

## **6. The Business of Peace: Why Entrepreneurship and Business Climate Reform should be the Centrepiece of Peace-Building Operations**

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International post-conflict administrators rarely have a strategy for economic growth. They tend to focus on humanitarian action, politics, and security, usually in that order. What could be more urgent?

Each of these tasks is seen as a crucial part of the state-building project. Accordingly, administrators privilege the public sector over the private sector, which has no address and no spokesman. The state, on the other hand, is easy to find and is usually in desperate shape. Restoring the state to health – principally as demonstrated by its ability to absorb foreign aid – can quite naturally come to be seen as the beginning and the end of peace-building.

That is a mirage, though the three canonical tasks of peace-building are indeed vital. Relief delivery builds the legitimacy of the transitional government and the international force. Political engineering aims to isolate ‘spoilers’ and empower the partisans of modernity, and hopefully also leads to stable alliances and consensual government. Using foreign troops to establish security makes emergency relief and political progress possible; training and equipping national security forces returns the monopoly of force to where it belongs: under the civilian control of a responsible state.

Success in these areas means that the international force can go home quicker, as it is always under pressure to do, because the countries that support such missions are reluctant to incur the high costs and risk their soldiers’ lives for very long. But given how few of the multinational post-conflict administrations of post-Cold War era can honestly be labeled as successes, it is important to intensify efforts to identify what critical variables the formula omits.

The most important omission, I argue, is economic growth, particularly for small and medium-sized entrepreneurs. As the Oxford economist Paul Collier has shown, only economic growth decisively reduces the risk of a return to civil war<sup>2</sup>. This does not mean that civil wars are ‘really about’ economics, to the exclusion of ideology, history, and vanity. It means that an upward growth trajectory makes a recurrence of war statistically less probable. Indeed, Collier found that the higher the post-war growth rate was, the harder it was to shatter the peace. We may not understand exactly how and why growth makes conflict less likely, but the relationship is robust.

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<sup>2</sup> Paul Collier, *The Bottom Billion: Why the Poorest Countries Are Failing and What Can Be Done about It* (Oxford: Oxford University Press, 2007).

Recalibrating peace-building operations for success thus requires not only the addition of growth as a priority, but a reordering of the priorities: security first, naturally, with economic growth close at heel, followed by emergency relief, and politics. Foreign aid is a tool to all these ends, but it is not an end in itself. As an input rather than an output, aid is also not a particularly valuable measurement of progress towards peace<sup>3</sup>. But measuring the rate of growth is.

### ***From Security to Growth***

The first priority of a peace-building operation must be everyday security. Insecurity, or the perception thereof, dramatically reduces economic growth and makes both domestic and foreign investment extremely unlikely. From the colonial period through to the humanitarian interventions of the 1990s, foreign forces have always been reluctant to do the risky work of maintaining order, as Kimberly Marten has documented<sup>4</sup>. It is the most common reason why peace-building missions fail. The failure of the United States and its allies to provide adequate security in Iraq and Afghanistan was thus not some peculiar aberration of certain individuals, but rather a commonplace of most such missions. Other contributors to this volume have written in eloquent detail, and from personal experience, about how difficult it is to maintain the will and capacity to create security in a hostile environment, and how to do so better in the future. So let's assume that the security situation is reasonably well in hand. What next?

The economic component of peacebuilding operations is usually planned by professional development personnel embedded in a special UN mission, or by a national aid agency such as the US Agency for International Development. Sometimes the public face of the international community is one of the private charities, such as Save the Children or Catholic Relief Services, that compete for contracts to deliver government aid and have experience in post-conflict environments. This is probably a mistake. The expertise of such agencies is emergency relief and poverty reduction programmes. There is a role for these, but economic growth is not, in the first instance, about distributing food aid, or building clinics and schools. The types of foreign aid that sometimes temporarily reduce poverty are not designed to cause growth, and it is unreasonable to expect them to. Accordingly, their contribution to the long-term peace-preserving effects of a high growth rate is minor.

Growth happens when private entrepreneurs – large and small, domestic and foreign – are able to take advantage of opportunities for profit. There is no other mechanism. The more they are able to do so, the more likely they are to expand their businesses, reinvesting some of their earnings in machines, innovation, and, most importantly, new employees. Insecurity will deter all but the most intrepid or ethically dubious entrepreneurs, because the risk of uninsurable losses is high.

A toxic attitude by the national government towards private enterprise – or simply a firm conviction that the state has the right and duty to regulate all aspects of economic life – can be nearly as effective a deterrent to entrepreneurial growth. The sorts of states that emerge from civil wars tend to embody such a retrograde stance, out of conviction or habit, or more prosaically out of the efforts of cynical bureaucrats to exploit vectors for corruption. For example, Afghanistan's economic modernisation

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<sup>3</sup> For a detailed account of how aid was badly used in Afghanistan, see Greg Mills, *From Africa to Afghanistan: With Richards and NATO to Kabul* (Johannesburg: Wits University Press, 2007).

<sup>4</sup> Kimberly Marten, *Enforcing the Peace: Lessons from the Imperial Past* (New York: Columbia University Press, 2004).

since 2001 has been seriously hampered by the high proportion of public servants who were educated in the Soviet Union and who continue to bear that outlandish nation's self-destructive prejudices towards private wealth. What kind of self-respecting state does not require a license for every conceivable sort of formal commercial process? What kind of state does not protect the people from rapacious, immoral capitalism?

When the post-conflict administration is indifferent to investment climate – or, better said, when it has decided to prioritise six or ten other issues in its engagement with the fledgling government – it is missing a major opportunity to consolidate peace. The international community can always find the time and money for programmes that aim to compel adherence to Western liberal values; the neglect of business climate is a choice, not a necessity.

### ***What Will Promote Entrepreneurship in a Post-Conflict Environment?***

If a post-conflict country is to grow rapidly enough to decisively reduce the risk of renewed conflict, the residue of intellectual indifference or hostility towards free enterprise must be rinsed out, along with the legal and administrative apparatus that hinders commerce and investment.

Some of the key rubrics to examine when assessing whether an environment is conducive to entrepreneurship are property rights, policy predictability, legal and administrative reform, trade facilitation, financial services, tax policy, and risk ratings. A richly detailed economic and public policy literature supports the comparative knowledge that the research departments of the World Bank and the International Monetary Fund have captured after fifty years of trying to understand what works and what does not in poor countries. Not all of the prescriptions of these institutions are equally sound, but there is broad consensus on the sorts of policy choices that make economies more competitive, dynamic, and predictable. But the most compelling testimony to the efficacy of these policy choices is the economic success of the countries that have adopted them<sup>5</sup>.

Legal and administrative reform is necessary, but not enough: post-conflict administrations and the national governments they support should decide how to spend their limited resources by prioritising interventions that will reduce the costs of doing business. This will usually mean economically productive infrastructure, particularly electricity-generation, but it can also mean tax cuts, more efficient customs procedures, or increased competition in key service sectors like transportation. Costs can also be reduced by reforming the public administration in such a way that the vectors for corruption and delay are reduced. This requires reducing the discretion of bureaucrats by eliminating unnecessary licenses and approvals, and by passing laws declaring that applications are automatically considered approved if the state does not respond within a certain time period.

There is no silver bullet, no answers to be derived from axioms, because the binding constraints of each economy are different. The constraints of war-torn economies may even present special symptoms that remain to be diagnosed by comparative research. But reducing the costs of doing business is the most effective strategy for promoting entrepreneurial growth, rather than trying to pick

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<sup>5</sup> The recoveries of Europe and Japan from the ravages of the Second World War are classic examples. China only grew after 1978, when it began to dismantle the state-run economy. More recently, Rwanda, Georgia, Vietnam, and El Salvador have all made major strides in recovering from civil wars – and avoided new civil wars – by embracing a trade and growth-led vision of their economic development.

‘winners’ based on educated guesses about where the profit-making opportunities in an economy are to be found.

### *Action and Urgency*

Making the country safe for commerce is not a priority for the first five years of a peacebuilding operation. It is a priority for the first six months, when the power of the post-conflict administration is at its apex. The euphoria and confusion of the immediate post-conflict period may be the ideal (or indeed the only) time to make the necessary reforms before entrenched local interests recover their equilibrium sufficiently to fight back.

But once the licenses, nuisance taxes, procedures, and so forth are eliminated, it will be politically difficult to bring them back. This is what was achieved in Georgia between 2004-2007, in the ‘radical’ period of Mikheil Saakashvili’s first term as president: even those opposition leaders most disgruntled with his aggressive business-climate reforms did not campaign on a promise to bring them back.

The audit process will show where the highest costs in the economy are, and therefore where spending will have the greatest impact on entrepreneurial growth. But some interventions can be undertaken at any time. They do not hurt, and usually help. They also send a powerful signal to the market that the relationship between business and government is permanently changing.

*Entrench property rights and capture the information.* Countries that experienced civil wars are usually places where respect for formal property rights was minimal. Furthermore, the breakdown of community trust caused by violence and forced migration means that traditional, informal systems of recognising ownership of land and buildings may be permanently destroyed. International administrators should not assume that such older systems are intact just because a country’s economy seems informal. This process may require the creation of specialised courts staffed with foreign adjudicators, as was done in Uganda after the end of the civil war in 1986. All claims to recover property that were not submitted before an announced deadline were null. The process does not have to be perfectly fair. It has to be done, and quickly, so that there is certainty in the market about what belongs to whom. It would, however, be appropriate to add a mechanism to compensate property owners who incur any losses because of haste.

In the course of registering property, attention could be paid to simplifying the process of transferring property from one owner to another; in some jurisdictions this takes years. And on both counts, improving the law is not enough. The information about ownership and value has to be captured in a way that it is publicly accessible, through modern land and company registries, preferably online. The annual Heritage Foundation/*Wall Street Journal Index of Economic Freedom* is an excellent tool for planning such interventions.

*Simplify the laws and regulations related to commercial activity.* There are not many ‘onesize- fits-all’ solutions in development, but this is one of them. It is about reducing bureaucracy and delays at all places where the government and private sector interact. Legal and regulatory reform alone will not unleash growth, but failure to attune the state to the needs of the private sector will unnecessarily constrain it. Administration programmes to ‘re-educate’ government officials to see themselves as facilitators of commerce, rather than as controllers of it, will also be necessary. If they cannot adjust to the new reality, they should be replaced without delay: the stakes are too high. A template exists for

planning: the World Bank's *Doing Business* indicator series, which has been published since 2004 under the leadership of Simeon Djankov.

*Reduce the costs of doing business.* There are many measures of how hard or easy it is to do business, but relatively few of the most important criteria for entrepreneurs: the cost of running a business. If entrepreneurs calculate that they will not be able to make a profit, they will not invest. The World Bank's *Enterprise Surveys* capture some of these perceptions, but the post-conflict authority will have to immediately undertake rigorous analysis of the factors that make the country a prohibitively expensive place to do business. The profile of each country is different, which is why there can be no template or silver bullet. In some countries, the main issue will be the cost of transportation or energy; in others, it will be the costs imposed by a heavy, regulatory state; in others, it is the cost of private security or the cost of credit. This sort of analysis is the only way for both postconflict administrations and transitional governments to know how to prioritise the spending of their scarce resources. But the overall aim should remain constant: reducing costs for entrepreneurs, so that they can turn a profit.

*Benchmark the country against the world, not against its region, or against other post-conflict countries.* A country emerging from war has a lot of black marks in its column. Because of the damage the conflict caused to its reputation, it will have to work much harder than other countries to be attractive to investors – domestic, diasporic, and foreign. It therefore needs to compete with the highest performers in the world that share its factor endowments and comparative advantages, whether or not they are in the same region, or share a history of conflict. The international administration can focus the attention of donors and national government decision-makers by making sure the real story of how close or far the post-conflict environment is from true competitiveness. This will help ensure that the right goals are set, so that sufficient resources can be directed to meeting them.

*Don't look for capital abroad if local commercial banks cannot lend what they already have.* Poor countries have capital. The credit market will take a long time to rebound from war, but local commercial banks in poor countries often cannot find enough creditworthy borrowers for the funds they already have. One important tool is the creation of a private credit bureau to help banks assess risk. A post-conflict administration might also help local banks manage exchange rate risk so that they can lend for longer periods of time. Another option is 'leasing' arrangements whereby the bank keeps title of the property or machine until it is paid off, which allows them to seize assets without going to court if necessary. Of course, there are many post-war countries that do not have a functioning commercial bank, and maybe never had one. In this case, using the good offices of the international administration to lure foreign banks to establish branches there is one of the most valuable economic services it can render to the country. Donors can be encouraged to help banks to establish operations, or expand their product offering, by underwriting some of the risk for a limited period.

*Take care that aid spending does not cause 'resource curse' effects.* Developing countries with weak institutions like Nigeria, Angola, or Congo that also possess abundant natural resources are especially vulnerable to civil war, dictatorship, and human rights abuses. They also tend to have stagnant growth rates. One reason is that the source of revenues has consequences for politics and governance. If the executive branch of a government has access to funding that is not raised through domestic taxation, the ability of parliament to balance the power of the executive is inherently limited. Similarly, a government that can finance itself through rents has little incentive to tax the population or to improve the business environment, leading to disenfranchised citizens and stifled entrepreneurs. There is

evidence that aid flows to governments have similarly damaging effects on institutions as natural resource rents do. There is a virtuous cycle among taxation, representation, and growth – a cycle that international peace-building operations often inadvertently disrupt. They can minimise the damage by drawing new legislatures into decision-making, insisting that the national government prioritise private sector development, and by helping government be able to make sure that businesses pay their fair share of tax.

*Promote public-private partnerships for infrastructure development.* Post-conflict countries are in a debt trap: in order to have their debts forgiven, they are prevented from borrowing new money for infrastructure for many years. After its successful election in 2005, ending more than a decade of brutal civil war, Liberia has fallen into this trap. The country needs infrastructure to grow, but has no means to raise the funding to build it. The record of the international community in delivering infrastructure after a conflict is not good, because the projects are expensive and difficult to manage. Some Chinese models of public-private infrastructure partnership might be appropriate in post-conflict environments, particularly now that the Chinese institutions that fund these projects have signed co-operation agreements with the World Bank.

*Emphasise local procurement.* As much as possible, the international administration's money should be spent locally, even if this results in inconvenience or slightly higher costs. It may be some time before external money comes into the economy. In the first year, the main jump-start for growth will be what the international community brings into the country for the peace-building operation. Local procurement includes not only food products and other goods, it includes services, and labour. In both Iraq and Afghanistan, thousands of low-skill service jobs were filled by imported foreign labour, mostly from Asia. In Afghanistan, even basic construction jobs went to Pakistanis and Turks, because they were more productive and easier to manage. This not only provoked resentment, it marked a huge lost opportunity to use the international presence to build capable Afghan construction firms that could later compete regionally. Instead, it seems likely that the United States will wind up its major infrastructure commitments to Afghanistan and leave behind not a single Afghan firm with international standards.

*Be predictable.* Entrepreneurs do not like surprises, particularly on matters that affect their bottom line, like taxes, customs procedures, and licensing requirements. The international administration should announce changes well ahead of implementation, so that economic actors have time to adjust, and they should inculcate the same practice in the national government. The post-conflict administration should also ensure it is a model of transparent tendering procedures – but ones suited for a poor country, not for Germany. Governments can hardly be expected to run open and accountable processes if the international community's are opaque and non-competitive. But it is also not sensible to transpose procedures designed for a modern industrial economy to a fragile country with weak institutions.

*Don't allow aid agencies and NGOs to crowd out the private sector.* Because they do not need to be profitable, non-profits have unfair advantages and can stifle competition. The international administration and the new government should avoid allowing them to bid on contracts that should be fulfilled by national private sector firms. Examples where this has happened include microfinance NGOs that drive for-profit microfinance firms out of business, and international non-profits that

survive lean times by bidding on construction contracts. Contracting opportunities should be limited to private sector firms, unless there is a compelling reason to allow NGOs to compete.

*Don't empower the state at the expense of the private sector.* For the sake of future growth and stability, the goal should be to remove the state from the productive sectors of the economy, not entrench it there. In the case of state-owned companies, this should not happen suddenly, because the human consequences for the employees would be severe, and could in fact have negative consequences for the security environment. But clear timetables for sale or privatization should be set, announced, and adhered to. This has the added benefit of limiting the state's ability to govern through patronage.

### *Caveats and Game-Changing Scenarios*

Some of the proposals above will not be applicable to every peace-building operation. Others, like the injunction to study the binding constraints to commerce and develop a strategy to reduce them, are. Much more than finding a template they can follow mechanically, international administrators need to understand why the establishment of the preconditions for entrepreneurially led growth is a peace-building priority, and make it a core plank of their strategy for success. They must then ensure that their staff includes professionals with demonstrated experience in firm-level analysis, competitiveness strategy, financial services, legal reform, and public administration reform.

Though frequent mention has been made of what the national government should do, it is critical not to overestimate what it is capable of, particularly in the early stages. If a priority is truly essential for growth or security, the international administration may need to take full responsibility<sup>6</sup>. And there are many tasks which are 'important', such as repairing the national stadium or the national museum, that should not be prioritised.

Peace-building operations are just like ordinary economic development operations, except that virtually nothing works properly and the threat of violence is very real. In other words, they are unlike any other kind of international engagement, and perhaps the most complicated kinds of missions the international community ever attempts to mount. This requires flexibility, improvisation, and the wisdom to know when guiding principles no longer apply – including the principles argued for here. If an insurgency breaks out, for example, as it did in Iraq in 2004, all bets are off. Counteracting an insurgency takes priority over all other considerations. 'Denial' of manpower is a key feature of any counter-insurgency strategy. This can mean large-scale, state-run jobs programmes and similar strategies that raise the costs of insurgency for the protagonists, but which have little to do with a long-term economic growth effort. Peace-building is no place for dogmatism.

But these operations can more often be successful – and less likely to require a repeat performance – if entrepreneurship and economic growth become central elements of the design of peace-building strategies.

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<sup>6</sup> In Afghanistan in 2005, USAID funded the construction of industrial parks in key Afghan cities. By the time the industrial park in Kabul opened, with great fanfare and cutting of ribbons, the plots had already sold out and entrepreneurs had begun building their factories and offices. The deal was that the Afghan government was required to provide water and electricity connections. They failed to do so, and so today the industrial park produces nothing.