

**ECONOMIC AND PRIVATE SECTOR**

PROFESSIONAL EVIDENCE AND APPLIED KNOWLEDGE SERVICES

HELPDESK REQUEST

# Private Sector Development in Fragile States

Simone Datzberger and Mike Denison

LSE Enterprise

September 2013

EPS-PEAKS is a consortium of organisations that provides Economics and Private Sector Professional Evidence and Applied Knowledge Services to the DfID. The core services include:

- 1) Helpdesk
- 2) Document library
- 3) Information on training and e-learning opportunities
- 4) Topic guides
- 5) Structured professional development sessions
- 6) E-Bulletin

To find out more or access EPS-PEAKS services or feedback on this or other output, visit the EPS-PEAKS community on <http://partnerplatform.org/eps-peaks> or contact Yurendra Basnett, Knowledge Manager, EPS-PEAKS core services at [y.basnett@odi.org.uk](mailto:y.basnett@odi.org.uk).

**Disclaimer Statement:**

The views presented in this paper are those of the authors and do not necessarily represent the views of Consortium partner organisations, DFID or the UK Government. The authors take full responsibility for any errors or omissions contained in this report.

# Contents

Abbreviations	iii
1 Introduction / Overview	1
1.1 The Query	1
1.2 Context	1
1.3 Defining Fragile States	2
1.4 Scope	3
2 Types of PSD Programmes	5
2.1 MACRO-LEVEL	5
Legal Reform and Business Regulation	5
Strengthening Financial Institutions and Macroeconomic Frameworks	7
Rebuilding Infrastructure	9
Encouraging Foreign Direct Investment (FDI)	11
Employment and Labour Rights	14
Making Markets Work for the Poor (M4P) approaches	16
2.2 MICRO-LEVEL	18
Promoting Value Chains	18
Promoting Business Associations and Community Groups	19
Microfinance	22
Corporate Social Responsibility (CSR)	25
Remittances and Diaspora	26
Entrepreneurship	28
Conclusion	30
References	32

## Abbreviations

CSR	Corporate Social Responsibility
DCED	Donor Committee for Enterprise Development
DFID	Department for International Development
EAC	East African Community
ECF	Extended Credit Facility
FDI	Foreign Direct Investment
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
ILO	International Labour Organisation
IMF	International Monetary Fund
LDC	Least Developed Country
LIC	Low Income Countries
MDTF	Multi Donor Trust Fund
M4P	Making Markets Work for the Poor
MIC	Middle Income Countries
MNC	Multinational Corporations
MNE	Multinational Enterprises
OECD	Organisation for Economic Cooperation and Development
OECD-DAC	OECD-Development Assistance Committee
OPIC	Overseas private Investment Corporation
PRGF	Poverty Reduction and Growth Facility
PSD	Private Sector Development
RCF	Rapid Credit Facility
SADC	Southern African Development Community

SAIIA	South African Institute for International Affairs
SME	Small and Medium Enterprises
SSA	Sub-Saharan Africa
TFG	Transitional Federal Government
TNC	Northern Based Transnational Cooperations
UNIDO	United Nations Industrial Development Organisation
WB	World Bank
ZANU-PF	Zimbabwe African National Union – Patriotic Front

# 1 Introduction / Overview

## 1.1 The Query

‘What does the literature say about the relationship between private sector development (PSD) and the stability of fragile states – i.e. what are the benefits and potential risks associated with private sector development programmes in fragile and conflict-affected states and how does fragility impact on how private sector development programmes are implemented?’

## 1.2 Context

PSD has been treated as an area of programming which is separate from post-conflict stabilisation for a long time. However, practitioners and scholars alike recently recognized the potentials of PSD programming in conflict-affected environments.<sup>1</sup> This review will outline what is available in the literature about the potential positive, but also negative, effects of PSD in fragile states and how PSD programmes can be implemented in conflict-affected settings. In so doing, particular attention will be paid to current reports, studies and analysis of the international donor community, aid agencies and international organisations but also academic debates.

As highlighted in a DCED (Donor Committee for Enterprise Development) literature review on this subject, post-conflict settings feature characteristics that make PSD programming more challenging, which can be categorized into four types: Economic, Political and Security-Related, Social, and Demographic<sup>2</sup>: (See graph on the right).



<sup>1</sup> C.f. CSIS Research Report on: Private Sector Development in Fragile, Conflict Affected and Violent Countries, 2013

<sup>2</sup> Sweeney, N. M (2009), Private Sector Development in Post-Conflict Countries: A Review of Current Literature and Practice, DCED, p 18

### 1.3 Defining Fragile States

The concept of 'fragile state' is not firmly defined academically or across development agencies.<sup>3</sup> For instance, the World Bank does "not presently define conflict-affected states as such definitions could reflect a political bias. Governments of client countries may define conflict differently than international institutions such as the World Bank."<sup>4</sup> Experts on the subject also continue to disagree about what constitutes fragility. However, while there is no commonly accepted global list of fragile states, there is at least a consensus on some clear-cut examples (e.g. Afghanistan or Somalia).<sup>5</sup>

DFID (Department for International Development) nevertheless operates on a working definition and holds that a fragile state covers "countries, where the government cannot or will not deliver core functions to the majority of its people, including the poor. The most important functions of the state for poverty reduction are territorial control, safety and security, capacity to manage public resources, deliver of basic services, and the ability to protect and support the ways in which the poorest people sustain themselves. DFID does not limit its definition of fragile states to those affected by conflict."<sup>6</sup> The Operational Plan (2011-2015) of DFID's Governance & Fragile States Department further positions that fragile and conflict affected states are furthest behind on the MDGs with only 10% of them on track to halve poverty and hunger by 2015. On the whole out of DFID's 28 priority countries, 20 are considered to be fragile.<sup>7</sup>

Similarly, for the OECD "a fragile region or state has weak capacity to carry out basic governance functions and lacks the ability to develop mutually constructive relations with society. Fragile states are also more vulnerable to internal or external shocks such as economic crises or natural disasters. More resilient states exhibit the capacity and legitimacy of governing a population and its territory. They can manage and adapt to changing social needs and expectations, shifts in elite and other political agreements, and growing institutional complexity. Fragility and resilience should be seen as shifting points along a spectrum."<sup>8</sup>

On the basis of this definition the OECD-DAC (Organisation for Economic Cooperation and Development - Development Assistance Committee) 2013 report on fragile states focuses on 47 countries. These include: Afghanistan, Angola, Bangladesh, Bosnia and Herzegovina, Burundi, Cameroon, Central African Republic, Comoros, Chad, Democratic Republic of Congo, Eritrea, Ethiopia, Georgia, Guinea, Guinea-Bissau, Haiti, Islamic

---

<sup>3</sup> Holden, Joseph and Pagel, Magarethe (2013): Private Sector Development and Conflict, What can be learnt from the experience of private sector development in conflict and post-conflict countries? EPS PEAKS, Helpdesk Request, Nathan Associates London, pp 8-9

<sup>4</sup> World Bank: Fragile and Conflict Situations FAQ, <http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/STRATEGIES/EXTLICUS/0..menuPK:511784~pagePK:64171540~piPK:64171528~theSitePK:511778,00.html>,

<sup>5</sup> DFID (2005) p 7

<sup>6</sup> DFID (2005): "Why we need to work more effectively in fragile states." available at: [http://www.jica.go.jp/cdstudy/library/pdf/20071101\\_11.pdf](http://www.jica.go.jp/cdstudy/library/pdf/20071101_11.pdf), p 7

<sup>7</sup> The operational plan does not specify which countries among DFID's current 28 priority countries are considered as fragile. According to DFID's annual report 2012-13 current priority countries include: Afghanistan, Bangladesh, Burma, Democratic Republic of the Congo, Ethiopia, Ghana, India, Kenya, Kyrgyzstan, Liberia, Malawi, Mozambique, Nepal, Nigeria, Occupied Palestinian Territories, Pakistan, Rwanda, Sierra Leone, Somalia, South Africa, Sudan, South Sudan, Tajikistan, Tanzania, Uganda, Yemen, Zambia, and Zimbabwe.

<sup>8</sup> OECD (2012a): "Development: Aid to developing countries falls because of global recession" OECD Development Co-operation Directorate (DCD-DAC) available at [www.oecd.org/dac/developmentaidtodevelopingcountriesfallsbecauseofglobalrecession.htm](http://www.oecd.org/dac/developmentaidtodevelopingcountriesfallsbecauseofglobalrecession.htm),

Republic of Iran, Iraq, Kenya, Kiribati, Kosovo, Democratic Republic of Korea, Kyrgyz Republic, Liberia, Malawi, Marshall Islands, Federated States of Micronesia, Myanmar, Nepal, Niger, Nigeria, Pakistan, Rwanda, Sierra Leone, Solomon Islands, Somalia, South Sudan, Sri Lanka, Sudan, Timor-Leste, Togo, Uganda, Republic of Yemen, West Bank and Gaza, Zimbabwe.

This literature review will make use of the following case studies:

*Afghanistan, Bosnia and Herzegovina, Burundi, Cambodia, Colombia, Chad, Democratic Republic of Congo, Haiti, Kosovo, Nepal, Nigeria, Liberia, Rwanda, Sierra Leone, Sri Lanka, Somalia, South Sudan, Timor-Leste, Zimbabwe.*

In the wide spectrum of fragility and resilience, some of these countries are more instable than others. Less fragile countries (e.g. Cambodia or Sri Lanka) were included to the review when they better suited as examples to shed light on current and past best practices but also lessons learned.

## 1.4 Scope

In response to the query, this literature review will discuss PSD in fragile states as:

- **an approach**
- **a specific peacebuilding and development intervention**
- **an outcome**

In this regard a considerable volume of literature has been published on PSD in developing (thus not only fragile) states and economies. A great deal of attention is often paid to employment generation and creation. Strikingly, the evidence of a link between job creation and stability in fragile states remains hitherto weak<sup>9</sup>. For this reason we were asked to focus mainly on other aspects of PSD in relation to stabilisation, and risks:

- Equality of outcomes (e.g. impact on income distribution)
- Equality of opportunity (e.g. equal rights to access and participate in markets, removal of barriers)
- Impact on political participation/voice (e.g.: creation of trade unions, revamping labour laws)
- Impact on state society relations (e.g.: meeting public expectations)
- Inclusion of marginalised groups – in economic, social and political structures
- Attitudes held by social groups towards others.

In the same way that the evidence of employment's effect on stabilisation is weak, the evidence that PSD programmes have had the above impacts is also deficient. As will be demonstrated below, aspects of PSD and PSD programmes are often evaluated against economic measurements, with little mention of their effect on stabilisation. Where stabilisation is a feature of an evaluation, causal inferences are generally weak, and based on unclear methodological approaches. This is largely because PSD programming

---

<sup>9</sup> Development in the Shadow of Violence: A Knowledge Agenda for Policy 2011

in conflict-affected areas is a new strand of programming, with little evaluation to date<sup>10</sup>. Naturally, case studies are presented below with the caveat that we make no assumptions about the transferability of a successful (or otherwise) programme in one situation to another.

### **Types of PSD programmes**

This review will examine the literature on a broad spectrum of PSD programmes, which can be roughly divided into two categories:

#### **1. MACRO-LEVEL**

- Legal reform and business regulations
- Strengthening financial institutions and macroeconomic frameworks
- Rebuilding infrastructure
- Encouraging FDI
- Employment and labour rights
- M4P approaches

#### **2. MICRO-LEVEL**

- Promoting market linkages and value chains
- Promoting business associations and community groups
- Microfinance
- Corporate Social Responsibility (CSR)
- Remittances and Diaspora
- Entrepreneurship

---

<sup>10</sup> Sweeney, N. M, Private Sector Development in Post-Conflict Countries: A Review of Current Literature and Practice, DCED 2009 p.11

## 2 Types of PSD Programmes

### 2.1 MACRO-LEVEL

#### Legal Reform and Business Regulation

Literature on the subject generally focuses on how law-making, corruption and weak business regulations challenge PSD in fragile states. A few studies highlight how in many fragile states, the absence of law can trigger conflict or even nurture war economies. This will be briefly illustrated by drawing on the case studies of Afghanistan, Liberia and Zimbabwe.

Many fragile states (e.g. Afghanistan, East Timor, or Guinea Bissau - to name but a few) suffer from weak legal systems, bureaucracies and business regulation and were already under-developed well before conflict began. In this context, Channell (2010) highlights that when it comes to development assistance for fragile states, requirements in the legal framework to attract FDI and boost PSD are less obvious. Yet, fragile states are often characterized by weak parliaments and legal and regulatory frameworks. Moreover, law-making and regulation are inevitably politicised. Against this background, Channell arrives at the following main conclusions:

- Urgent law-making, while sometimes necessary, can undermine the long-term processes needed to ensure legitimacy.
- Meaningful business legislation in post-conflict countries requires private sector input. Business is a vital link in drafting laws that lead to effective economic policy development reform.
- Some fragile states do have good laws, which are unfortunately not implemented or used. Thus, many barriers to a healthy business environment are a result of poorly applied regulations. These barriers require improved behaviour, not improved laws.
- In many post-conflict situations, extensive use of foreign consultants to draft laws leads to rejection of laws as non-representative even if the substance is excellent and the process was fully in line with legal requirements.
- Laws that are introduced urgently are often illegitimate as they too often violate one or more of the three tenets of legitimacy: process, substance, and representation. In addition, on average, most laws take at least 2-5 years after the first draft is prepared, with major reforms sometimes taking more than 10 years in normal circumstances.

In addition to the difficulties of law-making, a recurring obstacle for legal reforms and business regulations stressed in the literature about fragile states is corruption. Emerson (2006), for instance, provides empirical evidence supporting the main hypotheses that competition and corruption are negatively related.<sup>11</sup> Differently put, if industrial competition is a development goal of a country, than measures aimed at curbing

---

<sup>11</sup> Emerson, Patrick M (2006): Corruption, competition and democracy, *Journal of Development Economics* 81 (2006) Elsevier, pp 193-212

corruption could be a very important component of policies that seek to bolster industrial competition.<sup>12</sup>

The role of the public sector in combating corruption in PSD of fragile states is discussed by Leo et al. (2012). PSD, they argue, requires an appropriate institutional framework that the private sector cannot provide for itself. While there are several examples of private sector firms joining together to help stabilize the governance environment (such as Somaliland, see for instance case study on p13), most firms in fragile states are unwilling or unable to create the institutional framework necessary to promote PSD themselves.<sup>13</sup> How weak legal and institutional frameworks can impede PSD is illustrated in the case of **South Sudan**, where the relatively weak administrative capacity of the government has contributed to increased corruption and embezzlement.

## Case studies

### Zimbabwe: Poor local governance and politicisation of state and society undermine PSD

In the case of Zimbabwe, however, Leo et al. (2012) caution that businesses in the private sector have little legal protection due to the politicization of all branches of the government, particularly the judiciary and security forces. ZANU-PF (Zimbabwe African National Union – Patriotic Front) has actively used partisan militias to suppress individuals or businesses considered a threat to the state. Regulations in the Indigenization and Economic Empowerment Act of 2010 (which stipulates that all firms must have at least 51% local ownership within five years), or the Land Reform Act of 2000, have effectively destroyed Zimbabwe’s once-productive commercial farming sector.<sup>14</sup>

### East Africa: PSD and regulatory reforms

The *World Bank Doing Business Report* (2013) suggests that regulatory reform simplified registration processes in the East African Community (EAC)<sup>15</sup> region. Starting a business in the EAC currently requires an average of 8 procedures and costs an average of 33.6% of income per capita – compared to 12 procedures and a cost of 140% of income per capita in 2005. The EAC has achieved greater convergence in the streamlining and cost of regulatory processes than in the strength of legal institutions relevant to business regulation. Of the 74 institutional or regulatory reforms implemented by EAC economies from 2005 – 2013, many were in the areas of starting a business, registering property and dealing with construction permits.<sup>16</sup>

### Liberia: PSD can finance conflict and nurture war economies

Literature also addresses how legal reforms and law-making should be designed to ensure that PSD does not do more harm than good. In the case of Liberia, Solá-Martín

---

<sup>12</sup> Ibid. p 211

<sup>13</sup> Leo, Ramachandran, and Thuotte (2012), p 5

<sup>14</sup> Ibid. pp 69-70

<sup>15</sup> The EAC includes: Burundi, Kenya, Rwanda, Tanzania and Uganda.

<sup>16</sup> World Bank and International Bank for Reconstruction and Development (2013): *Doing Business in the East African Community 2013, Smarter Regulations for Small and Medium-Size Enterprises – Comparing Business Regulations for Domestic Firms in the East African Community and with 185 Economies*, p 1

(2011), argues that FDI and exploitation of mineral resources by foreign companies through a concessionary system have not been converted into development for a majority of Liberians. The concessionary system also played a central role in financing Liberia's war economy. In exploring the strategic sectors of the Liberian economy and their impact on the security and development dimensions of peacebuilding, Solá-Martín recommends policy measures to enhance land reform and small farmers' rights in the revitalization process of the political economy of post-conflict Liberia.<sup>17</sup>

### **Afghanistan: Absence of law and corruption impede PSD**

The case of Afghanistan elucidates how the near absence of law and efficient legal regulations gave rise to the spread of mafia-like networks, consisting of warlords-turned-investors, their business friends, local and national politicians, and the police. Giustozzi (2006) analyses at length how these mafia-like networks reduce opportunities for long-term growth and opportunities for a more appropriate social role for business in the peacebuilding process. In his view, without proper law and order, the prospects of businessmen becoming involved in peacebuilding remain dim – despite on-going projects in the legal sector.<sup>18</sup>

### **Strengthening Financial Institutions and Macroeconomic Frameworks**

As the previous section has shown, securing finance while maintaining stability in fragile states is difficult in the absence of predictable laws. Institutions and banking systems are also unreliable.<sup>19</sup> Siegle (2011) stresses that fragile states typically suffer from a dearth of financial institutions that provide citizens with options for managing savings and credit. This, in turn, severely constrains access to capital to launch businesses (spurring employment).<sup>20</sup> Similarly, Leo et al. (2012) find that access to finance remains one of the major constraints to PSD in sub-Saharan African fragile states. This is also emphasised by Besada (2013) who lists the underdeveloped banking system in Sierra Leone as one of the key factors deterring investors.<sup>21</sup>

Siegle (2011) argues that the establishment of viable and accessible financial institutions requires deep familiarity with the local population. Likewise, clients' creditworthiness and business plans have to be assessed. If there is no incentive for clients to repay loans, default rates will increase sharply thereby undercutting the financial viability of the institutions as well as the bank's respective contract-enforcement norms. Also, the majority of clients in fragile states are often based in rural areas. Siegle therefore recommends to link stabilisation efforts with established independent rural-based financial networks to accelerate the functionality of these

---

<sup>17</sup> Solá-Martín, Andreu (2011): Liberia: Security challenges, development fundamentals, *Third World Quarterly*, Volume 32, Issue 7, August 2011, pp 1217-1232,

<sup>18</sup> Giustozzi, Antonio (2006): Afghanistan: Exploring the peacebuilding potential of the private sector, in *Local business, Local Peace: the Peacebuilding Potential of the Private Sector*, International Alert.

<sup>19</sup> Hameed, Sadika and Mixon, Kathryn (2013): *Private-Sector Development in Fragile, Conflict-Affected, and Violent Countries*, CSIS Working Group on Private-Sector Development in Fragile States, Centre for Strategic Studies, p. 5

<sup>20</sup> Siegle, Joseph (2011): *Stabilising Fragile States*, Africa Centre for Strategic Studies of the National Defense University, p 14

<sup>21</sup> Besada, Hany (2013): *Doing Business in Fragile States: The Private Sector, Natural Resources and Conflict in Africa*, Background Research Paper, Submitted to the High Level Panel on the Post-2015 Development Agenda, p 32.

institutions.<sup>22</sup> This would also increase the equality of opportunities for the broader population.

In 2011 the IMF published a paper entitled *Macroeconomic and Operational Challenges in Fragile Situations*, which acknowledges that: “the implementation of Fund-supported programs in fragile Low Income Countries (LIC) has been bumpy, possibly reflecting too bold reform agendas or too optimistic assessments of implementation abilities. The mode of engagement with LICs in fragile situations has overwhelmingly been through the Poverty Reduction and Growth Facility (PRGF) / Extended Credit Facility (ECF) and conditionality in programs with fragile states has been relatively ambitious. Such programs have been affected by frequent interruptions.”<sup>23</sup> It is worth noting that engagement with fragile middle-income countries (MICs) has been generally beneficial.

For Hameed and Mixon (2013) the IFC (International Finance Corporation) and OPIC (Overseas Private Investment Corporation)<sup>24</sup>, could play an important role in investing in fragile situations. They refer in particular to on-going projects in which OPIC has supported sectors such as: insurance, banking or the real estate (next to extractive industries). So far, Afghanistan has the largest number of OPIC-support business projects, followed by Liberia, Iraq and Haiti.<sup>25</sup>

## Case studies

### Afghanistan: Current challenges in developing a commercial banking system

Pavlović, Jelena and Charap, Joshua (2009) show how in late 2001, following decades of conflict, the financial and banking systems of Afghanistan were devastated. The banking system comprised six state-owned commercial banks that were largely inactive. New banking laws were passed in 2003 and in early 2004, based mainly on international best practice. In 2004 total commercial bank assets were less than US\$ 300 million. By March 2008, the total assets of the 16 operating commercial banks were almost US \$ 1.7 billion. On the whole, the capital market in Afghanistan is developing rapidly despite deficiencies in the legal framework – notably, weak formal mechanisms for contract enforcement. As of March 2008 there were 16 licensed commercial banks that were supervised by the central bank. These banks operate in the same environment, yet have widely different approaches to lending: at one extreme are banks which have negligible lending activity, while others have a large portfolio to domestic businesses. In the future it will be important for the central bank to strengthen further its prudential oversight of weak commercial banks to take prompt and corrective measures to encourage banks to redress weaknesses in the system. Poorly rated banks appear to be providing financial services that are otherwise lacking in the system and therefore central bank

---

<sup>22</sup> Ibid. p 14

<sup>23</sup> IMF (2011): *Macroeconomic and Operational Challenges in Fragile Situations*, Paper prepared by the Strategy, Policy and Review Department in consolidation with other Departments, approved by Reza Moghadam; p 5

<sup>24</sup> OPIC (the US's Government's Development Finance Institution) works with the U.S. private sector and thus helps U.S. businesses gain footholds in emerging markets, catalysing revenues, jobs and growth opportunities both at home and abroad.

<sup>25</sup> Hameed and Mixon (2013), p 6

interventions must be weighed against possible adverse impacts on the availability of bank credit.<sup>26</sup>

### Somalia: Consequences of the absence of a fully functional Central Bank

Somalia's financial system has been ruined by two decades of conflict. In January 1991, all state institutions that provided services and regulated the economy collapsed, including the Central Bank of Somalia and the entire banking system. The commercial bank liabilities that had survived the 1989 bankruptcy of the only commercial bank in the country disappeared. The country has also been suspended from accessing global financial markets, a situation that compromises the leverage of the Transition Federal Government (TFG) in domestic as well as international financial markets. In addition, past circulation of counterfeit currency (by individuals) has led to inflation and hyperinflation and an increasingly dollarized system within the Somali economy. The Central Bank of Somalia reopened its offices in 2006 but continues to have limited functionality.<sup>27</sup> To this day the bank has no Board and corruption and fraud is pervasive. Most recently, the U.N. Group of Experts to the Security Council's Somalia and Eritrea sanctions committee detected that of \$16.9 million (11.1 million pounds) of international aid transferred by fiduciary agent PricewaterhouseCoopers (PwC) to the central bank, about \$12 million could not be traced.<sup>28</sup>

All in all, the absence of a fully functional Central Bank in Somalia is a critical issue that needs to be addressed as a matter of urgency, as a viable central bank is needed to execute monetary policy, act as a financial agent of the government, and support financial sector development that will enable longer term investments and private sector led growth and development. In the longer run, this will be important to enabling Somalia to take the necessary steps to access international financial markets.<sup>29</sup>

### Rebuilding Infrastructure

In general terms the connection between infrastructure and economic growth is well established, and Calderon and Serven (2010) find evidence that improved infrastructure in Sub-Saharan Africa has positive effects on income equality<sup>30</sup>. However, Jones and Howarth (2012) assess the evidence of infrastructure programmes' effect on stabilisation in fragile and conflict affected states. They find that 'there is little evidence

---

<sup>26</sup> Pavlović, Jelena and Charap, Joshua (2009): Development of the Commercial Banking System in Afghanistan: Risks and Rewards, IMF Working Paper, WP/09/150, p 3

<sup>27</sup> The information provided in this paragraph is cited from a Draft Discussion Paper (Round Table) entitled: 'Banking, remittances, and the role of the central bank in promoting financial and private sector development in Somalia', First Istanbul Conference on Somalia (21 – 23 May 2010), p 1

The first Istanbul Conference in 2010 on Somalia was attended by high level representatives from 57 countries and 11 international and regional organizations, as well as by the TFG leadership, the regional administrations, and representatives from wide-ranging segments of Somali society, including youth, women, business community, elders, religious leaders and the Diaspora. More information can be obtained at: <http://www.mfa.gov.tr/the-second-istanbul-conference-on-somalia-final-declaration-1-june-2012-istanbul.en.mfa>,

<sup>28</sup> REUTERS, (2 July 2013): Somali central bank governor denies U.N. charges over funds, See: <http://uk.reuters.com/article/2013/07/02/uk-somalia-governor-idUKBRE9610T220130702>

<sup>29</sup> Istanbul Conference on Somalia, Discussion Paper (2010): p 3-4

<sup>30</sup> Calderon and Severn (2010), as quoted in Jones, S., and Howarth, S, Supporting Infrastructure Development in Fragile and Conflict-Affected States: Learning from Experience p.1.

to suggest that infrastructure investment necessarily plays a significant role in the process of stabilisation<sup>31</sup>.

## Potential benefits and risks

The World Development Report framework 2011 posits the following potential benefits of infrastructure for stabilisation and peacebuilding:

1. The process of collaborating on a construction project may restore confidence in collective action and the accommodation of divergent interests
2. Employment creation, and stimulation of economic activity generally
3. Internal connectivity, allowing integration of marginalised regions.
4. Investment in specific institutions (courts, police, military) may improve security<sup>32</sup>.

Yet, Jones and Howarth find that there is little solid evidence to suggest that the above has been realized. Further, they outline the risks that poorly designed PSD infrastructure projects are wasteful, or worse, exacerbate fragile situations:

1. Fuelling corruption and rent-seeking, in the absence of strong enough institutions
2. Raising public expectations which, through long lead times and extremely difficult conditions for implementation, are not met.
3. Violence over construction contracts (found in Nepal)
4. Conflict over infrastructure projects with significant environmental impacts. There is an extensive literature on dams and their environmental and social impacts which cannot be covered here.
5. Increasing internal connectivity can also have negative impacts, for example by making movement by armed groups easier, and increasing the negative impacts brought by the presence and behaviour of government troops<sup>33</sup>. Studying disaggregated data on violence and road networks in the North Caucasus, Zhukov finds that roads are a 'at best, a mixed blessing'. Roads can both increase access to isolated problem areas, but they can also create attractive targets for insurgents. Further, by easing communication, road connections can make it easier the relocation of insurgent activity<sup>34</sup>.
6. Exacerbating tensions between social groups<sup>35</sup> (see cases, below).

The message is not, though, entirely negative. Jones and Howarth also find evidence that suggests that projects under the Community Driven Development framework have had positive impacts on social cohesion and participation. They qualify this by pointing to negative examples, but overall conclude that 'there are enough examples of successes in the case study countries and elsewhere to confirm that CDD is generally a sound approach, but that very great attention to detail is essential.'<sup>36</sup>

With respect to the longer term, it is unfortunate that impact assessments of infrastructure projects that look beyond the first few years after a project are rare. Evidence of the long-term impact of infrastructure projects in fragile states on growth is weak, although Mallet and Slater argue that in the post-conflict context of widespread

---

<sup>31</sup> Jones and Howarth (2012) p.iv.

<sup>32</sup> World Development Report 2011 as quoted in Jones and Howarth (2012) p6.

<sup>33</sup> Jones and Howarth (2012) p.35

<sup>34</sup> Zhukov, Yuri M., Roads and the Diffusion of Insurgent Violence: The Logistics of Conflict in Russia's North Caucasus, *Political Geography* 31(3): 144-156 (2012) p.54.

<sup>35</sup> Jones and Howarth (2012) p.37

<sup>36</sup> Jones and Howarth (2012) p.40.

destruction of infrastructure, skills gained through initial projects may support future growth<sup>37</sup>.

Note: Here we largely discuss cases of government and donor-led infrastructure projects. For examples of the private sector-led projects (telecoms in particular), see the section on FDI pp 11 – 14.

## Case studies

### Nepal and Kosovo: Divergent impacts of road construction towards social stabilisation

A paper by the International Bank for Reconstruction and Development (IBRD) highlights two cases: one where a road project has worked towards social stabilisation (Nepal) and one where a road undermined social stabilisation in another (Kosovo). The Rural Access Improvement and Decentralization Project in Nepal aimed to provide-country-wide coverage and, this paper claims, has allowed non-rural areas to feel secure and included<sup>38</sup>. In contrast, NATO peacekeepers in Kosovo built roads that connected areas more densely populated by minorities, so that they could avoid travelling through Albanian areas. While the minority populations were better connected to each other, the IBRD report claims that divisions between majority and minority groups were exacerbated<sup>39</sup>.

### Nepal: Positive effects of road building

In another Nepal case, Howarth and Jones report evidence of success of Enhancing and Protecting Interventions (EPIs) activities, designed to spread knowledge of the Rural Access Programme (RAP) to affected stakeholders, and to ensure that they were able to participate in the decision-making process. The EPIs later evolved into Social and Economic Development programme which aimed to assess both, the short and long-term impacts of road building. An impact assessment reported positive effects of this programme – by engaging and providing work for unemployed youth, the road building project discouraged youths from joining rebel groups, and a policy of equal pay for equal work improved the economic and social position of women<sup>40</sup>.

## Encouraging Foreign Direct Investment (FDI)

The literature reveals a mixed picture of the effects of FDI on stability and conflict. FDI is generally seen as a potential engine of economic development, and economic development has been linked to reducing the chances of a recurrence of violence. However, the conditions in fragile states result in FDI reducing stability and consequently increasing the chances of conflict.

---

<sup>37</sup> Mallett and Slater (2012) 'Growth and livelihoods in fragile and conflict-affected situations'. Working Paper 9.

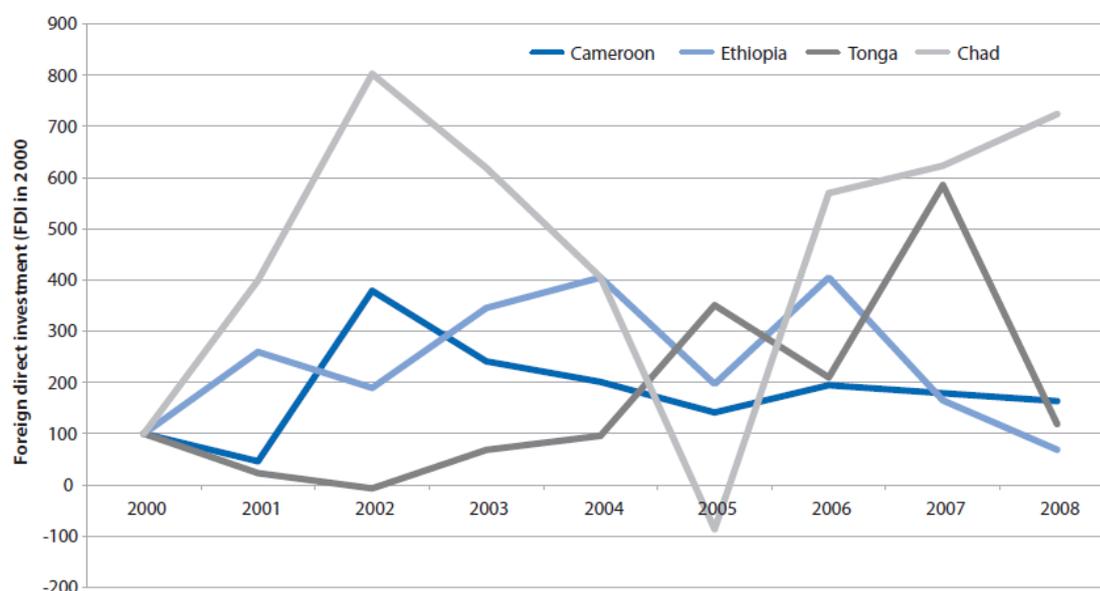
London: Secure Livelihoods Research Consortium p.37

<sup>38</sup> Rebosio, M. and Wam, P.E., Violent Conflict and the Road Sector: Points of Interaction, The International Bank for Reconstruction and Development/World Bank (2011) p.9.

<sup>39</sup> Ibid.

<sup>40</sup> Howarth and Jones (2012) p.37

According to the OECD FDI is marginal in most fragile states, but grew as a whole in every year in 2000-2010<sup>41</sup>. This however masks the volatility of FDI in fragile states, as shown by this graph, showing FDI volatility in Cameroon, Ethiopia, Tonga and Chad in 2000-2008<sup>42</sup>:



The most FDI-dependent fragile states in 2008 were Guinea, DRC, Djibouti, Angola and São Tomé and Príncipe.

### The conditions for FDI

A World Bank paper on international companies and post-conflict reconstruction suggests that whether a firm will take the risk of investing in a fragile state depends to a large extent on the scale of a potential investment, as well as the time required to make returns. The author notes that:

- Smaller, 'junior' extractive companies are more likely to take risks if geological opportunities are attractive – particularly at the exploration stage.
- Mobile phone companies require smaller fixed investments and can make quicker returns. Further, fragile states offer markets that are yet to be 'saturated'.
- Immediate construction contracts offer reduced risks, given security of financing by international donors.

<sup>41</sup> OECD (2010), *Resource Flows to Fragile and Conflict-Affected States*, OECD Publishing. <http://dx.doi.org/10.1787/9789264092198-en> p.129

<sup>42</sup> UNCTAD (2009) *World Investment Report: Transnational Corporations, Agricultural Production and Development*, UNCTAD, New York; UNCTAD Foreign Direct Investment database, [www.unctad.org/Templates/Page.asp?intItemID=1923](http://www.unctad.org/Templates/Page.asp?intItemID=1923) as cited in OECD (2010), *Resource Flows to Fragile and Conflict-Affected States*, OECD Publishing. <http://dx.doi.org/10.1787/9789264092198-en> p.129

## Case studies

### Somalia: Mixed impact of telecommunication ventures

In spite of the absence of a state regulator of telecommunications, Somalia had 50,000 mobile subscribers in 2004. Several US-based companies have established joint ventures with Somali companies. In response to fierce competition between rival companies the UNDP and the International Telecommunications Union led the formation of the Somali Telecom Association, based in Dubai. There have been severe disparities in network coverage across the country, as operators have refused to allow users of different networks to communicate with one another - a problem in the northern Somaliland region. The absence of a government regulator also means that no taxes are collected from this reasonably profitable industry<sup>43</sup>.

### Sierra Leone: Mixed impact of telecommunication ventures

Celtel, a Netherlands-based international company, established operations in Sierra Leone in 2000 – before the civil war in Sierra Leone was over in 2002.

Bray reports positive and negative social impacts of this venture. In many cases access to mobile telephony has made business easier and quicker. However, a concern has been that, as in Somalia, coverage has been uneven, raising concerns of exacerbating political and social divisions. In response the company made efforts to expand its coverage into sensitive areas, and formed a partnership with a US-based conflict resolution NGO.

### Liberia: FDI and entrepreneurial capture in pre-conflict Liberia

Painting a negative picture of FDI in fragile contexts, Suzanne Kathleen McCoskey argues that FDI, mostly by a single tire and rubber company, introduced distortions in the distribution of entrepreneurial talent in pre-conflict Liberia. Existing institutions responded to FDI by allocating domestic entrepreneurial talent to:

- (i) Monopsony rent-seeking behaviour
- (ii) The development of small, independent rubber farms encouraged by the foreign concession.

Rather than encourage innovation and SMEs, this FDI allowed the dominant class to benefit further from foreign capital inflows, further deepening the fault line between coastal and rural Liberians<sup>44</sup>.

The case of Liberia, above, demonstrates the intersection of FDI with other aspects of the economy in a fragile state – in this case, entrepreneurship. The example of Somalia, above, shows that without regulation and tax collection capacity, fragile states can lose out from potentially significant sources of tax revenue.

Some literature explores the relationship of FDI and programmes aimed towards other aspects of stabilisation. For example, Appel and Loyle argue that post-conflict justice

---

<sup>43</sup> Bray, J. International Companies and Post-Conflict Reconstruction: Cross-Sectoral Comparisons, Social Development Papers, Conflict Prevention and Reconstruction paper no.22 (2005).

<sup>44</sup> McCoskey, S.K., Foreign Direct Investment and Entrepreneurial Capture in Pre-Conflict Liberia, *Journal of Small Business and Entrepreneurship* 24.2: pp. 197–216

institutions can help post-conflict states attract investments, by sending a signal to investors about the state's willingness to reconstruct a post-conflict zone<sup>45</sup>.

## Employment and Labour Rights

Although evidence of a link between job creation and stability remains weak<sup>46</sup>, peacebuilding literature has established that the lack of employment opportunities for youths represents a considerable risk of civil violence in failed states<sup>47</sup>. A recent OECD Report on Fragile States (2012) finds that in the majority of fragile states the 15-34 age groups makes up than one third of the population. This proportion is expected to remain steady in the vast majority of fragile states, while decreasing markedly in most non-fragile states. However, OECD emphasises that one should not consider unemployed youth as a threat to global security, but rather be aware of the need to better understand the full implications of such trends for poverty reduction, job creation, and fragility. This should be done in the context of other processes, including technological innovation for instance.<sup>48</sup>

The importance of access to employment is also stressed by the New DEAL which includes among others 'Economic Foundations: Generate employment and improve livelihoods' as a priority.<sup>49</sup> For De Vries, Hugo and Specker, Leontine (2009) PSD in fragile states can potentially lead to the creation of urgently needed jobs thereby stimulating the local economy. However, job creation will only be successful if locals benefit from skills training, capacity building and access to capital to new and existing entrepreneurs.<sup>50</sup> The case of Columbia exemplifies that PSD, or the private sector more generally, can also have reverse effects and advance social exclusion and societal marginalisation. This phenomenon is highlighted by Godnick and Klein (2009) who examine reintegration programmes of ex-combatants.

## Case studies

### Colombia: Exclusion of ex-combatants from private sector reintegration programmes

Reintegration programmes in Columbia offered ex-combatants four options, or "paths":

- Grants for individual livelihood projects;
- Grants for collective associative projects among ex-combatants;
- Private-sector employment; and

---

<sup>45</sup> Appel, Benjamin J and Loyle, Cyanne E, 'The Economic Benefits of Justice: Post-Conflict Justice and Foreign Direct Investment' *Journal of Peace Research* 2012 49:685

<sup>46</sup> Development in the Shadow of Violence: A Knowledge Agenda for Policy 2011

<sup>47</sup> See for instance: Ware, Helen (2005): Demography, Migration and Conflict in the Pacific, *Journal of Peace Research*, Vol. 42, no 4, pp 435-454; or De Vries, Hugo and Specker, Leontine (2009): Early Economic Recovery in Fragile States Priority Areas and Operational Challenges', Clingendael Institute, The Hague;

<sup>48</sup> OECD (2012): *Fragile States 2013: Resource flows and trends in a shifting world*, DAC International Network on Conflict and Fragility, p 99

<sup>49</sup> The New DEAL reached a consensus on the five key dimensions of fragility: legitimate politics (inclusive political settlements and conflict resolution); security; justice; economic foundations (employment and livelihoods); and revenues and services. See:

<http://www.newdeal4peace.org/peacebuilding-and-statebuilding-goals/>,

<sup>50</sup> De Vries and Specker (2009): pp 54-63

- Scholarships for high school and higher education.

The private sector in Columbia was not overly enthusiastic about providing direct employment opportunities to ex-combatants. Approximately 80 per cent of the income-generating projects failed with many of the remaining projects having low viability. Two of the more successful income-generating activities were mini-markets and private telephone kiosks run by some ex-combatants. Colombian companies were hesitant to bring ex-combatants into the workplace because of security concerns but also lack of skills required for many positions and tasks. In response, the High Commissioner for Reintegration shifted the focus from requesting companies to provide employment to ex-combatants to one of improving the quality of the skills of the demobilised for the workplace on its own terms. Ex-combatants were prepared to compete with other Colombians in the marketplace as opposed to asking for special employment preferences. Despite these on-going efforts, mafia-like organisations such as Aguilas Negras or any other illicit activities remain too attractive an option for young men with low levels of education.<sup>51</sup>

### Sub-Saharan Africa: Informal economies impede PSD

Another challenge to employment generation in fragile states through PSD are emerging and expanding informal economies. According to UNIDO (2008) informality seems to be the highest in Sub-Saharan Africa (SSA), where the OECD (2012) classified in total 24 states in SSA as fragile. UNIDO further reports that most new jobs are created in the informal economy and consequently the relative size of the informal economy is increasing. In 2002 around 61 per cent of urban employment in SSA was informal and as much as 93 per cent of new jobs were created in so-called shadow (informal) economies. 80 per cent of the non-agricultural work forces in SSA are informally active. This exceeds by far the estimates for more developed countries, but also for developing countries like India, Indonesia, Pakistan and the Philippines.<sup>52</sup>

UNIDO also highlights the issue of labour laws. It is a balancing act to protect workers while maintaining sufficient flexibility of labour laws to bring about efficient levels of employment for businesses. Too rigid labour laws constrain businesses and investments given that firms may be discouraged from hiring new workers even if growth opportunities exist.<sup>53</sup> Cambodia serves as a successful example of creating and sustaining a labour rights regime despite fragility and continuing PSD.

### Cambodia: How labour rights boosted private sector growth and social protection

Dicaprio's (2013) paper contributes to research on the political economy underlying social interventions in fragile states. Over the past decade, donor support for social protection and labour market programmes has increased significantly. Although World Bank lending for social protection tripled from 1998 to 2011, in the long run sustainability of these donor-assisted projects remains uncertain. Against this backdrop, Dicaprio's article elucidates how, in less than a decade Cambodia's garment sector has

---

<sup>51</sup> Godnick, William and Klein, Diana (2009): The challenges of supporting 'alternative' economic opportunities for peacebuilding – Perspectives from Columbia, International Alert, pp 24-25

<sup>52</sup>UNIDO (2008): Creating an enabling environment for private sector development in sub-Saharan Africa, United Nations Industrial Development Organization and Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) pp 14-16

<sup>53</sup> Ibid. p 33

been transformed from a cluster of sweatshops where human rights violations were pervasive, into hundreds of monitored factories that are more likely to comply with the labour law (than they are to engage in forced overtime). In 1997, Cambodia was a Least Developed Country (LDC), post-conflict fragile state and a tenuous democracy. Although the 1993 constitution guaranteed a variety of social protections and labour rights, operationalization was close to non-existent. In 2012, the ILO-affiliated monitoring mechanism found that more than 90% of surveyed factories neither interfered with freedom of association nor engaged in anti-union activity. This rapid evolution has not only spurred sustained growth in FDI, but also a reframing of the international perception of Cambodia from a dangerous hinterland to a viable production site for ethically branded apparel. The impetus for change, according to Dicaprio, was a donor intervention that linked working conditions in the garment sector to market access under a global quota system that expired in 2005. This included the creation of institutions that would give effect to the labour law and empower works to use them. The institutions and social dynamics that resulted from the program have produced a sustainable framework for worker rights. Thus, the case of Cambodia demonstrates that by promoting the creation of political spaces available to interest groups in fragile states, donors can amplify the positive impacts of foreign assistance in these areas.<sup>54</sup>

### Making Markets Work for the Poor (M4P) approaches

While M4P is an established approach to development in low income countries, it has only recently been applied in fragile and conflict-affected situations. Its utility in such situations is subject to debate, which is yet to be decided due to insufficient evaluation to date.

Supporting the claim that M4P has limited utility in post-conflict environments, Maguire argues<sup>55</sup>:

- The M4P approach is premised on the pre-selection of appropriate markets for delivering large impacts, but such markets are disrupted by conflicts and so are not readily available for selection.
- Rule of law needs to come first, to bring about the conditions necessary for a positive market environment.
- By emphasising large scale, system-based approaches, the poorest and most marginalised could be left out. Women, in particular, are 'conspicuously absent' from the theory of the M4P approach.
- M4P could be useful, but as a component of a broader human rights-based approach.

Opposing this claim, Ockenden argues that M4P can be an effective approach if it is grounded in a comprehensive political economy and conflict analysis:

- The M4P approach is in part a diagnostic tool which focuses on markets – an important aspect of fragile situations.
- M4P programmes can be flexible, using pilot programmes before scaling up.
- Risk management can be easily incorporated, in part because of the emphasis on facilitation rather than direct involvement by practitioners.
- M4P is applicable to the social sector as well as goods and services.

---

<sup>54</sup> Dicaprio, Alisa (2013): The Demand Side of Social Protection: Lessons from Cambodia's Labor Rights Experience, World Development, Elsevier Ltd. Vol. 48, pp 108-119

<sup>55</sup> Maguire, S., Supporting the motion "The M4P approach has limited utility in post-conflict environments", M4P Hub debate <http://www.m4phub.org/debates/discussion-papers.aspx>

Ockenden claims that M4P has not been used extensively in fragile contexts because it emphasises indirect facilitation, when pressing problems seem to demand direct and swift action ('impulse interventions')<sup>56</sup>.

Evidence is yet to vindicate either side of this debate. The dearth of evidence is best captured by Mallet and Slater in a systematic review of literature on M4P. They found only three relevant studies, on M4P approaches in Bangladesh, Kenya and Uganda. Quantitative methods were only used in one study, and only one discussed causal logics at any length. Despite these difficulties, Mallet and Slater drew the following conclusions:

- 'M4p Interventions, including competitiveness measures, market chain innovation and producer collective action and marketing can lead to increases in the income of beneficiaries (three studies)
- The participatory market chain approach can foster social cohesion, developing trust within a network of producer and research organisations (one study)
- M4P interventions can bring about modest increases in employment within target sectors (two studies)
- M4P interventions can increase (capacity for) innovation among farmers and PMGs [Producer Marketing Groups] (two studies).'<sup>57</sup>

## Case study

### Somali Region of Ethiopia: Making the input supply market work for the poor

Examples of M4P in fragile contexts are emerging, as shown by a recent case study from the Springfield Centre and MercyCorps, written by Oakeley and Proud<sup>58</sup>, assessing a market support project in the Somali Region of Ethiopia. Although the effects of the programme on the dynamics of conflict are not dealt with explicitly, the report shows positive results in terms of this market.

The Revitalizing Agricultural/Pastoral Incomes and New Markets (RAIN) programme was designed to transition relief efforts into longer-term development interventions, in a context which was environmentally fragile, socially disparate, economically weak, and politically unstable with marginal regional representation at the federal level and a weak local government<sup>59</sup>. The animal health inputs system was identified as an aspect of the market that, if improved, would bring about substantial positive change across the market. While noting that the programme has only been active for 18 months, and so a full impact assessment is impossible, Oakeley and Proud report that has had the following impacts:

- Enhanced pharmaceutical distribution
- Enhanced private veterinary pharmacy (PVP) business pharmaceutical distribution network

---

<sup>56</sup> For the debate in full, including discussion, see <http://www.m4phub.org/userfiles/file/M4P%20Hub%20Debate%20Summary.pdf>

<sup>57</sup> Mallet and Slater (2012) p.47.

<sup>58</sup> Oakeley, R. and Proud, E., Making the Input Supply Market Work for the Poor: Full Case Study from the Somali Region of Ethiopia (2013).

<sup>59</sup> Ibid p.3.

- Enhanced PVP service capacity
- Enhanced Community Animal Health Workers (CAHW) service capacity
- Increased pastoralist/agro-pastoralist livestock productivity

### Operational points of interest:

Through conducting a market-based analysis, RAIN staff were able to analyse how previous interventions, including the provision of free pharmaceuticals, were distorting the market and making it harder for private actors to function.

The programme originally used a value chain approach that concentrated on core formal markets, and interventions were developed accordingly. When it became apparent that a market-based approach dictated a change in strategy, RAIN was met with substantial resistance from their delivery partners and regional government. This was ameliorated by a dual approach whereby part of the team were assigned to provide 'quick wins' to meet the expectations of local government, giving the rest of the team space to develop a new strategy.<sup>60</sup>

## 2.2 MICRO-LEVEL

### Promoting Value Chains

Value Chain Development focuses on moving poor individuals into higher-return, growth markets, and upgrading their products and processes so that they can compete in wider markets. The most substantial work assessing value chain projects in conflict-affected environments was carried out by USAID in 2008, in a series of reports. Parker (2008) synthesises the findings of these reports<sup>61</sup>:

Value Chain projects were used to achieve one of two primary objectives:

#### 1. Increase economic activity and stimulate growth:

- Eco-tourism in Rwanda, with receipts from zero to \$33 million/year over a five year period.
- Domestic dairy sales in Kosovo increasing by \$36 million over a four-year period
- Coffee in Rwanda, with sales of export-ready coffee rising from zero to 940 tons after five years.

#### 2. Reach vulnerable and cut-off social groups, to increase their economic and social participation and standing:

- A Shea butter programme reaching women cut off by conflict in South Sudan

---

<sup>60</sup> Ibid p.5.

<sup>61</sup> Parker, Joan C. (2008): A Synthesis of Practical Lessons from Value Chain Projects in Conflict-Affected Environments, USAID microReport #105,

- High-value fresh vegetables in Nepal, increasing community cohesion and participation (discussed in more detail below)
- In Northern Uganda internally displaced persons living in remote camps were interlinked with the cotton value chain despite their confinement to the camp area.
- A poultry value chain programme linking home-bound women in Afghanistan to markets and each other

Operational recommendations based on these findings include ensuring that the private sector leads the upgrading of the value-chain, with donors playing a ‘facilitating’ role. It should be acknowledged that results for programmes in conflict environment take longer to become evident (projects achieved initial milestones after at least two years, with another three years required to achieve economic results).

## Case Study

### Nepal: Successful high-value vegetable value chains

International Development Enterprises<sup>62</sup> et al, the authors of the Nepali case study, assess two value chain development projects, the Smallholder Irrigation Market Initiative (SIMI), primarily aimed at reducing poverty, and the UJYALO project, aimed at integrating the value chain approach with psychosocial and peace-building activities, with peace-building as the primary objective<sup>63</sup>. Based on interviews of stakeholders, the authors posit that the programmes increased trust and cooperation, within families, in farmers’ groups and between neighbours; decreased interfamily and inter-community conflict; and deterred individuals from joining Maoist groups. The authors also claim improvements in the social status of women, with some women taking lead roles in farmers’ groups. Some women moved from being reluctant to participating in public events to being active in vocalising local needs. Interviewees also claimed an increase in women’s mobility and financial independence, with some women earning income for the first time<sup>64</sup>.

One constraint to the findings of this study is that while the UJYALO project incorporated psychosocial and peace-building activities into a value chain approach<sup>65</sup>, this report does not assess the long-term effect of these activities because only (primarily) one group in the value chain – farmers – were participants of these activities. The timing of the assessment also came too soon after the project to accurately assess long-term impact.

### Promoting Business Associations and Community Groups

International Alert has published a comprehensive study of business and business associations in fragile situations. This report outlines a spectrum of business activity, from that which sustains conflict through, for example, participation in illicit trade, to activity that reduces conflict and builds peace, with survival and coping activity in-

---

<sup>62</sup> Bauman, Peter (2008), A Comparative Case Study of High-Value Vegetable Value Chains in Nepal, International Development Enterprises, Winrock International, USAID microREPORT #108

<sup>63</sup> Ibid p.1

<sup>64</sup> International Development Enterprises et al (2008) p.36

<sup>65</sup> Including: developing community groups, provision of legal advice and counselling for victims of torture and conflict, peace education programmes, training in human rights, peace-building and mediation. International Development Enterprises et al (2008) p.7.

between<sup>66</sup>. The report claims that ‘the most successful initiatives in terms of macro-level impact involve sections of the business community working cohesively to maximise influence over political dynamics, or to raise public awareness about conflict and peace.’<sup>67</sup>

Strength of the evidence: While this study is comprehensive, the authors acknowledge its limits. For the most part cases were not tested through a ‘strict impact-evaluation lens’, and a uniform process was not applied to every case study<sup>68</sup>.

## Case study

### Sri Lanka: Business for Peace Alliance

International Alert reports the progress of two business associations in Sri Lanka – one Colombo based (Sri Lanka First, SLF), the other island-wide (the Business for Peace Alliance, BPA). SLF, made up of companies from the garment, tea, tourism and freight (ie, predominantly exporting) industries undertook several activities, including a public and political awareness campaign about the economic costs of war, and lobbied all parties in the conflict to come to the negotiation table. International Alert claims that this advocacy ‘helped to bring a pro-peace government to power’<sup>69</sup> though it is unclear exactly how, and to what extent, this lobbying had this influence. This group significantly reduced its activities once the ceasefire agreement was signed.

The BPA was supported by International Alert and the UNDP, with the objectives to support reconciliation, business-to-business relationships across the ethnic divide and regional inclusion in the peace process<sup>70</sup>. International Alert reports positive impacts on business relationships between Sri Lanka’s 17 regional chambers of commerce. Like the SLF this group lobbied the government, but for specific policy outcomes, including:

- The opening of a bank for SMEs, to provide low interest loans
- An additional fishing Channel
- Keeping a major road open during night- as well as day-time<sup>71</sup>.

There is no mention of whether these lobbying activities have had a positive impact on the economy, or stability.

Overall, case study material collected for the report reveals a range of interventions by business seeking to promote peace in a variety of conflict settings. Some examples listed in the report are summarized in the table below.<sup>72</sup>

---

<sup>66</sup> International Alert, Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector (2006) p.2

<sup>67</sup> Ibid. p.9

<sup>68</sup> Ibid. p.20

<sup>69</sup> Ibid. p 570

<sup>70</sup> Ibid. p.572

<sup>71</sup> Ibid. p.573

<sup>72</sup> Ibid. pp 4-5

<b>Peace entrepreneurship</b> <b>An overview of cases (selection)</b> <b>Source: International Alert Local Business, Local Peace: the Peacebuilding Potential of the Domestic Private Sector (2006 : pp. 4-5)</b>	
<b>Afghanistan</b>	<ul style="list-style-type: none"> <li>• A high level conference encourages business to engage in dialogue with the government in order to strengthen its role in the country's reconstruction</li> <li>• Business gets involved in the Afghan new Beginnings Program, a Disarmament, Demobilisation and Reintegration DDR programme, providing training and employment to ex-combatants</li> <li>• Local businessmen participate in a <i>shura</i>, or council, that seeks to tackle corruption in the local administration</li> <li>• Members of the Afghan diaspora return to invest in the country's economy</li> <li>• US NGO Business Council for Peace supports women entrepreneurs in creating sustainable businesses</li> </ul>
<b>Bosnia and Herzegovina</b>	<ul style="list-style-type: none"> <li>• <i>Nova Banka Bijeljina</i>, the leading bank in SME finance, lobbies authorities to achieve cross-entity harmonisation of banking regulations, creating a unified banking market and facilitating investment across different entities</li> <li>• <i>Organic Medici</i>, a business growing and processing organic herbs, works with farmers across different ethnic and entity divides to source products, and employs minority returnees,</li> <li>• Croatian company <i>Kras</i> reinvests in <i>Mira Prijedor</i> biscuit factory in Republica Srpska, assisting its recovery from war-time losses</li> <li>• Informal markets such as Arizona in Broko district provide spaces for inter-ethnic economic cooperation at the same time as securing livelihoods.</li> <li>• International NGO CHF's Municipal and Economic Development Initiative supports multi-ethnic business associations which form into the Regional Enterprise network, contributing to economic policy-making at both local and national levels</li> <li>• Tuzla-based NGO <i>Ipak</i> enters into a partnership with local furniture company Score, which offers places to young refugee graduates of <i>Ipak's</i> carpentry training</li> </ul>
<b>Burundi</b>	<ul style="list-style-type: none"> <li>• The country-wide women's network Dushirehamwe combines conflict transformation with economic co-operation and livelihood generation initiatives.</li> <li>• Burundi Enterprise Network is formed to lobby and engage with the government to improve the business climate and create a more equitable and peaceful economy</li> </ul>
<b>Colombia</b>	<ul style="list-style-type: none"> <li>• Business plays a high-profile role in the Pastrana administration's peace process with the armed group FARC</li> <li>• The energy company <i>Interconexion Electrica S.A.</i> creates the <i>Programa de Desarrollo para la Paz</i>, an initiative that tackles the root causes of conflict at the community level</li> <li>• <i>Compañia Envasadora del Atlántico</i>, in collaboration with the UNDP, helps organise farmer associations that produce passion fruit for its export business, providing them with livelihood alternatives to coca plantation</li> <li>• <i>Allianzas Red</i> works to involve the private sector in reintegrating initiatives that offer training and employment opportunities to IDPs</li> <li>• The national Federation of Chambers of Commerce initiative <i>Empresas por la Paz</i> combines conflict resolution training at the micro-level with business start-</li> </ul>

	up support to participants.
<b>Democratic Republic of Congo</b>	<ul style="list-style-type: none"> <li>Local businesses in eastern Congo employ ex-combatants and co-operate with MONUC to strengthen stability at the community level and engage in policy dialogue at the national level.</li> </ul>
<b>Kosovo</b>	<ul style="list-style-type: none"> <li>The international NGO mercy Corps promotes dialogue-rich development in an initiative to foster both reconciliation and business linkages that were lost during the conflict between Albanian and Serb Kosovars</li> </ul>
<b>Nigeria</b>	<ul style="list-style-type: none"> <li>Marketplaces in Nigeria offer space for inter-ethnic economic interaction, fostering peaceful relationships and leading to co-operation on community-level security</li> </ul>
<b>Sierra Leone</b>	<ul style="list-style-type: none"> <li>The Sierra Leone branch of African diaspora mobile phone company Celtel partners with international NGO Search for Common Ground to launch a new mobile phone network in former rebel strongholds in the north, combining the launch with a radio-broadcast debate on the importance of national reconciliation and the role of communications</li> <li>The Sierra Leone market Women's Association provides micro-finance schemes and training to market women to strengthen their livelihoods and contributions to the post-war economy</li> </ul>
<b>Somalia</b>	<ul style="list-style-type: none"> <li>Telecommunications company Nationlink partners with UNICEF and a local NGO to provide vocational training and employment to demobilised child soldiers.</li> <li>Facilitators of the peace process involve businesspeople in a high level conference to secure their buy-in and commitment to a peace agreement and reconstruction of the country</li> <li>Businesses support the Mogadishu Security and Stabilisation Initiative that seeks to address security concerns in the capital, including roadblocks.</li> <li>Businesspeople supply investments and goods for the running of local social services such as hospitals, and themselves provide essential public services such as electricity.</li> </ul>

## Microfinance

Since the 1970s, the concept of microcredits has become more and more popular, and viewed as having the potential to reduce poverty in a straightforward and sustainable manner.<sup>73</sup> There is a vast body of literature on how microfinances services may empower many poor women in developing countries. When it comes to fragile states or post-conflict environments, the benefits but also challenges of microfinance in promoting income generation are less well explored.<sup>74</sup> By drawing on the case studies of Angola, Cambodia, Mozambique and Rwanda, Wilson (2002) identifies 8 conditions that have an impact on microfinance: Civilian upheaval, disrespect of rule of law, socio-economic

<sup>73</sup> C.f. Hanlon, Joseph, et.al. (2010): Just give money to the poor: the development revolution from the global south, Kumarian Press, U.S.

<sup>74</sup> De Vries and Specker (2009), p 62

impacts, macro-economic impacts, macro-economic indicators, economic policy change, financial infrastructure, political instability, and infrastructure.<sup>75</sup>

De Vries and Specker (2009) argue that in spite of the good press microfinance has received, micro-credits are not the one-stop solution to poverty. First, micro-credit schemes may be quite time-consuming to set up. Second, rural credit schemes have failed where the debt-bearing capacity of local people was overestimated, or where there was too little knowledge of already existing (informal) credit systems. Third, forming local groups of borrowers may also be difficult where people are widely dispersed across the countryside, or where social tensions are high. Moreover, after conflict, communal solidarity can be overshadowed by mistrust, which, in turn affects the implementation of microfinance schemes. Thus, without significant financial sector reform, micro-finance alone is unlikely to solve the problem of lack of business opportunities and credits that SMEs (Small and Medium Enterprises) need to grow. In response to these identified challenges, De Vries and Specker recommend the following initiatives:

- Decentralize credit schemes as much as possible
- Use existing organisations for micro-finance
- Consider credits to particular high-needs groups
- In order to minimize the risk of loans not being repaid, money could be put into a communal fund, comparable to an internal banking system.
- Look beyond small firms and consider making credit lines or grants available to medium-sized and large private firms. (e.g. to contribute to a bigger scale to employment generation).
- Micro-credit provided to ex-combatants requires parallel, long-term support programmes.
- Provide skills training to entrepreneurs.

McDonald (2006) further holds that specific country conditions must be applied to the general model of microfinance to better determine priorities among the various strategies. In his view, emerging experience indicates certain 'rules of thumb' which may be useful for programme design decisions. These rules of thumb are far from complete but meant to offer a starting point in the design of initiatives to promote PSD in post-conflict reintegration and reconstruction programmes. These include<sup>76</sup>:

- Micro-level strategies involving skills training, SME promotion and microfinance are likely to be most effective in meeting short-term employment objectives in immediate post-conflict periods.
- Micro-level strategies alone are unlikely to address long-term cycles of underdevelopment. This indicates a need for a micro, meso and macro level strategies.
- Micro-level strategies involving microfinance are subject to relatively few essential conditions and can, if professionally managed, reach high volumes and broad target groups.
- Micro-level strategies may be prone to rent-seeking. This can increase the challenges of implementation in weak governance environments.

---

<sup>75</sup> Wilson, Tamsin (2002): Microfinance during and after armed conflict: Lessons from Angola, Cambodia, Mozambique and Rwanda, Concern Worldwide & The Springfield Centre for Business in Development, Output of a project supported by the Enterprise Development and Innovation fund of DFID.

<sup>76</sup> McDonald, M.H. (2006): Private Sector Development in Reintegration and Reconstruction Programmes, Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH, pp 28-29

- Meso-level strategies involving group or regional cooperation should reflect concepts typically associated with peacebuilding and reconciliation.
- Meso-level strategies to improve large scale infrastructure, financial systems and the investment may be necessary to enable SMEs to fully participate in the reconstruction boom that typically follows peace agreements. This indicates the need to initiate reforms as soon as possible in post-conflict settings.

## Case Studies

### South Sudan: Success of microfinance largely depends on enabling environment

In addition to commercial banks, many microfinance institutions operate in South Sudan. However, Leo et. al. (2012) observe that they currently service less than 1 per cent of available clients in the greater Juba region, and offer a limited range of products. As of 2010 microfinance institutions had not started addressing the rural and agricultural sectors effectively – where most households derive their primary source of income. Lending rates are comparable with those of other developing countries, ranging between 15 – 35 per cent. Banking sector growth and coverage going forward, for both commercial and microfinance institutions, will depend on strengthening land registry systems, improving legal and enforcement mechanisms, enhancing bank management capacity, and reducing high transaction costs driven in part by poor infrastructure (electricity, telecommunications, transport). Overall, donor programmes are not aligned with many of South Sudan’s greatest business environment obstacles – particularly electricity and access to finance. Despite being these the two largest business constraints, donors supported only one electricity project and one microfinance-related programme as of 2010. This suggests that donors should explore ways of helping South Sudanese farmers and business owners to better access affordable expansion and operational capital.<sup>77</sup>

### Cambodia and Timor-Leste: Why success of microfinance is context-specific

Alldén (2009) addresses how microfinance has developed different results in both countries. While in Cambodia this strategy has been quite successful, in Timor-Leste microfinance is considered less effective for poverty reduction.

**Cambodia** had the essential pre-conditions for launching microfinance activities in a conflict-ridden society. Microfinance was introduced as the conflict came to an end in 1991 and was initially used as a humanitarian aid instrument. What facilitated the development of microfinance activities was that there was still a banking sector in 1991 and there was no dearth in human resources – both skilled and educated. Another reason for its success was the genuine international and national support for microfinance. Donors had the opportunity to pressure the government into adopting rules and regulations at an early stage and Cambodians have accepted this type of activity as a major tool for poverty alleviation.

In the case of **Timor-Leste**, no microfinance sector existed until 2001. The banking system had just begun to re-emerge two years earlier and human resources were still limited. The 2006 crisis reversed some of the positive developments since 2001 and some smaller MFIs had to close down. Hence, one of the pre-conditions for successful microfinance developments – the end of violent conflict – had not been reached by

<sup>77</sup> Leo, Ramachandran, and Thuotte (2012), pp 37-41

2006. Furthermore, microfinance in Timor-Leste did little to help solve the unemployment problem in the country. Alldén therefore concludes that with increased government support and regulations providing clear guidelines for operation, donor support and by education the public in the government about the potential and weaknesses of microfinance, Timor-Leste might achieve a similar success story to that of Cambodia.<sup>78</sup>

## Corporate Social Responsibility (CSR)

How a context of conflict influences MNEs' (Multinational Enterprises) CSR activities, and how partnerships can best be embedded in MNEs strategies and practices is a nascent area of study. Kolk and Lenfant (2013) examine MNEs and conflict issues, including interactions with NGOs in Central African fragile states. The authors shed light on possible MNE contributions to peaceful societies by highlighting a few innovative partnerships of MNEs and non-business partners in Central Africa. Innovative partnerships, they argue, take the conflict context into account, have a learning capacity-building component, are part of a more comprehensive development plan, but also are embedded at the community level, and tackle issues directly related to the conflict, such as governance, human rights, artisanal mining, and transparency. Kolk and Lenfant warn of the potentially disruptive aspects of social investment activities undertaken by MNEs in partnership with NGOs. Likewise, CSR interventions in the social domain can create a culture of dependency and potentially weaken the role of the government. This gives rise to the question as to whether MNEs are supposed to (partly) take over government functions with CSR substituting the responsibility of the state? In other words, can CSR programmes undermine state capacities? One way out of this dilemma may be tripartite partnerships that involve government (agencies) and focus on capacity and institution building – however, these partnerships seem problematic in countries characterized by fragile or even largely absent state structures. Overall, the article underlines the complexity of operating in fragile states and the balancing act faced by public, private and non-profit actors in such settings.<sup>79</sup>

## Case Study

### Chad: Challenges of implementing CSR

Cash (2011) critiques CSR programs in resource-rich developing countries and questions the role of corporate interventions in such settings. She lays out how CSR has been “operationalized” in Chad to ensure that the finances generated from oil projects are properly managed. Her analysis examines at greater length the challenges to implementing a CSR agenda in fragile states such as Chad, highlighting, specifically, the barriers to facilitating development in environments exhibiting Dutch Disease-like symptoms. Most MNCs (Multinational Corporations) in Chad argue that they are not responsible for socio-economic development. Rather, they view CSR projects as a supplement to long-term government projects. The government of Chad is both unwilling and unable to regulate state activities, calling into question their ability to create the right

---

<sup>78</sup> Alldén, Susanne (2009): Microfinance and Post-Conflict Development in Cambodia and Timor-Leste, SOJOURN: Journal of Social Issues in Southeast Asia vol. 24, No. 2, pp 269-284

<sup>79</sup> Kolk, Ans and Lenfant, Francois (2013): Multinationals, CSR and Partnerships in Central African Conflict Countries, in Corporate Social Responsibility and Environmental Management, 20, (1), 43-54.

mechanisms in order to control the actions of MNCs. Cash thus questions whether corporations should foray into the realm of socio-economic development when their activities are primarily tied to increasing profit margins. The problem arises in particular when responsibility for public services falls to corporations, which are traditionally the responsibility of the state. In fragile states such as Chad, where the capacity to perform these functions is limited, the area becomes blurred. In Cash's view, Chad appears to be actively retarding the rate of capacity-building within ministries and the civil service, in a bid to maintain (if not increase) political power.<sup>80</sup>

Banfield et al. (2003) assess the possibility of the convergence of conflict prevention and CSR policy frameworks on the issue of TNCs (Northern Based Transnational Cooperations) and conflict. They suggest that greater inclusion of developing country and local community perspectives in CSR efforts would also enhance prospects for CSR initiatives themselves to avoid triggering conflict dynamics. CSR policy frameworks and instruments have to be cognisant of both their function in conflict-prone zones, and opportunities for promoting greater conflict sensitivity among TNCs. This requires to<sup>81</sup>:

- Appoint a high-level working group to conduct a thorough review of all relevant existing policy instruments and capabilities relating both to CSR and conflict prevention.
- Engage in dialogue with other policymaking institutions to identify where added value might be, and to ensure complementarity at the global level.
- Develop clear institutional priorities on coherence between CSR and conflict-prevention frameworks, in consultation with relevant stakeholders.
- Design strategic and operational frameworks to promote these, including through addressing institutional blockages where they exist.
- Review best practice as evidenced in other institutions.

## Remittances and Diaspora

Remittances from Diasporas continue to play a significant role in fragile states, both in providing more stable sources of income than most other external flows, and in transferring social norms and values.<sup>82</sup> Ideally, the Diaspora serves as a source to a society's transformation from abroad by making various contributions, including FDI, transfer of knowledge and technology, market development and cultural change.<sup>83</sup> In reality, however, substantial remittances frequently do not maintain local businesses in the fragile state environment.<sup>84</sup> Overall, the OECD (2012) reports that remittance flows to fragile states have grown, but remain highly concentrated, with 80% going to just five countries: Bangladesh, Nigeria, Pakistan, Sri Lanka and Nepal. Besides, the costs of sending remittances to fragile states varies widely, with lows and highs ranging from 2,2

---

<sup>80</sup> Cash, Audrey C. (2011): Corporate social responsibility and petroleum development in sub-Saharan Africa: The case of Chad, in: Resources Policy 31 (2012), Elsevier, pp 144-151

<sup>81</sup> Banfield, Jessica; Haufler, Virginia and Lilly, Damian (2003): Transnational Corporations in Conflict Prone Zones: Public Policy Responses and a Framework for Action, International Alert

<sup>82</sup> OECD (2012); and DIIS (2008): Diaspora and Fragile States, Policy Brief, Danish Institute for International Studies, The

<sup>83</sup> Evans, Jadotte (2012): Brain Drain, Brain Circulation and Diaspora Networks in Haiti, The Least Developed Countries Report 2012, Harnessing Remittances and Diaspora Knowledge to Build Productive Capacities, Background Paper Nr. 1, November 2012, UNCTAD, p 21

<sup>84</sup> Leo, Ramachandran, and Thuotte (2012), p 6

per cent to 22,5 per cent. The G8 and G20 have committed to lower the costs of remittances from an average of around 10 per cent to 5 per cent by 2014.<sup>85</sup>

The GFMD - Global Forum on Migration and Development (2012)<sup>86</sup> further suggests that African investment funds have the potential to attract investments from wealthy African migrants abroad. Such funds can take the form of regional funds, mutual funds, and private equity to be invested in African companies and pension funds. These investment funds are equity investments, unlike diaspora bonds. The creation of these funds, in turn, may require stronger investor protections to ensure proper management of the funds. The GFMD thus recommends putting in place mechanisms such as: management of funds by a state agency; management of funds by a private company; and management of funds by a combination of a private company but with participation of members from the diaspora.<sup>87</sup>

## Case studies

### Somalia / Somaliland: Lack of formal financial institutions constrain transactions

Leo et al. (2012) highlight that telecommunications, financed mainly through remittances and members of the Somaliland born Diaspora has been a key driver of recent economic growth. Competition between providers in Somaliland and the rest of Somalia has led phone services to be among the cheapest in all of Africa.<sup>88</sup>

Likewise, household level private remittances have been key sources for reconstruction of homes and businesses in Somaliland. Nonetheless, the lack of formal financial institutions constrains business transactions and growth, leading to dependency on neighbouring banking and financial sectors. A leaked cable also revealed that an official of the United Kingdom's largest Somalia remittances transfer firm believed that the lack of a legislative framework in the financial services sector was hindering economic growth.<sup>89</sup>

### Haiti: Security and property rights issues constrain Diaspora FDI

In the case of Haiti the sectors that are mostly affected by 'brain drain' phenomenon are the health sector and that of electronics as these are the only fields in the country where demand for labour exceeds supply. Over the years, Haitian market mechanisms have proven incapable of filling the void by attracting and keeping in the country more workers in those fields. Evans (2012) further holds that security and property rights issues constrain Diaspora FDI. While there are some scattered investments, on the whole the Diaspora seems to be reluctant to making serious investment in Haiti, advancing political instability, heavy bureaucracy and feckless politicians as the main deterrent. Meanwhile, already established entrepreneurs in Haiti tend to view some sectors of the Diaspora as

---

<sup>85</sup> OECD (2012) p 73

<sup>86</sup> The GFMD background paper was prepared by staff from the World Bank, IOM, IFAD, and Round Table Coordinators.

<sup>87</sup> GFMD (2012): Supporting Migrants and Diaspora as Agents of Socioeconomic Change, Background Paper, 12 Oct 2012, Global Forum on Migration and Development, Mauritius, p 15

<sup>88</sup> Ibid. p 75

<sup>89</sup> Ibid. pp 76 - 77

too demanding by placing the bar too high in terms of guarantee for their potential investment.<sup>90</sup>

## Entrepreneurship

Relative to a burgeoning literature on entrepreneurship in general, including a substantial body of work on entrepreneurship in developing states, entrepreneurship in post-conflict situations has received little attention. There has, however, recently been increased interest in this field – particularly in academic circles. Much of this literature posits entrepreneurship as a phenomenon that can either enhance or exacerbate a fragile situation. As usual, much hinges on definitions, and many use Baumol's (1990) description: 'Entrepreneurs are defined, simply, to be persons who are ingenious and creative in finding ways that add to their own wealth, power, and prestige.' Within this umbrella, of course, come predatory, rent-seeking, monopolistic actors, about whom much has been written within the field of 'war economies' (Duffield, Keen). As seen in the above section on FDI, entrepreneurial activities can work against equality of outcomes, and equality of opportunity. Naude notes that the implication of this is that increasing entrepreneurship overall may be less important than influencing how entrepreneurship is allocated into productive activities<sup>91</sup>.

Naude argues that entrepreneurs can contribute to the stabilisation process in several ways:

- Economic growth, in particular, reallocating resources from low productivity uses to high productivity uses
- A 'cost discovery function, exploring activities which may or may not be profitable
- Filling niches in the provision of services usually provided by state institutions.
- 'radical innovation' (as against 'incremental innovation') which can undermine vested interests and 'crowd out' rents by providing new opportunities.
- 'survivalist' entrepreneurs, while unable to provide the above opportunities, can reduce the risk of poverty by providing modest incomes.

To encourage these positive impacts of entrepreneurship, Naude posits, six dimensions of post-conflict settings need to be considered:

1. The context of war and conflict, in order to understand the incentives that affect behaviour of various sources of entrepreneurship
2. The relationship between institutions and entrepreneurship, and the relationship with institutional reform
3. Roles played by ethnic/immigrant entrepreneurs and entrepreneurs in diaspora
4. The scope of the market in these contexts
5. Human and financial capital requirements.
6. The relationship between government and the private sector (whether the former is working to remove barriers to participation in the economy, or creating them).

Sanders and Weitzel (2012) develop a model of (mis)allocation of entrepreneurial talent in post-conflict environments. Their framework suggests that in the 'stateless' context of a post-conflict situation, the equilibrium for many entrepreneurs wards against productive activities and towards destructive ones (in this case, raiding). The implication is that while the state is recovering its capacity to reduce the payoffs of raiding, the

---

<sup>90</sup> Evans (2012) p 21, pp. 33-34

<sup>91</sup> Naude, W., Peace, Prosperity, and Pro-Growth Entrepreneurship, UNU-WIDER Discussion paper No. 2007/02, August 2007 p.4.

provision of microcredits could provide a stop-gap to adjust the incentive structure toward positive activities. Importantly, though, the authors make explicit the fact that it may not be possible to apply or empirically test this model in the data. At best it uncovers a basic underlying mechanism<sup>92</sup>.

In another model by Desai et al, reward structures are critical determinants not only of immediate activity but also have an impact on future reward structures. Where the political economy is uncertain in the long term, the long-run equilibrium is likely to be towards destructive entrepreneurship. This work notes several research areas that are insufficiently understood:

1. The specific dynamics and causes of destructive entrepreneurship
2. Country or regional empirical research
3. Effects of demographic and political change over time<sup>93</sup>.

## Case study

### Rwanda: The role of entrepreneurship in conflict reduction

Tobias and Boudreaux conducted a survey which suggests association between entrepreneurial activity in Rwanda's recently liberalized coffee industry, and positive attitudes between ethnic groups. A research team carried out questionnaires at ten coffee washing stations (CWS), at which Hutus and Tutsis work collaboratively in a labour-intensive process. The tentative findings of this exploratory research were that frequent contact is associated with low distrust, and with conditional forgiveness. Highly frequent work contact is highly associated with low distrust, and highly frequent social contact is linked to conditional forgiveness. 'Pleasant contact' is associated with a peaceful expectation of the future in Rwanda<sup>94</sup>. Further, they found that respondents at CWS that had been in operation for longer than others were more likely to report a heterogeneous perception of the other ethnic group. Responses were not influenced by ethnicity, or the ethnic mix of participants at a particular CWS.

As Tobias and Boudreaux note, the association between contact and attitudes does not imply causation. This survey was exploratory and there was no control group, denying potential causal inference.

---

<sup>92</sup> Sanders, M. and Weitzel, U, Misallocation of Entrepreneurial Talent in Postconflict Environments, *Journal of Conflict Resolution* 2013 57:41 p.61

<sup>93</sup> Desai, S. Acs, Z.J. and Weitzel, Utz, A Model of Destructive Entrepreneurship: Insight for Conflict and Postconflict Recovery, *Journal of Conflict Resolution*, 2013 57:20.

<sup>94</sup> Tobias, J. and Boudreaux, K, The Role of Entrepreneurship in Conflict Reduction in the Post-Genocide Rwandan Coffee Industry, *Journal of Small Business and Entrepreneurship* 24.2 p.16

## Conclusion

The literature reveals how the complexity of fragile states means that PSD programmes can have positive and negative effects on stability and peacebuilding. Areas such as legal reform, strengthening macroeconomic institutions, rebuilding infrastructure, FDI, introducing or revamping labour rights, improving access to microfinance, M4P or developing entrepreneurship can potentially work both for and against the equality of outcomes and the equality of opportunity in fragile states. Against this background some of the key findings of this literature review include:

- Legal reform requirements in the legal framework of fragile states to boost PSD are often underestimated and deserve greater attention within the realms of development assistance. Law-making, however, is a long-term process and should not violate the tenets of legitimacy and representation.
- Although the connections between infrastructure and economic growth are well established in the literature, impact assessments of infrastructure projects that look beyond the first few years after a project are rare.
- Lack of access to finance and capital to launch businesses as well as dearth of local financial institutions (e.g. reliable central banks) remain one of the major constraints to PSD (in particular in sub-Saharan African fragile states).
- Literature reveals a mixed picture of the effects of FDI on stability and conflict. Its success depends largely on the context and environment.
- Apart from Cambodia's success story, the importance of instituting a solid labour rights regime in fragile states needs to be further explored (in the literature and consequently practice and research). More generally, it is a balancing act to create a labour rights regime and protect workers while maintaining sufficient flexibility of labour laws to bring about efficient levels of employment for businesses and foster PSD.
- Microfinance is not necessarily a one-stop solution to poverty reduction and largely depends on the enabling environment of the fragile state in question.
- CSR interventions (if not part of a comprehensive development plan) can potentially do more harm than good and should not substitute government services or any other forms of development assistance.

The multitude of interests of actors at the global, regional and local level (and their inter-linkages) was highlighted in the sections on legal reform, macroeconomic frameworks, FDI, CSR, Diaspora and remittances. Local realities can not only challenge FDI, but also, external private sector actors and IFIs can distort local economies and peacebuilding processes. Recalling Siegle (2011), the establishment of accountable and accessible financial institutions requires deep familiarity with the local population. At the same time, however, many authors and reports stress the need for local capacity building and training to ensure that FDI and any other kind of foreign assistance to boost local PSD benefits the population as a whole and does not lead to more corruption, impoverishment and instability.

How political participation and voice can positively impact PSD and FDI, as well as simultaneously increase stability and prosperity is shown in the case of Cambodia. The creation of political institutions and instruments (such as trade unions or the introduction of a new labour rights regime) contributed to economic growth and peace (see Cash 2011). On the other hand, the case of Chad for instance demonstrates that an

authoritarian regime can purposely suppress these developments to maintain political power. Likewise, Leo et al. (2012) marginally discuss how PSD was undermined by the politicisation of state and society in Zimbabwe.

This clearly gives rise to the question of what role the international donor community and IFIs should play to strengthen local political frameworks to enhance the effects of PSD on the stability of fragile states. Is PSD only compatible with emerging or transitioning democracies if the aim is to ensure stability, prosperity and peace? In this light, scholars such as Cash (2011) or Kolka and Lenfant (2013) rightly question the role of MNCs and whether they should be a substitute for service provision of the state (be it temporary or permanently). Likewise, to what extent should the development of the Private Sector go hand in hand with the development of Public Sector Management in fragile states?

Overall, there seems to be very little evidence in the literature on the impact on state society relations and whether PSD and state relations meet public expectations. One of the reasons could be the lack of empirical data gathered from public surveys or interviews on the ground. The interlinkage of PSD on state society relations thus remain certainly an area to be further explored and should receive greater attention among practitioner but also academic circles and in their respective studies and publications.

## References

Alldén, Susanne (2009): Microfinance and Post-Conflict Development in Cambodia and Timor-Leste, SOJOURN: Journal of Social Issues in Southeast Asia vol. 24, No. 2, pp 269-284

Appel, Benjamin J and Loyle, Cyanne E, 'The Economic Benefits of Justice: Post-Conflict Justice and Foreign Direct Investment' Journal of Peace Research 2012 49:685

Banfield, Jessica; Haufler, Virginia and Lilly, Damian (2003): Transnational Corporations in Conflict Prone Zones: Public Policy Responses and a Framework for Action, International Alert,

Bauman, Peter (2008): International Development Enterprises: A Comparative Case Study of High-Value Vegetable Value Chains in Nepal, Winrock International, USAID micro REPORT #108, 2008.

See: <http://microlinks.kdid.org/sites/microlinks/files/resource/files/mR%20108.pdf>

Besada, Hany (2013): Doing Business in Fragile States: The Private Sector, Natural Resources and Conflict in Africa, Background Research Paper, Submitted to the High Level Panel on the Post-2015 Development Agenda. See:

<http://www.post2015hlp.org/wp-content/uploads/2013/06/Doing-Business-in-Fragile-States-The-Private-Sector-Natural-Resources-and-Conflict-in-Africa-FINAL-May-25-2013.pdf>,

Bray, J. International Companies and Post-Conflict Reconstruction: Cross-Sectoral Comparisons, Social Development Papers, Conflict Prevention and Reconstruction paper no.22 (2005).

Cash, Audrey C. (2011): Corporate social responsibility and petroleum development in sub-Saharan Africa: The case of Chad, in: Resources Policy 31 (2012), Elsevier, pp 144-151

Channel, Wade (2010): Urgency vs Legitimacy. Tensions in Rebuilding the Legal Structure for Businesses in Post-Conflict Countries, See:

[http://www.cipe.org/sites/default/files/publication-docs/Urgency%20and%20Legitimacy\\_0.pdf](http://www.cipe.org/sites/default/files/publication-docs/Urgency%20and%20Legitimacy_0.pdf)

De Vries, Hugo and Specker, Leontine (2009): Early Economic Recovery in Fragile States Priority Areas and Operational Challenges', Clingendael Institute, The Hague, See:

[http://www.clingendael.nl/sites/default/files/20091100\\_cru\\_paper\\_Ispecker.pdf](http://www.clingendael.nl/sites/default/files/20091100_cru_paper_Ispecker.pdf),

DFID (2005): "Why we need to work more effectively in fragile states." available at: [http://www.jica.go.jp/cdstudy/library/pdf/20071101\\_11.pdf](http://www.jica.go.jp/cdstudy/library/pdf/20071101_11.pdf), p 7

DFID (2011): Operational Plan 2011-2015, Governance & Fragile States Department (Policy Division), see:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/67560/gov-frag-sts-dept-2011.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/67560/gov-frag-sts-dept-2011.pdf),

Dicaprio, Alisa (2013): The Demand Side of Social Protection: Lessons from Cambodia's Labor Rights Experience, World Development, Elsevier Ltd. Vol. 48, pp 108-119, See: <http://www.sciencedirect.com/science/article/pii/S0305750X13000843>,

DIIS (2008): Diaspora and Fragile States, Policy Brief, Danish Institute for International Studies, See: [http://www.diis.dk/graphics/Publications/Briefs2008/PB\\_2008\\_10\\_Diasporas\\_and\\_Fragile\\_States.pdf](http://www.diis.dk/graphics/Publications/Briefs2008/PB_2008_10_Diasporas_and_Fragile_States.pdf),

Emerson, Patrick M (2006): Corruption, competition and democracy, Journal of Development Economics 81 Elsevier, pp 193-212

Evans, Jadotte (2012): Brain Drain, Brain Circulation and Diaspora Networks in Haiti, The Least Developed Countries Report 2012, Harnessing Remittances and Diaspora Knowledge to Build Productive Capacities, Background Paper Nr. 1, November 2012, UNCTAD, See: <http://unctad.org/en/PublicationsLibrary/ldcr2012-bp1.pdf>,

GFMD (2012): Supporting Migrants and Diaspora as Agents of Socioeconomic Change, Background Paper, 12 Oct 2012, Global Forum on Migration and Development, Mauritius, See: [http://www.gfmd.org/documents/mauritius/gfmd12\\_mauritius12\\_rt\\_1-2-background\\_paper\\_en.pdf](http://www.gfmd.org/documents/mauritius/gfmd12_mauritius12_rt_1-2-background_paper_en.pdf),

Godnick, William and Klein, Diana (2009): The challenges of supporting 'alternative' economic opportunities for peacebuilding – Perspectives from Columbia, International Alert, See: [http://www.international-alert.org/sites/default/files/publications/LEO\\_Colombia.pdf](http://www.international-alert.org/sites/default/files/publications/LEO_Colombia.pdf),

Giustozzi, Antonio (2006): Afghanistan: Exploring the peacebuilding potential of the private sector, in Local business, Local Peace: the Peacebuilding Potential of the Private Sector, International Alert.

Hameed, Sadika and Mixon, Kathryn (2013): Private-Sector Development in Fragile, Conflict-Affected, and Violent Countries, CSIS Working Group on Private-Sector Development in Fragile States, Centre for Strategic Studies  
See: [http://csis.org/files/publication/130617\\_Hameed\\_PrivateSecDevel\\_WEB.pdf](http://csis.org/files/publication/130617_Hameed_PrivateSecDevel_WEB.pdf),

Hanlon, Joseph, et.al. (2010): Just give money to the poor: the development revolution from the global south, Kumarian Press, U.S.

Holden, Joseph and Pagel, Magarethe (2013): Private Sector Development and Conflict, What can be learnt from the experience of private sector development in conflict and post-conflict countries? EPS PEAKS, Helpdesk Request, Nathan Associates London, pp 8-9

IMF (2011): Macroeconomic and Operational Challenges in Fragile Situations. Paper prepared by the Strategy, Policy and Review Department in consolidation with other Departments, approved by Reza Moghadam.  
See: <http://www.imf.org/external/np/pp/eng/2011/061511A.pdf>,

Istanbul Conference on Somalia (21 – 23 May 2010): Draft Discussion Paper (Round Table) entitled: 'Banking, remittances, and the role of the central bank in promoting financial and private sector development in Somalia', See: <http://www.somalitalk.com/2010/may/istambul/banking.pdf>,

Jones, S., and Howarth, S, Supporting Infrastructure Development in Fragile and Conflict-Affected States: Learning from Experience. See: <http://www.opml.co.uk/sites/opml/files/FCAS%20infrastructure%20final%20report.pdf>

Kolk, Ans and Lenfant, Francois (2013): Multinationals, CSR and Partnerships in Central African Conflict Countries, in *Corporate Social Responsibility and Environmental Management*, 20, (1), 43-54.

Leo, Benjamin; Ramachandran, Vijaya and Thuotte, Ross (2012): Supporting Private Business Growth in African Fragile States, A Guiding Framework for the World Bank Group in South Sudan and Other Nations, Center for Global Development, See: [http://www.cgdev.org/files/1426061\\_file\\_Leo\\_Ramachandran\\_Thuotte\\_fragile\\_states\\_FINAL.pdf](http://www.cgdev.org/files/1426061_file_Leo_Ramachandran_Thuotte_fragile_states_FINAL.pdf),

Maguire, S., Supporting the motion "The M4P approach has limited utility in post-conflict environments", M4P Hub debate. See: <http://www.m4phub.org/debates/discussion-papers.aspx>

McDonald, M.H. (2006): Private Sector Development in Reintegration and Reconstruction Programmes, Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH, See: <http://www2.gtz.de/dokumente/bib/06-1280.pdf>,

McCoskey, S.K., Foreign Direct Investment and Entrepreneurial Capture in Pre-Conflict Liberia, *Journal of Small Business and Entrepreneurship* 24.2: pp. 197–216

Naude, W., Peace, Prosperity, and Pro-Growth Entrepreneurship, UNU-WIDER Discussion paper No. 2007/02, August 2007

Oakeley, R. and Proud, E., Making the Input Supply Market Work for the Poor: Full Case Study from the Somali Region of Ethiopia (2013).

OECD (2010), *Resource Flows to Fragile and Conflict-Affected States*, OECD Publishing. <http://dx.doi.org/10.1787/9789264092198-en>

OECD (2012): *Fragile States 2013: Resource flows and trends in a shifting world*, DAC International Network on Conflict and Fragility, See: <http://www.oecd.org/dac/incaf/FragileStates2013.pdf>,

OECD (2012a), "Development: Aid to developing countries falls because of global recession" *OECD Development Co-operation Directorate (DCD-DAC) website*, 4 April 2012, available at [www.oecd.org/dac/developmentaidtodevelopingcountriesfallsbecauseofglobalrecession.htm](http://www.oecd.org/dac/developmentaidtodevelopingcountriesfallsbecauseofglobalrecession.htm),

Parker, Joan C. (2008): A Synthesis of Practical Lessons from Value Chain Projects in Conflict-Affected Environments, USAID microReport #105, See:

<http://egateg.usaid.gov/sites/default/files/Synthesis%20of%20Practical%20Lessons%20from%20Value%20Chain%20Projects%20in%20Conflict-Affected%20Environments.pdf>,

Pavlović, Jelena and Charap, Joshua (2009): Development of the Commercial Banking System in Afghanistan: Risks and Rewards, IMF Working Paper, WP/09/150, See: <http://www.imf.org/external/pubs/ft/wp/2009/wp09150.pdf>,

REUTERS, (2 July 2013): Somali central bank governor denies U.N. charges over funds, See: <http://uk.reuters.com/article/2013/07/02/uk-somalia-governor-idUKBRE9610T220130702>,

Sanders, M. and Weitzel, U, Misallocation of Entrepreneurial Talent in Post-conflict Environments, Journal of Conflict Resolution 2013 57:41 Siegle, Joseph (2011): Stabilising Fragile States, Africa Centre for Strategic Studies of the National Defense University, See: [http://africacenter.org/wp-content/uploads/2011/07/Stabilizing\\_Fragile\\_States\\_Global\\_Dialogue.pdf](http://africacenter.org/wp-content/uploads/2011/07/Stabilizing_Fragile_States_Global_Dialogue.pdf),

Solá-Martín, Andreu (2011): Liberia: Security challenges, development fundamentals, Third World Quarterly, Volume 32, Issue 7, August 2011, pp 1217-1232

Sweeney, N. M, Private Sector Development in Post-Conflict Countries: A Review of Current Literature and Practice, DCED 2009

Tobias, J. and Boudreaux, K, The Role of Entrepreneurship in Conflict Reduction in the Post-Genocide Rwandan Coffee Industry, Journal of Small Business and Entrepreneurship 24.2 pp 217-242. See: [http://www.relooney.info/NS4053e/Entrepreneurship-Post-Conflict\\_4.pdf](http://www.relooney.info/NS4053e/Entrepreneurship-Post-Conflict_4.pdf)

UNIDO (2008): Creating an enabling environment for private sector development in sub-Saharan Africa, United Nations Industrial Development Organization and Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) See: [http://www.unido.org/fileadmin/user\\_media/Publications/documents/creating\\_an\\_enabling\\_environment\\_for\\_private\\_sector\\_development\\_in\\_subSaharan\\_Africa\\_01.pdf](http://www.unido.org/fileadmin/user_media/Publications/documents/creating_an_enabling_environment_for_private_sector_development_in_subSaharan_Africa_01.pdf),

Ware, Helen (2005): Demography, Migration and Conflict in the Pacific, Journal of Peace Research, Vol. 42, no 4, pp 435-454.

World Bank and International Bank for Reconstruction and Development (2013): Doing Business in the East African Community 2013, Smarter Regulations for Small and Medium-Size Enterprises – Comparing Business Regulations for Domestic Firms in the East African Community and with 185 Economies, See: <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Special-Reports/DB13-EAC.pdf>,

Wilson, Tamsin (2002): Microfinance during and after armed conflict: Lessons from Angola, Cambodia, Mozambique and Rwanda, Concern Worldwide & The Springfield Centre for Business in Development, Output of a project supported by the Enterprise Development and Innovation fund of DFID. See: <http://www.springfieldcentre.com/wp-content/uploads/2012/10/sp0202.pdf>,

Zhukov, Yuri M. 2012. "Roads and the Diffusion of Insurgent Violence: The Logistics of Conflict in Russia's North Caucasus". *Political Geography* 31(3): 144-156. See: <http://j.mp/sJDRBO>.