

Understanding Business Need as the Basis for Economic Growth and Stabilization

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“Aid chases need, but investment chases opportunity.”

Secretary of State Hillary Clinton

Paul Collier, among others, has convincingly argued that poor nations, especially nations that are not growing economically, have a greater tendency toward conflict and violence. Looking at post-conflict countries, he notes that “[t]he lower the income, the higher the risk of conflict reversion; and the slower the economic recovery, the higher the risk.”² One of the primary challenges for post-conflict stabilization, then, is economic growth.

According to Harberger, “all economic growth takes place at the level of the productive enterprise.”³ Stated differently, growth happens at the firm level – whether the firm is a multinational corporation or a mom-and-pop kiosk – as people engage in business. In a post-conflict setting, the goal is to enable businesses to grow more and more businesses to grow.

Business health and growth depend on the ability of business owners to balance three factors: costs, risks and revenues.⁴ If revenues are not sufficient to cover costs and risks, then the enterprise will go bankrupt. If revenues are merely equal to costs and risks over time, then the business merely achieves subsistence, an unstable status that does not attract investment and does not enable growth. If revenues exceed costs and risks, the profitability generated allows the enterprise to reinvest and grow, creating jobs, providing goods and services, and generating tax revenues.

The Basic Paradigm

- Economic growth is essential to stability
- Economic growth happens at the firm level
- Firms grow when their revenues exceed their costs and risks
- Conflict creates high costs and risks
- *Therefore*, interventions in conflict-affected environments should seek to **reduce costs and risks**

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² Collier, Paul, *Wars, Guns and Votes: Democracy in Dangerous Places*, p. 88. (Harper Collins, New York: 2009)

³ Harberger, Arnold, “On the Process of Growth and Economic Policy in Developing Countries,” p. 3. USAID, PPC Issue Paper No. 13, December 2005. <http://www.econ.ucla.edu/harberger/PNADE081.pdf>

⁴ Many economists treat risks as a subset of costs. (See Harberger, for example, who combines the two within the concept of “real cost reduction.” id.) While technically correct, risks represent a separate and distinct science, and in practice are addressed differently from other kinds of cost. For purposes of analysis, this paper will consider the factors separately.

The goal of development practitioners who wish to promote economic growth must be to reduce the costs and risks of doing business, increase revenue potential of businesses, or both. Given that businesses generally find costs easier to calculate, control, and manage, the greater challenge is to reduce risks. In conflict-affected societies, risks are severe.

The purpose of this paper is to suggest ways in which risk (and some costs) can be mitigated through the assistance of foreign organizations, whether military or civilian, and through interaction of these organizations with local, regional and international public and private sector actors. In other words, in the context of Secretary Clinton's observation on investment and opportunity, the purpose of development interventions is to increase the overall level of opportunity.

The Dynamics of Business: High Risks Require High Returns

Some businesses will flourish under almost any circumstances, including wars. But risky investments demand a premium, and investors often seek very high returns in order to take chances with the time, money, or other assets they put to work in their commercial endeavors. Healthy economies tend to be founded on lower risk activities that bring returns of 6-15%. In risky environments, however, investors often require returns of 50% or more. This produces higher prices, lower availability of goods and services, and higher likelihood that enterprises will fail. To protect themselves, investors⁵ also tend to structure the investments for short-term results, seeking to recover capital within only a few years. This may not lead to growth.

Long-term, low-return investments are not palatable in risk-laden environments, such as a country recovering from war. Conflict-affected societies simply do not create opportunities for broad-based growth or investment. As commercial risks are reduced, however, investment can increase and growth becomes more readily attainable; economic growth itself reduces various risks, thus creating a virtuous cycle for increased social and economic stability.

The military has the primary role of reducing risks in terms of conflict. However, given the premise of Expeditionary Economics – that the military will inevitably have an impact on economic activity and should be prepared to engage the economy to support growth until stabilization permits civilian intervention – it is necessary that military actors promote economic recovery until civilian specialists can take over. As Collier has noted:

“[P]ost-conflict countries are fragile, and . . . there does not seem to be a simple political solution. The strategy that makes a difference, really bringing down risks, is peacekeeping, evolving into an over-the-horizon guarantee, for which the exit strategy is economic recovery speeded by aid.”⁶

⁵ “Investor,” for purposes of this paper, includes anyone – individual or corporate – applying labor, money, tangible property or other assets to an enterprise in order to produce goods or services for a return in excess of costs and risks. This can include a peasant farmer or an international corporation.

⁶ Collier, p. 95.

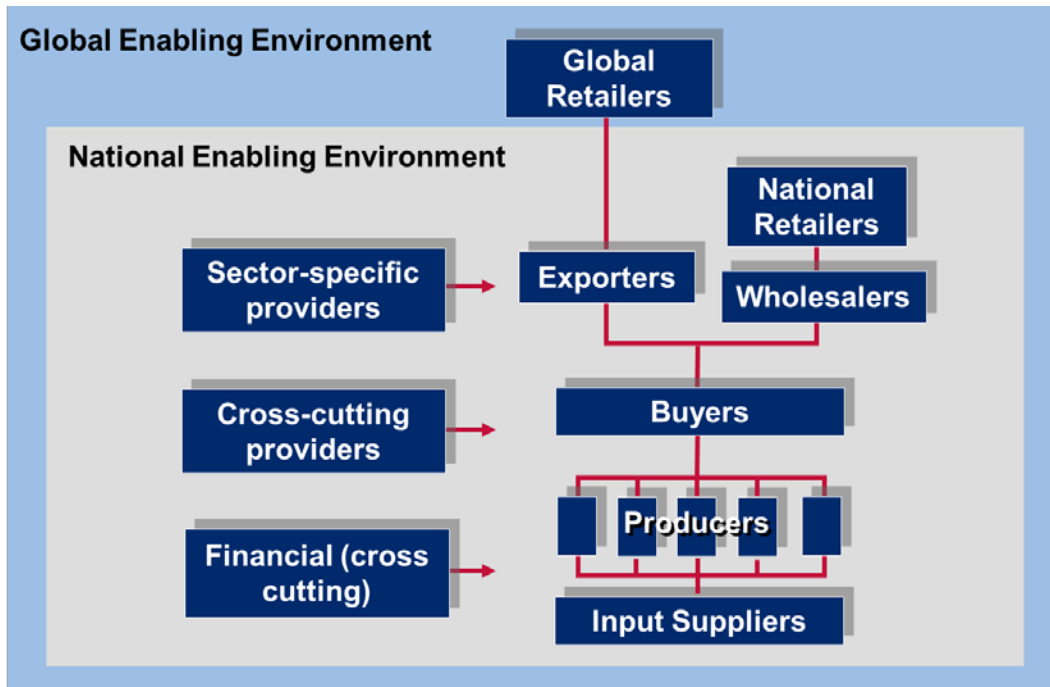
While establishing peace, the military can also play a role in economic recovery. A captain whose unit must remain until development professionals arrive can, if prepared, have significant local impact in reducing the microeconomic costs and risks that are keeping healthy investment at bay. These challenges may range from systemic, such as inappropriate laws in which the captain and her unit may have little influence, to more mundane, such as the destruction of the local marketplace during the conflict. The starting point is to identify the multiple risk and cost factors, then address those within the military's competence.

Risks: Where to Find Them

While the concept of risk can be understood on a very general basis, it occurs at very specific points in business transactions and operations. A useful approach for understanding this is the value-chain model, frequently used in development to promote economic coherence in a given commercial sector.

Value chains describe the entire array of businesses involved in creating a good or service and moving it to market, and the relationships between those businesses. It starts with inputs, such as seed or fertilizer, and ends with the sale to the final customer. For example, the wheat value chain starts with seeds, water and fertilizer (inputs), which are harvested and passed to producers who turn the wheat into flour, bag it, and sell it to various buyers, for local markets or export markets. Transport companies may provide services at various points – such as importing fertilizer and shipping unmilled wheat to producers – while finance providers are likely to be involved at each point along the chain as well. Other services – accounting, export clearance, quality experts – may also provide services along the way.⁷ Disruptions and distortions along the chain affect the profitability at the different points along the line, which ultimately affects producers.

⁷ For more extensive information on value chains, see www.microlinks.org.



The disruption of conflict can affect every point in the value chain, from the destruction of transport corridors to the dissolution of established relationships between producers and their suppliers. As a region stabilizes and the population returns to more or less normal activity, there will be a great need for rebuilding the structures and relationships that allow business to function effectively and efficiently. The challenge, of course, is to create *long term* stable conditions, but there is much that can be done in the short term to bolster the foundations of growth.

Most short-term interventions, especially at the local level, cannot effectively engage the systemic problems within a post-conflict society. For example, the banking system must be re-established in connection with the central, national government. Instead, it is more likely for military units to focus on specific local or sectoral issues at the ground level.

The value chain concept is helpful in understanding the impact of various breaks in the chain, but does not necessarily help to locate the nature of the costs and risks. For this, other optics can be useful.

Tools of Engagement

There are at least six areas that affect the revenue calculus of firms:

- Markets
- Infrastructure
- Enabling Environment
- Finance
- Knowledge

- Governance

These six areas are interlinked and interdependent, with each supporting the others. Weakness in any means weakness for the whole. Each is also likely to offer specific short-term opportunities for positive interventions in the micro-economy. Depending on the point of intervention – local versus national, government versus private sector – the needs may be outside the manageable interest of the military unit(s) engaged, yet there will most certainly be manageable opportunities.

The foundation for all of these is security. While not all businesses require security to operate,⁸ the security situation affects all businesses. The impact may be direct (damage to people and property) or indirect (delays in transport or unreliable electricity). Either way, the end result is higher costs and risks, leading to lower growth dynamics, and lower economic stability. For each of this six factors, security must be a priority.

Each area is described below, with illustrative examples of interventions. This framework should also be used over time, however, to identify and gather experiences (both positive and negative) of those on the ground.

Markets. In its broadest sense, the concept of “markets” encompasses local, national, regional, and international trade relationships and mechanisms. Markets include a village center where local merchants offer goods for sale as well as international demand for those goods. In the post-conflict setting, one goal is to help local markets become functional again by ensuring a secure place to buy and sell, possibly through restoring the actual infrastructure if it was damaged in the conflict, or providing physical security.

Yet markets are for more than infrastructure. Several guidelines are useful in understanding and engaging market challenges:

- Focus on immediate needs. In a post-conflict setting, many regions may be dependent on humanitarian aid – food, shelter, clothing, fuel. It is important to replace humanitarian supply with local supply as quickly as possible. This suggests a focus on reinvigorating agriculture in rural areas and reestablishing transport lanes and mechanisms. (This will likely require infrastructure investment.)
- Focus on existing markets. Normally, the easiest short-term path for growth is to re-establish production that was disrupted by the conflict. For example, a cotton-growing region will have knowledgeable returnees who can recover and recuperate cotton farms. Before investing in such commodity production, however, it is essential to determine whether there is still a viable market for products: the disruption may have caused previous buyers to find new sources of

⁸ See Cusack, Jake and Erik Malmstrom, *Bactrian Gold: Challenges and Hope for Private-Sector Development in Afghanistan*, February 2011, Ewing Mariam Kauffman Foundation, at http://www.kauffman.org/uploadedfiles/ee_bactrian_gold_report.pdf

- supply, with little interest in re-establishing the old. Local food production for local markets, however, can yield immediate positive results.
- Recognize temporary new markets. The military, NGOs and the expatriate community in general constitute a critical mass of relatively well paid buyers. Whenever possible and appropriate, buy local supplies, or buy imports from local suppliers. This injection of cash into the local market will help to stimulate growth and stability in the short-term. (Caution: be aware of potential inflationary pressures caused by too much foreign money chasing too few local goods.) On another angle, helping local producers understand the needs of the expatriate community can open new production opportunities.
 - Note gender differentiation. Some activities are traditionally reserved to one gender. For example, women are in charge of cattle in Pakistan but not Africa while men do most of the sewing in Africa, but not in Eurasia. Market support should be targeted to ensure that both men and women have opportunity.
 - Support cash crops as well as staples. There are two ways to obtain food: produce it yourself, or produce something else that can be sold to buy it. Interventions in local markets should be careful not to distort incentives through assistance that inappropriately disfavors cash crops.

Infrastructure: In 2007, the Afghan business community produced a survey of priorities for business. Despite ongoing violence and a rise of kidnappings in Kabul, their number one concern was electricity, not security. The risk of production stoppage through power outages, or damage to equipment from unpredictable electrical supply, posed far greater threats than random violence.

Infrastructure is vital to keeping down the costs of business, but also the risks. A study by the Center for Global Development on business challenges in Africa found that infrastructure was first on the list of private sector priorities. The quality of roads, water supply and power not only made commerce more expensive, but also fragmented markets into smaller, non-competitive units that repressed investment and encouraged the formation of cartels and monopolies.⁹

Infrastructure is a clear priority in restoring the economy, locally and nationally. Useful interventions can include:

- Irrigation canals. For the rural sector, repairing damaged irrigation systems is critical, especially those serving a large population. This work can employ numerous community members as well, providing much needed income. Care should be taken, however, not to pay for traditional maintenance arrangements – in one case, well-meaning expatriates hired local farmers to clean up the irrigation canals, interrupting established community systems that did not require payment.

⁹ Ramachandran, Vijaya, Alan Gelb, and Manju Kedia Shah, *Africa's Private Sector: What's Wrong with the Business Environment and What to Do about It*. Center for Global Development, 2009. <http://www.cgdev.org/content/publications/detail/1421340/>

- Electricity. Repairing the national central infrastructure can take years; but generators can supply immediate and medium-term needs. During Lebanon's civil war, there was generally ample electricity because individuals were permitted to sell excess generator electricity to their neighbors. While assisting with restoration of the grid, it may be possible to work with local leaders to permit temporary use of privately owned generators until the national (monopoly) supplier can reach them again.
- Transport corridors. Roads, bridges and ports directly affect the prices of goods and services. Improving transport efficiency brings down costs and increases competition, which further reduces costs. Repair and construction projects also provide significant employment opportunities, as with irrigation repair.
- Marketplaces. The physical space for markets is important not only for selling, but for reforging the community relationships fractured by war. If a community once had a central market, then it may be useful to rebuild it. It may be necessary to establish markets in new locations, but this should be done only after careful consultation with community leaders to ensure the location does not violate any cultural or relational constraints.
- Trash collection. Getting trash off the streets improves health and psychological well-being, but it also removes hiding places for IEDs. US military units have successfully reduced the incidence of IEDs in conflict-affected neighborhoods by hiring local workers to keep the streets and alleys clean.

Enabling Environment. The enabling environment – whether for business, agriculture, and agribusiness – describes the interface between government and private sector in the form of laws and regulations that permit and prohibit various business activities. These can be seen across the life-cycle of a business, such as business registration, licensing, employment of workers, getting loans, and obtaining property.¹⁰ The enabling environment also includes framework laws, such as contract, bankruptcy and banking regulations, as well as the institutions that enforce them.

Post-conflict circumstances are often more accurately described as a business *disabling* environment. Aside from the impact of violence on the institutions needed for implementing business regulations, the regulations themselves were very likely skewed to create a system of unfair privileges, which may have given rise to the conflict in the first place.

Short-term, local interventions may not be able to address some of the more systemic problems, such as revising laws, but there are still windows of opportunity for improving the enabling environment:

- Employment first, formalization later. Most developing countries have a high incidence of informal labor, which is normally a sign that the policy environment is awry. In the post-conflict setting, it is more important to get people working

¹⁰ See the World Bank's *Doing Business* materials for an extremely useful overview of basic business regulations. www.doingbusiness.org.

than to get them into a formal system of labor. It may be possible to utilize both approaches, which should be encouraged, such as hiring local staff formally but hiring road workers informally. In post-war Bosnia & Herzegovina, labor laws were so restrictive that some delegations of the international diplomatic community simply refused to observe them and hired in accordance with the benefits offered in their home country.

- Competition matters. Procurement of goods and services is a significant source of economic activity. Whenever possible, procurement should be handled on a competitive basis, with care given not to inappropriately favor any given supplier in a way that creates entrenched interests or encourages monopolization. Likewise, care should be given not to replace existing service providers such as transport companies with foreign service providers. Humanitarian aid efforts have sometimes imported their own trucks, equipment, and workers to provide services that could have been provided locally.
- Model best practices. Contracting should be transparent, consistent, and predictable, serving as an example of best practices. Procurement in many countries is rife with corruption and favoritism, breeding discontent and resentment. Modeling appropriate systems can serve as an example for longer-term reforms. Where possible, make payments through wire transfer, direct deposit, or even mobile banking, instead of using cash; this can reduce systems of kick-back and patronage that undermine incentives for work.

Finance. Poverty and conflict are often intertwined. In severe conflict settings, it is not unusual for some sections of the economy to devolve into barter systems, with little cash available, or little confidence in the local currency if inflation is rampant. Likewise, access to finance is diminished, with few commercial loans available.

Establishing healthy financial systems is a complex, multi-faceted task requiring years of work on multiple fronts. Short-term assistance can help to ease financial needs during the long rebuilding phase. Military units often have Commander's Emergency Response Program (CERP) funds¹¹ funds and other resources available for local development purposes, but interventions should be structured so as not to undermine the end goals:

- Vouchers, not commodities. Rather than directly supply seeds, construction materials or other goods in a reconstruction project, supply vouchers to the recipients in order for them to then choose local suppliers, with the vouchers then redeemed for cash by the suppliers. This spurs dynamism and competition in the local market, helping to recreate the previous value chains. The AVIPA project in Afghanistan used seed vouchers with 60,000 farmers, helping to restore seed markets and improve agriculture.
- Grants, not loans. Lending, in general, is preferable to grants for a variety of reasons. However, in early stages of economic recovery, conditions often mandate the use of outright grants to stimulate start-up. As conditions improve, or as NGOs or donors move in with more assistance, care should be given in

¹¹ See the following link for more details: <http://usacac.army.mil/cac2/call/docs/09-27/ch-4.asp>.

transitioning from grants to loans to avoid confusion and mixed messages regarding repayment obligations. Otherwise, competing programs can undermine approaches and results.

- Stimulate on-lending. Rather than provide multiple small credits or grants to individuals for purchase of the same basic supplies, provide financing to suppliers who can then provide credit to their customers. If possible, fund competing suppliers to ensure price competition for the benefit of the end users.
- Leasing is *halal*. As business resumes, the market for commercial equipment is likely to be constrained by lack of credit for purchase. Leasing is a time-tested form of secured finance that comes without cultural suspicions, particularly in Islamic communities where leasing is historically *shariah* compliant. Assist competing suppliers to establish leasing facilities for high demand equipment.
- Women are lower risks. Worldwide, studies on loan repayments usually find that women are better at repayment than men, often significantly. If lending is appropriate, be sure that women are allowed and encouraged to participate.

Knowledge. Business skills and market information are critical components of success; without them, benefits of reform and reconstruction can be lost. There may be limited skills in the local community for various forms of reconstruction endeavors, or local farmers may utilize outmoded forms of production. These gaps present training opportunities that could potentially be provided by US soldiers and civilians who bring relevant experience with them.

In addition, healthy markets rely on up-to-date market information from national and regional markets. In many developing countries, such information is limited in the hinterlands, and conflict can disrupt even that limited supply. With cell phone technology, construction of new information networks can accelerate rapidly to support new and traditional value chains, but may need assistance getting started.

Whether skills or information, expeditionary economists can provide assistance, but with caveats:

- Trusted inputs first. Farmers, especially subsistence farmers, tend to be highly conservative in their choices. As they restart their farms, they will prefer to start with crops and seeds they know, and will be slow to try new varieties and options. This should be respected, but also provides an opportunity for working with a few pilot farmers to introduce better varieties or new cash crops that others can then emulate.
- Stimulate market information. As part of building relationships locally, consider providing basic market price information from key national markets of relevance to the locale. Soldiers from farming backgrounds are likely to have experience with market information, and can assist local counterparts in establishing or reestablishing communications, possibly based on cell phone systems established by development projects elsewhere.
- Basic management needed. One of the greatest knowledge gaps in developing countries – post-conflict or otherwise – is in the area of basic management skills.

Many fragile states have practiced command systems that did not require or reward project management capacity. In working with local suppliers, contractors, or local staff, offer basic management courses, and give local staff supervised management responsibility to train them on the job. Include women in these courses: they are often marginalized and need assistance to enter the mainstream.

- Train, but based on demand. Skills such as carpentry, electrical work, plumbing and construction are often in high demand and can be readily offered by experienced staff. However, all training should be based on market research: in Liberia, a project to employ ex-combatants trained them in bricklaying and carpentry without first discovering that there was already a surplus of unemployed noncombatant carpenters and bricklayers. Training can fill gaps, but should not exacerbate them.

Governance. The way in which a country is ruled multiplies the risks or the benefits of doing business. A quick glance at any international ranking of development, whether the World Bank's *Doing Business* indicators or the UNDP's *Human Development Index*, shows that countries faring best in income, education and health are those that are best governed; conversely, misery and conflict reign along the bottom of the list, where governments are frequently characterized by corruption, cronyism and incompetence.

In Afghanistan, the Taliban's most effective recruitment theme is the corruption of Afghan government. A young man in Kabul told this author in 2007 that he supported the return of Taliban government to end the corruption and misrule he saw everywhere. Corruption is essentially an abuse of power, and thus is likely to be rife in post-conflict conditions where traditional relationships of trust have broken down. Likewise, many countries that fall into conflict have a history of predatory government, which is simply another form of institutionalized corruption.

Cleaning up corruption and establishing trustworthy government is beyond the capacity of any short-term intervention. Yet there are a number of actions that can instill integrity at the micro level and serve as a model for future relationships between stakeholders:

- Procurement integrity matters. Procurement is not only an important economic driver, it is a principle place of corrupt behavior throughout the world. Units that procure goods and services locally should establish transparent, competitive and published systems of procurement based on merit. In helping to rebuild local government functions, it may also be possible to insist that they adopt similar systems.
- Why, not just how. Training of local police and militia offers the opportunity for instruction in public service, not merely in the tactical basics of policing. Rule of law is a mindset that depends in great part on a public service mentality, which is not inherent in many governance systems, and must be taught.
- Dialogue as foundation. Public-private dialogue allows government and governed to fashion more effective policies and promotes implementation of rules by creating consensus. It also helps to re-knit the social fabric torn by conflict by

rebuilding healthier social relationships. Modeling this behavior will improve public relations; training local counterparts, especially in local government, will lay the foundation for more effective and responsive government.

- Pay end-users, not middle-men. Patronage systems frequently require kick-backs in a pyramid payment system, allowing jobs to be bought and sold rather than earned and kept. When possible, set up payment systems through direct payments to those employed on a project through local bank accounts or mobile banking systems. This can undermine extortionate relationships, reduce resentments and help to inculcate greater accountability and government effectiveness.
- Promote parliamentarians. Recent economic research suggests that stronger, representative parliaments lead to greater growth and stability than strong executives.¹² This suggests that projects should work to build relationships with national representatives of local populations, whether elected or appointed, to build constituencies that lead to greater respect for the national government, as well as greater representation. Holding regular meetings between business and government officials to address local needs can help to reframe concepts of government in terms of accountability and representation.

Bringing the Six Factors Together

Each element of the investment environment discussed has an impact on costs and risks of doing business, and therefore on prospects for economic growth and stability. It may often be beyond the resources and mandate of any project or intervention to address all simultaneously, but by taking each into account, better programs can be built.

For example, a long-term road-building project should include public finance considerations for how to maintain the road over the long term, but the urgency of the immediate situation requires such more complicated systems to be left for future assistance. Nonetheless, the road-building program (infrastructure) can incorporate: skills and management training for local workers (knowledge); standardized employment contracts for workers (enabling environment); transparent procurement processes (governance); encouragement of leasing, or new credit products secured by contracts (finance); market access components (markets) such as feeder roads; and local procurement of supplies or catering services through women-operated businesses (markets and gender).

These micro interventions require creativity, but are based on simple awareness. At times, projects will have to embrace trade-offs between urgency and long-term legitimacy, or immediate effectiveness versus overall efficiency.¹³ Yet they make a

¹² Kroenig, Matthew and Meran Karal-Delhay, "Do Legislatures Matter for Economic Growth?" Working Paper, July 10, 2010.

http://www.bizclir.com/galleries/expert_opinion_files/Kroenig%20and%20Karan%20Delhay_Legislatures%20and%20Economic%20Growth%20Working%20Paper.pdf;jsessionid=aMykar0ncTIg5CeY3

¹³ Regarding trade-offs, see generally, USAID, *Securing the Future: A Strategy for Economic Growth*, April 2008.

http://www.usaid.gov/our_work/economic_growth_and_trade/eg/eg_strategy/eg_strategy_v4_final.pdf And reference paper by Jay Smith.

difference in the investment calculus of local business and, eventually, foreign investors. Few outside investors will consider serious investment in the fragile conditions of a conflict-affected environment, yet every day the local population makes investment decisions that can enhance or reduce local stability.¹⁴

Any given project may be a drop in the bucket of what is required, yet every drop is needed.

¹⁴ For additional practical insights on programmatic possibilities for business in conflict-affected environments, see International Alert's website, at http://www.international-alert.org/peace_and_economy/index.php