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REBUILDING POST-CONFLICT AFRICA: RECONSTRUCTION AND REFORM

Tony Addison

November 1998

UNU World Institute for
Development Economics Research
(UNU/WIDER)

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1. Introduction

More than 30 wars – most of them intrastate – have been fought in Africa since 1970. Conflict reached new heights in the 1990s; in 1996 fourteen of Africa's 53 states were afflicted by armed conflict. These accounted for more than half of all war related deaths world-wide. [1]

Africa's war damaged economies and societies must be rebuilt. But the challenges are many; social and economic infrastructure must be reconstructed, fractured communities must be resettled and new livelihoods developed. The costs are immense and domestic resources are limited. 'Wish lists' are of little help. What we need are well-defined priorities to guide resource use; in particular to ensure that poverty reduction is achieved. Therefore hard choices must be made.

As well as reconstruction, post-conflict countries are engaged in changing their development strategies. Their aim is to achieve broad-based (poverty reducing) growth. This involves altering economic policies, public spending and - critically - institutions. This process is commonly described as one of 'adjustment' or 'reform'.[2]

Ideally, reform should be fully compatible with reconstruction. Since both are working towards the same objective - to rebuild societies and place them on the development road - they should be one and the same process. Unfortunately this is seldom the case in practice, partly due to the number of aid agencies involved and their different responsibilities.

There are many aspects to post-conflict reconstruction. This paper focuses on one crucial aspect: how to ensure that economic reform is compatible with reconstruction. To achieve this task we must understand what communities need in order to rebuild their livelihoods, and how a new private sector is emerging as liberalisation and privatisation proceed. Communities and entrepreneurs constitute two key national actors in reconstruction. These issues are discussed in section 2. The third actor is the state, the focus of section 3. We pay particular attention to fiscal issues, since this is an area of tension in the relationship between reform and reconstruction. Section 4 concludes by setting out ways in which economic reform can help to securr peace. Examples are drawn from Africa and, when relevant, from other regions.

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[1] Countries which are, or have been, in conflict since 1970 include: Angola, Burundi, Congo, Democratic Republic of Congo (DRC), Eritrea, Ethiopia, Guinea Bissau, Liberia, Mozambique, Namibia, Rwanda, Sierra Leone, Somalia, South Africa, Sudan, Uganda, and Zimbabwe.

[2] A better description is 'transition' - a term used to describe the process in Eastern Europe - which embraces the notion that market liberalisation will not yield broad-based growth unless institutional change and investment take place (Addison, 1998). However, for the purposes of this paper we will stick with the conventional term 'reform'.

2. Communities, Entrepreneurs, and States

2.1 The Challenge

Aid helps reconstruction and reform but success ultimately depends on the actions of three sets of *national* actors; communities, entrepreneurs, and states:

- **Community Reconstruction**. Post-conflict communities are impoverished. If they are not helped to reconstruct their livelihoods together with their human and social capital then growth, if it occurs, will be shallow and poverty will remain deep. And the supply responses of smallholders and informal producers to economic reforms will remain limited, thereby constraining the success of reform itself. Key problems include the scale of human need in relation to the resources available to meet it - we must therefore prioritise help carefully - and insecurity among communities about their rights to natural resources, particularly land.

- **Private Sector Development**. Broad-based development will not occur unless entrepreneurs are able to invest and create the matrix of markets in which communities make their livelihoods (especially in agriculture). Without sufficient investment, markets will remain thin, remoter regions will be left behind, and reform will not generate growth. Key problems are the absence of an efficient domestic financial system to fund private investment and underdeveloped regulatory systems and weak property rights (see section 2.3)

- **Building a Development State**. A market economy capable of spreading its wealth widely will not develop in the absence of a state capable of protecting property rights, regulating markets in the public interest, and providing public goods, particularly basic health services and primary education. A democratically accountable state is needed to sustain reform by building consensus in civil society. Key problems include financing the state and its institutional development, weak budgetary systems, and insufficient attention to social priorities in fiscal frameworks (see section 3).

These are large and complex questions, and this paper offers only tentative answers. We start with the need to understand what is happening within communities, and to embed this knowledge in policy-making.

2.2 Community Reconstruction

From Humanitarian Assistance to Poverty Reduction. War leaves a legacy of soldiers to be demobilised, weapons to be decommissioned, and refugees to be resettled. As well as meeting these immediate needs, we must rebuild the economic and social infrastructure which supports longer-term human development. As reconstruction proceeds, increasing amounts of resources can be shifted from humanitarian assistance to more permanent social recovery. Wartime food aid, for example, can be reduced as projects to raise smallholder food production take effect and as targeted nutritional assistance is introduced.

Angola illustrates the scale of the problems. There are anywhere between 9 and 15 million land mines in a country of 10 million. War has depopulated the rural areas and many towns; some 40 per cent of Angola's population is now packed into Luanda (World Bank, 1996). These immediate problems together with the demobilisation of ex-combatants need to be resolved if peace can be secured. At the same time, resources to restore smallholder agriculture and social infrastructure must be stepped up. Agricultural production is now 5 per cent of its pre-conflict level. Social infrastructure is inadequate; more than half the classrooms available in 1980 were unavailable by the 1990s (Tvedten, 1997: 110). Angola is unfortunately not unique. The low level of human development indicators in a selection of post-conflict countries is shown in Table 1.

The purpose of this paper is not to detail the level of human suffering that exists, important though it is. Rather, we make the following points on the relationship of community reconstruction to economic reform.

Setting Expenditure Priorities. Public money must be focused on core services of most benefit to the poor; primary education, basic health services and safe water and sanitation (see Addison and Ribe, 1996, for SADC examples). But given the scale of needs, and the resource constraints, hard choices exist within the area of basic services. For example, until revenue mobilisation rises, it may not be possible - within existing budget constraints - to reconstruct both rural education and health services destroyed during conflict and to make entirely new investments in areas which never had services. Lack of resources may force a choice of one over the other - an undesirable state of affairs. Hence, it is critical to carve out savings from other areas of the government budget in order to reduce the constraint on funding basic services.

In the face of these difficulties, governments and donors may be tempted to focus on highly visible social programmes which nevertheless have limited coverage, and to avoid the hard choices necessary for the proper resourcing of basic services. Because it entails a comprehensive review of the effectiveness of public expenditure, economic reform provides an opportunity to resource basic services. If done well, public expenditure reform supports the objective of social reconstruction. But this is only possible if the macro-economic framework itself - particularly its fiscal deficit target - is not unduly restrictive (see section 3).

Rewriting the Aid Contract to Focus on Poverty Reduction. Aid conditionality attempts to induce a set of policy changes - the 'inputs' into recovery - through up-front commitments by government. But it is over-complex, assumes that donors have full information about what are the right policies and spending priorities, and repeated reform breakdowns show its limited effectiveness (Killick, 1996).[3] Collier *et al* (1997) suggest a new government-donor contract which places more emphasis on a small set of 'outputs' of reform - growth for example. These can be monitored by *retrospective* assessment, with good performers (adjusting for bad luck, such as external shocks) being allocated more aid.

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[3] Moreover, the role of aid in conflict situations must be reassessed. The domestic contest over the resources provided by aid has sometimes contributed to the outbreak of conflict (see Uvin, 1998 on Rwanda and Maren, 1997 on Somalia, for example) and has, in some cases, prolonged it (see Duffield, 1994).

Table 1

HUMAN DEVELOPMENT INDICATORS FOR SELECTED CONFLICT, POST-CONFLICT & NON-CONFLICT COUNTRIES

	Life Expectancy at Birth (years, 1995)	Adult Literacy (%, 1996)	Combined first, second, and third year level gross enrolment ratio (%, 1995)	HDI Index
Angola	47.4	42.0	30	0.344
Burundi	44.5	35.3	23	0.241
Eritrea	50.2	25.0	29	0.275
Ethiopia	48.7	35.5	20	0.252
Guinea Bissau	43.4	54.9	29	0.295
Mozambique	46.3	40.1	25	0.281
Sierra Leone	34.7	31.4	30	0.185
Uganda	40.5	61.8	38	0.340
Average for UNDP Low Human Development Group	56.7	50.9	47	0.409
Non-Conflict Comparison Countries				
Ghana	57.0	64.5	44	0.473
Namibia	55.8	76.0	83	0.644
Tanzania	50.6	67.8	33	0.358
Zimbabwe	48.9	85.1	69	0.507

Source: UNDP (1998) *Human Development Report, 1998.* New York: Oxford University Press for the United Nations Development Programme.
Note: the human development index is based on three indicators: longevity, as measured by life expectancy at birth, educational attainment, as measured by a combination of adult literacy (two thirds weight) and the combined first-, second- and third-level gross enrolment ratio (one-third weight); and standard of living, as measured by real GDP per capita (PPP$) - the latter is not shown in our table (UNDP, 1998: 107). Countries are classified into three groups: high human development (HDI values of 8.00 and above); medium human development with HDI values of 0.500 to 0.799, and low human development, with HDI values below 0.500.

Taking this idea forward, we suggest that for countries that signal commitment to social recovery - by shifting public money to core social services - agreed targets for key social 'outputs' (infant mortality, female enrolment etc) should be monitored and enter the 'aid contract'. Until social data collection is improved, the components of the UNDP's human development index (HDI) - see table 1 - and the associated gender development index (GDI), could be used.[4]

[4] The HDI is not a 'perfect' measure of human progress; no such indicator exists (Anand and Harris, 1994). But it has the considerable merit that the necessary data are available for 174 countries. The GDI is available for 163 countries. Our suggestion here is to use its social components; life expectancy and measures of educational attainment, rather than the index itself (because of disagreements over its weighting) and to invest in more data collection to diversify the social indicators. Without such investment, neither governments nor their donor partners can assess the effectiveness of their policies (Addison, 1996).

Investing in Poverty Information - to identify priority needs - is critical to sharpening the poverty focus of public policy. Timely household surveys and participatory studies clarify the social impact of reform and identify the incidence of public expenditures, which are often skewed towards the non-poor (Addison, 1997a). On this basis, poverty reduction can be embedded into public expenditure reallocations, and the targeting of nutrition assistance (to replace wartime food aid) can be enhanced. Mozambique, for example, is building a good base of poverty information using a variety of techniques. Making this information freely available, as South Africa has done, strengthens democracy by providing a base of objective information for debate within civil society.[5]

2.3 Private Sector Development

Without a vigorous and competitive private sector neither reconstruction nor economic reform can succeed. Regulatory reform and financial reform are critical to the process. But so too is the protection of property rights (including the rights of communities) and the provision of public goods. Without a development state, transactions costs are high, and development is slow (North, 1997). In Somalia today, commerce is quite vigorous but investment in production is limited by the absence of enabling formal institutions (Mubarak, 1997).

A great deal can be said about institutional development. But, here we confine ourselves to one key point; reconstructing institutions is necesary for economic reform to work. The following issues arise:

Reducing Investor Uncertainty. Chronic uncertainty prevails in countries with histories of conflict; time horizons are short and opportunistic behaviour flourishes (renaging on contracts is one example). Under predatory states, opportunistic behaviour by political elites and lack of investment in state institutions leads to pervasive corruption, which lowers and distorts private investment.[6]

Entrepreneurs therefore favour safe areas and commerce (for example the trade in food into capital cities and import businesses). Commerce requires less physical capital than production and it is easier to exit in uncertain times. It also has more immediate returns, an important advantage when the future is unpredictable. Production investments are more vulnerable to policy reversal, which is frequent under unstable government. Total investment therefore falls and shifts away from long term production investment. Overcoming investor uncertainty is therefore a key task in post-conflict countries:

- Broad-based development requires increased investment in long-term production, particularly in agriculture, and remoter regions (in which destruction is often greatest, and poverty deepest).

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[5] Such information reveals politically unpalatable facts, such as differences in regional living standards (a potential source of conflict), but hiding the facts does not ease social tensions. Governments which keep social data secret are usually hiding evidence of their own resource misallocations (Malawi under Banda is an example).

[6] Corruption discourages private investment by more than equivalent taxation because corruption is largely arbitrary in its application. Entrepeneurs therefore face a cost which is additional to the bribe itself (Wei, 1997).

- The successful transition from state- to private-sector agricultural marketing depends on private investment to establish new market networks for grains and cash crops. With more entrants, competition increases and margins (and therefore real consumer prices) fall. More private investment in storage and transport reduces fluctuations in food prices. Both effects benefit the poor as consumers. More private investment in marketing benefits smallholders selling cash crops.

- Reducing country risk raises domestic and foreign bids for state owned enterprises (SOEs). This enhances their restructuring and improves their growth prospects. It also increases government proceeds from privatisation, thereby easing the finance of social investments.

Uncertainty is at its highest after long conflicts, and greatest after civil wars. Angola's conflict has lasted on and off for 20 years. Mozambique's war lasted 16 years. But the nature of the political settlement also affects how fast investor uncertainty declines. Private investment in Angola is still limited four years after the Lusaka protocol which formally ended the war, and is now discouraged by further fighting.[7] In contrast, Mozambique secured peace through successful multi-party elections; foreign investment grew after the 1992 ceasefire as investor confidence increased, and accelerated after the 1994 elections. Successful investment in the institution of democracy has provided the political space for economic reform to do its work, and encouragement for a strong private investment response. Mozambique received direct foreign investment commitments of at least $1 bn in 1997.

Attracting Foreign Investment. Since investment opportunities in post-conflict countries substantially exceed domestic savings - and the gap is larger than for a non-conflict developing country - it is critical to attract foreign investment. When past foreign investment has been low, potential foreign investors have little information to guide their risk assessments, which may be unduly high.[8] Potential foreign investors gather information by observing the investments of others. But if initial investment is low, potential investors have very little information to guide them. Each investor is reluctant to go in first even though the returns to first entrants may be very high *ex post.*[9]

Donors can reduce investment inertia by providing partial insurance of the political risks and by improving information flows to potential foreign investors. But it is largely up to governments to signal reduced country risk. Producing a simple, clear, enforcable - and uncorrupted - regulatory framework is a good place to start. Securing private property rights entails considerable institutional investment, especially in formerly state socialist countries in which much property was vested in the state (Angola, Ethiopia, and Mozambique, are examples).

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[7] The major exception is foreign investment in the oil sector which, being offshore, is protected. Mobil alone is planning to invest a further $1 bn to expand its Angolan operations. Congo also has substantial oil investment (again offshore and enclave). Insecurity has constrained the development of an on-shore service industry in both countries, thereby limiting the employment benefits of oil investment.

[8] A country's diaspora is better at estimating the investment risks than foreign investors. Returning capital (both human and financial) has been important to the reconstruction of Eritrea and Ethiopia.

[9] Instead they wait for the positive informational externalities provided by first entrants. This "wait and see" behaviour can result in limited foreign investment after peace despite lower risk (see Thimann and Thum, 1998).

Managing Investment Projects and Privatisation. In particular, the rights of communities must be safeguarded. Access to arable land, pasture, forests and fisheries is the natural resource base of most households, particularly the rural poor. Access and traditional community management has been disrupted by colonialism, state socialism, and war. The result is overlapping and competing claims over land.

Mozambique provides one example. Community rights have been ignored in the privatisation of many state farms (Myers, 1993). Most of the smallholder lands originally incorporated into state farms were not returned to communities. Instead they were incorporated into new private farms and mixed enterprises such as as Lomaco in Gaza province, in which the multinational Lonhro has a majority share (Noronha, 1994). In southern Mozambique (in the area stretching along the coast from the South African border), a whole series of projects has been proposed, some with major and negative impacts on the natural resource base of local communities.

The rights of communities must be given better legal protection, and the impact on communities of projects must be carefully assessed. This requires serious institutional investment in national capacities for appraising the social and environmental effects of projects and, perhaps, more decentralised decision-making (when this gives more voice to communities). In Mozambique there has now been extensive debate about the need to secure land rights, but more action is needed (Addison and Ribe, 1996).

Moreover, privatisation must be carefully implemented. Privatisation is essential because it releases public money for core social spending and public goods, and the state does not have the resources or managament expertise to run, for example, telecommunications. But success or failure in creating a market economy depends on *transparent* privatisations within a proper legal framework. Although the Former Soviet Union may seem far away from Africa's concerns, the FSU transition experience highlights the dangers of mismanaging privatisation. Non-transparent privatisations have resulted in an accumulation of wealth and political power which works against broad-based development and democratisation (Yavlinsky, 1998). Unfortunately, Africa now has its own examples of irregular privatisations.

Appropriate Regulation. Market liberalisation and privatisation need the support of a sound regulatory framework. Regulatory mechanisms must protect the public interest, especially in sectors which are natural monopolies, while not unduly limiting the incentive to start new enterprises (Stiglitz, 1994). Unfortunately, countries have made little investment in regulatory institutions, and this needs urgent attention.

Regulation of the financial sector is especially important. In post conflict countries, financial systems need to be recapitalized and banking networks rebuilt (especially in rural areas) to restart both savings and investment (in private agricultural trade, for example). Financial reconstruction is necessary to raise investment responses to economic reform and to mobilise domestic savings, including the modest savings of communities.

Considerable resources are necessary to recapitalise a financial system, which in turn requires privatisation of state banking (as in Mozambique) and foreign investment. But, in the rush to regenerate the financial system, unsound banks can easily be created with financial speculation (especially in real estate) prevailing over lending long-term to

productive investment. The regulatory capacity of most of the region's central banks is rudimentary, especially in post conflict countries. Eritrea's central bank has been built from scratch and Ethiopia's central bank only established a regulatory department last year. The recent bank failure in Zimbabwe, which has a history of strong financial supervision, is a worrying sign.

Lack of prudential financial regulation followed by financial collapse is a major cause of social instability. The collapse of Albania's pyramid lending scheme and Indonesia's banks are recent and spectacular examples. Bank distress played a role in the lead up to many of Africa's conflicts. For example, in Congo, Guinea Bissau and Somalia, state banks were used to redirect lending for personal gain and eventually collapsed under portfolios of bad loans, taking small depositors with them.

Financial liberalisation as a reform strategy must be carefully assessed. The new consensus is two-fold. First, financial liberalisation improves growth by improving savings mobilisation, the use of funds and the quality of investments (all important in post-conflict countries which have low savings and many potential investments). But, second, a strong regulatory framework must be built before substantially reducing controls on the borrowing and lending practices of the private financial sector (Stiglitz, 1998). We can add a third point; prudent financial regulation can only be sustained in countries which invest in democracy and its institutions to provide the political space for regulators to carry out their work without political interference.[10]

Politics and the Private Sector. The private sector provides a source of party political finance (as it does in the mature democracies) in contrast to the state funding typical of Africa's old one-party systems. Historically, the growth of democratic institutions in Europe and North America ran alongside the growth of the private sector and civil society.

We see in Africa (and other democratising regions) an increase in the phenomenon of 'straddling', whereby political leaders and high state officials invest in private enterprises through intermediaries. Two forces propel this. One is the growth of the private sector itelf, as economic reform and reconstruction from war take effect. Second, is the growing institution of multi-party elections, and therefore the need for party finance.

Excessive straddling can be highly detrimental to growth since politicians have an incentive to create economic rents for selected parts of the private sector (see Bigsten and Moene, 1996, on the Kenya case). This in turn harms the management of the reform and reconstruction agendas. Businessmen without high political friends may be discriminated against in regulation and taxation; this is cited as a barrier to investment by Ethiopian businessmen, for example (Hansson, 1998: 23). Because straddling increases tax evasion (by the favoured) it exacerbates fiscal problems. Finally, straddling has featured in the processes leading up to conflict. In Burundi, for example, ministers held monopolies in entire sectors (gasoline distribution, for instance).[11]

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[10] Financial crises occur in mature democracies as well. The key point is that the separation of powers, the creation of constitutional checks and balances, and the development of a free media (all examples of democratic investments) restrain, but do not completely prevent, political manipulation of the financial system.

[11] I am grateful to Léonce Ndikumana for his comments on these issues.

3. The State and its Finances

3.1 The New State Agenda

A critical task is to construct a developmental state. This is a set of democratically accountable institutions capable of effective policy design and implementation. The new state agenda is compared to the old agenda in Box 1. The new agenda is ambitious, controversial, and resource intensive.

Civil service reform is one of the most important tasks. Since independence, public employment has expanded rapidly across Africa, and accounts for especially large shares of fomal employment in post-conflict countries where private employment has collapsed. In Angola, for example, the public sector accounts for 75 per cent of formal employment. Usually the civil service is underpaid (the average state wage in Guinea Bissau is less than half that of a hotel waiter, for example) and low morale reduces the quality of public services.

In some countries, staff are now being retrenched; civil service reforms aim to improve the quality of services (in part by raising pay), and to carve out savings for use elsewhere, particularly to strengthen basic social services. Eritrea, for example, reduced its public workforce by one-third shortly after independence, one of Africa's most rapid and comprehensive retrenchments, and doubled the pay of some its employees (IMF, 1997).

Civil service reform yields savings, but it is not a panacea for budgetary crisis. Raising civil service wages to market levels (to retain key staff and raise efficiency) is expensive. The professional labour market in post-conflict countries is thin, and the state must compete with aid donors and a revitalised private sector for scarce skills.

Limited public revenues will require new innovations; Mozambique, for instance, put out its customs service to competitive contract, and the newly reorganised service must meet higher revenue targets. Such a radical recasting of state operations appeals to proponents of the 'minimal state'. But overhauling budgetary institutions and planning systems, regional decentralisation, and delivering basic social services - to name just three critical tasks - will be resource and skill intensive. Thus, the new developmental state will eventually look very different to the old state, but it is unlikely to absorb fewer resources.

Rent-seeking is a real danger and interventions have often enriched elites by taxing the poor. And every dollar wasted on unnecessary bureaucracy is a dollar less for reconstruction and poverty reduction. Therefore, the onus is on democratic governments to prove that they provide value for money to communities and entrepreneurs.

BOX 1 THE STATE: OLD AND NEW AGENDAS

OLD AGENDA	*NEW AGENDA*
Political and state organization	
• one party, centralized states	• multi-party, decentralized states
• property rights vested in the state, politicized judiciary	• private property and human rights protected within an independent legal framework
• large predatory military	• professional military
• state media	• independent media
State owned enterprises	
• loss-making SOEs in production, commerce and utilities	• privatization, commercialization, foreign and domestic purchase of equity; regulatory system for privatized SOEs
• state financial system, directed and politicized credit allocation	• privatization or commercial banks permitted to operate alongside state banks
Budgeting and planning	
• weak budgetary and planning process; budget overruns, capital spending not matched by recurrent spending, O and M crises	• tight budgetary and planning process to coordinate sector plans/budgets to overall development strategy, and focus public money on core expenditures
• non-transparent budgeting and planning, weak financial control, expenditures and revenues off budget, debts incurred outside normal Treasury procedures	• greater transparency: accountability to new legislatures, all expenditures and revenues brought within the budgetary framework; strict debt reporting procedures
Public administration	
• centralized public administration	• decentralized public administration to match political decentralization
• large civil service, favouritism in hiring	• smaller scale and more professional civil service, elimination of 'ghost workers'
• underpaid and demotivated state employees: narrow salary range, real wage decline	• public wages commensurate with private sector; real wages increased
• over-complex bureaucratic rules and regulations linked to corruption.	• straightforward and clearly understandable system fairly applied
Tax and customs authorities	
• weak and corrupted tax and customs authorities	• restructured tax and customs authorities, customs service put out to private contract
Central bank	
• weak voice in macro-policy decisions relative to government and political leadership	• increased autonomy
• politicized financial regulation	• strong powers to regulate and supervise the financial system
Government statistical service	
• weak capacity to collect social and economic data, culture of data secrecy	• investment to ensure regular data collection for policy making

3.2 Overcoming the Fiscal Crisis

The new state agenda will remain a wish list unless it is properly financed; at present it is not. Reconstruction expenditures are high, revenues are low (war reduced tax bases) and distorted (over dependence on trade taxes). Countries are severely indebted; almost all Africa's conflict/post-conflict countries are classified as 'Heavily Indebted Poor Countries'.

The 'Peace Dividend'. Demobilisation and the creation of a smaller and professional military are both expensive. Badly paid armies typically live off the land during conflict; civilians bear much of their cost, a 'tax' which is also highly regressive. The post-war state must take over these costs, otherwise they remain as a burden on community reconstruction. This, and the other costs of war-to-peace transition, absorb considerable amounts of public money, thereby limiting the size of the fiscal peace dividend in the immediate post-war years (Azam *et al*, 1994, Bevan, 1994).

In Eritrea, for example, government incurred large one-off extraordinary expenditures on demobilisation, reintegration, back pay to ex combatants, and payments to 'martyrs' families' who suffered casualties in the war. These expenditures peaked at 7.3 per cent of GDP in 1995, and payments to martyrs' families alone accounted for 13 per cent of total recurrent expenditures. Establishing a new peace-time defence force was also expensive: the salary costs of this amounted to 2.9 per cent of GDP in 1996, including increased pay for the armed forces (IMFa, 1997: 7).

Nevertheless, some countries have experienced a fiscal peace dividend. In the three years prior to the end of the war, the Ethiopian government spent on average 46.6 per cent of total current expenditures on defence, while social spending accounted for 17 per cent. In the first three years of peace the defence share fell to 16.4 per cent, and the social expenditure share rose to 23.5 per cent. In Uganda, savings in defence spending over 1992-95 (after demobilisation) amounted to annual budget savings of 10 per cent of recurrent expenditures on average (Colletta, *et al*, 1996: 20).

But the size of the peace dividend is limited if insecurity remains high after the formal end of war (Azam, *et al*, 1994). In some cases, peace has been temporary and conflict has taken new forms - Angola may be in this situation now. Peace is an international public good; securing it will permit resources to be redeployed to social need.

Tragically, an arc of conflict and instability presently extends from southern Sudan, Somalia and the Horn down through the Great Lakes region and into the DRC, Congo and Angola. In West Africa, Guinea Bissau, Liberia, and Sierra Leone remain unstable, with high levels of violence, while Nigeria pursues its own uncertain trajectory. The efforts of the international community to keep the peace are not seen as credible; witness the disastrous interventions in the Great Lakes region and Somalia together with the under-funding of UN peace-keeping efforts. And the regional powers in Africa are displaying a worrying competitiveness, as the recent events in DRC show (Herbst, 1998).

This insecurity keeps military budgets high across Africa. The Ugandan Government, for example, recently raised defence spending by 26 per cent from $104 mn to $131 mn in its 1998/99 budget, citing insurgency in the north and west. Eritrea and Ethiopia have now embarked on a potentially calamitous path, which threatens to derail plans to raise social

spending. Until peace is secured in Africa, military expenditures will continue to take a large slice out of the region's public spending.[12]

Budgetary Institutions. These are weak at mobilising revenue and allocating it to priorities, particularly poverty reduction. Planning systems produce wish lists, use incremental budgeting rules, and hard choices about resource allocation are avoided. This is compounded by off-budget donor projects which siphon recurrent spending away from core programmes (Wuyts, 1996). There is also a mismatch between sector budgeting and the macro-economic framework, particularly the fiscal deficit. Consequently, capital investments are made without sufficient recurrent funds (leading to schools without books etc.). These problems are common to low-income countries, but they are particularly acute in post-conflict economies, given their depressed starting points. Movement to a sector investment approach - to draw all contributions to a sector's finance into a common framework - are an important step forward; Mozambique's health sector is an example (Marshall, 1998: 169).

Non-Transparency. Improper use of public funds is highly correlated with a country's vulnerability to conflict. Somalia is an example; the budget was kept unclear to siphon off public money and aid "... the structure of the budget of Somala renders it essentially useless a tool for analyzing government expenditures" commented a World Bank public expenditure review shortly before the civil war (World Bank, 1991 cited in Coolidge and Rose-Ackerman, 1997). Donors, although aware of the problem, maintained aid flows despite clear evidence of corruption and a growing contest for aid which contributed to the eventual conflict (Maren, 1997).

Non-transparency is particularly problematic in countries rich in natural resources, with the exception of Botswana which has successfully used its mineral rents to fund development. In oil rich Angola, oil revenues are largely kept outside the state budget, and their use is unclear (see Aguilar and Stenman, 1996).[13] Non-transparency was also a feature of Zaire (see Boye and Ndikumana, 1998).

Debt Relief. Conflict countries have built up considerable debts which they are unable to fully service from meagre export earnings. In some cases - Angola and Congo - there are large commercial debts. These are mostly short-term credits taken on at very high interest rates against the collateral of oil earnings. In these countries, borrowing to buy arms has effectively mortgaged away a considerable amount of future oil and diamond earnings, thus limiting their use to finance reconstruction. There is also the problem of 'odious' debts contracted by regimes such as that of Mobutu of Zaire/DRC (see Ndikumana and Boyce, 1998)

[12] In its budget for 1998/99 (announced in June 1998) the Ethiopian Government allocated 995 mn birr to defence, 257 mn to the social sectors, and 257 mn for economic development. In making the announcment, the prime minister commented that the defence budget is marginally larger than in 1997 reflecting the border conflict (Source: *Africa Research Bulletin*, Vol.35 No.7, p.13545). It is to be hoped that military spending in both Eritrea and Ethiopia can be contained otherwise their border dispute will drain resources from urgent social sector spending.

[13] The main sticking point in Angola's relations with the IMF is accounting for the use of the oil revenues accruing to Sonangol, the state oil company. The overvalued exchange rate is also used to calculate the domestic currency value of the dollar oil earnings, which lowers the value of the transfer to the state treasury.

But in most countries the problem is one of official debt. The World Bank estimates that if the net present value of the debt to export ratio exceeds 200 per cent then full debt service is impossible; the median ratio for the 'Heavily Indebted Poor Countries' (HIPCs) is 438 per cent. In 1997 Mozambique's ratio was 1,020 per cent, the highest of any HIPC undertaking reform. This reflects the large inflow of concessional funding to reconstruct Mozambique's economy, and the war's effect on its export earnings (in comparison, non-conflict Tanzania, another HIPC, has a ratio of 634 per cent). Under new proposals, Mozambique (and other countries with a record of sustained adjustment) will receive debt relief amounting to a 57 per cent reduction in the present value of its debt. A full debt write off must eventually come, in part because the Asian crisis and the resulting depression in commodity prices will damage the ability of HIPCs to service their debts.

A key priority is to shift spending on debt service into core social expenditures (Addison, 1997b). Those opposing writing off official debts argue that there is no guarantee that resources will be redeployed to social recovery. This is a further reason for building a democratically accountable state (a measure that can also prevent the recurrence of unsustainable debt accumulation). Responsible governments are trying to signal their commitment. Uganda, for example, has unilaterally ring fenced debt relief for poverty reduction through primary education and basic health services, and will open its accounts to prove that the commitment is met. Such commitment deserves more donor support.

3.3 The Fiscal Framework

In summary, reconstruction expenditures are large and the tax base is low. As a result, the fiscal deficit *before grants* is very high in post-conflict countries; it was between 20 and 30 per cent of GDP in Mozambique in 1990-95. Consequently, these countries are very dependent on programme aid for budget finance (White, 1996). Mozambique has received $8 bn in aid since 1990 (see Table 2). Its fiscal deficit after grants has ranged between 5 and 12 per cent of GDP since the war's end.

Eritrea was initially cautious in accepting aid, but it is now more aid dependent than Ethiopia (see Table 2).[14] Despite the aid inflow, its fiscal deficit *including* grants still amounted to 18 and 16 per cent of GDP in 1995 and 1996 respectively, a rise from 7 per cent in 1993-94, reflecting the acceleration of reconstruction expenditures and war-related extraordinary expenditures (IMF, 1997a: 7).

Before economic reform, countries financed their large fiscal deficits by borrowing from the state financial system at low (administered) interest rates - thereby crowding out the private sector - and by monetising the remaining (unfunded) deficit, thereby creating high inflation (still the situation in Angola). Together with external terms of trade shocks this reduced growth by causing macro-economic instability.

[14] Breakaway Somaliland, which is not an internationally recognised state and which therefore receives very little aid, illustrates the fiscal problems of trying to reconstruct without aid. Export taxes (principally livestock exports) and the limited seignorage from the issue of the (weak) currency finance public expenditures. Security and general administration expenditures accounted for 59 per cent of the 'Government' of Somaliland's total budgeted expenditures in 1998, leaving little for social and development expenditures (Source: *Africa Research Bulletin*, Vol.35 No.2, p.13363).

Table 2
AID INFLOWS FOR SELECTED CONFLICT, POST-CONFLICT & NON-CONFLICT COUNTRIES

	Total Net Official Development Assistance (ODA) Received, 1996 (net disbursements)		
	US $ millions	As % of 1995 GNP	Per Capita (US $)
Angola	544	19.4	51
Eritrea	157	22.8	44
Ethiopia	849	14.6	15
Guinea Bissau	180	72.9	168
Mozambique	923	72.2	57
Sierra Leone	195	24.1	46
Uganda	684	12.0	36
Average for UNDP Low Human Development Group	--	3.3	11
Non-Conflict Comparison Countries			
Ghana	654	10.8	38
Tanzania	894	23.2	30
Zimbabwe	374	6.0	34

Source: UNDP (1998) *Human Development Report, 1998*. New York: Oxford University Press for the United Nations Development Programme.

The Fiscal Deficit. The IMF typically requires a recipient of its ESAF lending to cut the primary deficit (expenditures excluding debt service minus taxes) and eventually achieve a primary surplus.[15] This also implies a cut in the deficit before grants so as to reduce the crowding out of private investment in domestic financial markets and to end high inflation.

Nobody seriously questions the principle of fiscal prudence. But for countries which have demonstrated a commitment to restoring the public finances, it is likely that the IMF's fiscal policy conditionality is too tight, and therefore an impediment to reconstruction since it unduly limits public investment and the financing of associated recurrent costs. Certainly many in the donor community are critical of this aspect of IMF conditionality. For example, Joseph Stiglitz (the chief economist of the World Bank) concludes in a recent and thinly disguised critique of the IMF position that:

> "For the last several years Ethiopia has run a deficit of about 8 per cent of GDP. Some outside policy advisers would like Ethiopia to lower its deficit. Others have argued that the deficit is financed by a steady and predictable inflow of highly concessional foreign assistance, which is driven not by the necessity of filling a budget gap but by the availability of high returns to investment. Under these circumstances – and given the high returns to government investment in such crucial areas as primary education and physical infrastructure (especially roads and energy) – it may make sense for the government to treat foreign aid as a

[15] The Enhanced Structural Adjustment Facility (ESAF) is the Fund's most important instrument for low-income countries (Abed, 1998). Post-conflict countries which currently have ESAF arrangements in place include: Congo (suspended), Ethiopia (suspended), Mozambique, and Uganda.

legitimate source of revenue, just like taxes, and balance the budget inclusive of foreign aid" (Stiglitz, 1998: 10),

In effect many investment projects with high social returns may be left on the shelf if the fiscal deficit before grants is severely cut, in which case there is a basic incompatibility between the fiscal aspect of reform - when it involves an overtight fiscal deficit target - and the reconstruction objective. Moreover, if two projects have strong complementarities (for example, a basic health care project and a primary education project), but the budget constraint permits only one investment, then the social rate of return for the single project is lower.[16] This implies both lower growth and slower social recovery.

Starting from a point of low post-war investment, and provided that sound investments are chosen, their realised returns should exceed the cost of concessional borrowing. The tax base rises with growth, and more revenue can be mobilised as investments in tax institutions take effect. Budget balance (or surplus) before grants in future years can then offset a high fiscal deficit in the early years of reconstruction. To put in place such a longer-term fiscal framework we need to move beyond the restrictive five-year term of the ESAF instrument. But of course, such a longer-time framework will only work in countries committed to fiscal responsibility and in which appropriate institutions are being developed.

The IMF's financial-programming framework is largely a set of accounting identities rather than a true forecasting model. It is therefore very limited as a means for devising a fiscal framework for reconstructing economies when much of the future fiscal position will be driven by the rate of return on post-war investment and the recovery of the tax base (i.e. dynamic effects).[17] Unfortunately, we do not have anything better, and building policy models that capture these dynamic effects (and collecting the data for them) is an essential technical input into improving fiscal policy.

Aid Financing. The argument over whether the IMF's fiscal conditionality is too tight partly depends on our view of aid, and its trend (Foster and Thomas, 1998). The IMF's fiscal caution arises in part out of its view that total aid is in long-term decline and therefore aid-financed expenditures may not be sustainable. Aid flows can also cause instability in government expenditures (for example when donors fail to disburse after commitment).[18] The IMF therefore advises governments to eventually try and match their recurrent revenue (which excludes the one-off proceeds of privatisation) to their recurrent expenditure. Any aid shortfall will therefore reduce public investment (and therefore growth), but not recurrent spending and core state functions.[19]

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[16] There is considerable evidence that social sector projects are complements to each other - for instance improving female education raises the effectiveness of health care services because women are the main health care providers in the household.

[17] Such dynamic effects are associated with a positive correlation between well-designed public investments and private investment i.e. 'crowding in' may occur (on this debate see Oshikoya, 1994).

[18] In an independent study, Gemmell and McGillivray (1998) find that aid is a relatively unstable form of government finance.

[19] Given their limited access to international commercial borrowing and their thin domestic debt markets, SSA countries are unable to use fiscal policy in the normal way - to smooth consumption over time by borrowing to finance variations in the fiscal deficit across the business cycle. Fielding (1997) finds a close correlation between *current* government revenue and *current* expenditure for a sample of 12 SSA countries for the period 1970-89. Hence the low-income countries of SSA are subject to a degree of fiscal inflexibility which would be unacceptable in the conduct of fiscal policy in developed countries.

Is the IMF being too pessimistic about aid? Is aid to post-conflict countries such as Ethiopia and Mozambique steady and predictable? Certainly aid is in decline in aggregate. Aid to SSA fell from $18.9 bn in 1994 to $16.8 bn in 1996. But aid to countries which are committed to reform and poverty reduction may nevertheless increase. Indeed, the recent external evaluation of ESAF by a group of independent experts (IMF, 1998: 32) points out that aid flows to these countries are likely to rise, because donors will increasingly focus their aid on countries with a conducive policy environment (aid is only effective when this is the case, see Burnside and Dollar, 1997).[20] Once a target for the fiscal deficit before grants is set, any increase in donor aid must in effect be saved rather than spent by government; this implies the reduction of domestic public debt rather than spending the aid on building schools, or other reconstruction needs.

At times this has led to criticism of the IMF by bilateral donors; their parliaments vote aid for it to be spent on schools and clinics, not to be saved in the recipient's accounts. Mozambique is an example of donor disquiet. Mozambique's fiscal deficit before grants was reduced from 29.2 per cent of GDP in 1990 to 22.2 per cent in 1993, the year after the end of the war. Mozambique also managed to reduce inflation from 150 per cent at the start of the 1990s to under 50 per cent at the war's end, as monetisation of the deficit was reduced and as output started to recover (see Ubide, 1997). To many observers this ranks as good performance for a country just coming out of 16 years of civil war (Addison and de Sousa, 1998).

Increased aid flows in the run up to the 1994 elections reduced the fiscal deficit after grants from 12.3 per cent of GDP in 1990 to 5.2 per cent in 1993. But the fiscal deficit before grants rose again to 29.7 per cent in 1994 (8.2 per cent after grants) reflecting a surge in recurrent spending matching the increase in aid-financed capital spending, as well as spending on resettlement, demobilisation and the elections. In 1995, the IMF, dissatisfied with fiscal policy, threatened to suspend lending. Many donors protested that the IMF's fiscal deficit target was too harsh and that it would stall aid disbursements if the government could not match aid-financed capital expenditures with recurrent funding (Hanlon, 1996). The IMF for its part, seems to be more cautious than bilateral donors and the World Bank about the ability of countries to absorb aid (to translate funding into actual infrastructure).[21]

More attention must given to incorporating realistic expenditure estimates into the macro-economic framework and to looking again at the division of responsibilities and co-ordination between the respective agencies. Until this is done, the agenda of fiscal reform will only match imperfectly the agenda of reconstruction. The current position imposes costs on both donors and countries.

[20] But perhaps we are too optimistic about the way the world works. Alesina and Dollar (1998: 2) find that cross section differences in the amount of aid received by countries are dominated by political factors such as colonial links and strategic alliances. Their time series evidence shows that at the margin changes in aid flows tend to reward democratisation and economic reform. A typical democratising country gets a 50 per cent increase in aid. But the pattern of aid distribution at any point in time is dominated by political factors.

[21] In Ethiopia the IMF suspended ESAF disbursement in 1997, while the World Bank and bilateral donors continued disbursement. This indicates fundamental differences in the macro-economic views of donors, a highly undesirable state of affairs.

Before leaving this critical issue entirely, we must briefly make three final points:

Taxation. A tight fiscal deficit target implies higher taxation. Until investment in improving tax institutions takes effect, this implies greater taxation of the existing tax base using existing tax instruments (which are often distortionary and regressive), thereby discouraging private investment and slowing reconstruction. This problem often manifests itself in the continuation of high trade taxes when, from an efficiency and welfare perspective, it is desirable to reduce and rationalise them. Uganda is among the countries experiencing this problem (see IMF, 1998: 32).

Improving Budgeting. A very tight fiscal deficit target encourages governments to keep expenditures off budget (and in practice bilateral donors may collude in this if they decide that the IMF target is over-tight). This undermines budgetary management, and thereby the focus of public money on core expenditures. There is considerable evidence, from both developing and developed countries, that over-rigid fiscal rules act as a disincentive to investments in improving budgetary institutions (see, for instance, Alessina and Perotti, 1996). This has been a problem in Mozambique; donor projects have proliferated and it is very difficult to obtain a clear picture of what is spent, where it is spent, and by whom it is spent (government, donor, NGO) - see Wuyts (1996).

Democratisation. Democratisation - preparing constitutions and organising elections - is demanding of resources. These demands compete with those of economic reconstruction for resources, but constructing a democracy is crucial to long-term economic success. Moreover democratisation requires political and administrative decentralisation which complicates budgetary reform. For example, the construction of Ethiopia's federal system involves the creation of matching budgetary processes to allocate powers and responsibilities between the centre and regions. The investment costs involved in creating these institutions are greater than those in non-federal states but are necessary to secure the political settlement. The creation of a decentralised administration in Mozambique is also taking time and resources. There is potentially an inconsistency between very tight fiscal frameworks and successful democratisation if decentralisation cannot be properly funded.

4. Conclusions

This paper has only touched on some aspects of reconstruction. Its basic message is that we must work to make the tasks of reconstruction, reform, and democratisation compatible with each other: They should be mutually supporting. To conclude, we set out three "do's and don'ts" for avoiding conflict (as they relate to our topic of economic reform). These partly emerge out of recent and ongoing UNU/WIDER research (Addison, 1998, Nafziger, Stewart, and Väyrynen, 1998).

- ***Decentralise political and economic power***

Many countries have histories in which political and economic power was centralised. This is especially the case in countries which experimented with Marxism-Leninism, for example Ethiopia under the Derg (Addison, 1998). Centralisation is also the basis of predatory states which aim to channel assets and incomes toward the ruling elite (Zaire, for example). The number of secessions - attempted (southern Sudan), internationaly recognised (Eritrea) or de facto (Somaliland) - will rise if more of Africa's over-centralised states fail to meet local/regional needs. Secession may resolve tensions, and provide the basis for starting reconstruction. But new tensions can emerge; for example, in the case of the Eritrea-Ethiopia war, over Eritrea's introduction of a new currency to replace the Ethiopian birr. Decentralisation is a difficult process, particularly its fiscal aspects, but it is critical to conflict avoidance.

- ***Avoid high inequality***

High income and asset inequality creates a sense of relative deprivation among disadvantaged groups and regions. International evidence shows that high initial inequality is bad for growth and poverty reduction and slow growth is one of the predictors of conflict; apartheid South Africa and El Salvador are examples (Nafziger *et al*, 1998). Once high asset inequality is created it is very difficult to reverse, especially in the case of land. Land reform, and other measures to reverse asset inequality, are difficult to organise and implement (Zimbabwe is an example), and therefore it is critical to avoid generating high inequality in the first place. In particular, the early years of reconstruction and reform are critical; at such times large and undesirable asset transfers can take place in the ways described in section 2.3. Ndikumana (1998) highlights the potential role for egalitarian development strategies in resolving Burundi's conflict.

- ***Minimize Macro-economic shocks***

Countries have very different abilities to tolerate adverse internal and external economic shocks. Rodrik (1998) shows that many of the sharpest falls in growth occur in divided societies (as measured by such variables as income inequality and ethnic fragmentation) with weak institutions of conflict management (such as the rule of law, democracy, and safety nets). This a compelling explanation of why similar sized shocks (such as a commodity price fall or a drought) can cause only temporary recession in some countries but outright collapse in others. Looking around Africa we can see - after nearly two decades of crisis and adjustment - considerable differences between societies in their ability to withstand shocks.

Two conclusions follow from this. First, investment in democratic institutions and deepening civil society is, aside from its intrinsic merit, good economics; countries cope better with economic adversity. Second, in fragile societies the costs of getting policy wrong - delaying reform but also errors in designing reform itself - are much higher than in more secure societies. Therefore, advocating drastic medicine - fast financial liberalisation for example - carries higher risks in fragile societies (as does avoiding any reform at all). *Ex ante* action - good economic policy - is always better and cheaper than *ex post* crisis management.

The developing world is now in the midst of probably the worst economic recession in living memory. This will inevitably wash into Africa's fragile economies. We need more international action - including more concessional finance and more responsible lending practices - to avoid the derailment of Africa's fragile recoveries, and to prevent new social crises arising from the economic shocks caused by falling commodity prices and instability in emerging financial markets.

Africa has been traumatised by many wars. Unfortunately, the 1990s - which at the start appeared hopeful with the end of the cold war - has seen unimaginable brutality. There have been exciting changes; the birth of the new South Africa and Mozambique's peace, to name but two. Nevertheless, the prevention of conflict and the reconstruction of war-torn societies remain the most urgent tasks facing us today.

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