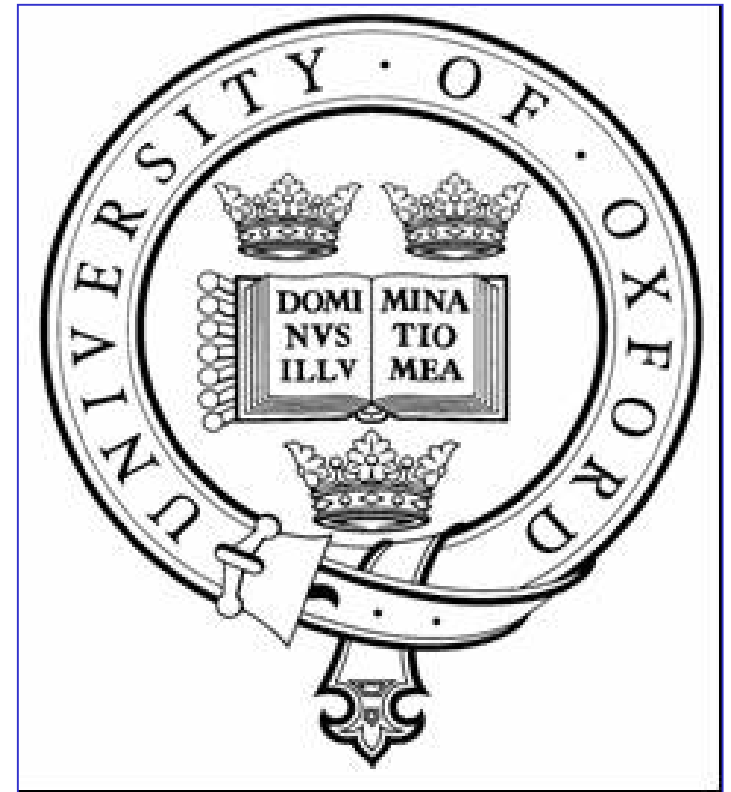


Economic Management for Conflict Prevention: Macroeconomic Policy

Valpy FitzGerald
Oxford University

**UNDP/JICA 'Conflict Prevention
and Development Co-operation
in Africa' Policy Workshop
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“For as the nature of foul weather, lieth not in a shower or two of rain; but in an inclination thereto of many days together; so the nature of war consisteth not in actual fighting, but in the known disposition thereto during all the time there is no assurance to the contrary.”

Hobbes *Leviathan* (1651) pt. I ch. 33

Three questions

- How is the macroeconomy of a poor pre/peri/post conflict country different?
- Which are the appropriate (i.e. desirable and feasible) macroeconomic objectives?
- What should macroeconomic policy contain in order to prevent conflict?

The 'special' nature of the
pre/peri/post-conflict
macroeconomy

Macroeconomic impact of conflict

- Direct conflict impacts on production (traded, agriculture) and trade reduce forex earnings. Tax revenue down. Inflationary pressures.
- Indirectly uncertainty undermines investment (large and small); aid sustains consumption but undermines productive investment and thus job creation.
- Social and infrastructure budgets squeezed by security. Aid may sustain these, but not production support. Inflation targeting => high interest rates.

Economic development cost of conflict

- Battle casualties few; limited direct destruction (except landmines). Human mortality rises: basic needs supply failure, forced migration, epidemics etc
- Investment collapses; except for protected enclaves and aid programmes. Flight of domestic human and financial capital.
- Output and livelihoods loss from breakdown of goods and labour markets. Shift to informal activities production and trade (smuggling). Loss of jobs *and* labour supply.

Post-conflict reconstruction

- Extremely slow – due to dislocation of input & output markets; ‘new’ activities still profitable. Uncertainty remains. Contrast with natural disasters.
- Absent a real *economic* ‘peace dividend’ compared to ‘modern’ industrial wars (excess capacity, new technology). ‘Business’ worsens inequalities.
- Donor effort focused on poor (MDG strategy) instead of production & exports. Aid becomes main ‘export industry’ with remittances after migration

Appropriate (i.e. desirable
and feasible)
macroeconomic objectives

Instruments and institutions

- ‘Technical’ approach to core macroeconomic policy (fiscal, monetary, exchange rates, banking etc) has profound social and structural consequences.
- Adding PRSPs as a ‘bolt on’, or aid additionality for social provision budgets, is *not* enough. More policy space needed on core issues.
- Thus macropolicy redesign required to support conflict prevention implies institutional changes – e.g. central bank autonomy, treasury targets.

Contrasting economic strategy objectives in poor economies

“PEACETIME”

- Raise efficiency
- Increase output
- Raise saving
- Reduce poverty
- Increase world market integration

“CONFLICT”

- Reduce uncertainty
- Increase employment
- Raise investment
- Reduce horiz inequity
- Reduce external vulnerability

Repairing development costs of conflict

- Loss of entitlements, based on markets (wages, sales), government (health, education) and social (trust, remittances) requires universal benefits (however small) *not* targeting alone.
- Destruction of physical plant, economic infrastructure, market institutions etc requires a comprehensive development plan: private sector (e.g. middle farmers) cannot do this alone.
- Shifting away from aid dependence towards diversified exports as motor of growth, and extending this into job creation, should be the central objective.

Implications for macroeconomic policy design to support conflict prevention

fiscal

- Need to diversify and deepen tax base to replace aid funding of budget; resource rents can provide public revenue but require careful oversight but also broad contributor base as key dimension of new social contract.
- Horizontal equity and production support rather than poverty focus alone in designing expenditure. Health and education should be provided universally as far as possible (or at least a long term goal).
- Fiscal deficits should not be financed by domestic borrowing (high real interest rates, commercial banks switch to money market); low import duties needed to reduce smuggling, so more effort needed on property taxes.

monetary

- Macroeconomic stability central, but *can* be defined differently from zero inflation and rapid growth.
- To support broad investment, necessary to restore long-term rural credit systems (development banks with technical assistance) and keep interest rates low (wind up the T-bills market). Micro-credit systems cannot support middle producers.
- To support export diversification a competitive and stable reach exchange rate is needed, which requires active intervention in the foreign exchange market (*neither* a free float *nor* a nominal anchor) by the Central Bank.

External finance

- Fluctuations of in aid disbursements are major source of macroeconomic instability, so donor groups should commit to longer-term budgetary.
- Present commodity boom brings benefits to growth and macro-stability, but provision must be made for future balance of payments support in downturn.
- Debt writeoff process has stalled, and overhang persists – which causes widespread investor uncertainty about longer term country solvency post-conflict.

THANK YOU

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Economic 'roots' of conflict

- Armed conflicts arise from horizontal distribution problems (perceived or real intergroup injustice etc) and their repression; not vertical inequality (i.e. poverty).
- Little or no evidence of 'resource conflicts' at root of problem; other than displacement from above
- 'Greed versus grievance' notion a serious misconception; relationship is much more complex due to need to fund conflict; a process which creates 'new capitalists' with interest in continuing profits. But they still need support...

Changing nature of war?

- LIC introduced as a counter-insurgency concept; but best description of many ‘third world’ wars as well as, of course, indigenous resistance to external ‘modern’ military.
- No set-piece battles or fixed positions; territories occupied by lightly armed troops or ‘bands’
- Boundary between peace and war is unclear in violent societies in any case
- Historical parallel with pre-modern (i.e pre-18C) warfare, without standing armies, condottieri and largely ‘civilian’ technology etc

War and human development

- War is a major threat to HD: 8/10 of lowest HDI countries have been or are at war; plus regional effects. Incidence heaviest in low-income countries; and most deaths (90%) among civilians.
- Lack of HD (institutions, inequity etc) a major cause of conflict/war
- BUT there is enormous variability in effects, which implies scope for policy intervention to mitigate effects of war; and possibly reduce conflict.

Financing low-intensity conflict

- Financial requirements are limited (light arms cheap; little munitions used; cellphone telcoms); limited mainly to food and transport – both ‘civilian’.
- Asymmetry between ‘incumbent’ (higher costs, higher income and aid) and ‘insurgents’ (lower costs, refugee camps etc)
- ‘Living off land’ unfeasible (poor rural populations plus need for support). So ‘business’ activities used: drugs, smuggling, protection etc.