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The Road to Post-War Recovery

by Graciana del Castillo and Edmund S. Phelps

For the world's advanced countries, a key challenge is to broaden economic and social inclusion without diminishing the economic dynamism they already have. The problems of war-ravaged countries are far more acute and their choices much more constrained. Indeed, they confront a double challenge: to create dynamic economies and to promote, at the same time, economic and social inclusion. Without both of these elements, national reconciliation will likely prove impossible.

Social exclusion in industrial countries imposes costs throughout society that policymakers must address with effective and targeted measures. Lack of jobs, for example, often leads people, particularly the young, away from work and into dependency on drugs and crime. Society, then, needs to pay for the costs of crime prevention policies and the administration of justice.

A flexible labor market, as many suggest, will not in itself promote inclusion. Welfare programs in war-ravaged countries often aggravate joblessness by reducing work incentives and creating a culture of dependency. Minimum-wage laws and labor agreements often make the least productive workers unaffordable to law-abiding employers. So what these countries need are more employment opportunities and higher salaries in the private sector for these workers.

Specifically, a wage subsidy program that lowers the cost of hiring full-time unskilled workers could make it more attractive for firms to hire them. At the same time, on-the-job training would make the program attractive to workers and to society as a whole. Governments could afford the cost of the subsidies since cutting unemployment would not only lower public security costs, but would also reduce the need for welfare programs.

In countries coming out of war or other conflicts, efforts at inclusion are futile in stagnant economies. Without both dynamism and inclusion, the path to peace will be elusive, as recent experiences in Kosovo, East Timor, Afghanistan, Iraq, and many countries in Africa illustrate.

Thus, post-war transitions require that policies that encourage dynamism and inclusion go hand in hand. Economic recovery needs to begin as soon as possible, not only because this is essential to maintaining political and social stability, but also because donors are unwilling to support economic reconstruction unless countries do their part to create an environment conducive to ensuring its sustainability. In the midst of political, social, and institutional vulnerabilities, as well as the vast damage to human and physical infrastructure that are the legacy of conflict, this is a monumental task.

Policymaking in these war torn economies is unique. Most countries in post-conflict situations suffer from weak fiscal positions, rendering the provision of internally financed subsidies impractical in most cases.

Moreover, foreign assistance, while stable in "normal" developing countries, often exhibits sharp spikes in countries undergoing war-to-peace transitions. In many cases, post-conflict aid can reach extraordinarily high levels after the conflicts ends, both in per capita terms and relative to the size of the recipient economies. Typically, however, this type of aid declines very rapidly.

Low-income countries in the normal process of development, for example, receive steady inflows of official foreign assistance of about 3% of their gross national income. By contrast, aid reached 95% of gross national income in Rwanda soon after the conflict ended, but fell to 20% within five years.

Consolidating peace following violent conflict has little chance of success unless jobs are created and the economy is quickly stabilized and brought onto a path of investment and growth with low inflation. The United Nations reckons that if economic reconstruction fails in terms of promoting dynamism and inclusion, countries in the transition to peace have an even chance of reverting to war.

Leaving aside the cost in terms of human lives, the economic costs of maintaining peace are but a fraction of what would be required for humanitarian assistance, military intervention, and peacekeeping operations should the country relapse into conflict. Hence, effective financing for peacetime is a good investment of donors' resources and a major factor in conflict prevention.

But donors need to avoid some common mistakes. In many cases, economic reconstruction has failed partly because donors required that their own nationals or companies be used. This policy has often led to programs that countries do not want and to employment of foreign experts for tasks that nationals could and should have performed. By providing domestic firms with wage subsidies for hiring unskilled workers, donors would increase the effectiveness and fairness of their assistance in support of national-led reconstruction and conflict prevention.

Given lower labor costs, local businessmen could decide to invest under the conditions of uncertainty and high risk that characterize post-conflict situations. The advantages in terms of employment creation, reintegrating former combatants into productive activities, savings from safety-net programs, and improved public security would be many. This type of aid would also provide political support for the authorities from a population grateful for policies that promote job creation.

At the same time, this policy would have neither the fiscal cost associated with government-financed subsidies, nor the distortions caused by the difficulty of cutting subsidies once the government has offered them. Grant-supported subsidies would remain in place for a finite period, and donors would gradually phase them out as aid programs expire. Furthermore, such subsidies would help reactivate the private sector, which is essential as large-scale post-conflict aid withers to the low levels that are common under conditions of normal development.

Graciana del Castillo, a Director of the Centennial Group, teaches at Columbia University and is author of the forthcoming book *Post-Conflict Economic Reconstruction*. Edmund Phelps, Nobel laureate in economics for 2006, is Professor of Economics at Columbia and author of *Rewarding Work*, which is being reissued this autumn.

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