The Economics of Peace in War-Torn Countries:
The Historical Record and the Path Forward*

By

Graciana del Castillo
Senior Fellow, Ralph Bunche Institute for International Studies
City University of New York (CUNY)

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Introduction

Since the fall of the Berlin Wall, the ‘economics of peace’—that is, ‘economic reconstruction’ or the ‘economic transition’ in countries emerging from Cold-War related conflicts and embarking in a complex transition to peace—required a new paradigm. One would think that with its stellar record of setting the stage for world peace, the Marshall Plan—the most successful reconstruction program of all times—could have provided the model for more recent experiences. Although the Plan holds some far-reaching lessons, it took place in a radically different political, security, social, and economic context.

The paper is organized as follows: Section I discusses differences between economic reconstruction in the present context and reconstruction in the past. It also discusses the dismal record of war-torn countries and reviews what is at stake if such record is not improved. Section II distinguishes between the economics of war, the economics of peace and the economics of development. Conflation between economic reconstruction and normal development, as well as delays in moving away from the underground war economy, have had tragic policy consequences for war-torn countries.

Section III provides a cursory review of the four aspects of the multipronged transition to peace—security, political, social and economic—and analyses how they are closely interrelated and reinforce each other. In particular, it examines how the economic transition affects the other areas and how these in turn are affected by the economic transition.

Based on such analysis and the existing empirical evidence that breaking certain principles has often led countries back to conflict, or has impeded them to return to a path of normal development with much reduced foreign intervention, the Concluding Remarks in Section IV summarize basic principles that should be widely debated for improving economic reconstruction so that countries neither relapse into conflict nor become aid dependent.

I. The Marshall Plan vs Post-Cold War Economic Reconstruction

Economic reconstruction at the time of the Marshall Plan involved European countries that were coming out of an ‘inter-state’ war with industrial economies, solid institutions, educated labour forces and competent civil services. In such context, the term ‘economic reconstruction’ referred basically to the rehabilitation of basic services and infrastructure for the reactivation of world production and trade.

By contrast, economic reconstruction in the post-Cold War context has taken place in countries at low levels of development, inadequate human and institutional capacity, large macroeconomic disequilibria, counterfeited currencies, and lack of resources. Coming out of civil war or other internal conflict (although often with interference from neighbours), these countries required special efforts at national reconciliation.
‘Economic reconstruction’ in such a context needed to be defined more broadly to include not only the rehabilitation (or creation) of basic services and infrastructure, but also the modernization of a basic macro- and microeconomic institutional, legal, regulatory, and policy framework necessary to create a viable economy. The latter is a necessary, if not sufficient, condition for effective policymaking, for reducing the large internal and external imbalances of the past, for increasing savings and investment, and for the productive utilization of large volumes of aid that these countries require.

The Marshall Plan accounted for only 2 per cent of the combined national income of recipient European countries. In the post Cold War period, aid to close to 70 per cent of the countries transitioning to peace with the support of foreign interventions spiked to roughly 20–40 per cent of GDP on average during the first five years of the transition. Even during the whole first decade, aid to 55 per cent of them averaged 15–35 per cent of GDP, with aid to Liberia and Afghanistan, the two largest recipients, averaging over 50 per cent of GDP (Table 1). During the second decade, aid to Mozambique still amounted to over 20 per cent and to Haiti and Rwanda around 18 per cent yearly on average.

In contrast also with the reconstruction of Korea and Vietnam (del Castillo 2008b: 1269–76), the international community backed and pressured countries emerging from conflict to embark in a complex multipronged transition to peace. While the Security Council assumed leadership in the ‘political’ and ‘security’ aspects of this transition, the Bretton Woods institutions used their advice and lending conditionality to promote rapid ‘economic’ and ‘social’ transformation.

‘Economic reconstruction’ in the new context means different things to different people. Because it takes place simultaneously in the four areas, the press, analysts, and politicians in donor countries often use the term interchangeably with ‘nation-building’ (the construction of a national identity) or ‘statebuilding’ (the construction of a functioning state) or refer to it simply as ‘development. While the UN includes economic reconstruction under ‘post-conflict peacebuilding,’’ the U.S. State Department refers to it as ‘post-conflict stabilization and reconstruction,’ UNDP as ‘early recovery,’ and the World Bank as ‘post-conflict reconstruction.’

Economic reconstruction has taken place in a diverse group of poor countries (even if some of them are rich in untapped natural resources). Many of them managed to achieve a fragile peace following a negotiated peace agreement. In others, a tenuous peace was established following foreign military intervention with the purpose of either protecting civilian populations, or simply for the purpose of regime change (Table 2). More recently, countries in the Middle East and North Africa are emerging from social uprisings and also embarking in economic reconstruction.

In most of these cases, national governments have made sovereign decisions including with respect to economic reconstruction, even if those decisions were constrained by aid conditionality imposed by donors. In Kosovo and East Timor where state institutions had collapsed, the Security Council gave the UN a very intrusive role in carrying out all executive and legislative decisions. To a much lesser extent, the same was true of
Cambodia. In Iraq, the U.S. assumed such functions following military intervention and had a strong imprint in Afghanistan as well.

In an effort to build societies in the image of those of advanced countries, the international community has tried to convert—practically overnight—insecure and destitute societies into liberal democracies with free-market economies, predominant private sectors, and independent central banks. Imposing such an unrealistic agenda on poor, polarized, mismanaged, and war-ravaged countries could reflect the ideological belief that only societies based on principles of democracy and free markets are capable of achieving and preserving peace and stability and of generating increased prosperity. It most probably represents efforts, particularly in countries rich in natural resources, to create the adequate conditions where companies, contractors, and experts from donor countries can flourish.  

The recipe has invariably been a combination of centralized government with early and relatively free national elections, together with peacekeeping or counter-insurgency operations to keep the peace, humanitarian assistance to save lives and provide minimum levels of consumption, and a few large and relatively productive investment projects requiring new and expensive infrastructure that takes time to build. This recipe has benefitted mostly foreign investors and a few domestic elites. Generally lacking a ‘peace dividend’ for the large majority of the population—that is, a significant improvement in their economic livelihoods and wellbeing—the recipe has simply not worked.

The record is indeed bleak: The UN last reported that ‘roughly half of all countries that emerge from war lapse back into violence within five years’ (UN 2005: 31). Although surprisingly the UN has not reported more recent data, a cursory analysis of UN multidimensional operations in countries in which the Security Council has identified a threat to regional peace and security is discouraging. As Table 2 shows, of the 21 countries in which the UN had some multidisciplinary operation since the end of the Cold War, 12 relapsed into conflict (57 per cent). The Peace Index includes 7 and the Failed States Index includes 11 of these countries among the 25 worst performers in the respective indices, many of which are still at war. Some of them have not relapsed thanks to peacekeeping operations or foreign troops in place to keep the peace.

This unfortunate record has not only led to human tragedy, insecurity, large number of refugees and internally displaced populations, deprivation, and huge costs to the UN and other foreign forces but has also led to corruption, money laundering, and financing for terrorists. The Corruption Perception Index includes 9 and the Anti-Money Laundering Index includes 7 of these countries among the 25 worst performers. Had all these indices report data on the 21 countries in our sample, the situation would be even worse.

Of those that managed to keep an unsettling peace, the large majority have ended up unable to stand on their own feet and have fallen into an aid trap. As an illustration, after more than two decades of peace and large volumes of aid, Mozambique remains among the 10 worst performers in the Human Development Index. Afghanistan has the ominous record of having both returned to conflict and fallen into an aid dependency from which it will take decades to detox. The latter is also true of Liberia that has succeeded in keeping
the peace thanks to a long-lasting and costly peacekeeping operation, amounting to about two-thirds of Liberia’s GDP in 2009–11 (del Castillo 2012: 8, 10). In these two most aid dependent countries, flows increased over the decade, rather than decrease, as it should have. Moreover, these three countries, together with 7 more in which the UN has had long and expensive operations, are among the 25 worst performers in the HDI. Only a few, most notably El Salvador, have managed to avoid relapsing into war and becoming aid dependent, and have made some progress in the HDI.

As Nobel Laureate Edmund S. Phelps stated in the Foreword to Rebuilding War-Torn States, it could have been expected that when wars stopped, countries would have found their footing again and set about to make up the lost ground with regard to their development (Phelps 2008: vii). But rebuilding from the ashes of civil war in poor countries has proved quite unnerving.

II. The Economics of War, the Economics of Peace, the Economics of Development

In countries torn by civil war that need to rebuild their economies, the ‘economics of peace’ (or economic reconstruction) is an intermediate and distinct phase in between the ‘economics of war’ (or underground war economy) and the ‘economics of development’ (or development as usual in countries not affected by war). The aim of the economics of peace phase must be to re activate economic activity while minimizing at the same time the high risk that these countries have of relapsing into war. This requires using conflict-sensitive and inclusive economic policies to address the root causes as well as the consequences of conflict.

This phase is particularly challenging since the country needs to move away from the ‘economics of war’ of the past. This requires bringing under control as soon as possible activities such as drug production and trafficking, smuggling, extortion, money laundering, illegal logging, wantonly exploitation of minerals and gemstones. There are many reasons for the urgency to move away from the economics of war. Illicit, rent-seeking, and highly lucrative activities such as these are an ideal source of finance to insurgen cies and terrorist groups as they are to corrupt national politicians and businessmen. Another reason is to avoid that donors, avid to finance the ‘private sector,’ end up supporting economic elites of warlords, corrupt officials, and others that accumulated capital illegally. This would entrench poor governance, corruption and other illicit practices as it has happened in Afghanistan, Iraq, Liberia, and Haiti. Because drugs and other such activities provide livelihoods to poor farmers and other vulnerable groups, however, opportunities elsewhere need to be created as illegal activities are brought under control.

As Cold War-related confrontations were winding down, the international community pressed countries transitioning to peace to take action on four different fronts simultaneously: To surrender violence and establish or modernize the institutions for public security (security transition). To move away from lawlessness and political exclusion to a framework where the rule of law, participatory government, and respect for basic rights prevail (political transition). To create programs for national
reconciliation so that former enemies can abandon ethnic, religious, sectarian, or ideological confrontations of the past (social transition). To transform war-ravaged and mismanaged economies into viable ones in which former combatants and other war-affected groups, as well as ordinary men and women in society, can earn a decent and licit living (economic transition). These four fronts are closely interrelated and failure in any one of them would put the others at risk—as it has actually happened in a number of countries.

Because countries such as El Salvador transitioning to peace a quarter of a century ago were at low levels of development, those of us at the office of the UN Secretary-General involved in the implementation and monitoring of the 1992 Chapultepec peace agreement initially thought that the economic transition would be ‘development as usual.’ As such, it was implicit that the UNDP and the World Bank would assume the leading role. We soon realized that economic reconstruction needed a new paradigm.

At the time, we identified a problem that has continued to haunt countries coming out of war for the next quarter of a century: the UN and the Bretton Woods institutions were overseeing separate, simultaneous political and economic processes that were on a collision course (de Soto & del Castillo 1994). As it is well documented in the literature and in official reports of the organizations involved, lack of timely foreign aid for some of the critical peace-related programs in the UN-sponsored Salvadoran peace agreement, together with the domestic financing constraints imposed by the conditionality of the IMF-sponsored program in place, made the implementation of such programs tortuous.

Troublesome problems afflicted two main programs—the so-called ‘arms-for-land’ and the creation of the new civilian police—that were crucial to the success of the entire peace process. Not surprisingly, as prospects for the initiation of the land program faded, the FMLN stopped demobilization. This brought the country to the brink of war only nine months after the signature of the peace agreement (Goulding 2002: 241–45).

From this experience we soon realized that economic reconstruction with the main purpose of ensuring that conflict would not recur was basically a ‘political’ endeavour that presented special challenges. Because of this, I argued that it was not ‘development as usual.’ In fact, war-torn countries faced ‘the double burden of implementing peace-related programs in addition to normal development challenges.’ If anything, it was a ‘development-plus’ challenge (del Castillo 1995: 29–30; 2000: 227–234).

I also argued that, under such conditions, countries ‘have to settle for less than optimal policies in their economic reform efforts so as to accommodate the additional financial burden of reconstruction and peace consolidation’. I recognized that ‘the imperative of peace consolidation competes with the conventional imperative of development, putting tremendous pressure on economic policy decisions, especially budgetary allocations’ (del Castillo 1995: 29–30, 37). After the Treaty of Versailles, John Maynard Keynes had already warned of the high economic consequences of peace (Keynes 1920), but monetary and fiscal orthodoxy trumped over them in the wake of the Cold War.
Because there cannot be sustainable development without peace, the ‘political or peace’ objective should prevail over the ‘economic or development’ one whenever the two clash, which is frequently. If we accept this proposition, it follows that the paradigm for the ‘economics of peace’ must be fundamentally different from that for the ‘economics of development.’ In the latter, policymakers should pursue optimal or first-best policies, have the luxury to plan policies and programs with a medium- and long-term framework in mind, and must respect the ‘equity principle’ according to which groups with the same needs should be attended equally.

Such best practices are not so under the economics of peace. Countries coming out of war or other crisis have fewer policy options, must feel a sense of urgency, and should display a tolerance for distortions that are largely lacking during the normal development process. Crises often require emergency solutions to satisfy humanitarian needs. Though necessary, these often create distortions and may even interfere with medium- and long-term development goals. At the same time, these crises generate interest and concern from the international community that leads to spikes in aid and to an intensive and often intrusive foreign intervention, something that under normal development would be considered interference in national affairs. The ‘ethics of peacebuilding’ often need to replace the ‘equity principle’ since preference to some war-affected groups may be necessary to ensure that spoilers—factions who see peace as inimical to their economic interest, power, or ideology—get a stake in the peace process (del Castillo 2008a: 30–38; 2011b: 5–7).

The Box below shows the different phases and summarizes the characteristics and challenges of each of them.

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<th>PHASE</th>
<th>CHARACTERISTICS &amp; CHALLENGES</th>
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<tr>
<td>ECONOMICS OF WAR or underground war economy</td>
<td>Macroeconomic mismanagement and a large number of illegal activities prevail. Some development activities take place in the midst of war (education, health, other services) but are often interrupted by it.</td>
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<tr>
<td>ECONOMICS OF PEACE (or economic reconstruction) (or economic transition)</td>
<td>Conflict-sensitive and inclusive economic policies should prevail—even if suboptimal from an economic perspective—to reactivate the economy while reducing the risk that conflict recurs. Typical development activities interrupted during the war start during this period but have to take place amid critical peace-related tasks (rehabilitation, DDR, demining), which should always take priority during this phase. Reconstruction is thus a development-plus challenge.</td>
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<tr>
<td>ECONOMICS OF DEVELOPMENT (or development as usual) (or normal development) (or long-term development)</td>
<td>Economic policymaking after the high risk of conflict wanes. Policymakers should now aim at optimal policies and other best practices in development to move the economy towards a more productive phase.</td>
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Because of the explicit mandate of development organizations to collaborate with governments, we soon found out in El Salvador that the UNDP and the World Bank lacked the impartiality, or at least the perception of it, to deal with unequal partners—a sovereign government and non-state actors such as the FMLN that happened to be also signatories of the peace agreement. For this reason, development organizations should play a critical technical role, but only the UN Secretariat can lead at the political level (del Castillo 2008a: 45–47).

Development organizations have had problems accepting that economic reconstruction is fundamentally different from development as usual. In the early 1990s, UNDP argued for a ‘continuum from humanitarian relief to development’—an operational concept that it later acknowledged it was not useful (UNDP 2000: 38). Neither UNDP nor the World Bank agreed, despite repeated requests from the Secretary-General, to support the arms-for-land program in El Salvador. The World Bank argued that there were 300,000 peasants without land and that preference should not be given to a few (del Castillo 2008a: 44). Indeed, in a speech on ‘Securing Development’ in 2008, the then President of the World Bank, Robert Zoellick, recognized that the Bank treated war-torn countries as ‘simply harder cases of development’ (Zoellick 2008).

At the time, Zoellick also expressed concern about the poor record of war-torn countries, and finally acknowledged that ‘development may need to be suboptimal economically—good enough rather than first-best’ if the record was to improve (ibid). The same year, Paul Collier accepted, ‘Indeed, until recently, the organizations dedicated to economic development did not systematically distinguish postconflict settings as requiring a distinctive approach. Yet policy in the postconflict phase needs to be distinctive, both that of the government and that of the donor agencies. It should not be simply development as usual’ (Collier 2008:103).

Unfortunately, what was finally recognized conceptually has not yet translated into operational changes. Moreover, the World Bank Development Report 2011: Conflict, Security, and Development did not even mention this issue. Interestingly, although Zoellick refers to his ‘Securing Development’ speech in the Prologue, there is no mention of it, either in the 384-page report or in the bibliography. Is this indicative of what the Bank’s staff thinks of the need for second-best economic policies to keep the peace during reconstruction? Indeed, there are little signs that the organization has changed its development as usual practices in any significant way.

Following the experience of El Salvador that created serious strains between the UN and the IMF, the latter prepared, at the request of the Secretary-General, a minimalist monetary and fiscal framework for policymaking that would not put unnecessary pressure on the scarce technical, administrative, and managerial capacity of war-torn countries (del Castillo 2008a: 115, 280–81). Moreover, in his speech ‘The G-7 in 1996: What is at stake,’ the Managing Director, Michel Camdessus, recognized, that ‘the volume of our technical assistance resources is insufficient and our methods especially, are ill-suited’ to post-conflict countries where ‘it is necessary to effect rapidly a sort of blood transfusion between the government of yesterday and that of tomorrow… This kind of assistance … must be reinvented’ (Camdessus 1996). Despite such realization, it was only in 2005 that
Fund staff accepted that tax policy in post-conflict situations may require adopting policies that are not ‘first best’ from an efficiency point of view and executive directors agreed, with the right caveat that policies which are not optimal should be phased out as soon as feasible (del Castillo 2008a: 280–81).

To be fair, the Bretton Woods have somewhat improved the terms of their lending to war-torn and other fragile societies (del Castillo 2010a: 88–90; del Castillo 2008b: 1281–1292), as they have improved the way they work together with the UN in those countries. But an undeniable policy of these institutions has been, and continues to be, to use their advice and lending conditionality to create a perfect macroeconomic framework based on inflexible monetary and fiscal policies and unrealistic fiscal and external targets, and to establish the microeconomic foundations based on pure laissez-faire policies—a framework that has clearly deprived these countries of the simplicity and flexibility that is so essential to them (del Castillo 2008a: 177–179).

This is indeed too bad. As Phelps has noted, ‘the idea promoted by some multilateral and bilateral donors that the war-torn countries can afford to follow laissez-faire policies—that in these countries unfettered markets work best and only the advanced countries need the paraphernalia of subsidies, licenses, regulations, corrective taxes, and so forth—is a costly ideology. … There may be a need for judicious and well-designed departures from laissez-faire—just as the United States in the early years of the republic adopted some of the infant industry ideas of Alexander Hamilton. Prohibitions against any and all interventions in the market place in a country whose institutions and culture have been destabilized seems dogmatic and injudicious’ (Phelps 2008: viii–ix).

III. The Transition to Peace: Historical Background and Path Forward

While each country should go through this transition at its own pace and adapt it to its own culture, idiosyncrasy, and resources, this has not generally been the case. In fact, the recipe for foreign statebuilding interventions has been suspiciously similar. Since aid is never sufficient or timely to finance all the critical peacebuilding activities that are necessary, the rapid, effective, and inclusive reactivation of the economy is key to the overall transition’s success.

That the economics of peace takes place amid the simultaneous transition does not mean, however, that war-torn countries can afford to wait to have the elected authorities, the institutions, the policies, the good governance, the security, the rule of law, the judiciary, and the human capacity in place before they engage in production, investment, and trade. Indeed, the economics of peace needs to take place within whatever conditions are in place, and it cannot wait for the foreign interveners to get their act together, or for civil servants to be trained so that they can do it right. Thus, economic policies will need to adjust as other aspects of the transition improve.

What follows is a cursory description of the factors that have most affected the poor historical record with war-torn countries and that need to be widely debated to improve the path forward.
The security transition

Security has proved to be a precondition for effective economic reconstruction. Unlike inter-states war, making peace in the aftermath of civil wars requires overcoming daunting security dilemmas. Spoilers use violence to undermine or overthrow peace agreements. This occurred repeatedly in the 1990s, for example, in Angola, Rwanda, and Sierra Leone where the international community was unable to lure spoilers into the peace process through adequate economic and political incentives.

The same is often true after regime change. In Iraq, the U.S. policy of de-Baathification and the dismantling of the Iraqi army during occupation of the country in 2003 added to the 60 per cent of the population that was already unemployed. Looting and other criminal activities against government offices and other property led to a sharp deterioration in security and impeded economic reconstruction. Insecurity had all kinds of economic consequences including on monetary policy and bank activities, on the cost of lending and insurance, and on the sabotage of key oil infrastructure (del Castillo 2008a: 195–196).

Although security is a precondition for the success of the overall transition to peace, progress, or most often lack of it, in the other areas has in turn affected the security conditions in the country. This is what economists call ‘reverse causality’ and others refer to ‘virtuous circle’ or ‘two sides of the same coin’. Whatever the name of this two-way process, security will not take root without progress in political reform, economic reconstruction, and national reconciliation.

Despite clear evidence of reverse causality, the UN has failed to recognize the importance of economic reconstruction and effective reintegration as a critical socio-economic component of ‘peacebuilding.’ Likewise, by focusing on a misguided ‘peace-through-military’ strategy in Afghanistan and Iraq—with economic reconstruction on the side and only as an afterthought—the U.S. government has also ignored this two-way relationship and it has proceeded as if peace could be established by military means alone. The experience of these two countries well attests to how inefficiencies and lack of progress with respect to the three other areas led in turn to the deterioration of security conditions, with tragic human and financial consequences both to the countries and to foreign interveners (del Castillo 2014b: 156–58).

Economic reconstruction has proved expensive and futile in chronically insecure environments. Since insecurity lowers the return on donors’ projects and distorts domestic actors’ incentives, efforts will not be sustainable (Addison and McGillivray 2004: 363). Nevertheless, the United States, operating under what was labelled ‘expeditionary economics doctrine’ created provincial reconstruction teams (PRTs)—consisting of a mixture of civilian experts and military officers—to provide humanitarian and reconstruction support in insecure areas of Iraq and Afghanistan. Military commanders had plenty of money to spend and, as one commander put it, ‘we thought that by throwing as much money as possible to the problem, we would get it solved.’ This
created serious price distortions and promoted corruption (del Castillo, 2014b: 232, 220). The U.S. oversight bodies have collected enough evidence to show that investments in such areas, particularly large infrastructure ones, have gone to waste (SIGAR and SIGIR quarterly reports to the U.S. Congress).

This does not mean, however, that the reactivation of economic activity can wait until security is established throughout the country. There is always some kind of economic activity that can prosper, even in relatively unstable situations. People need to eat, trade, and repair basic infrastructure and services even in these areas. The challenge is how to replace humanitarian aid with reconstruction aid to reactivate investment in those areas.

At the same time, a large part of the economic aid to Afghanistan, for example, was channelled to the insecure provinces of the south, in which the effectiveness of aid was particularly low. Such policy was much resented in parts of the country were security was maintained and residents were deprived of aid, which they could have employed more effectively. This is also well documented by the U.S. oversight bodies.

UN peacekeeping operations or foreign forces often help to keep the peace and perform security tasks. To eventually assume such responsibility, most war-torn countries need to reform their armed forces for defence against external threats and create civilian police forces for public security.

A fatal mistake of the international community has been to support the creation of institutions, particularly in the security area, with disregard to prospects for domestic financing. Although an extreme case, Afghanistan best illustrates this problem. To beef up the national security forces, the United States alone poured roughly $45 billion (equivalent to 40 per cent of Afghanistan’s GDP) into the country from 2009 to 2014. As a result, Afghan security forces have created recurrent expenditures that the government will not be able to finance for years to come. In 2013–14, security averaged 63 per cent of total operating expenditure. At the same time, the operating budget of the Afghan security forces (which excludes investment) was on average 30 per cent higher than what the government collected in total revenue during that period (del Castillo 2014b: 234–35).

The warning by two experts that Afghanistan needed larger and more effective security forces, but it also needed ‘to be able to sustain those security forces’ (Rubin & Rashid 2008), was right on target and totally disregarded. The international community should not promote institutions in war-torn countries going forward that the countries themselves will not be able to sustain financially.

The political transition

While societies need to develop political institutions and select their leadership according to whatever their initial parameters are with respect to religious, ethnic, or class characteristics, they are largely dependent on external support. As a result, foreign interveners have played a critical role in their political development.
Peace agreements often dictated the terms for the interim and/or transitional arrangements. As the new authorities—be they interim, transitional, or elected—assumed power, they had to consolidate their legitimacy, something that proved extremely difficult in most cases. With whatever legitimacy they had and whatever territory they controlled at the time, governments needed to provide security, justice, human rights protection, and basic services and infrastructure to the population. They also had to carry out stabilization and reform for the reactivation of the economy and for the effective utilization of aid.

As Nobel Laureate Roger Myerson has noted, bright hopes for new democracies in Afghanistan and Iraq have soon faded. Based on his theoretical work as a game theorist and knowledge of constitutional frameworks, Myerson’s work is of great importance to any effort to improve political development and economic reconstruction in war-torn countries. What follows resumes some of his most relevant points for our analysis (Myerson 2011, 2014a, 2014b).

Myerson argues that while most analysts have asked whether the nation might have moved too quickly into a presidential election, the more relevant factor may well be that the move to introduce democratic local government was too slow. Foreign interveners often promote a centralized system of government—in which the president appoints the provincial/state governors—which facilitates their assistance. As a result, insurgencies often take root in communities where responsible local leadership is lacking.

Myerson posits that, as competition among firms in markets can reduce profits and yield better values for consumers, so competition among political parties in a democracy should reduce elite privileges and yield better government services for the public. So far, however, by handing interim or transitional authority to one leader that would have the privilege to build up the first national patronage network, foreign interveners may be effectively choosing the long-term leader of the nation.

At the same time, when foreign forces help to defend the authority of a state, its national leaders have more incentive to centralize political power narrowly around them. But such centralization can alienate key local leaders who are not aligned with the president’s faction and could lead to opposition against local leaders appointed by the president. In Myerson’s view, this would in turn make the central government more dependent on costly foreign support.

Forces against decentralization are strong once a centralized government is established. On the one hand, incumbent presidents may be threatened by potential competition from local leaders who could eventually build a good reputation by providing public services and infrastructure to local citizens in an inclusive and effective way. On the other, the president’s close supporters have a strong invested interest in maintaining centralization, since they may expect one day to become governors or mayors.

As Myerson points out, successful democratic development would require an ample supply of leaders who can compete for the presidency. By decentralizing the political system through local elections, local leaders would become accountable to citizens in
their constituencies since they would only be re-elected if they can prove their competence. A decentralized system can create a broad class of local leaders who have a positive expected stake in defending the new political system. This would reduce the government’s reliance on foreign forces (or peacekeeping operations, as the case may be). For all the reasons mentioned, Myerson strongly recommends that, going forward, foreign interveners should carefully take account of the political nature of the state that they are helping to build.

In Afghanistan, lack of local political leadership and insecurity in many provinces, allowed warlords to continue controlling customs revenue (a major source of tax revenue) and drug profits in areas under their control. Central government’s domestic revenue averaged only 5 per cent of GDP in the first five years, which seriously affected efforts at economic reconstruction and national reconciliation (del Castillo 2014b: 145–46, 197).

Political legitimacy at the national level affects economic policymaking options and uncertainty surrounding the sustainability of economic reform and property rights have been major deterrents to sustainable investment. Interim governments—and even more UN transitional authorities or an occupying force—should abstain from economic reforms whose sustainability investors may question. This applies to privatization of state-owned enterprises in general, and to liberalization of critical sectors of political value in particular, such as oil in Iraq or the Trepca mines in Kosovo. Both were unrealistic projects, which not surprisingly, never materialized. Indeed, one of the tragic errors of the US-led occupation was the early indication that the U.S. authorities intended to privatize Iraqi assets, including in the oil sector. Although they soon backtracked, the insensitivity of the announcement incensed Iraqis and had a high security cost (del Castillo 2008a: 151–53, 207–08).

The social transition

The effective reintegration of former combatants into society and productive activities is sine qua non for national reconciliation, as it is the reintegration of returnees, displaced populations, and other war-affected groups. Such a humongous challenge has proved impossible in stagnant and mismanaged economies. At the same time, reintegration has been particularly difficult in countries undergoing necessary but rigorous economic stabilization and structural reforms programs. The experience of El Salvador in 1992 (although the IMF imposed less stringent fiscal and monetary targets in subsequent years) is well documented (del Castillo 2001: 1978–79), and so is the one on Iraq (Looney 2004).

Public jobs in infrastructure rehabilitation and services as well as jobs with foreign agencies, which are by nature transitory, have proved inadequate to the task. Productive reintegration requires sustainable livelihoods that countries have mostly failed to create. It also requires advance planning, bold and innovative solutions, large financial resources, and staying the course with the right policies, frequently for many years (del Castillo 2008a: 255–261).
Good and bad experiences with economic reconstruction in the last quarter of a century clearly indicate that the international community should not underestimate the importance of supporting reintegration in a sustained manner going forward. Programs with more training, technical assistance, and credit have proved to show better results, but lack of support on a sustained basis has led to public insecurity and even a relapse into conflict (del Castillo, 2008a: 135; 2010: 199–200).

The economic transition

The capital sin of economic reconstruction has been the inability to create conditions such that people could see a quick improvement in services and work opportunities. Lack of inclusive domestic policies, together with fragmented and wasteful use of aid for the reactivation of investment and the provision of basic services and infrastructure, have been major impediments to effective economic transition. The problems with aid in general and with turf-battles and other inefficiencies at the UN and donor countries have been discussed elsewhere (del Castillo, 2014c: 146–155; 2014b: 166–174). Suffice it to say here that most foreign-supported economic policies and infrastructure development have been targeted to foreign investors and domestic elites, depriving the large majority of a level-playing field for investment while providing for some of their basic needs through humanitarian assistance. Moreover, in some countries, as much as 70–80 per cent of total aid has been channelled outside the government budget and hence according to donors’ own agenda, which has precluded an integrated reconstruction strategy according to the countries’ own priorities.

Many of these countries grew rapidly (albeit from a low base) during reconstruction. Table 2 shows that of the 18 countries for which there are data, 5 of them grew at between 7 and 11 per cent throughout the first decade. Others, such as Angola for example, grew at 15–20 per cent in years following peace agreements, and output collapsed when the country returned to civil war. In largely rural countries, such as Afghanistan, output fluctuated widely depending on the weather.

However, most of the high growth was in construction and services, largely targeting the foreign presence (civilian and military) in the country. High growth often led to upbeat reports on the part of foreign interveners, despite the obvious fact that they could not be sustained. By failing to create sustainable opportunities for the population at large, war-torn countries have missed out on the productive capacity and creativity of a large part of society, making inclusive and prolonged growth elusive, and often fuelling new conflicts over land, water, other natural resources, and displaced communities. As Tony Addison noted, it is important that the natural capital (land, forest, fisheries) of poor communities, often lost to predators during the war, be strengthened quickly through tenure reform to protect them from the land grab and displacement that often occurs after war (Addison 2003: 10).

Despite every foreign intervener paying lip-service to the need to bolster gender equality, subsistence agriculture and livestock production—where the large majority of women work and which provides between 70 and 80 per cent of livelihoods in most war-torn
countries—has been greatly neglected in favour of productive projects which have a long-gestation period and require expensive infrastructure that takes time to build. Lack of basic inputs has made the productivity of women in agriculture particularly low. Lack of food security has often made these countries food dependent, despite having been self-sufficient before the war.

For economic reconstruction to succeed and support other aspects of the transition, it is necessary to think outside the box to start gradually replacing aid with foreign direct investment (FDI) and exports as sources of revenue and foreign exchange, particularly in resource-rich countries. In this regard, a fair and equitable legal framework is most crucial, as it is to avoid conflict-insensitive policies that fuel discord by putting governments and foreign companies, often from emerging markets, in a direct confrontation with local communities. The control of natural resources is often a root cause of conflict and their exploitation can become a major challenge as wars end (del Castillo, 2014a).

Foreign investors and local communities must find win-win ways of working together. For this purpose, proposals for ‘reconstruction zones’ (del Castillo 2011a; 2012a), not unlike the ‘promise zones’ that President Obama is gradually introducing since January 2014 in vulnerable parts of the United States, should be carefully debated, as should any other proposals that could promote peace, stability, and prosperity. Other conflict-sensitive proposals for improving the use, impact, and fairness of aid, such as providing domestic firms with subsidies for hiring unskilled and war-affected groups (del Castillo & Phelps 2007), or providing farmers with loan and price support policies to replace illicit drug production should also be debated (Phelps & del Castillo 2008).

**Concluding Remarks**

Building more effective states and replacing the war economy has acquired a new sense of urgency since extremist groups such as Hezbollah, Hamas, Al Qaeda, the Taliban, ISIS, Boko Haram, among others, increasingly recruit people by providing services and other needs to those deprived of them due to government failures. These groups finance themselves mostly by drug and other racketeering activities that thrive in insecure areas lacking alternative livelihoods.

The renewed sense of urgency also relates to the growing global repercussions of failed statebuilding interventions. War-torn countries have a disproportionate political impact and large financial consequences. As the global crisis hit in 2009, Afghanistan, for example, was at the top of the U.S. and other donors’ foreign affairs agenda despite representing only 0.02 per cent of global output (del Castillo 2010b: 197; 2014b: 198–99). By 2014, with Iraq and Afghanistan together accounting for only 0.3 per cent of global output, the United States had spent roughly $1.6 trillion (or $20,000 per family of four) in the two wars, in addition to the trillions of dollars in non-budgetary expenditure accruing on pensions and disability payments. Moreover, war-torn countries have affected the relationship between the United States and major allies over Iraq, and have led to the worst confrontations between the United States and Russia since the end of the
Cold War over Kosovo, Abkhazia and South Ossetia. More recently, Syria and Ukraine illustrate best the impact that these countries can have on international relations.

The direct and collateral effects at the regional level are also large. Despite the basic intra-state nature of conflicts in Afghanistan, the DRC, Syria and Iraq, the negative impact from the interruption of production, investment, and trade are felt throughout their respective regions. Moreover, conflicts result in refugees and displaced populations and increased transnational criminal and terrorists activities.

Much attention has been given in public debate, in the academic literature, and in the press to the security, political, and social transitions. By contrast, the economic transition, which is fundamental for the others to succeed, has been much neglected. At the same time, both analysis and policymaking have proceeded with a silo mentality—that is, with the four areas discussed mostly in isolation from each other, rather than in a multidisciplinary fashion—as they should given the high interrelation between them.

Anniversaries—such as the 30th of UNU-WIDER together with the 70th of the UN this year—provide an opportunity to reflect on the lessons of the past and set new paths for the future. The purpose of this paper has been to review the past and contribute ideas on how to move forward in a more cost-effective way to reduce the high risk that countries in the transition to peace have of relapsing into conflict, ending up aid dependent, or experiencing significant migration. Avoiding such fate should be the first and foremost consideration in policymaking until countries can move to a path of normal development.

A debate, such as the one that took place at the time of the Marshall Plan, must take place among foreign interveners; national authorities and other experts; and political, security, and economic scholars on a wide variety of issues. In my view, and despite the peculiarities of each particular case, some of the basic principles and related questions to debate that could put economic reconstruction in a fundamentally different path going forward are the following:

**Economic reconstruction is fundamentally different from development as usual.**

How to strengthen support for a new paradigm for economic reconstruction in which sub-optimal, emergency, and targeted policies are temporarily acceptable, despite the delays in economic stability and distortions they may create, to ensure that the country does not slid into conflict? How to make such paradigm operational at the level of national and local governments, as well as at the organizations of foreign interveners? How can the UN, the Bretton Woods institutions, and other foreign interveners be more effective and avoid internal turf battles? How can a simple and flexible framework for macro- and microeconomic policymaking be established at the national level to create an appropriate economic environment within the political, security and social constraints of the transition and the scarcity of human resources, capabilities, institutions, and infrastructure? How can the international community best support programs for productive reintegration of groups that have been marginalized by the war?

**Political decentralization is essential for better leadership and effective reconstruction**

How to establish and support political decentralization à la Myerson to improve democratization efforts and the conditions under which economic reconstruction takes
place? Should elections at the subnational level take place before national elections? How to apply Myerson’s dictum that any country that accepts foreign intervention should, as a matter of principle accept that assistance be also provided to legitimately elected subnational governments? What is the most effective way for foreign interveners to channel aid to support local leaders and to improve the distribution of public goods and promote productive activities at the subnational level? Should aid be channelled through a trust fund in the national budget ear-targeted to subnational governments or should it be allocated directly to the local authorities? What is the most effective way to ensure that customs revenues collected at the borders, a major source of finance in war-torn countries, are included in the national budget and fairly distributed to local governments?

**Aid policies need to be rethought conceptually and operationally**
How can the fragmented aid policies of the past be made more effective and accountable? What is the best way to transition more rapidly from humanitarian aid for saving lives and providing minimum levels of consumption, to reconstruction aid to promote investment in critical sectors such as agriculture and small businesses that provide the livelihoods of the large majority? How to ensure that policies and institutions are designed in accordance with the country’s financial and technical capacity? How can foreign interveners support the country in making reasonable projections in terms of aid and tax revenue to avoid unworkable plans, unreasonable expectations, and long-term aid dependency? How best to use aid to establish well-planned and synchronized programs for disarming and reintegration, which are *sine qua non* for making the transition from peace irreversible? What resources and technical assistance would be necessary to provide incentives to the ‘rank and file’ of different insurgencies to reintegrate into society and productive activities? How can aid be used to provide loan and price support programs to sharply reduce drug-related and other such activities that provide financing to the insurgencies? How can it be used to turn the entrepreneurial spirit of small farmers and other micro-entrepreneurs into productive activities so that dependency on aid withers over time? How can aid be best used to provide domestic firms with subsidies or other incentives for hiring unskilled and war-affected groups? What is the most effective support that foreign interveners can provide in highly insecure situations with the purpose of reactivating investment?

**Countries need to replace aid with foreign investment and exports as soon as feasible**
What is the most effective way to promote foreign direct investment and exports to replace aid as a source of foreign exchange in war-torn countries? What is an effective and fair legal framework for the exploitation of natural resources and to ensure that foreign investors do not operate as ‘enclaves’ in the country? How can governments, foreign interveners, foreign investors, and local communities work together in ‘win-win situations’ where the foreign investors benefit from increased security and the communities benefit from a level-playing field, better services, and improved livelihoods?
Bibliography


Table 1: Aid Comparison Across War-Torn Countries

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Source: Calculated by author using data from World Economic Outlook Database (April 2015); OECD total aid based on official development finance (ODF) (August 2015)

Note: ODF data include (a) bilateral ODA, (b) grants and concessional and non-concessional development lending by multilateral financial institutions, and (c) Other Official Flows (including refinancing loans) which have too low a grant element to qualify as ODA. Data shows ODF disbursements during the first decade of the transition to peace in the reported countries; it also reports the average aid flows during the first 3 years (t0-t2), 5 years (t0-t4), and 10 years (t0-t9). Kosovo is not included among the countries that had multidimensional UN operations since data is available only from its independence in 2008. Somalia is not included either for lack of data.

1/ Data for Afghanistan was adjusted in 2008-09 to account for $8.8 billion debt relief from Russia; 2/ Bosnia data for 1995-97 are from WEO April 2013; 3/ Democratic Republic of Congo; 4/ Data for 2003 taken from IMF, Letter of Intent (Sept. 2004); 5/ Data for 1999 taken from IMF Statement at Donor’s Meeting (June 2000).
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Sources: Calculated by author using UCDP-PRIO data on conflict; IMF World Economic Outlook Database (April 2015); and latest indices

Notes:
1/ Includes countries coming out of internal conflicts (often with regional implications) that embarked in the transition to peace with UN and/or other foreign support up to 2011. Dates in first column indicate first decade of the transition.
2/ Peace agreement (PA) or military intervention (MI). MI* indicates MI for humanitarian purposes and MI** for regime change.
3/ Yes indicates that the country relapsed into some kind of conflict that required intervention, led to large number of refugees, or collapsed the economy.
4/ AG is the average growth rate of the country during the first decade of the transition to peace. In Afghanistan and Timor-Leste data for the first year is not available (NA) and for Bosnia the first four are NA.
5/ The Failed States Index is compiled by the Fund for Peace. 6/ The Human Development Index is compiled by the UNDP. 7/ The Corruption Perception Index is compiled by Transparency International.
8/ The Anti-Money Laundering Index, a measure of money laundering and terrorist financing, is compiled by the Basel Institute of Governance.
9/ UCDP-PRIO do not report data on Timor-Leste or Kosovo. For these, information is from UN.
Endnotes

1 Work with Mario I. Blejer on ‘Capitalism in war-torn countries’ (in progress).
2 Analysts using a wider sample, which includes countries that are not going through the complex transition and have localized conflicts such as Peru and Colombia, have estimated probabilities of 40 to 50 per cent. More than the exact figure, what matters is the high probability of war-torn countries to relapse.
3 To avoid repetition, these terms are used interchangeably throughout the text.
4 The speech is listed without its name and with the wrong year in the bibliography and referred to it only in footnote 27 in relation to the linkages between political, security and economic dynamics.
5 To be fair to the Bretton Woods institutions, in some cases it was the economic authorities of the sovereign countries that pushed for an orthodox macroeconomic framework. This was clearly the case of Afghanistan where the finance minister was a former World Bank official (and now president) (del Castillo 2008a: 177-79, 188-89; 2014b: 181–184).