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# 1

## Post-Conflict Reconstruction in Africa: Some Analytical Issues

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### 1 Introduction

In contrast to much of the twentieth century, when warfare between rich states was the norm, contemporary conflict now occurs almost exclusively in poor developing countries and is mainly internal in nature (although external parties and neighbouring countries may support internal belligerents). The period 1990–2000 saw nineteen major armed conflicts in Africa, ranging from civil wars to the 1998–2000 war between Eritrea and Ethiopia (Wallensteen and Sollenberg, 2001). Although the picture is grim, there has recently been some good news: a peace agreement has been signed in Angola; the governments of the Democratic Republic of the Congo (DRC) and Rwanda have signed a peace agreement; talks have resumed between the government and the rebels in Sudan. Sadly, these positive developments need to be counterbalanced with the empirical regularity with which peace agreements break down (Walter, 2001). Ensuring that the benefits of reconstruction are broad-based rather than narrow in their benefits, it is important to minimize the chances of conflict reigniting, since grievances will otherwise fester. Accordingly, the containment and reduction of inequality, and not just a reduction in absolute poverty, may be central to broad-based reconstruction.

This means that transition from war to peace may not be seen as only a political process, or one in which attention being paid to the economic dimensions of conflict should take a back seat to the political settlement (as is sometimes argued). Concomitantly, economists may not ignore the implications for social conflict of economic decisions: conflict and the potential for conflict play a strong role in retarding growth, development and poverty reduction (Murshed, 2002). Indeed, civil wars and conflict are among the major causes of development and growth failure in today's developing world, a point increasingly emphasized by aid donors such as the UK's Department for International Development, the World Bank, and the United Nations (DfID, 2001; World Bank, 2001; United Nations, 2000).

As societies slide into war, competing groups are formed to overcome collective action problems (in the sense of Olson, 1965). Ethnicity, whether based on language, religion or other distinctions, is often a superior basis for collective action in contemporary conflicts in poorer countries than other social divisions such as class that featured in the internal conflicts of early-twentieth-century Europe.<sup>1</sup> Moreover, as Azam (2001) indicates, organization or action along ethnic lines is often a product of the failure of the state to provide public goods. Thus conflicts rooted in grievances over one group's standard of living relative to another, can take an increasingly ethnic dimension as leaders mobilize followers by appealing to ethnic differences (for example, the appeal to religious affiliation in Nigeria's local-level conflicts). So too with greed over valuable natural resources; in the 1990s, Angola's rebel movement – the National Movement for the Total Independence of Angola (UNITA) – increasingly emphasized ethnicity to organize support among the Ovimbundu people so as to win control over the country's diamonds and oil.

The greed versus grievance dichotomy is important to the debate on the nature of conflict (see Murshed, 2002). But for either of these forces to cause large-scale violence there must be other factors at work, specifically a weakening of dispute resolution mechanisms, which some refer to as state failure (Marshall, 1999, for example). We may view today's African conflicts as being rooted in a partial or complete breakdown of the *social contract* – the agreed rules that govern the distribution of resources and obligations across society – and the concomitant mechanisms for settling differences. Furthermore, the social contract has economic and redistributive dimensions that are, in turn, embedded in fiscal institutions. The social contract, its collapse, and the centrality of its reconstruction post-conflict therefore provide the organizing themes of this chapter.

Section 2 is concerned with conflict and the breakdown of the social contract, including possible reasons why a peaceful social compact or agreement might become infeasible in the pre-conflict phase. Section 3 analyses how commitments to peace, and the broad-based fiscal transfers it entails, can be sustained and enhanced. Section 4 continues on the theme of designing commitment technologies to peace, this time in the context of capturable natural resource rents. Section 5 discusses post-conflict reconstruction, and how its design can rebuild a peaceful and broad-based social contract. Finally, Section 6 concludes with a discussion of areas of major concern in post-conflict societies.

## **2 The collapse of the pre-conflict social contract**

Within nation-states, the fiscal system will secure a workable social contract if the allocation of public expenditure and the apportionment of taxes are judged to be fair, or at least not so unfair that some groups regard taking resources by force the better option. There are many examples of conflicts

emerging out of fiscal disputes. Côte d'Ivoire, for example, has become increasingly unstable with the collapse of the social contract engineered by the late President Houphouët-Boigny, in which he allocated public spending across the regions to buy the loyalty of the country's ethnic groups. Similarly, conflict in Burundi and Rwanda has had strong fiscal dimensions (Ndikumana, 2001). Disputes over the apportionment of revenues from natural resources are especially common and, as in Nigeria, they often take on ethnic and regional dimensions.

Azam and Mesnard (2001) analyse the difficulties in sustaining social contracts that involve revenue sharing via fiscal transfers.<sup>2</sup> Contemporary civil wars are more often related to the *breakdown* of explicit or implicit arrangements to share resources or revenues, rather than their *absence*. One reason that a contract to share revenues encounters difficulties is the imperfect credibility with which the side that controls the resources honours its commitment. Let there be two parties to the potential armed conflict, the government and a rebel group. The government party has access to revenues and royalties, but is threatened by the excluded rebel group, which may violently overthrow the government with probability  $\pi$ , related to a contest success function. On the other hand, it may choose not to fight if it receives a fiscal transfer from the government. Similarly, the government has a choice between fighting the rebels and offering them a fiscal transfer. The utility function of the government ( $U^G$ ) may be denoted as:

$$U^G = (1 - \pi) \left( \frac{\mu F^R}{F^G + \mu F^R} \right) (Y^G - F^G - \lambda G) \quad (1)$$

where  $Y^G$  is the income of the government,  $F^G$  represents government military expenditure,  $G$  the transfer to the rebels,  $\lambda < 1$  captures the imperfect credibility with which the government transfer is made, and the probability of the government staying in power is  $1 - \pi$ , which in turn is a function of the contest success function, as well as the relative fighting efficiency of the rebels *vis-à-vis* the government  $\mu$ . The contest success function (see Hirshleifer (1995) for example) is given by:

$$\pi = \frac{\mu F^R}{F^G + \mu F^R}$$

It is defined in terms of the rebels, and says that the probability of their success in the military contest with the state depends on their military expenditure,  $F^R$  relative to the total military expenditure made by both sides to the conflict  $F^G + \mu F^R$ , weighted by the rebel side's relative military efficiency,  $\mu$ .

The rebel utility function ( $U^R$ ) is given by:

$$U^R = Y^R - F^R + \lambda G + \pi(.) (Y^G - F^G - \lambda G) \quad (2)$$

The income of the rebel group is described by  $Y^R$ , and the cost of waging a war represented by  $F^R$ . A great deal can be said about the sources of income and war finance for the rebel side. The rebels may obtain an income from natural resources under their control (illegal diamond mining in Sierra Leone, for example), by raising external finance via promising commercial concessions once they seize the state (the strategy of Laurent Kabila when he overthrew Mobutu Sese Seko in DRC in 1997), criminal activities such as drug trafficking, or sympathetic contributions from diasporas (Eritrea).

A feasible social contract favouring peace must give the rebels as much utility via a credible transfer as they would get in the event of a (probability weighted) overthrow of the state. A social contract favouring peace in return for a transfer is infeasible if, at a critical level of  $\pi = \varphi$ , the probability of toppling the government by war is greater than the chances of it credibly making the transfer,  $\lambda$ .<sup>3</sup> Also the social contract is less likely with regimes that prefer military expenditure  $F^G$  over making a fiscal transfer to the rebels, a common outcome in countries with powerful militaries, such as Sudan. Note that, for the government, no transfer is made in the case of a civil war, and in the case of a credible transfer being possible there is a saving in military expenditure. There is therefore a trade-off between military expenditure and a credible transfer. For the rebels, there is the transfer and no fighting expenditure if there is peace. When the transfer is highly improbable, and the potential spoils are great, warfare is more likely. This captures the pre-conflict situation. We now turn to problems of enhancing commitment to peaceful behaviour, post-conflict.

### 3 Sustaining the post-conflict commitment to peace by the government

We now consider policies that may enhance the credibility of the government's commitment to the broad-based transfer to the rest of the society, which will increase the chances of an enduring peace. Let us postulate that peace has been established, usually through external intervention, and for the moment there is no war, such that  $\pi = 0$  in Equation (1), and the government is in no imminent danger of losing power to the rebels. The price of peace is the transfer to the rest of society, including the erstwhile rebels. Will the government stick to this commitment? There are two types of government: the first type (labelled as 1) will honour its commitment, and the second type (labelled 2) may not honour its commitment. Let us consider the utility function of the first or good type of government:

$$U_1^G = f(Y^G - F^G - \lambda G) \quad (3)$$

Its disutility from fighting (differentiating Equation 3 with respect to  $F^G$ ) leads to:

$$-f_1 = 0 \quad (4)$$

This type of government obtains no utility from fighting the rebels and makes the transfer, hence  $\lambda = 1$  in Equation (3).

Turning to the second type of government, which is perhaps more realistic in relation to post-conflict situations:

$$U_1^G = f(Y^G - F^G - \lambda G) + h(F^G) \quad (5)$$

This type of government derives positive utility from renegeing on its commitment to the transfer, captured by the parameter  $h$ , implying that it is willing to fight in order to make a smaller transfer or no transfer at all. Maximization with respect to fighting the rebels yields:

$$f_1 = h_1 \quad (6)$$

Thus this type of government will equate the marginal cost and benefit of renegeing on pre-commitments to peace via the transfer, so future peace is not guaranteed and the problem of imperfect credibility of the commitment to the broad-based transfer remains  $\lambda < 1$ .

The presence of imperfect credibility requires policy-makers, particularly external powers and donors (which can be crucial to ending civil war) to devise *commitment technologies* to peace. Consider an example, leading to an innovative term in the utility function of the 'bad' (type 2) government:

$$U_1^G = f(Y^G - F^G - \lambda G) + h(F^G - m(F^G)) \quad (7)$$

Here,  $m$  refers to the cost of fighting or renegeing on strategic pre-commitments imposed by donors. This takes the form of a variety of sanctions, military as well as through the suspension of aid. Maximization with respect to fighting will now yield:

$$f_1 = h_1(1 - m_1) \wedge m_1 \geq 1 \quad (8)$$

When compared to Equation (6), Equation (8) states that the incentive to deviate from peaceful commitments is diminished, as the marginal utility of fighting is reduced. Furthermore, as  $m_1 \rightarrow 1$ , the temptation to deviate from agreements is zero, as with the first type of government in Equation (4).

#### 4 Natural resource rent contests and imperfect commitment among rebels

Many conflicts in Africa occur amid natural resource wealth. However, it is not natural resource endowments *per se* but rather the *type* of natural resource that matters. Addison, Le Billon and Murshed (2002) distinguish between *point resources*, which are non-renewable and geographically concentrated (for example, diamonds and oil), and *diffuse resources*, which are renewable and geographically spread, such as soil and water. Conflict occurs in countries with diffuse-resource endowments when access and ownership are highly unequal, but its probability falls when asset redistribution is undertaken and is certainly less evident than in countries richly endowed in point resources such as Angola, Congo-Brazzaville, DRC and Sierra Leone.

Exactly how point-resource endowments increase the chances of conflict is now debated vigorously. One factor might be the difficulty of managing the macroeconomic consequences of resource windfalls, resulting in boom and bust cycles that ultimately lower the rate of economic growth, where low or declining growth in employment and living standards is a factor in generating conflict (as found by Nafziger, Stewart and Väyrynen, 2000). Another is the incentive of political insiders to undermine state institutions (such as budgetary systems) deliberately, in order to conceal the siphoning-off of resource revenues. This leads to the collapse of the state from within, together with its ability to exercise social control and defend itself against usurpers (as in Mobutu's Zaire). Support for the government also declines as its commitments take the form of highly imperfect contracts. Additionally, opposition groups attract the finance of unregulated international trading networks interested in capturing valuable natural resources (giving rise to merchant-capital wars, such as those in West Africa, which receive arms and finance from entrepreneurs based in the Middle East and the former Soviet Union).

In this section we examine credibility problems related to the temptation to renege on peace agreements when capturable (point) natural resource rents are at stake. Again, we have two sides, whom we refer to as government and rebels.<sup>4</sup> One side is either tired of fighting or it has an interest in peace. In our example this group is the government. The other side, the rebels, may have something to gain from the resumption of fighting, such as rents from resources (as in Angola). The roles played by the government and rebels in the games that follow can be reversed without altering the results. Both sides have entered into a peace deal. The government side derives no benefit from breaking this agreement. Consider the utility function of the rebel group ( $U^R$ ):

$$U^R = -(1/2)c_1w^2 + Bc_2(w - w^e) \quad (9)$$

The first term on the right-hand side of Equation (9) is the pure cost of conflict in quadratic form, where  $w$  represents warfare or belligerent behaviour and  $c_1$  is the parameter measuring the direct cost of warfare. The negative sign before it is to indicate the cost or disutility from fighting. The quadratic form of the cost function indicates that the costs of war rise more than proportionately as the level of  $w$  rises. The second term on the right-hand side of Equation (9) indicates the gains to the rebels from renegeing on a peace agreement, or the benefit from a 'surprise' war, where the level of actual conflict ( $w$ ) exceeds the level of conflict *expected* in advance ( $w^e$ ). In other words, the spoils of war can only be wrested via the ruse of peaceful intentions. The parameter  $c_2$  captures the magnitude of this effect: the higher is  $c_2$ , the greater is the gain from feigning peacemaking first and looting later. It may also be viewed as a subjective measure of *greed*. In addition to this, the greater the abundance of lootable resources ( $B$ ), or rents to be extracted, the higher is the gain from a surprise war.

The rebels maximize their utility in Equation (9) subject to  $w$ , which leads to:

$$w = Bc_2/c_1 \quad (10)$$

This result can be interpreted in the following manner: the equilibrium choice of warfare is greater the higher is the element of pure avarice,  $c_2$ , the higher the availability of lootable resources,  $B$ , and the smaller the direct cost of fighting,  $c_1$ .

As far as the government is concerned, its utility function could take the form:

$$\begin{aligned} U^G &= -(w - w^e)^2 \forall w \geq w^e \\ \text{and} \\ &= (w - w^e)^2 \forall w < w^e \end{aligned} \quad (11)$$

We shall focus our attention on cases where the government's utility declines in surprise warfare when actual war is greater than expected. The opposite, when actual levels of belligerency fall below expectations (pleasant surprises) are intellectual *curiosa*. The disutility from surprise war arises either because the government has to engage in unforeseen military expenditure that diverts income from other types of public expenditure, or because war increases its need for foreign loans or aid. For example, following UNITA's return to war in 1998, Angola's government had to raise military expenditure sharply, much of it financed by oil revenues and foreign borrowing.

Now assume that the rebels enjoy a first-mover advantage and can announce total peace, and then engage in surprise warfare. In this case, the actual and

expected levels of warfare would diverge —  $w=Bc_2/c_1$  and  $w^e=0$  in Equation (9). This involves cheating on a pre-announced commitment. At this juncture, reputation becomes important. The government forms a view of the rebel announcements based on the past behaviour of the rebels. This implies that, for the rebel group, there exists a future cost of cheating in the context of a low-intensity conflict. The cost is equal to the loss of reputation for honesty, but this cost comes in the future.

In summary, the socially optimal policy of zero warfare ( $w=0$ ) is *time inconsistent* or *incentive incompatible*, and thus will not be a possible outcome. The optimal policy of no conflict is infeasible, as it is inconsistent with the incentives and expectations of the parties to the game. More particularly, the government knows it is in the interests of the rebels to renege on a pre-announced policy of total peace, and thus will not find any peace-offering credible. Furthermore, there will be a range of possible conflict intensities that are feasible equilibrium outcomes; thus multiple equilibria are possible. A rise in war booty raises the minimum conflict threshold. Also situations where the future is heavily discounted are likely to raise the fighting threshold associated with the best enforceable outcome.

We now consider policies to reduce conflict. Much of this implies manipulating the attitudes of the rebel leadership via sanctions, arms controls, trade restrictions and foreign aid. Consider a reformulated version of the rebel utility function where we embed external conflict prevention policy parameters, and an additional cost component associated with an implicit or explicit international agreement:

$$U^R = -(1/2)c_1(M_1)w^2 + Bc_2(T, M_2)(w - w^e) - c_3(M_3)(w - w^e) \quad (12)$$

Aid ( $T$ ) may be utilized by a foreign power to reduce greedy attitudes,  $c_2$ . Similarly, trade sanctions ( $M_2$ ) on items such as 'conflict' diamonds, money laundering and the activities of foreign entrepreneurs (in supplying arms and finance) might have the same effect. International controls on arms transfers ( $M_1$ ) and/or sympathetic assistance from non-residents could be utilized to raise the direct cost of war,  $c_1$ . This lowers the fighting efficiency of the rebels,  $\mu$  in Equations (1) and (2).

The last term in Equation (12) represents another commitment technology by *delegation*, and  $c_3$  measures the costs of renegeing on peace agreements as a function of sanctions ( $M_3$ ) imposed by other external signatories or parties to the agreement.

The presence of commitment technologies, sanctions, conditional aid and controls on international trade (from looted resources) lowers the optimal level of belligerency among rebels. This can be seen by maximizing Equation (12) with respect to  $w$ , which yields:

$$w = (Bc_2 - c_3)/c_1 \quad (13)$$

This leads to a lower level of warfare when compared to Equation (10). There is a direct effect of the external sanction or outside commitment technology,  $c_3$ . Then we have the indirect effects emanating from the manipulation of the behavioural parameters of the rebels,  $c_2$  and  $c_1$ .

Our discussion indicates that establishing peace is a tough job, as the recent experiences of Angola, the Democratic Republic of the Congo (DRC), and Guinea-Bissau show. But even if a peace agreement can be put in place, the difficulties do not end there: the form that reconstruction takes also affects the sustainability of peace. It is to these issues that we now turn.

## 5 Broad versus narrow reconstruction

The 1990s saw substantial donor-supported reconstruction: Angola, Ethiopia, Mozambique and Sierra Leone are African examples. To be successful, reconstruction must rebuild the social contract, otherwise conflict can reignite. Fundamental political and economic reform is therefore necessary to change the rules of the game, such innovation being akin to the deep interventions described in Dixit (2001).

In principle, the temptation to renew conflict could be eliminated completely if the 'prize' (oil revenue, for example) is absorbed into national income (then  $w=0$ , in Equations (10) and (13)). The gains from capture and surprise warfare will vanish in rebel utility functions, as  $B=0$ . Input by external actors, such as linking peaceful behaviour to aid flows, will then be unnecessary ( $c_3=0$  in Equation 12).

But promises of action are not enough. As we saw in Section 2, the social contract became unviable because the credibility of a transfer ( $\lambda$ ) is low relative to the probability of rebel success in armed conflict. Also, as in Section 4, the commitment to peace may be subject to temptations to renege on the agreement. The credibility of the fiscal transfer may be restored through the creation of democratic institutions. But such institutional reform takes considerable time. A badly functioning democracy also implies incomplete contracts and imperfectly credible institutions of commitment. For example, the quality of fiscal institutions may be so low (as a result of destruction or neglect) that they are unable to deliver the necessary transfer even when the government is committed to making the transfer to its former opponents. The size of the transfer ( $G$ ) in Equation (2) may be too small in per capita terms if the income of the excluded rebel group is low.

Our discussion so far has been quite pessimistic, in part because peace is viewed as being dependent on the distribution of a 'fixed pie'. But peace is more likely to endure if the 'pie' can be made to grow. Growth, by raising the tax base, increases the possibilities of redressing grievances through

fiscal transfers. Growth itself provides additional income to further reduce grievance (and perhaps mitigate greed) and tightens the labour market, thereby reducing the attractiveness of joining a warlord or rebel group (a point emphasized in Collier and Hoeffler, 2001). The initial years of peace may offer considerable scope for growth as the economy re-achieves its pre-war production frontier (Mozambique, whose war ended in 1992, has achieved annual real GDP growth of 6.2 per cent over the period 1990–9, with growth of over 11 per cent in the late 1990s).

Just as economic growth in general can distribute its benefits broadly or narrowly across society (depending on the initial distribution of assets and skills), so too does reconstruction-led growth. Pre-war asset and skill distributions may have been highly unequal (with the resulting grievances contributing to conflict), and can worsen dramatically during wartime. Those who are already poor often lose the few assets they have, and looting adds to the number of poor (Nafziger, Stewart and Väyrynen, 2000). In contrast, warlords and their followers accumulate assets, and so while the early years of peace may see quite rapid gross domestic product (GDP) growth, it can be very narrow in its benefits, unless policies are put in place to restore the productive assets and human capital of the poor. The immediate post-conflict situation may also offer a golden opportunity for pro-poor asset redistribution (something that cannot be done easily during peace), although this can be impeded when rich ‘winners’ from war block the necessary measures.

However, the ‘post-conflict’ economy will be highly distorted, and this can impose an unfortunate path-dependence on reconstruction and growth. One source of distortion is the sharp increase in transaction costs ( $\sigma$ ) resulting from war (including the destruction of transport, the planting of land mines, and institutional collapse) that drive a wedge between producer and consumer prices. Typically, production (especially agriculture) is more vulnerable, leading to a sharper increase in its transactions costs compared to other sectors such as urban-based trade and services (as was the case in Mozambique’s sixteen-year civil war). To get a handle on this problem, consider a model with two sectors, agriculture and services, whose relative prices are  $P_A$  and  $P_S$  respectively, with transaction costs  $\sigma_A$  and  $\sigma_S$ . The transaction costs lower the supply price of the two goods because producers have to incur this extra cost. Given  $\sigma_A > \sigma_S$ , relative prices shift, resulting in a switch in activity from production (agriculture) to services:

$$\frac{P_S - \sigma_S}{P_A - \sigma_A} > \frac{P_S}{P_A} \quad (14)$$

if

$$\sigma_A > \sigma_S$$

This output change is additional to the increase in production costs resulting from the direct destruction of institutions, infrastructure and skills in the

two sectors (which usually affect production disproportionately, especially agriculture). Services and trade, including smuggling and other rent-seeking, dominate wartime economies and, because of the relative price effect, the collapse in production usually exceeds that resulting from destruction alone. Smallholder agriculture, the basic livelihood of Africa's poor, is hit especially hard. For example, at the time of writing, Angola's agricultural output is now less than 5 per cent of its pre-war level.

The result is shown in Figure 1.1. Three production frontiers are indicated:  $PP$  (peace),  $WW$  (war) and  $RR$  (recovery). These have the usual properties. Assume a peace equilibrium of  $E_p$  given by the relative price (with  $\sigma_A, \sigma_S=0$ ).<sup>5</sup> Growth will be along a ray such as  $Gp$ , as aggregate investment pushes the production frontier outwards over time. Contemporary wars generally reduce aggregate output. The wartime production frontier must therefore lie within the peace-time frontier. Agriculture ( $A$ ) is hit harder than services ( $S$ ), and the production frontier changes shape (to form  $WW$  reflecting the greater difficulties of  $A$  production). And the relative price shift in favour of services causes a structural shift to the new equilibrium  $E_w$ . There may be periods of growth during wartime, from a point below the peacetime production frontier, but it will be  $S$ -biased (along the ray  $Gw$ ) and is therefore unlikely to reduce poverty sufficiently.

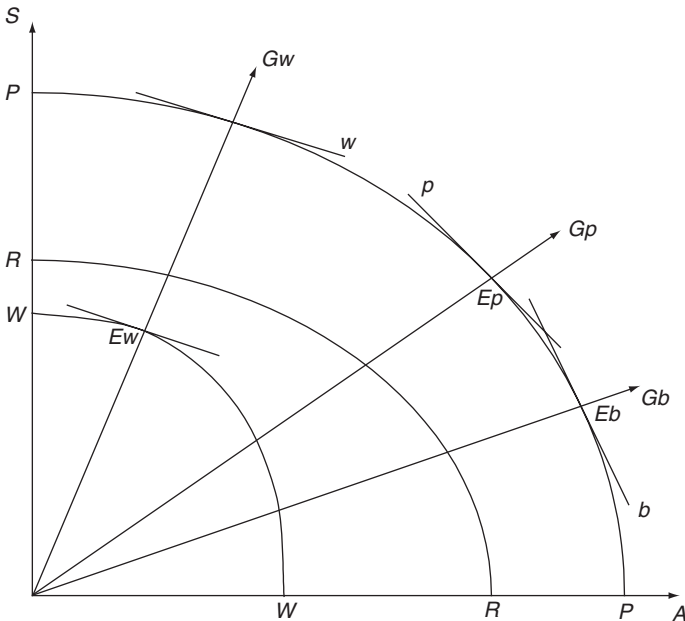


Figure 1.1 War, peace and recovery

If a peace agreement is signed, then transaction costs start to fall. Accordingly, agricultural output recovers as relative prices shift back in its favour and as infrastructure is rebuilt; the economy moves through a series of reconstruction frontiers such as *RR*. Although this reconstruction is characterized by a more than proportionate rise in *A*, the main livelihood of the poor, benefits of recovery may still be distributed too narrowly because of the loss of assets and skills among the poor (see de Sousa, 2003 on Mozambique). Moreover, the economy's pre-war structure may have been far from optimal for growth, poverty reduction or peace because of policy distortions — a history of policy bias that depresses  $P_A$  relative to  $P_S$  as in many African economies. Hence significant economic reform must take place alongside reconstruction if broad, rather than narrow, recovery is to take place. In Figure 1.1 reform is shown as raising the return further on *A* relative to *S* activities (that is, to the relative price line *b* so that the economy recovers along *Gb*). There is wide agreement on the need for fiscal reform to raise public spending on pro-poor basic health care and primary education, although implementation is often fraught with difficulties.

If peace is uneasy then there is an additional constraint on rebuilding the social contract via broad-based reconstruction and growth. To see why, consider the net present value (NPV) of a private investment project in sector *i*, producing an output  $Q_i$  (Equation 15). In addition to raising transaction costs ( $\sigma$ ) and production costs (*C*), conflict raises uncertainty about the future, and therefore affects the private discount rates of potential investors (*r*):<sup>6</sup>

$$NPV_i = \frac{\sum Q_i(P_i - \sigma_i) - C_i}{(1 + r)^t} \quad (15)$$

The rise in *r* has differential sectoral effects depending on the time-profile of private benefits and costs associated with different types of activity. Thus production sectors such as agriculture require more fixed capital than trade and services (which may only need working capital), and profits from trade can be realized more quickly than from production, whose profits may only start to flow after several periods (particularly in agriculture, where tree crops have a lengthy gestation). Any rise in the private discount rate will tend to lower the NPV of investments in production relative to trade and services. This amplifies further the war-time collapse in the production sectors, and the expansion of trade, services and associated rent-seeking.

Restarting activity in pro-poor production activities such as agriculture can therefore be especially hard after war when the peace is uneasy, since while transaction costs can be reduced (for example, de-mining rural roads lowers  $\sigma$ ) and infrastructure rebuilt (lowering *C*), an uneasy peace keeps private discount rates (*r*) high. Consequently, the reconstruction-growth path may create insufficient income and employment, and its narrowness lead to frustration among large sections of the excluded population. Hence the

effectiveness of donor support to reconstruction, while lowering  $\sigma$  and  $C$ , will be reduced if parallel political initiatives (both domestic and international) are not undertaken to secure peace, and lower  $r$ .

In summary, if grievance is the main source of conflict, then broad-based reconstruction (along  $Gb$ ) is necessary to re-create a sustainable social contract. In particular, growth raises wage levels and reduces the attractiveness of predation as a livelihood (Collier and Hoeffler, 2001).

## 6 Conclusions

We have stressed the importance of the breakdown of the social contract, in particular its fiscal component, as contributing to civil war in Africa. We went on to examine the problems of sustaining a commitment to peace both by a government whose commitment may be tenuous, and by a group that has something to gain from the resumption of hostilities in terms of controlling resource rents. Finally, we considered the difficulties in engineering broad-based and pro-poor growth and reconstruction in post-conflict societies.

This chapter has emphasized the importance of economics and rational-choice political science. This is not to underestimate the complexity of contemporary war, nor its deep roots in cultures and history (especially colonial legacies), nor to neglect the importance of other social science methodologies in addressing it. Nevertheless, there is a danger in seeing every conflict situation as being in some way culturally or historically unique, and thus perhaps intractable. The approaches discussed in this chapter do provide a framework in which to identify the fundamental constraints that must be overcome to end war, as well as the trade-offs involved.

To conclude, we highlight two areas of pressing concern that need attention. The first is the issue of grievance. For a social group that has experienced years of decline in its absolute living standards (whether measured by income, human development indicators or both), a peace deal that delivers an absolute rise in its living standard may be sufficient to secure its withdrawal from violent conflict. In this case, the current donor focus on absolute poverty reduction will also be conducive to reviving the social contract. But grievances may also be expressed in relative terms; the rebel group may seek a closing of the gap in its standard of living with wealthier groups, not just a rise in its absolute well-being. In this case, governments (and donors) will need to be much more concerned with reducing inequality, especially across regions. For example, Mozambique has seen some (modest) improvements in living standards in areas dominated by the rebel group, RENAMO, since the end of the civil war in 1992. But, continuing discontent among RENAMO supporters, which flared into violence in 2001, reflects their perception that the fruits of reconstruction have so far been concentrated in regions controlled by the FRELIMO government, so that the regional gap shows no sign of narrowing, and may indeed have widened.

Additionally, relative differences in living standards across social groups may play a greater part in fermenting grievances in societies rich in point resources, since the monetary value of the associated flows of income is more evident than in the case of societies dependent on diffuse, renewable resources, where much of the associated output is not marketed. The expected return from controlling natural-resource-rich countries is therefore considerably higher than in controlling countries which may have rich diffuse resources, but in which there are considerable costs in organizing and profiting from production (such as in agriculture) even if a belligerent secures the territory. Indeed, in natural-resource-rich countries it is sufficient to control only that part of the territory in which the resources are mined, which may exacerbate state collapse (DRC, for example).

Second, the peace dividend. Development economists typically classify military spending as unproductive. But donor efforts to reduce military spending, and free public money for development spending, are typically thwarted, by moving the spending off-budget, even in countries such as Uganda that have demonstrated commitment to poverty-reduction. Countries can have legitimate security interests, especially when they find themselves in bad neighbourhoods, and poor people place security high on their list of priorities. Defence spending will remain high, with large opportunity costs for development spending, until the international community can offer a credible regional peace, thereby preventing harm to countries that contract their defence capabilities unilaterally. Yet UN peacekeeping operations remain grossly underfunded; their cost in the year 2000 amounted to less than half of 1 per cent of the approximately US\$800 billion that member states spend on national defence (United Nations, 2000). If peace were credible, then the developmental impact of releasing those resources from military spending could be immense, and the resulting broad-based development thereby in turn solidifying the social contract upon which peace is ultimately sustained.

## Notes

- 1 On the complexity of the relationship between ethnicity and violence see Bates (2000), among others.
- 2 The term fiscal transfer also covers broad-based social expenditure across all groups, and the award of jobs and other benefits from government contracts. It could even mean power sharing.
- 3 Alternatively, the 'contract' governing the transfer from the government to the rebels may be highly incomplete. This is likely to arise in the context of state failure, and where government actions are not transparent.
- 4 A more detailed version of the analysis in this section can be found in Addison and Murshed (2002).
- 5 The pre-war equilibrium will depend on policies that in turn affect the relative price, and thus the structure of output. As drawn, agriculture takes a larger share of pre-war output relative to services, which is typical of a low-income country when policy does not have a large bias against farmers.

6 Moreover, conflict increases the cost of capital (as risk premiums on loan rates rise and as the monetary base shrinks), acting as a further disincentive to invest.

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