process
  - Stimulate political competition, create checks & balances

# Political parties and local institutions

- Political parties in post-conflict areas need to represent the interests of larger social groups rather than just closed elite circles
- Political parties have an important role in building institutions
  - Parties need to build greater role for and capacity of the parliament
  - Parties should not be proxies for divvying up power in the government
  - Parties should support practices leading to the emergence of visionary and accountable leadership

**“Institutions can’t be transferred wholesale.”**

**- Douglass C. North**



# The role of private sector and business community

- Local business communities in post-conflict countries can contribute to overcoming obstacles to growth and development such as:
  - Unfair competition
  - Weak rule of law and corruption
  - Limited channels for the private sector to have a voice in shaping economic policies
- The role of voluntary business associations
  - Provide services to members and increase their competitiveness
  - Serve as an advocacy vehicle to help improve the overall business climate



- Development of the absorptive capacity is key for reconstruction efforts
- Local ownership and inputs in the reconstruction process are crucial for capacity building in post-conflict countries
- The aid flow and sequence should follow the increase of absorptive capacity and the path of sustainable development needs

**Successful post-conflict reconstruction:  
From peace to sustainable development**



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