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Aid to conflict-affected countries: lessons for donors

Tony Addison and Mark McGillivray

Since the end of the Cold War, there have been 58 different armed conflicts in 46 different locations. Most have been civil wars in developing countries (Eriksson et al., 2003). These civil wars have had strong regional dimensions—notably the contest over the eastern provinces of the Democratic Republic of the Congo, involving neighbouring Rwanda and Uganda—and strong international ones, especially since the 9/11 terrorist attack on the US. There is some good news: the number of conflicts in 2002 was the lowest since 1998 (Eriksson et al., 2003), and the conflicts in Angola and Sri Lanka appear to be over. However, there is also bad news: Afghanistan’s democratisation is stalling, Iraq faces a very uncertain future, and international terrorism is causing serious human damage and economic disruption.

Aid plays a highly controversial role in conflict-affected countries—both those at war and those attempting ‘post-conflict’ reconstruction. There is no clear understanding of how aid might keep conflicts from breaking out or escalating, or how different types of aid influence outcomes (Addison, 2000; Demekas et al., 2002; Picciotto, 2004). This is a large canvas, and no one paper can address all the issues. In this paper, we focus on some of the most urgent.

The first section looks at the implications of conflict for aid effectiveness and selectivity. We argue that, while aid is generally effective in promoting growth and by implication reducing poverty, it is more effective in promoting growth in post-conflict
countries. We then consider the implications of these findings for donor selectivity models and for assessment of donor performance in allocating development aid among recipient countries. We argue that, while further research on aid effectiveness in post-conflict scenarios is needed, existing selectivity models should be augmented with, inter alia, post-conflict variables, and donors should be evaluated on the basis, inter alia, of the share of their aid budgets allocated to countries experiencing post-conflict episodes. We also argue for aid delivered in the form of projects to countries with weak institutions in early post-conflict years.

The second section focuses on policies for donors operating in conflict-affected countries. We set out five of the most important principles: (1) focus on broad-based recovery from war; (2) to achieve a broad-based recovery, get involved before the conflict ends; (3) focus on poverty, but avoid 'wish lists'; (4) help to reduce insecurity so aid can contribute more effectively to growth and poverty reduction; and (5) in economic reform, focus on improving public expenditure management and revenue mobilisation.

The third section concludes by emphasising the fact that there is no hard or fast dividing line between 'war' and 'peace' and that it may take many years for a society to become truly 'post-conflict'. Donors, therefore, need to prepare for the long haul.

### Aid effectiveness and selectivity

In this section, we review the findings of two sets of studies, on aid, growth, and poverty reduction and on aid allocation, selectivity, and donor performance.

### Aid, growth, and poverty reduction

For nearly 30 years, research on the macroeconomic effectiveness of aid failed to produce consensus on whether or not aid increases growth and by implication reduces poverty. Cassen (1994) summarised the situation:

> Much of the literature on the macroeconomic effects of aid deals with relatively large groups of developing countries. Its results are ambiguous. The relationship between aid and growth is rather weak: it can be either positive or negative, depending on the country groupings and time period chosen.

Combined with evidence that aid tended to work well at the project level, this led to discussion of the well-known macro-micro paradox of aid (Cassen, 1994; Mosley, 1997).

The publication of Burnside and Dollar's (1997, 2000) landmark study changed the debate. Burnside and Dollar (1997, 2000) argued that project-level evidence was irrelevant given the fungibility of funds and proposed an empirical aid-growth model, built on the hypotheses that growth in aid-receiving economies depends on the level of aid relative to GDP, the quality of the recipient’s economic policies, interaction between the level of aid and policies, and other variables (initial GDP, ethnic fractionalisation, institutional quality, and so on). They estimated the parameters of their model using data for a sample of 56 countries covering the periods 1970–73 to 1990–93. They found that aid alone did not have a statistically significant positive impact on growth, but that aid interacting with policy did. This led the World Bank (1998) and others to conclude that aid alone was ineffective, and that it only worked in countries with good policies. Others were more cautious in their interpretation, noting that Burnside and Dollar’s finding was that the impact of aid was contingent on policy—specifically that more aid, up to a point, and better policies combine to increase growth.

The Burnside–Dollar research has spawned more than 25 econometric studies, almost all of which agree with its fundamental thrust: that aid is effective in promoting growth and, by implication, in reducing poverty. In addition, a number of studies have looked at the link between aid and indicators of the quality of life, concluding that aid is effective in this regard as well. It seems that the macro-micro paradox is dead and buried (McGillivray, 2003a).

These studies have failed to confirm the relevance of recipient country economic policies for aid effectiveness. Most of them, including Roodman (2003), have challenged the empirical robustness of the Burnside Dollar aid-policy interaction. They conclude that aid works in promoting growth irrespective of the policy regime of the recipient country. Some have challenged the interpretation of the aid-policy interaction. McGillivray (2003b) notes that the interaction term can be interpreted in two equally valid ways: in the Burnside and Dollar way, (the impact of aid on growth depends on policy) or in the reverse, (the impact of policy on growth depends on the level of aid).

While this debate will probably rage on for some time, the heart of the disagreement is less about the relevance of country policy than about the validation of econometric links between policy and aid effectiveness.

There is general agreement among researchers and policymakers that better policies, appropriately defined, should result in more effective aid (Robinson and Tarp, 2000; Beynon, 2001, 2002; McGillivray 2003a, b). Thus, Gomanee et al. (2002) identify aid
Aid allocation, selectivity, and donor performance

Donors provide substantial amounts of aid to conflict-affected countries. In 2001, for example, OECD members provided more than US$ 5 billion in bilateral assistance to post-conflict countries,\(^3\) amounting to about 15% of total OECD bilateral assistance in that year. These amounts have likely risen since then, given the situations in Afghanistan and Iraq.

There appears to be little evidence, however, that donors systematically consider conflict when allocating aid. Collier and Hoeftler (2002) find, perhaps not surprisingly, that countries in conflict receive less aid than they would otherwise. However, they also find that countries in the final years of a post-conflict decade receive less aid than they would otherwise.

These results are of great concern for poverty reduction. A clear implication of the Burnside–Dollar research is that if aid is to be poverty-efficient, it should be allocated to countries in which it is most effective. This is the basic premise of work by Collier and Dollar (2001, 2002), in which poverty-efficient aid allocations are derived from a formal aid-allocation framework. This ‘selectivity’ approach, as it has become known, has attracted much support and some controversy in research and policy circles. Collier and Dollar argue that aid allocations should be positively related to the perceived quality of a country’s policies and to the numbers of people living in poverty within the country, and negatively related to national income per capita. Thus, for two recipient countries with identical poverty levels and per capita incomes, the difference in aid receipts would be determined by the differences in their policy regimes. Of course, if one does not accept that policy matters for aid effectiveness in the Burnside–Dollar sense, one could still justify such an allocation rule by arguing that aid, or its denial, might lead to policy reform ex post. This in turn might give rise to improved aid effectiveness, as per Morrisssey (2002).

There would appear to be a strong case for expanding the Collier–Dollar and other donor-developed selectivity frameworks to include post-conflict variables. If aid is more effective in promoting growth in post-conflict countries, then, other things being equal, these countries should receive more aid than others do.

Moreover, donors should be evaluated against the shares of their aid that they allocate to post-conflict countries. Table 1 shows the shares of aid that donors have allocated to
Table 1. Measures of donor performance, 2001

<table>
<thead>
<tr>
<th>Donor</th>
<th>ODA to GNI ratio (Rank)</th>
<th>Grant element (Rank)</th>
<th>ODA to LLDCs (Rank)</th>
<th>Partially tied (Rank)</th>
<th>Tied (Rank)</th>
<th>MDG-targeted (Rank)</th>
<th>Aid to post-conflict countries (%)</th>
<th>Aid to post-conflict countries (Rank)</th>
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<tbody>
<tr>
<td>Australia</td>
<td>14</td>
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<td>Belgium</td>
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<td>Canada</td>
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<td>Denmark</td>
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<td>Finland</td>
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<tr>
<td>France</td>
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<td>Luxembourg</td>
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<td>7.5</td>
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<tr>
<td>Norway</td>
<td>2</td>
<td>11</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>24.3</td>
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<tr>
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<td>16</td>
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<td>16</td>
<td>57.0</td>
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<td>Spain</td>
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<td>Sweden</td>
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<tr>
<td>Switzerland</td>
<td>6</td>
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<td>UK</td>
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<td>US</td>
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Notes: ODA is official development assistance; GNI is gross national income; LLDCs are least developed countries; MDG is Millennium Development Goals; DAC is the Development Assistance Committee of the Organisation for Economic Cooperation and Development. 

post-conflict countries, together with the typical variables on which donors' allocative performance is assessed.

A related concern has to do with countries in conflict or in the early post-conflict years. These countries are likely to do very poorly on assessments of policy and institutional quality and, therefore, might be penalised by donors using existing or augmented selectivity frameworks. Penalising such countries would be inappropriate: it would cause some of the poorest people in the poorest countries to be denied external assistance, and it would do nothing to reduce the risk of a return to violent conflict. Donor mechanisms are in already in place to work with such countries, such as the World Bank's 'Low-income countries under stress (LICUS)' programme, but these mechanisms are arguably greatly under-funded.

How might aid be provided to countries that are still in conflict or in the early post-conflict years, and that score poorly in terms of institutional and policy criteria? Well-designed project support, delivered independently of the recipient country government, may have an important role to play in these countries. Projects can restore badly needed infrastructure, and can win broad-based local support for peace and reconstruction processes. There is of course an issue of recipient government ownership of such projects, and related concerns that project outcomes might not be sustained. However, well-designed projects can minimise the likelihood of non-sustainability; so too can a productive dialogue between donor agencies and recipient governments. There is a 'low hanging fruit' danger, discussed in the next section, but this can be avoided if projects are well designed, well targeted, and well implemented. Projects within well functioning ministries and local governments in otherwise malfunctioning states can be assisted when general budgetary support is not feasible and when such government units are effective in reaching the poor; examples of these steps are given below.

Guiding principles for donors

What policies should donors follow in countries affected by conflict? We look at some general principles, and in the process examine the relationship that is often assumed between aid, policy, growth, poverty and peace in these countries.

Principle 1: Focus on broad-based recovery from war

War causes immense human suffering, and broadens and deepens poverty. Ending war saves lives, but may do little for livelihoods. Refugees and internally displaced persons will resettle, but without human capital, infrastructure, and secure access to their assets, they will be unable to participate fully in post-conflict recovery. In contrast, elites— including some of those who profited from the war—can do very well in post-conflict reconstruction, consolidating their gains and sometimes exploiting the confusion of war.
and its aftermath to seize assets from poor communities. In the worst case, warlords control the state and rebuild its institutions to maximise their own wealth and power (Liberia under Charles Taylor being the prime example).

Hence, reconstruction may turn out to be narrow—its benefits focused on an elite minority—rather than broad-based, leaving many people impoverished and stoking up political trouble for the future (Addison, 2003). The strategy for post-conflict recovery should accordingly focus on reducing absolute poverty as a primary objective. That strategy may need to aim for reducing overall inequality as well, when high inequality—across ethnic groups, regions, and other social divisions—has inflamed grievances and contributed to conflict (Stewart, 2001).

Donors, therefore, need to be clear in the poverty focus of their post-conflict assistance. Principles 2 to 4 highlight how to do this.

**Principle 2: To achieve a broad-based post-conflict recovery, get involved before the conflict ends**

In many conflicts, there are opportunities to get involved in poverty-reduction projects, rather than just providing humanitarian assistance, before a peace deal is achieved. For instance, in Mozambique, donors supported rural-livelihood projects under the Safe Areas scheme (those areas not affected by the war) during the latter part of that country’s 16-year civil war. In Luanda, livelihood projects were supported during Angola’s civil war (de Sousa et al., 2003). Such early action is crucial because securing and building the human capital of the poor will do much to ensure that they come out of war with at least some skills to use in the peace. For example, de Sousa (2003) found that households in Mozambique’s Manica province who were assisted in this way had higher incomes and better human development indicators in the immediate post-conflict years than households who had only received humanitarian assistance. The former group were able to use their skills to rebuild their lives more quickly than the latter.

Part of the wartime misery of poor people is due to bad policy rather than just the exigencies of wartime economies. For example, Angola’s hyperinflation in the 1990s inflicted an avoidable extra burden on the poor. Economic policy formulation does not stop in wartime; it just gets harder. Donors should do as much as they can to support pro-poor projects before a war ends, and to help governments manage public expenditures, in order to improve the allocation of public money to pro-poor priorities. This principle implies channelling financial and technical assistance to support policy reform before a war ends. For example, providing technical support to key ministries and the central bank, locating and supporting pro-poor allies among the line ministries (the health ministry was in the vanguard in Mozambique), and, if possible, providing adjustment credits and grants to support pro-poor policy reform, or at least building the capacity for post-conflict recovery (as in Sri Lanka).

**Principle 3: Focus on poverty, but avoid ‘wish lists’**

Although poverty reduction is a core priority, it depends on clearly defining priorities and providing enough resources, both financial and human, to execute them. Many post-conflict recovery strategies get swamped by too many priorities that are poorly conceived and have little chance of implementation. Resources end up spread too thinly a lot of badly designed initiatives start and then run out of resources, and the entire agenda ends up in a giant ‘wish list’. More resource mobilisation (external resources, such as aid and debt relief, and internal revenues) is of course crucial, and if resources can be found then the tradeoffs between goals can be relaxed somewhat. Yet the difficulties of setting priorities almost never disappear entirely.

Countries and donors that stick with a wish list tend to grab the ‘lowest-hanging fruit’, implementing what is easiest rather than what has the highest priority for poverty reduction. This has two effects. First, the areas with the worst poverty, in incidence and/or intensity, may simply get left out. These areas often received little assistance before the war; because both their environment and location are tough or because their people are politically disadvantaged, (in which case they may have been active as rebels). Second, the wish list draws attention away from the key constraints on poverty reduction at a time when something could be done about them. The central issue here is the weak property rights of the poor and their communities with respect to land and other natural capital such as forests or fisheries. The chaos of large-scale population displacement and resettlement is compounded by often badly designed and anti-poor policies on land tenure (for example, the socialist-era nationalisation of common property resources in Africa). Powerful commercial interests sometimes allied to people with political power in the post-conflict government, then manoeuvre to secure the best assets, whose value rises sharply with peace (agricultural land close to infrastructure, urban real estate, and
coastal areas with tourist potential). This is now happening in Angola, as it did in Mozambique in 1994–96 (Addison 2003; Wuyts 2003).

Hence, post-war economic growth delivers more benefits to people with productive assets (the wealthy) than to those without (the poor). Early action to secure and build the assets of the poor will raise the growth-elasticity of poverty reduction in the post-war period, and is, therefore, an urgent priority.

**Principle 4: Help to reduce insecurity so aid can contribute more effectively to growth and poverty reduction**

Within the donor community, an often-heard story goes like this: if a post-war government can implement a set of ‘good’ economic policies, then these will promote growth. Growth will reduce poverty, depending on the poverty elasticity of growth, and—through improving livelihoods—will secure peace, by reducing everyone’s incentive to fight now that they can happily make a peaceful living. Hence, insofar as aid flows increase a government’s incentive towards good policy, aid promotes peace. We call this the aid-policy-growth-poverty-peace ($A \rightarrow P \rightarrow G \rightarrow P \rightarrow P$) story. We alluded to this idea above when we emphasised broad-based recovery as a principle, and the evidence on growth was discussed earlier.

The nice thing about this story is that one instrument—good policy—achieves three different outcomes: growth, poverty reduction, and peace. Behind that good policy is aid—so aid achieves three different, good things. If this story is true, donors could get a lot more from aid to conflict-affected countries than from aid to peaceful countries, and might want to let that differential influence their aid allocation across countries, as discussed above.

Like all good stories, this one takes hold of the imagination because it has a kernel of truth, or rather three kernels. First, we can list bad policies that harm growth, and while our individual lists might differ somewhat, there is consensus (among economists at least) about what countries should not do: overvalue the currency, thereby undermining the production of tradables; tax agriculture to the point at which real producer incentives decline over time; finance the fiscal deficit with a level of monetary expansion that generates hyperinflation, and so forth. Second, by achieving growth, whether through policy reform or something else, a country effectively enlarges the social pie.

Competition for that social pie does not have the same level of desperation, and potential for violence, as competition for a stagnant or shrinking pie (such as the negative growth of sub-Saharan Africa over much of the last 30 years). Growth offers better prospects for win-win politics, rather than the ‘You win therefore I lose’ politics that too often accompany falling GDP, and that eventually fracture institutions of conflict-containment (as for example in Côte d’Ivoire and Sierra Leone in the 1990s and Nepal today). Third, when growth reduces poverty, people are less drawn to make a living by fighting. It dulls, though it does not eliminate, the persuasiveness of the recruiting-sergeants who roam among Africa and Asia’s young unemployed. Much evidence shows this to be the case (Gates, 2001).

In practice, however, the aid-policy-growth-poverty-peace story is a bit too good to be true. Do we really believe that we can hit three targets, or four if we include policy reform itself, with one instrument? It is not impossible, but there are some major issues along the way.

**Aid to policy reform ($a \rightarrow p$) in conflict-affected countries**

The story about aid to policy reform is an old one, so we will not repeat what has been said before. In conflict-affected countries, it gets some important twists. First, good policy can only be made by functioning institutions. Some conflict-affected countries, such as Mozambique and Sri Lanka, have surprisingly robust institutions that formulate good policies when politicians give them a chance to do so. Even Angola and the Democratic Republic of the Congo have some fine macroeconomic technicians. However, Afghanistan does not, and new countries—Timor Leste, Eritrea in 1993—need to build those institutions. With no institutions, there is little chance of any, let alone good, policymaking.

Second, in some cases, donors or foreign authorities themselves are effectively the government, as in Kosovo, or with the UN transitional administration in pre-independence East Timor, and the US and British authorities in Iraq. Lack of ‘ownership’ of policy reform, much discussed in the literature, is not an issue in these cases.

Third, donors can convince themselves that it is good policy that determines whether they should start (or continue) to give money to a conflict-affected country. What really drives such decisions is often some larger geopolitical concern of the donor country, in which the aid agency is very much the junior partner to the foreign ministry and the
control of lucrative natural resources or from their ability to tax local trade and commerce. For instance, the ability of Afghanistan’s administration to take control over the country’s customs revenues is impeded by warlords who impose their own local taxes.

Policy reform to growth \((p \rightarrow g)\) in conflict-affected countries

Removing market distortions in key productive sectors holds out the promise of raising growth. In many conflict-affected countries, state market controls collapsed during the war. Still, the injection of foreign aid relaxes rationing in goods markets, and thereby eases the supply of inputs and capital equipment for producers. Insofar as reconstruction gets infrastructure back into operation—by de-mining key rural roads, for instance—aid allows producers to respond more effectively to any improvement in price incentives.

Going beyond the direct immediate post-war rehabilitation efforts of international actors (NGOs, the military) requires public expenditure reform to make infrastructure spending a continuing priority.

Continuing high insecurity can thwart policy reforms. High discount rates play an important role in distorting the incentives of political actors, as mentioned above, but their effects are not confined to the political sphere. They also reduce investment in private-sector projects that have immediate costs and delayed returns. These are typically long-term investments in the production sectors such as manufacturing and agriculture. Their fixed-asset content makes the owner vulnerable to predation, losing the asset to looting before any return is generated. This cuts the expected profitability of the investment, which is further reduced by a high discount rate that lowers the net present value of the future profit stream. The disincentive to invest is further compounded by the effects of conflict on the domestic financial system: producers either face rationing, which locks all but the safest borrowers out of the credit market, or high interest rates, as lenders add large premiums to loan rates in an effort to reduce their risk (Addison et al., 2004). Again, investors in production sectors tend to fare the worst: lenders’ perception of the risks of default discourages them from lending for long-term investments.

All of this favours investment in sectors where the returns are immediate and involve little investment in fixed assets. Commerce is the best investment in this regard. Hence, conflict-affected countries are characterised by a great deal of selling and reselling of
scarce goods and trading in foreign exchange. While it is true that peace reduces or eliminates wartime rationing, the relative incentive to invest in commerce over production can still favour the former because of continuing high insecurity.

Such uncertainty discourages the production of tradables (exportables or importables) in conflict-affected developing economies. Thus, an economy may significantly adjust the real exchange rate and yet see little output response from the tradable sectors.

Furthermore, some conflict-affected countries experience a decline in the competitiveness of their exports, due to international developments unrelated to the conflict. This means that their leading pre-war sector may not have the same potential post-war. Meanwhile, during the conflict they may develop an international comparative advantage in a good or service, such as narcotics, that international donors wish to discourage. This leaves the economy dependent upon foreign aid for its legitimate foreign exchange. Afghanistan's shift from cotton to opium production during its wars and the international community's struggle to reintroduce cotton farming, exemplifies this trend. Weakness in the international cotton market—due to the rise of other developing-country exporters but also to large US subsidies to domestic cotton production—together with a strong global heroin market, shifted Afghanistan's terms of trade against cotton and in favour of opium. Donor projects to wean farmers away from opium production will struggle in the face of this terms-of-trade shift, and the Afghan economy will need large inflows of aid for the foreseeable future. It is often said that trade is the other side of the aid coin, and this is even more the case in conflict-affected countries, which remain highly aid-dependent (and highly indebted) until they can achieve sustained trade-led development. The protectionism practiced by the rich world diminishes aid-effectiveness in conflict-affected countries, and indeed undermines the international security agenda.

Growth to poverty reduction (g→p) in conflict-affected countries

The extent to which GDP growth reduces poverty is a matter of debate. It is not our purpose to review the debate here (see instead Van der Hoeven and Shorrock, 2003). We instead note three twists in the growth-poverty argument for conflict-affected countries.

First, it follows that the constraints that high insecurity imposes on investment in tradable sectors present a problem for poverty reduction through growth. One of the sectors that suffer most is agriculture, which provides the main livelihood for many poor people. Thus, continuing post-conflict insecurity will reduce the ex post return from donor projects in rural areas. Large amounts of food aid will continue to be needed.

Second, much of the mining sector typically has the weakest links to the rest of the economy, and therefore the smallest employment-multiplier effects. (Angola, where the oil sector constitutes an offshore enclave, is an acute case; in contrast, alluvial diamonds in Angola and Sierra Leone generate more direct employment.) Achieving poverty reduction through growth in these sectors therefore depends on pro-poor public spending of revenues. This in turn depends on having an effective public expenditure management system—a tall order in most conflict-affected countries (see principle 4 below).

Third, resource-poor regions need to receive priority in infrastructure and human capital spending, or growth will be very unevenly spread. A high national growth rate can disguise considerable regional variation in per capita income. For instance, Mozambique's national growth rate since the end of its civil war has been impressive, often exceeding 8 percent a year, but some regions have stagnated. Many of these are regions that gave political support to the former rebel movement (RENAIMO), which now forms the political opposition. Hence, high and rising regional inequality is not conducive to peace.

Poverty reduction to peace (p→p)

The links from aid to poverty reduction are similar in post-conflict economies to those elsewhere, but the problems with those links may be more severe in countries that have high levels of insecurity and weak institutions. However, pessimism for all post-conflict countries is not warranted. If a country can build a reasonably stable post-war government, then policy reform and growth may flow. In Uganda, sustained growth has contributed to post-conflict stability by generating employment and per capita income growth (Collier and Reinikka, 2001). Likewise, Mozambique, which started economic reform well before the end of its civil war, has achieved sustained growth and improvement in human development indicators, thereby contributing to peace, despite the persistence of regional inequalities.

Poverty reduction can contribute to peace by reducing competition between communities for resources, and may make it more difficult for demagogues to mobilise
followers. Nevertheless, we should also recognise that the drive for wealth and power motivates warlords—who may offer a young potential fighter more than he can ever hope to gain as a smallholding farmer or urban worker. Therefore, when powerful players remain on the stage, intent on grabbing power and wealth through war, we should not overestimate the contribution of poverty reduction to peace. The international community needs to deploy effective force to contain spoilers and to reduce their access to weapons, finance, and the markets for the spoils of war—natural resources in particular.

**Principle 5: In economic reform, focus on improving public expenditure management and revenue mobilisation**

Conflict has fiscal dimensions. Who gets what—via public spending—and who pays for it—via taxes—may play a role in the descent into conflict. In turn, violent conflict leads to further fiscal deterioration (Gupta et al., 2002). Revenues from indirect taxes fall as economic activity shrinks, the quality of tax institutions declines, and governments become ever more dependent on import duties and other trade taxes, which also decline as external trade shrinks and as the quality and honesty of the customs service deteriorates. The resulting fall in revenues reduces governments’ ability to fund development expenditures and, in raising the fiscal deficit, it contributes to macroeconomic instability. These all help to worsen poverty.

Whatever form the political settlement takes, it will have a fiscal dimension. People will expect some new and often radically different distribution of services and infrastructure. This new pattern of public spending must be financed. Tax and revenue generation, including some measure of political agreement on tax and revenue incidence, are therefore central to the creation of a working peace agreement. However, post-conflict finances are often ignored until it is too late.

Aid inflows can buy time for domestic political actors to reach a working agreement and rebuild necessary revenue institutions. As the economy recovers, a broadening tax base will provide some revenue buoyancy even under existing tax arrangements, and revenue growth will accelerate as new tax arrangements and institutions come into being. However, aid inflows to reconstructing economies can quickly tail off, and political actors will have trouble in the future if they neglect early attention to revenue mobilisation.

Even if all parties are genuinely committed to peace, revenue institutions may be so degraded that they cannot raise enough revenue. State capacity, including the public expenditure system, may be so weak that it cannot use the revenues raised to deliver improved infrastructure and services. Such degradation will also reduce a government’s ability to use aid to redress grievances and achieve broad-based recovery (Addison and Murshed, 2003). Further difficulties arise from the need in most countries for wholesale fiscal reform. This often calls for a measure of fiscal federalism to reverse the over-centralisation of political and fiscal power (examples include Ethiopia and Bosnia-Herzegovina). Territories that secede (Eritrea, Timor Leste) need to build national fiscal institutions on the often-weak foundations of the local institutions imposed by previous central or colonial authorities. This takes considerable time and investment, and inevitably constrains revenue mobilisation in the early years.

For these reasons, we argue that the fiscal dimension of policy reform, and of aid itself, is the most important dimension of the reform agenda for donors to focus on (McGillivray and Morrissey, 2004). Donors often get distracted by less important dimensions. For instance, there is an excessive concentration on market liberalisation and privatisation, partly because these are much easier to implement than a sound public expenditure and taxation system. Market liberalisation (if appropriate) or privatisation (when in the public interest and transparently conducted) are important to growth and poverty reduction, but less important than fiscal management. For, in addition to its development dimension, fiscal management has a crucial role to play in strengthening governance and democratisation. Societies cannot build peace without transparent public accounting, effective use of natural resource wealth for public spending, and strong institutions that mobilise public revenues for clear development purposes. Donors should focus on in their financial and technical assistance to governments these tasks.

**Conclusion**

To be effective, the efforts of donors and national actors (governments, the private sector, and communities) must be supported by vigorous action to achieve security for developing countries. Too many ‘post-conflict’ countries are characterised by high levels
of insecurity and violence. As we have argued, such insecurity lowers the return on donor projects and distorts domestic actors’ incentives. High insecurity forces political actors to concentrate on short-term political survival, often thereby compromising action on broad-based, poverty-reducing recovery. Aid is then less effective because the necessary policy reforms, particularly of public expenditure management and revenue mobilisation, happen late or not at all. Moreover, high insecurity holds back long-term investment in the productive side of the economy, thereby constraining economic growth and the ability to earn foreign exchange. Consequently, countries remain highly aid-dependent.

Aid, therefore, needs to operate within a global security framework that rapidly deploys peacekeeping forces of sufficient quality and size to achieve the goals given to the UN by its peacekeeping mandate. This framework must be backed by action to tackle the global flow of weapons and the resources used to finance the destruction of states and societies. Finally, aid must be deployed within the context of a global trade environment that supports the efforts of developing countries to take advantage of opportunities offered by the world economy. Rich-country protectionism works against the security agenda of poor countries by holding back their growth and ability to generate resources for poverty reduction. In this way, it undermines aid effectiveness and the security agenda of the rich countries themselves.

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Endnotes
1. They include Srenness, 1999; Hansen and Tarp, 2000a, 2000b; Lenzin and Morrissey, 2000; Collier and Dehn, 2001; Delgado and Hansen, 2001; Goemder, 2001; Goemder and Hansen, 2001; Hudson and Fossey, 2001; Lenzin and White, 2001; Luo and Ram, 2001; Delgado et al., 2002; Collier and Hoefler, 2002; Hoefler and Hansen, 2002; Government et al., 2002, 2003; Marnous, 2002; Easterly et al., 2003; and Rodman, 2003. See Robinson and Tarp, 2000; Breenon, 2001, 2002; and McGillivray, 2003a, 2003b for reviews of much of this literature.
2. Rodman takes Collier and Dehn (2001), Guillaumeau and Chauvet (2001), and Burnside and Dollar (1997, 2000) to task, arguing that their econometric results are not robust. Collier and Hoefler (2002) have not yet been subjected to such a critique. Aid does not appear alone as an explanatory variable in their model, and it would be useful to test the robustness of their estimates by including this term. As they stand, though, the Collier-Hoefler results do seem quite robust, and the model from which they have been obtained has quite a sound theoretical base. This is not to say that more empirical validation of the impact of aid in post-conflict scenarios is not required.
3. This number has been calculated using data obtained from OECD (2003) and the country classifications in Collier and Hoefler (2001).
4. It is not to imply that the general trend in aid away from project support towards budgetary support is unwelcome. It is to say, though, that such an approach, which requires well-functioning institutions and (possibly) good policy regimes, is inappropriate for some countries.
5. Here we use the concept of tradability in its macroeconomic sense, not in the sense of whether the good is sold in a market or not.
6. See, for example, Nakamura (2001) on Burundi and Rwanda.

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