Research for Action 45

Underdevelopment, Transition and Reconstruction in Sub-Saharan Africa

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LIST OF ACRONYMS

CFA	Communauté Francophone Africaine
DRC	Democratic Republic of Congo
EE-FSU	Eastern Europe and the Former Soviet Union
EGS	Employment Generation Scheme
EPRDF	Ethiopian People's Revolutionary Democratic Front
ESAF	Enhanced Structural Adjustment Facility
FRELIMO	Mozambique Liberation Front (Frente de Libertação de Moçambique)
HIPC	Heavily Indebted Poor Countries
IMF	International Monetary Fund
MPLA	Popular Movement for the Liberation of Angola (Movimento Popular de Libertação de Angola)
OAU	Organisation of African Unity
PER	Public Expenditure Review
PAIGC	African Party for the Independence of Guiné and Cabo Verde (Partido Africano para a Independência da Guiné e Cabo Verde)
RENAMO	Mozambican National Resistance (Resistência Nacional Moçambicana)
SOE	State Owned Enterprise
TPLF	Tigrayan Peoples Liberation Front
UNITA	National Union for the Total Independence of Angola (União Nacional para a Independência Total de Angola)
UTR	Underdevelopment, Transition, and Reconstruction

FOREWORD

War, and the consequences of war, are amongst the most important - perhaps *the* most important - issues facing the African continent today. War has destroyed the lives and hopes of millions of Africans. Ending war, and dealing with its social and economic consequences, are major challenges for the United Nations system, together with the wider international development community.

Many countries are not only attempting to reconstruct from war, they are also engaged in economic reform. These separate agendas can be mutually supportive. But, as this paper makes clear, there are often inconsistencies between the reconstruction and reform agendas. As a consequence, the possibilities for securing long-term development are not maximized, and urgent human development problems go unresolved.

This paper explores these important issues, focusing on a set of African countries that have undergone deep social trauma. This group consists of Angola, Eritrea, Ethiopia, Guinea-Bissau, Mozambique and Somalia. They share a common history of state socialism. With the exception of Somalia, where the state has largely collapsed, these countries face a task of economic reform which is in many ways as difficult as in the transition economies of Asia, Eastern Europe and the Former Soviet Union. Enterprises must be privatized, market economies created, and the potentially divisive issue of land rights resolved. Many of the pitfalls of transition in Eastern Europe and Russia have been encountered in Africa as well. In particular, rising inequalities may fuel future conflicts.

Starting economic transition is difficult enough, but to do so in the context of reconstruction from war - or in the middle of a war, as Mozambique did - is to add further complexities. As this paper emphasizes, public finance is the area in which many of the tensions between the reconstruction and transition agendas emerge, and one in which much more attention must be given to poverty reduction. The present situation is highly unsatisfactory, being characterized as it is by fiscal frameworks that constrain social investment, major debt problems, and insufficient attention to the political reality of fiscal reform in fragile societies.

The project, of which this paper is an output, is therefore aptly named; countries must overcome underdevelopment (especially of human resources), they must make a successful transition from state socialism, and they must coordinate this with a broad-based reconstruction that creates the basis for poverty-reducing development. The paper's analysis is therefore relevant not only to the selected countries, but also to Africa as a whole.

Giovanni Andrea Cornia
Director, UNU/WIDER
October 1998

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ABSTRACT

Reconstructing Africa's war damaged economies is an urgent task. This is especially so in a group of countries - Angola, Eritrea, Ethiopia, Guinea-Bissau, and Mozambique - which must also complete their economic and political transition from state socialism. Somalia, which shares their common history, must eventually be rebuilt. All of these countries must address their deep problems of underdevelopment and poverty. The challenges are therefore three-fold: to overcome *underdevelopment*, to make the *transition* from state socialism, and to *reconstruct* economies and societies.

Socialism was influential across post-independence Africa. But UTR countries drew more explicitly on Marxism-Leninism and the Soviet development model. With the aim of accelerating growth, enterprises and property were nationalized and controls were established. But the result was a fatal over-centralization of political and economic power, and a slide into conflict exacerbated and fuelled by the politics of the cold war. Somalia collapsed into a turmoil from which it is yet to recover. Mozambique has made the most progress and, until their border war this year, Eritrea and Ethiopia were both moving forward. Angola faces urgent reconstruction problems but progress had been slow, and a return to outright war cannot be ruled out. Guinea-Bissau was knocked off course by a military revolt in 1998. Progress has therefore been tentative in the UTR group, and their future prospects depend on them finding political settlements that can secure their prospects for economic development.

War, and the uncertainty associated with it, distorts economies; investments with long-term returns, mainly in production activities such as agriculture and manufacturing, are cut back, and the economy becomes dominated by activities with short-term returns, such as commerce in cities and safe areas. Natural resource sectors may continue to operate, however, when protected by their location (for example offshore oil and gas) and when combatants seek to preserve them as the 'prize' for capturing the state.

Past failure to achieve broad-based growth contributed to conflict. This implies that reconstruction cannot simply entail the recreation of the pre-conflict economy. Policies, public expenditures, and institutions must be changed, often fundamentally. For this reason the agendas of reconstruction and economic reform (transition) cross over. Well-designed reforms can contribute to reconstruction and vice versa. But too often there is a mismatch between the reform and reconstruction programmes, and the ground for broad-based development is not secured.

Aid is important, but success ultimately depends on the actions of three national actors: communities, entrepreneurs, and states. However, communities are impoverished, private sectors are underdeveloped, and state capacities are weak.

For communities, the main challenges are to deal with the immediate post-war humanitarian and security problems and, equally important, accelerate programmes for longer-term poverty reduction. Regarding the first of these, the tasks are to resettle displaced populations, disarm and demobilize ex-combatants and assist their reintegration, reduce the level of violence (by filling the security gap and

decommissioning weapons), remove land mines which disrupt community livelihoods, and protect food security while phasing out food aid and increasing targeted support.

Regarding longer-term poverty reduction, the future pattern of growth is determined by (i) the distribution of human and social capital, access and control over natural capital (including land tenure) and access to physical infrastructure (ii) the policy framework which determines the returns to household investments and (iii) the quality of institutions, including the legal framework. State socialism and conflict altered every aspect of the pattern of growth, and transition and reconstruction alters it again. Focusing public policy more effectively on poverty reduction, in particular on core services of most benefit to the poor, is therefore an urgent task. To support this, the relationship between donors and governments should be changed in order to focus more on monitoring social outputs and less on unworkable policy conditionalities (and to direct aid to governments committed to poverty reduction). More investment in collecting social data is needed to understand the impact of reconstruction and transition on communities.

Turning to the second key actor, entrepreneurs, we can see that a new private sector is being created in UTR countries following decontrol and privatization. Overcoming investor uncertainty is a key task; this can persist and limit investment despite a fall in actual country risks. Angola and Mozambique are so far the largest recipients of foreign investment in UTR countries. But the impact of Mozambique's large investment programme is virtually unknown, while foreign investment in Angola is confined to the oil sector, which has few links to the rest of the economy.

Privatization is proceeding at different speeds across UTR countries. Privatization in the financial sector is especially important; reconstruction requires a financial sector capable of mobilizing and intermediating savings into private investment. Recapitalizing the banking sector is expensive, and requires private capital, which implies privatization. Political influence can create unsound banks and better financial regulation is needed. But the phenomenon of 'straddling', in which political leaders invest in commercial enterprises, endangers the independence of financial regulation, and can distort the privatization process. Privatization in the agricultural sector has seen the non-transparent privatizations of state farms and the denial of community rights and some inconsistencies between privatization and agricultural policy reform. Encouraging more private investment in agricultural marketing is especially important for food security and rural poverty reduction.

The third national actor is the state. A developmental state must be constructed. This is a set of democratically accountable institutions capable of effective policy design and implementation. If this is successful, the new state will look very different to the old state, but it is unlikely to be 'minimal'. The onus is therefore on democratic governments to prove that they provide value for money to communities and entrepreneurs. The new state agenda will remain a wish list unless it is properly financed, which it is not at present. Reconstruction expenditures are high, revenues are low (war reduced tax bases) and distorted (over dependence on trade taxes). Countries are severely indebted; almost all Africa's conflict/post-conflict countries are classified as 'Heavily Indebted Poor Countries' (HIPCs). The fiscal peace dividend is small (at least in the early years) and the high level of insecurity in Africa keeps military budgets high. Budgetary institutions are weak at mobilizing revenues and allocating them to priorities, and non-transparency and the improper use of public funds must be reduced.

As a result of these problems, and the sheer scale of reconstruction expenditures, fiscal deficits before grants are very high. Nobody seriously questions the principle of fiscal prudence but the IMF's fiscal policy conditionality may be over-restrictive; certainly many other donor agencies believe that this is the case. This leaves many investments with high social returns on the shelf, implying slower growth and poverty reduction. A much longer time frame is therefore necessary to evaluate fiscal policy in an economy under reconstruction.

The IMF's caution in part arises from the observation that real aid flows are in decline, and it therefore advises governments to move to a fiscal position in which any downturn in aid will not affect their recurrent, as opposed to their capital, spending. However, it is still possible for aid flows to individual countries to maintain their present levels or rise, and this is in fact the way the donor community is moving in seeking to redirect aid to countries committed to broad-based development. The IMF's fiscal policy conditionality, when it is over-restrictive, works against the new aid paradigm. Moreover, over-tight fiscal policy can lead to the use of distorting taxes that undermine reconstruction, it can work against improvements in budgeting, and it may be incompatible with democratization.

The paper only touches on some of the major challenges facing the UTR group of countries. Decentralizing political and economic power, minimizing macro-economic shocks, and preventing conflict through broad-based development are all crucial. This requires hard choices over resource allocations and public policy. But these choices are a great deal easier to make than those involved in ending a conflict and initiating reconstruction. *Ex ante* action - good economic policy - is always better and cheaper than *ex post* crisis management.

> '… peace and development remain inextricably linked – one feeding on the other, enabling the other, and securing the other. The renunciation of violence as a means of gaining and holding power is only the beginning. Then must follow a renewed commitment to national development founded on sober, sound and uncorrupted economic policies'. (UN Secretary General, Kofi Annan)[1]

> 'All these guns make for lazy minds'. (Bishop Dinis Sengulane of Mozambique)[2]

I INTRODUCTION

Rebuilding Africa's war damaged economies involves reconstructing communities, revitalizing private sectors, and building state capacities. This is a demanding set of tasks given the scarcity of financial resources and skills.

By failing to deliver broad-based growth, the economic strategies of conflict countries contributed to the onset of war. For this reason, reconstruction should not be about recreating the past. Past strategies must be rethought, and changes made in policies, public expenditures and institutions. Consequently, there is common ground between the agenda of reconstruction and that of 'adjustment' (or 'policy reform'). Indeed, since both aim to raise living standards, their design and implementation should be one and the same process.

However, this is seldom the case, mainly because of the variety of donor agencies involved each with its own responsibilities, together with weakness in national capacities. For example, communities are being helped to reconstruct but their needs are not adequately incorporated into either the design of privatization programmes or fiscal frameworks. Hence, possibilities for poverty reduction are missed.

The uneasy relationship between reconstruction and reform is discussed in this paper, and it is one of the core issues in our UNU/WIDER project. The project itself concentrates on a set of countries which have a history of intense conflict, the effects of which they must overcome, and a pressing need for new development policies, new public expenditure allocations and new institutions.

In making our country selection, we have chosen a group with a common history: Angola, Eritrea, Ethiopia, Guinea-Bissau, Mozambique, and Somalia. Marxism-Leninism provided the political and economic inspiration for their early development strategies. Enterprises and resources were nationalized, market controls imposed, and

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[1] Kofi Annan 'Africa Needs Outside Help, and Also Needs to Help Itself', *International Herald Tribune*, 2-3 May 1998: 6.

[2] Suzanne Daley 'In Mozambique, Guns for Plowshares and Bicycles', *New York Times*, 3 February 1997: 3.

Soviet style planning was attempted. But these strategies failed to conquer underdevelopment, poverty deepened, and economic reform - as in the Former Soviet Union itself - became an urgent need. In Eritrea's case, a whole new set of policies and institutions appropriate to a new nation must be created. In Somalia's case, economic reform was never completed and the state itself collapsed.

Africa's formerly state socialist countries are undertaking, or will eventually undertake, some of the most comprehensive reforms seen in Africa. Although their socialist experiments were short-lived in comparison to those of Asia (China, Laos, Vietnam), Eastern Europe, and the Former Soviet Union (EE-FSU), their transitions raise many of the same issues. These include investment in the institutions (such as property rights) appropriate to a market economy, the construction of a new financial system to fund private investment, and the creation of a developmental state (to name but three tasks).

Because Africa has now abandoned old political alliances, and the Soviet model is no longer seen as relevant, its policymakers have paid relatively little attention to what is happening in the transition countries. This is unfortunate, since the problems encountered in the EE-FSU transitions are evident in Africa as well. These include institutional failure, non-transparent privatization, the neglect of appropriate regulation (especially in banking), and a sharp and socially destabilizing rise in inequality.

Each of our countries has gone through intense conflict resulting from internal and external (cold war) political rivalries, exacerbated by economic failure. War has killed at least 4 million people, mostly non-combatants, in our countries. Their present political situations are mixed. Mozambique's reconstruction began after the 1992 cease-fire, and has accelerated after the 1994 elections. The Lusaka protocol of 1994 formally ended Angola's twenty years of war, but fighting erupted again this year and war may resume. Eritrea and Ethiopia began reconstruction after the Derg's overthrow in 1991 and Eritrea's independence, but the two countries fought a border war in 1998. In Guinea-Bissau a promising recovery was set back by a military revolt in 1998.

Bringing peace to Somalia, and then starting reconstruction, is one of the most urgent tasks facing the international community today. How to do this raises a myriad of problems. Our countries may hold lessons for eventually rebuilding Somalia or its successor states; alternatively Somalia's situation may be so unique that the relevant lessons are few. But it is important to find out.

Our chosen countries are at different stages of recovery, with some only just beginning (see Figure 1). With the exception of Mozambique, their recoveries have been set back by new political events this year. This halting progress is due in part to economic factors including difficulties in starting broad-based growth, tensions in trade relations (Eritrea and Ethiopia), and the continuing contest over the state (Guinea-Bissau) as well as natural resource wealth (Angola).

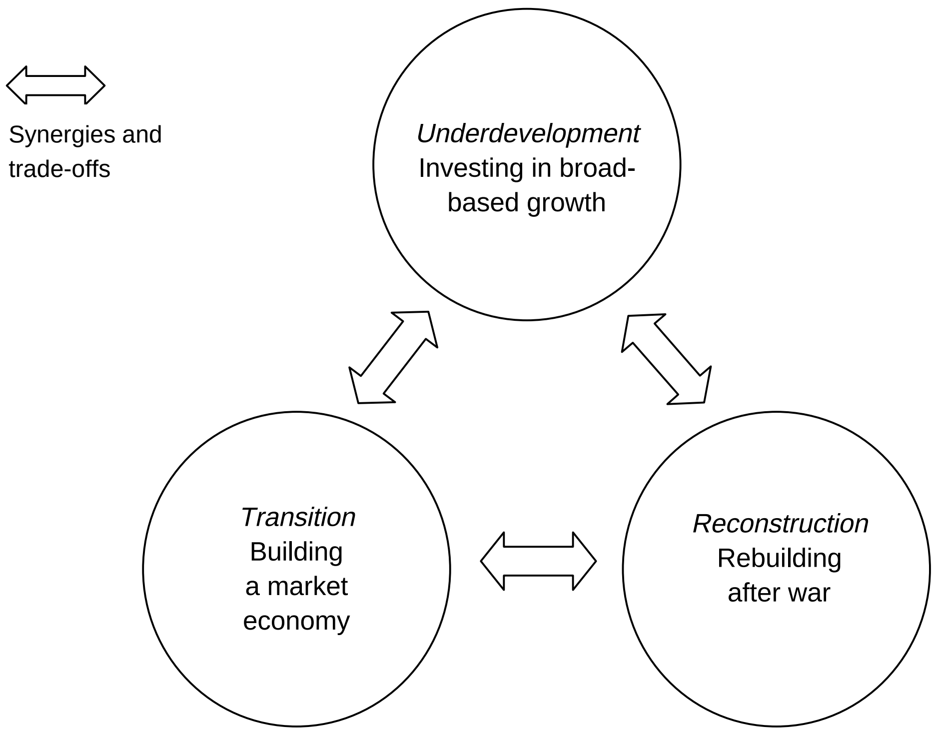
In summary, our chosen countries face a range of challenges, which are amongst Africa's most complex. The title of this paper (and also the project itself) reflects the three challenges they face: overcoming *underdevelopment* and the potential instability associated with it, completing the *transition* from state socialism, and *reconstruction* from conflict so that peace is durable (Figure 2).

FIGURE 1
TYPOLOGY OF UTR COUNTRIES

In reconstruction	Mozambique (earliest and most sustained transition)	RECOVERY
	Eritrea and Ethiopia (provided that recent tensions are resolved)	
Moving out of conflict	Angola (provided that the peace process gets back on track)	
	Guinea-Bissau (provided that the peace deal holds)	
In conflict	Somalia (negotiations between warlords have not yet established peace. Somaliland has seceded)	

Note: this summarizes the situation in November 1998.

FIGURE 2
THE THREE CHALLENGES:
UNDERDEVELOPMENT, TRANSITION AND RECONSTRUCTION



The intention of our project is to draw out lessons for the chosen countries, but also for Africa more generally, including both its conflict and non-conflict countries. Conflict - why it occurs, why some countries avoid it, how we end it, and how we reconstruct afterwards - is *the* issue facing Africa today.

One difficulty for research in this area is the sheer scale and variety of the problems faced by conflict and post-conflict countries. In getting to grips with the details, it is easy to loose sight of the larger picture. We therefore need a structure to provide ourselves with a frame of reference.

The structure of our UTR project emerges from the observation, often made, that while aid provides essential help, success ultimately depends upon the capacities and actions of *national* actors. These are: communities, entrepreneurs, and the state. But communities are impoverished, private sectors are underdeveloped, and states are weak. Success therefore requires overcoming each of these problems. The efforts of aid donors, in both the resources they provide and their advice, must be directed to this end.

The structure of our project is therefore organized around these three national actors and the challenges - of underdevelopment, transition, and reconstruction - that they face:

- *community reconstruction*: the reconstruction of communities and their social capital underpins national reconstruction. Seeing how communities rebuild, what their needs are, and how they adjust (successfully or not) to economic reform is critical to focusing public policy on social priorities, especially poverty reduction. How can the hard choices necessary for human development best be made?

- *the new private sector*: a vigorous private sector, and broad-based development, is unlikely to arise without well-designed privatizations, appropriate regulatory policies, and an efficient financial system. In creating a market economy, what can African countries learn from their own transition experiences and those in the FSU-EE and elsewhere?

- *the developmental state*: communities and entrepreneurs can only successfully rebuild if a developmental state, and its institutions, is created and effectively financed. Otherwise we are left with a 'wish list' of things to be done, and no hope of achieving them. But what must a developmental state do and how can its fiscal problems be overcome?

This paper discusses the issues, beginning with an overview of country histories, and a framework through which to interpret their current problems (section II). The three major themes are then discussed in sections III (community reconstruction), IV (the new private sector), and V (the developmental state). The paper concludes by drawing out some initial lessons and by suggesting ways forward. The purpose of the paper is not to be comprehensive, nor to explore individual country experiences in detail. Rather, its objective is to set the scene and to stimulate debate.

II SOCIALISM, CONFLICT AND TRANSITION

2.1 State socialism

While socialism was influential across post-independence Africa, UTR countries drew more explicitly on Marxism-Leninism than the 'humanist' socialist experiments in countries such as Tanzania and Zambia. Marxism's appeal lay in its critique of colonial exploitation and as an ideological means for overcoming ethnic differences and focusing on nation building. But its fatal consequence was an over-centralization of political and economic power once independence was won.

2.1.1 The Lusophone countries

Angola, Guinea-Bissau, and Mozambique won their independence after the 1975 Portuguese revolution (MacQueen, 1997).[3] But the deaths of the charismatic liberation leaders (Agostinho Neto, Amilcar Cabal, and Samora Machel) together with the fallout from the cold war and apartheid South Africa, combined to undermine early hopes, and economies crumbled under Soviet inspired planning and the resumption of conflict.

Angola's MPLA (backed by Cuba and the Soviet Union) seized power in 1975 after the Portuguese revolution, and defeated rival movements backed by the US and regional powers. But this marked the start of a twenty-year civil war. UN sponsored elections were held in 1992, the MPLA won, UNITA rejected the result, and intense fighting took place over 1992-93 (Parsons, 1995). The economy slumped and hyperinflation further eroded living standards (IMF, 1995, Stenman, 1995). A new peace agreement was signed in 1994, the start of a peace process which is not yet complete (see Box 1).

Angola has huge oil reserves and production could eventually exceed that of Nigeria, it produces 11 per cent of the world's diamonds (Angola is the world's third largest producer by some estimates), and it was once the world's fourth largest coffee producer (IMF, 1997b: 4). Liberalization began in the early 1990s, but it has been erratic and the economy remains one of Africa's most controlled; the parallel market exchange rate has been double the official rate (Aguilar, 1997, Aguilar and Stenman, 1996).[4] Oil revenues have fallen by 40 per cent following the continued weakness in the world oil price, and this has in turn increased pressure to accelerate reform.

Of the Lusophone countries, Mozambique initially progressed the most after independence (Wuyts, 1989). By the late 1970s, the primary health care system was a

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[3] São Tomé e Principe (population 130,000) is also part of this group. Portuguese plantations (which once produced 11 per cent of the world's cocoa) were collectivized after independence. The plantations remain in decline, despite privatization in 1990 (output is now half its 1990 level). São Tomé e Principe remains an extremely fragile state and may be on the edge of conflict.

[4] The overvalued currency has been maintained by strong political interests; officials with access to foreign exchange at the official rate resell it on the parallel market. In mid-1998 a stepped devaluation to bring the official rate into line with the parallel market rate was announced.

BOX 1
FROM CONFLICT TO PEACE?

Angola. The Lusaka protocol of November 1994 mediated by the UN formally ended 19 years of conflict. A cease-fire took effect in 1995, UN peacekeepers were deployed, and a government of national unity was formed in 1997. However, UNITA refuses to fully implement the Lusaka agreement. Serious fighting broke out in May 1998 as UNITA, which still has 15,000 well armed troops under its control, began retaking areas it had handed over, and as government forces pushed into UNITA-held areas. In mid 1998, the government came to the aid of the Kabila government in the Democratic Republic of Congo (DRC), with the aim of destroying the support of Congo's rebels for UNITA. In September 1998, UNITA members were excluded from parliament and the government. The UN has announced its intention to withdraw unless progress is resumed.

Eritrea and Ethiopia. Fighting broke out in May 1998 over a small border area that both countries claim. The introduction of Eritrea's new currency in 1997, and deteriorating trade relations, also fuelled the conflict. The two countries are now in an uneasy stand off. Ethiopia's larger population (55 million) would seem to make it militarily stronger than Eritrea (3 million) but Eritrea is better armed, has shorter lines of communication, and successfully resisted the armies of Selassie and the Derg for thirty years.

Guinea-Bissau. Fighting broke out in June 1998 in the capital between army rebels and troops loyal to President Joao Bernardo Vieira. The Senegalese Army and troops from Guinea intervened under a pact to aid forces loyal to the president. Thousands died as they fled the fighting, which continued until a cease-fire in late 1998. Under the peace agreement soldiers led by General Ansumane Mane, who began the rebellion, are to be represented in a government of national unity.

Mozambique. The country's multi-party system has been in place since the presidential and legislative elections of October 1994. Former opponents, FRELIMO and RENAMO, are in government and opposition respectively. The 1994 elections were close: FRELIMO won 53 per cent of the vote on a very high turnout. RENAMO threatened a last minute boycott of the 1994 elections, but relented after pressure from South Africa. It also threatened to pull out of the 1998 local elections. The next national elections are scheduled for 1999.

Somalia. Peace talks between some of the major clans took place in Cairo in December 1997, but no breakthrough was achieved, partly because other clans were outside the process. Somaliland (in the northeast) is the former British protectorate that was joined to the Italian Colony at independence in 1962 to form Somalia. Somaliland broke away early in the conflict and set up its own government (which is not internationally recognized, but has political relations with neighbours such as Ethiopia). Somaliland trades with the Arabian Peninsula, and has its own institutions including a central bank and a currency, both of which are weak.

model of its kind and schooling had improved. But smallholders were ill-served by an inefficient state marketing system, and resources were squandered on ill-conceived state enterprises. Tentative reform began in 1982, accelerated in 1986, and made headway despite the South African backed war, which intensified after 1985. Peace came in 1992 (Box 1). Mozambique has now sustained one of the longest reform programmes in Africa. The country has considerable potential in agriculture and tourism and can earn substantial sums from its port facilities, which before independence handled large volumes of transit trade. Growth is expected to be above 10 per cent in 1998.

Guinea-Bissau's liberation war devastated the rural economy in the 1970s. Despite the depth of rural poverty, the ruling party (PAIGC) focused on an impossibly ambitious industrialization plan. Economic planning and controlled prices undermined growth (Alvesson and Zejan, 1993). Economic transition began in 1986, and multi-party elections were held in 1994 (the PAIGC won). Privatization accelerated over 1994-97, the economy began to diversify, and Guinea-Bissau joined the CFA Franc Zone (Zejan and Kokko, 1998). But instability within the PIAGC has continued. In June 1998, an army faction attempted a coup when the president fired the head of the armed forces accusing him of allowing arms to be smuggled to rebels in the Senegalese province of Casamance. Widespread fighting then occurred (see Box 1).

2.1.2 The Horn of Africa

After the overthrew of Emperor Haile Selassie in 1974, Ethiopia's military regime (the Derg) introduced extensive economic controls and nationalization (Hansson, 1995). Despite some progressive measures (land reform for example), the strategy deepened Ethiopia's poverty. Private agricultural marketing was repressed, inter-regional grain movement banned, and smallholders were heavily taxed by means of low state producer prices (Dercon, 1995, Winter-Nelson, 1997). These measures, together with forcible resettlement and drought, contributed to the famines of the mid-1980s which killed over half a million people (Messer *et al*, 1998).

The Derg accelerated the war against Eritrea, the former Italian colony/British Protectorate that had been forcibly merged into Ethiopia in 1962. Eritrea's liberation movements allied themselves with those in Tigray and Oromo, and the Mengistu regime fell in May 1991. Power passed to the Transitional Government, and then to an EPRDF led government. Eritrea became de facto independent in 1991, and declared formal independence in 1993 (Iyob, 1997).

Growth resumed in both countries, but recovery has been set back by the border conflict in 1998 (see Box 1). The war's economic effects are severe: the transit trade with Ethiopia was Eritrea's main source of foreign currency earnings and Ethiopia faces the much higher transport costs associated with redirecting all its trade through Djibouti. The rise in military budgets will crowd out social and development spending if the dispute is not resolved.

Much of Somalia remains unstable. Somali leader Siyaad Barre seized power and proclaimed a socialist regime in 1969, later switching to US support after Ethiopia's revolution. A short but bloody war was fought with Ethiopia in the mid-1970s. With increasing military expenditures and erratic policies, and despite repeated attempts at structural adjustment, state institutions crumbled in a competition for power, land, and aid money (Adam and Ford, 1997, Clarke and Herbst, 1997, Coolidge and Rose-

Ackerman, 1997). Pastoralist incomes fell sharply relative to those of settled farmers and these and other tensions led to civil war (Auvinen and Kivimäki, 1998). Hope of restoring peace has so far foundered (Box 1).

The entire Horn is once again an area of extreme instability. Ethiopia has long-standing border disputes with Somalia. Both Eritrea and Ethiopia are opposed to the Government of Sudan, and its war in southern Sudan. Eritrea has border disputes with Sudan, Djibouti, and Yemen.

2.1.3 Other Marxist experiments

A number of other African countries went through Marxist experiments (see Herbst, 1990 for a review). These include Benin, Congo (Brazzaville), Guinea, Equatorial Guinea, and Madagascar. Economic policy was chaotic (see for example Ekholm Friedman, 1993 on Congo). Marxism-Leninism quickly became a veneer for personal gain and despotism in these countries differed little from that of the 'non-ideological' Amin of Uganda or Bokassa of the Central African Republic. Their subsequent histories have been very mixed. In Benin, Equatorial Guinea, and Madagascar former elites shed their socialist ideology and have retained political control.[5] Congo went through a swift and bloody civil war in 1997, in which the first elected president was overthrown after decisive intervention by Angolan forces. Its fortunes interact with those of the highly unstable DRC. Benin, after a shaky start, appears to be moving forward. Human rights continue to be abused in Equatorial Guinea and the country's new and large oil revenues appear to be misused. The prospects of Benin, Congo (Brazzaville), Guinea and Equatorial Guinea now partly depend on the future of the CFA Franc Zone, of which they are members or aspiring members.

2.2 Alternative paths

What does the future hold? Much depends on countries reaching political settlements that can mediate ethnic and regional differences; only then can peace and growth be sustained. Otherwise, the motivation to capture the state or to secede will remain. Ruling parties saw Lenin's principle of 'democratic centralism' as the ideology to bind their new nations together, but this led to the creation of repressive and over-centralized states. New solutions must be found. Ethiopia and Eritrea have grappled with this problem since 1991; the result was the agreed secession of Eritrea, the first to be internationally recognized in Africa (Tronvoll, 1998). Ethiopia's 1994 constitution established a federal system of ethnically based regions, each with its own parliament.

The agenda of political decentralization overlaps with that of democratization. Herbst (1990) notes that by the end of the 1980s Africa's Marxist leaders were willing to reject Marxism - which had failed as a development model - but not Leninism, the ideology of the one party state and of centralized power. Nevertheless, multi-party elections have been held as the result of domestic pressure for democratization, political conditionality attached to aid, and as part of the political settlement to end war (Bratton and van de Walle, 1997, Hare, 1998).

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[5] In Benin, the first freely elected president (a market liberal) was defeated in the second election by Benin's former Marxist dictator who now has a liberal ideology (Bratton and van de Walle, 1997). In Madagascar, the former Marxist president returned to power in the 1996 presidential election (Baker, 1998: 118).

Democratization gives voice to underdeveloped regions and their demand for more help from the centre, demands which state socialism suppressed. In Mozambique, the system of multi-party elections at both the national and local levels is intended to mediate regional tensions. The nation remains intact, but political power is being devolved through decentralization (Synge, 1997).

Eritrea/Ethiopia and Mozambique are two ways in which political settlement might be reached in Africa (Villalón, 1998). The first is 'reconfiguration' of the old nation state to create new states, the second is 'consolidation' of the existing nation state through new political arrangements (see Figure 3 which sketches the two alternatives). The Eritrea/Ethiopia path appeared promising until this year, but war now threatens both Eritrea as a nation and the political settlement in Ethiopia itself.

The consolidation and reconfiguration paths require considerable institutional investment to make the economic framework - the devolution of fiscal powers across regional and central government for example - compatible with the political settlement.[6] Nigeria, a federal state since independence, shows the inherent difficulties. The donor community may be unrealistic in its expectations about the speed of progress that can be achieved (see section V on the fiscal aspects).

Democratization is a means to an end; it constrains - but can never eliminate - opportunistic behaviour by political leaders and the associated corruption and rent seeking that hold back broad-based development. Democratization is also an end in itself, since freedom to choose one's government, freedom of expression, and freedom from fear are basic human rights, irrespective of democratization's development effect.

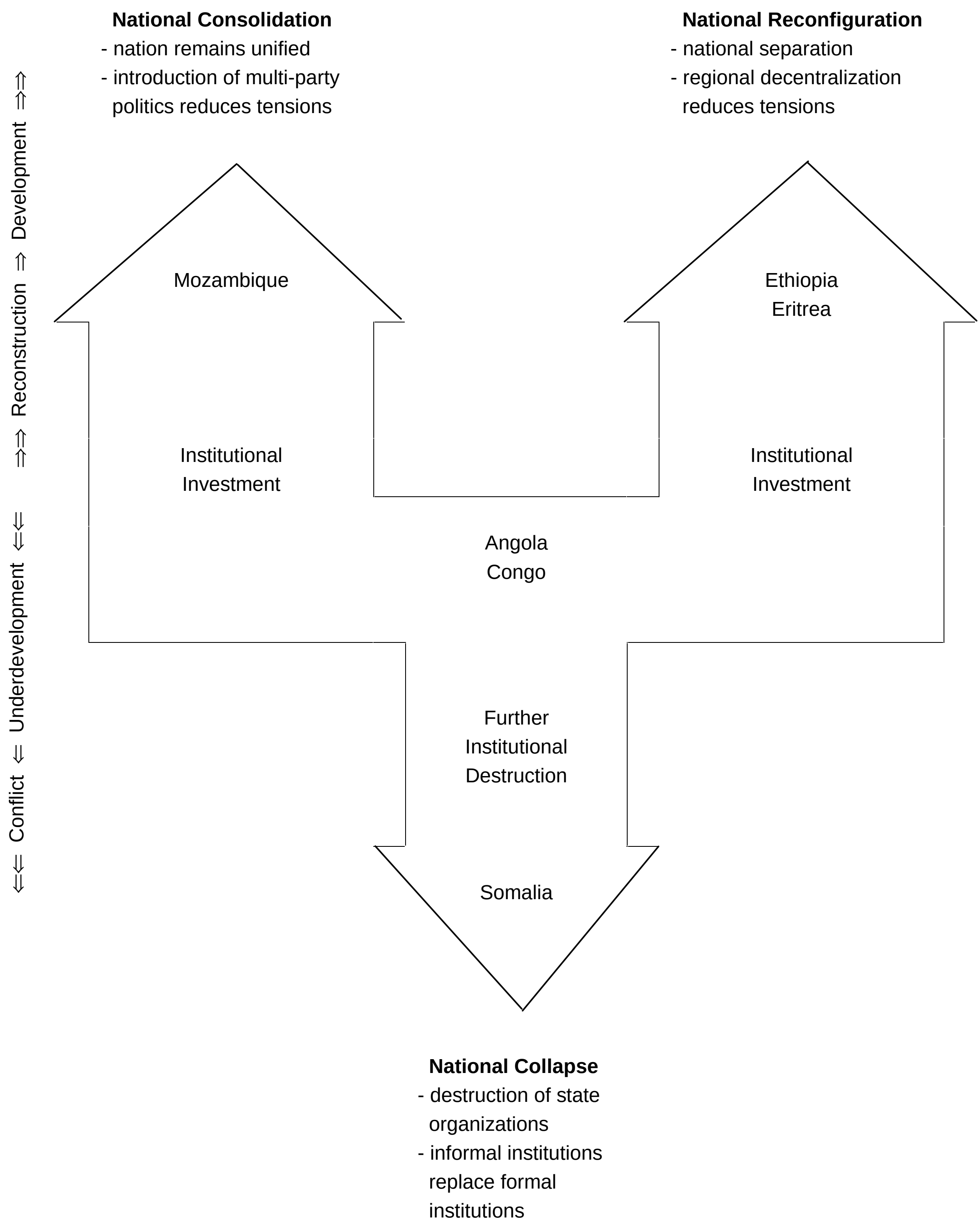
Multi-party elections are, however, 'incomplete contracts'; electorates can vote out badly performing politicians, but abuses of power will still occur (Persson *et al*, 1997). Mature democracies have histories of investments in mechanisms to improve the democratic contract through, for example, the separation of powers between the executive and legislative bodies, and the development of a free media. The institution of democracy is therefore far more than multi-party elections, important as they may be (Bevan, 1997: 290).

These institutional investments take considerable amounts of time. Huntingdon (1991: 267) argues that democracy becomes institutionalized only after two, not one, turnovers of government - this signals that the main political contenders are willing to yield ground through the democratic process. The United States achieved this 64 years after independence. Nobody can say with any confidence that democracy has begun to embed itself in much of Africa, certainly not in our project countries.

Angola remains at a critical juncture. The Angolan peace plan is based on the consolidation path, but this has not yet yielded a political settlement through which reconstruction can go forward. Reconfiguration - under which UNITA-held territory secedes - is not up for negotiation, and UNITA does not have the power (or allies) to achieve it by force. But it can continue the fight. The government has the military means to defend itself, but not the means to win outright. Stagnation (or worse) seems to be the

[6] On the role of economic policy in resolving conflict see Boyce and Pastor (1998) and Stewart (1993).

FIGURE 3
ALTERNATIVE PATHS



immediate future, particularly since both sides are now playing up the conflict's ethnic dimensions.

Somalia collapsed as a state as its institutions were 'mined out' by its political leaders. The de facto secession of Somaliland resulted, while the remainder is divided between warlords, and shifting clan alliances (Mubarak, 1997, Thakur, 1994). The consolidation route to reconstruction appears unlikely, and political settlement through reconfiguration may be necessary if the current impasse is to be broken.

How the UTR situations resolve themselves, and whether the outcomes are good or bad, will yield valuable lessons for Africa as whole, particularly regarding the economic dimensions of the political settlement. Our four-fold classification - reconfiguration, consolidation, stagnation, and collapse - can be applied to other African countries. Benin, for example, is following the consolidation route, the DRC is in a position similar to that of Angola, and Sierra Leone verges on state failure. Africa's future will almost certainly see more cases of secession and attempted secession. Unfortunately, many of these will occur as rebellions against unyielding and repressive states (the southern Sudan, for example) or as the outcome of state failures in which centralized power collapses and regions split away (the case of Somaliland, and perhaps the DRC's future).

Democratization may in some cases encourage secession; its costs are lower if secession is peaceful.[7] A region's incentive to secede increases if it expects to receive as an independent nation more assistance (through aid) than the fiscal transfers to it from the centre in a unified nation.[8] The way forward for Africa may be to redraw political boundaries (still largely seen as sacrosanct by the OAU and UN) and for free trade between the resulting independent nations. This may be the way the world is moving in any case. In the era of the WTO the benefits from being part of a large nation are now smaller than in the 1960s, when OAU members committed themselves to respecting existing (colonial) borders.[9] Unfortunately, Africa has a dismal history of regional economic cooperation; the contribution of trade disagreements to Eritrea-Ethiopia war is one more depressing example. Reducing the continent's high level of insecurity is a pre-condition for reaping the gains from greater regional economic cooperation, whatever form it takes.

2.3 Economic transition

A Soviet minister visiting the continent during the 1970s concluded that 'there are few people in the Soviet Union who would recommend building a socialist society under these particular conditions in Africa' (quoted in Herbst, 1990: 93). Nevertheless, Marxist governments engaged in rapid nationalization, confident that they could leap ahead. In the end, socialism lasted only a decade or so, and was interrupted by war. State capacity

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[7] But this is far from given, unilateral secession from a democracy can still lead to war, as the history of the United States shows.

[8] Regions may also choose to secede if they make net transfers to the centre (the case of regions well endowed with natural resources). Collier and Hoeffler (1998) empirically assess the determinants of the incentive to rebel.

[9] Alesina and Spolaore (1997) show that when the international trade environment is liberal, small countries can freely trade, and therefore the benefits to be being part of a large country diminish.

to run a controlled economy was much weaker than in the FSU-EE or China and Vietnam, and parallel markets remained active and took increasing shares of trade.[10] Ethiopia, for a time, achieved the most control over internal trade. However, socialism's impact was still considerable, both intentionally (property nationalization) and unintentionally (productivity collapse).

Economic transitions are now occurring alongside political transitions. Extensive reform began in Mozambique in the middle of the war (Kyle, 1994, Tibana, 1994). Angola began on-off reforms in the 1980s, and out of desperation to save itself the Derg regime began liberalization a year before its overthrow. Box 2 sets out the new and old policy agendas. Much of this is common to economic reform programmes in Africa in general. Trade liberalization and the elimination of currency overvaluation are intended to restore incentives for the production of agricultural and manufactured tradables and shift economies toward outward-orientated development. Product, factor, and credit markets are liberalized to raise efficiency and reduce rent seeking. Sections III; IV, and IV discuss key aspects of this agenda for UTR countries. The new agenda is ambitious in scope, and the liberalization components (and their sequencing) remain controversial (on the latter see Cornia and Helleiner, 1994, Lipumba, 1997). Countries are a long way from achieving key elements; poverty reduction is not yet incorporated into the overall macro framework, for instance.

The Soviet model was inappropriate for Africa, and national policy makers have turned their attention away from developments in their old allies. But, as this paper will argue, there is much of relevance to Africa in transition experiences elsewhere, despite the different historical contexts. Transition in Asia and EE-FSU yields seven especially important lessons (see Desai, 1997 and Stiglitz, 1994, for reviews):

(1) Weak property rights and weak democracy enable alliances of old political elites and new businessmen to accumulate assets by distorting privatization processes and transition policies for their own gain (Yavlinsky, 1998). Crony capitalism and organized crime replace state socialism and this eventually blocks transition to broad-based growth (as Russia now seems to show). These processes are apparent in contemporary Africa.

(2) Large asset transfers sharply raise income inequality, reduce political support for reform (people react against an unequal division of the burdens), and limit growth's benefits for the poor. Inequality due to war is already high in UTR countries, it will worsen if transition is badly designed, and this will endanger political settlements.

(3) Many transition economies have underinvested in the creation of a legal framework appropriate to a democracy and a market economy; this should have been phased in much earlier (Dragneva, 1998). As a result the legal environment is uncertain, the transactions costs of market exchange are very high (a barrier to building a market economy), and the legal system is politicized to the disadvantage of those without power (including the poor). The commercial law systems of UTR countries are similarly underdeveloped, out of date, and provide much scope for manipulation.

[10] Controls did not begin with independence and state socialism. Key markets in the colonial economies of Portuguese Africa were heavily controlled, particularly in agriculture, to protect settler interests.

BOX 2
POLICY FRAMEWORKS: OLD AND NEW AGENDAS

OLD AGENDA	*NEW AGENDA*
Development strategy	
• state-led development: state-owned enterprises in agriculture, industry, utilities, finance and commerce	• market led development: privatization and commercialization of SOEs, encouragement to domestic and foreign private investors
• inward-orientated development: protection of domestic market through import restrictions, export taxes on agricultural tradables	• outward-orientated development: export-led development, diversification into non-traditional exports
• Focus on large-scale manufacturing and capital subsidies for large industries. Small- and medium sized enterprises neglected.	• neutral incentives for capital intensity: reduction of disincentives to small and medium sized enterprises
• poverty reduction through consumer subsidies and price controls. Poverty reduction and human development disconnected from the macro-economic framework	• targeted safety nets, focus on basic health services and primary education and inclusion of poverty objective in overall macro framework
Macro-economic policy	
• passive monetary financing of fiscal deficits	• active use of fiscal and monetary targets, and deepening of domestic market for government debt to reduce monetization of fiscal deficit
• interest rate ceilings on loans and savings: negative real interest rates	• market determined interest rates: positive real interest rates
• directed credit	• market allocation of credit
• exchange controls	• liberalized current and capital account transactions
• quantitative import restrictions and high tariffs	• QRs replaced by tariffs, average tariff level, and dispersion of tariffs reduced
• currency overvaluation to subsidize capital-intensive production	• currency managed to maintain incentives to tradables production
Natural resources management and rural development	
• ownership of common property resources (land, forests, fisheries) vested in the state leading to over-exploitation	• private commercial land-ownership and/or traditional land tenure strengthened
• state marketing organizations: inefficient and rent-seeking	• private traders
• controlled producer prices: real producer price declines	• indicative producer prices
• subsidized inputs: fiscally unsustainable	• uncontrolled input markets
• state farms: inefficient use of public money	• smallholder and commercial farms
• mandatory and coercive peasants associations	• voluntary smallholder associations

(4) Privatization eases fiscal pressures, increases economic efficiency, and encourages foreign investment. But its benefits are lost without effective regulation to protect the public interest when competition is imperfect - the case in many FSU-EE privatizations (Stiglitz, 1994). Developed economies have invested in the necessary institutions, transition economies must build the same capacity (see section IV).

(5) A sound financial system is critical to economic recovery, but it is not created by rapid liberalization - as the FSU-EE transitions (and Asia's present crisis) demonstrate. Regulatory capacity must be built prior to liberalization, and full financial liberalization may be undesirable from the perspective of macro-economic (and social) stability. UTR countries have very little capacity to effectively regulate the financial sector.

(6) The state has remained chronically underfunded in many transition countries, Russia in particular (Lines, 1998). Without early and urgent attention to tax reform, public revenues remain too low to ensure basic state capacity, the tax base remains too narrow and is subject to increasingly higher levels of tax. This problem is discussed in detail in section V in the context of UTR countries.

(7) Transition countries have underestimated the economic returns to building democratic institutions. A strong democracy provides the political space for independent financial regulation and an impartial legal system, the mechanism to direct policy and public expenditures towards national - not private - interests, and the only satisfactory mechanism for reconciling competing ends with limited means. The UTR policy debate is too often marked by a separation between the economic and political dimensions of transition/reconstruction.

In summary, the transition experiences in Asia and EE show that a well-functioning market economy cannot be created by liberalization alone. Institutional development, especially democratization, is crucial. This paper argues that these transition experiences are highly relevant to UTR countries, and examples are given throughout the paper.

2.4 An analytical framework

Our discussion has so far highlighted the complexities of the reconstruction and transition processes. But it is easy to become lost in the detail, and to loose sight of the whole. We now set out a model, which makes simplifying assumptions in order to clarify the interaction between reconstruction and transition.

2.4.1 Uncertainty and its effects

A key stylized fact is the chronic uncertainty that characterizes UTR histories.[11] Private discount rates are high and opportunistic behaviour flourishes. The effects are sketched in Figure 4.

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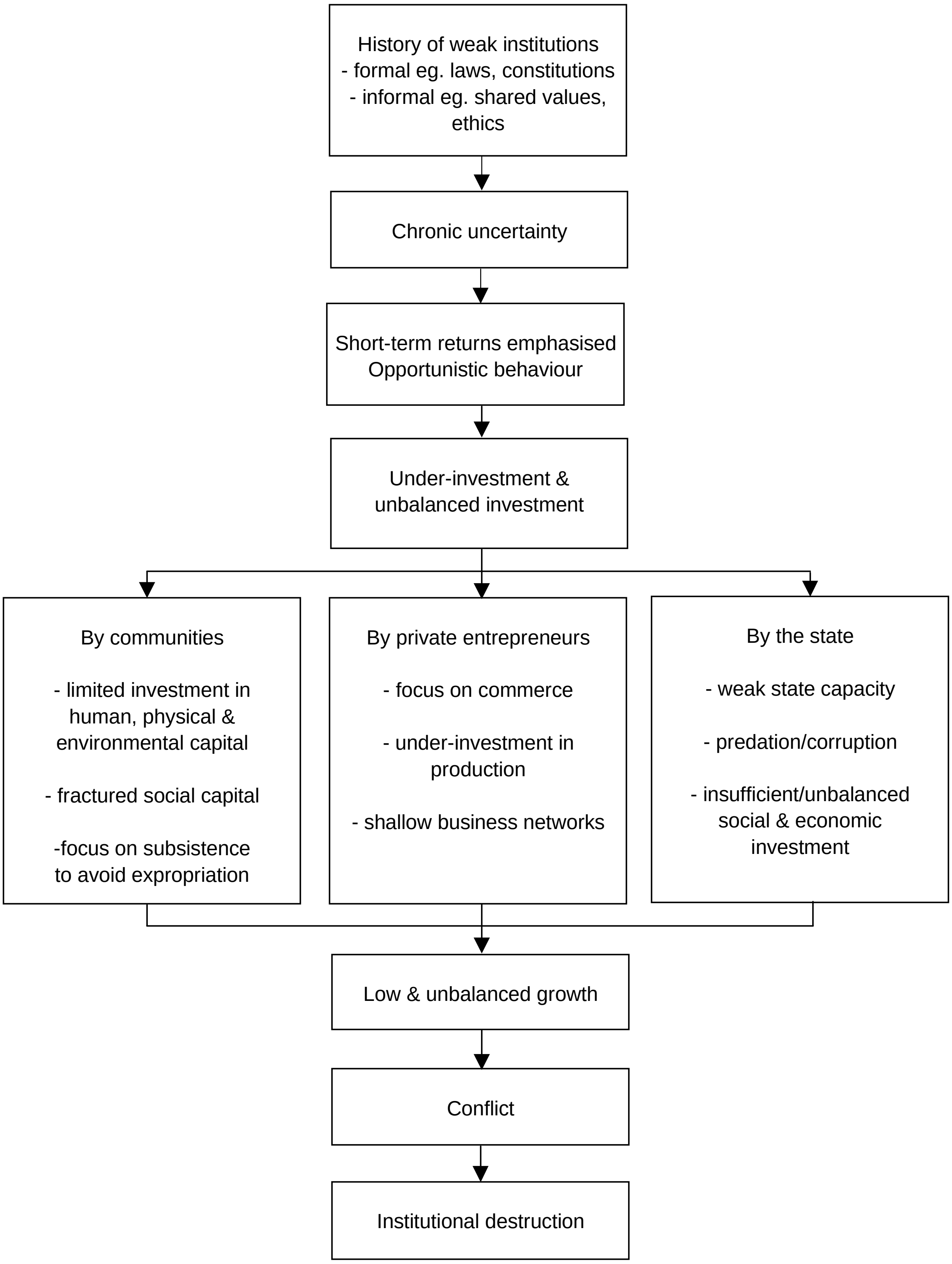
[11] The theme of uncertainty and its impact on economic structures is explored by Bates (1997) among others.

FIGURE 4
UNDERDEVELOPMENT-CONFLICT CYCLE



- Uncertainty raises the already high-risk aversion of poor communities. They focus on subsistence and avoid cash crops. The demand for education falls as the expected return is low. Opportunistic behaviour - over-exploiting common property resources for example - increases as uncertainty rises. Social capital, particularly the trust that underpins informal community safety nets, declines.

- Entrepreneurs favour commerce (internal and external trade). Commerce has more immediate returns than production and requires less physical capital; this makes it easier to exit if instability increases, and less vulnerable to policy reversal. Uncertainty discourages foreign investment.[12]

- Uncertainty undermines the state. Political leaders and civil servants maximize their own welfare rather than that of the nation. Institutional investment is ignored, and state institutions depreciate. Long-term planning is replaced by a culture of corruption and rent seeking. Corruption is a greater disincentive to investment than equivalent taxation (see Wei, 1997).

For each national actor, uncertainty lowers the investment rate and skews it towards activities with short-term returns.

2.4.2 Sectoral change

Consider Figure 5 which divides the economy into two sectors: *S* (activities which have short-term returns, such as commerce in safe areas) and *L* (activities, mainly production, with long term returns). The latter are more vulnerable to conflict and policy reversal by virtue of their higher fixed capital requirements and location (especially in the case of agriculture).[13]

Three production frontiers are shown: *PP* (peace), *WW* (war) and *RR* (recovery). These have the usual properties. The peace equilibrium is at *Ep* where the relative price line *p* (i.e. the relative returns in the two sectors) is tangent to the production frontier *PP*. In a peaceful economy the *L* sector will tend to be larger than the *S* sector, although its relative size and composition will depend on key policy variables such as the exchange rate. As shown, the *L* sector accounts for a larger share of output than *S* sector at the equilibrium *Ep*. Growth will be along a ray such as *Gp*. The peace growth-path may not be optimal; the pre-war UTR paths were certainly not broad-based (see below).

2.4.3 The war economy

Africa's wars destroy human-, physical-, social- and natural- capital and the transactions costs of market activity rise (see section III). Any wartime production frontier must

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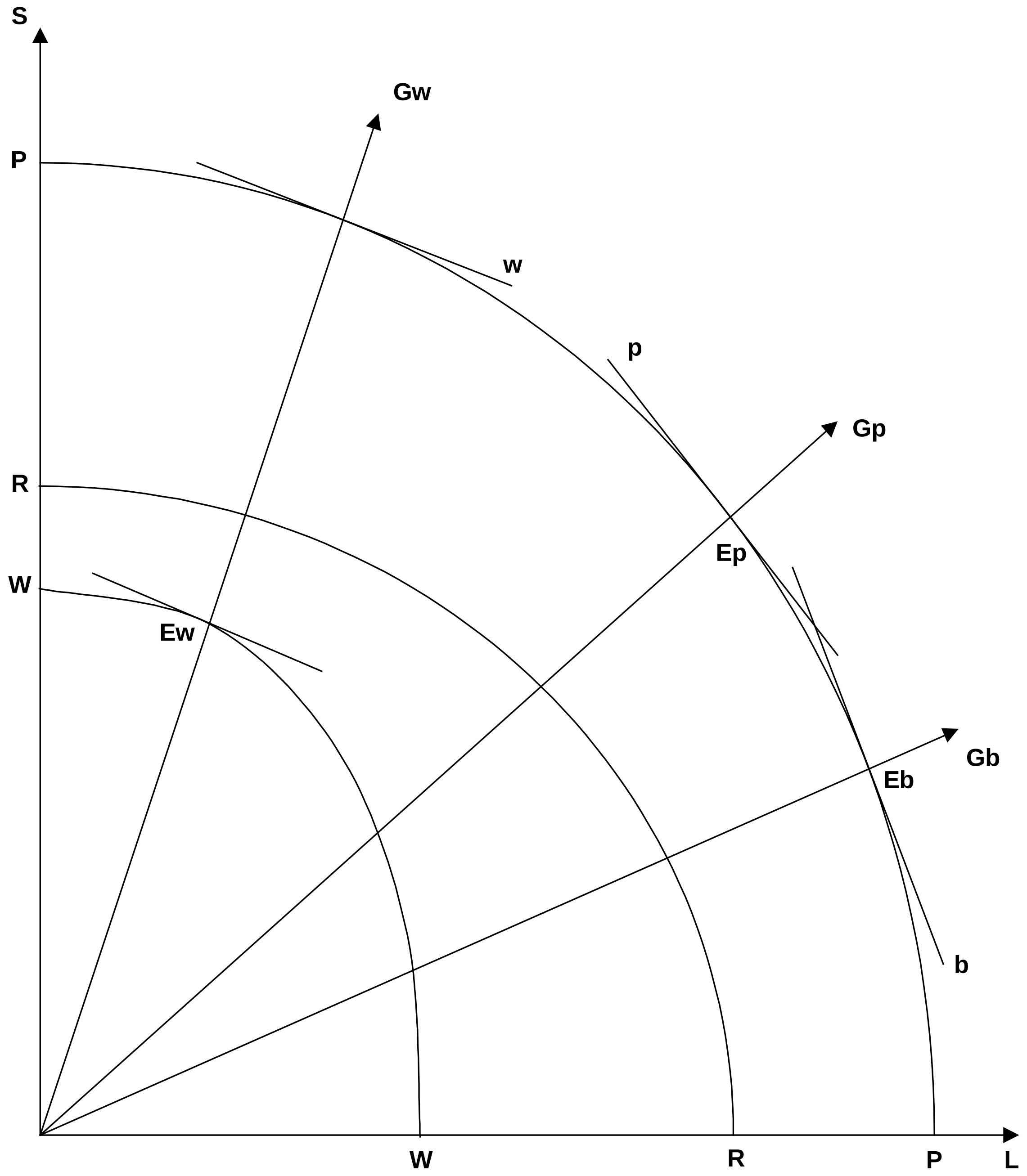
[12] The major exception is the oil and gas sectors. The oil and gas sectors in Angola and Congo (Brazzaville) are offshore, and therefore protected from pillage. More generally, opponents usually avoid damaging or over taxing the mining and oil sectors. These are a source of personal wealth and funds for arms purchases; their revenue also represents the 'prize' for capturing the state. A number of UTR conflicts centre around control over natural resources. In Angola, the government has oil and diamond revenues, while UNITA has reportedly earned up to $500 mn per year from diamonds (this may be an over-estimate). Conflict continues in Somalia over the fertile banana growing areas of the south; banana exports have paid for arms imports.

[13] In order to aggregate activities into these two sectors we assume away any changes in relative prices between the sub-components of *S* and *L*.

FIGURE 5
PEACE, WAR AND RECOVERY



therefore lie within the peacetime frontier (historically not the case in all wars, but certainly the case in UTR civil wars). *L* activities are hit harder than *S* activities, and the production frontier changes shape (to form *WW*). Returns to *S* activities rise relative to *L* activities (shown by the shallower price line *w*). A new equilibrium such as *Ew* emerges which will prove temporary if war intensifies.[14]

There may be periods of growth - from a point below the peacetime output level - depending on the war's characteristics (for instance changes in the geographical spread of the fighting). But these will be along a ray such as *Gw*. Such growth is unlikely to be broad-based. First, smallholder agriculture together with the non-farm economy - the main livelihoods of the poor - will contract during war. Second, any new growth may be concentrated in areas of natural resource extraction, protected from war; this is often capital intensive with few employment linkages (Angolan oil, for example). Third, commerce will revolve around rent-seeking activities arising out of rationing and price controls imposed under state socialism and extended during wartime. Some of the rents may trickle down to the urban informal sector (whose size increases as war forces rural to urban migration). Therefore, any wartime growth will be associated with rising inequality and is unlikely to reduce rural poverty.

Note, however, that the management of the war economy affects the size of the poverty and inequality effects (FitzGerald, 1997, Stewart and FitzGerald, 1998). In Eritrea, an effective food distribution system and high levels of social mobilization contained some of the worst effects. Mozambique's government managed to implement livelihood projects in some safe areas. In contrast, Angola has seen large increase in inequality and poverty (the latter mitigated somewhat by donor and NGO efforts, but with only meagre government commitment).

2.4.4 Peace and recovery

If peace is permanent, uncertainty falls, relative returns shift back in favour of production investments, and new investment in the *L* sector (production) occurs. The production frontier shifts to one such as *RR*.

To simplify, we could assume that the economy returns to the *Gp* growth path, and eventually the peacetime output level (*PP*) is recovered. The speed at which recovery occurs depends on investment inertia (the expectations of investors) and how fast the financial sector can be reconstructed to fund private investment (see section IV).

But this would be an over-simplification. A return to the pre-war pattern of growth (*Gp*) is unlikely since the distribution of assets (and therefore incomes) changes during war, and this alters the post-war growth pattern. Distressed asset sales and human capital loss will be highest when little effort is made to protect the poor during war, and when the military and politically powerful manage the wartime economy to accumulate assets (Duffield, 1994, provides many examples). If so, post war growth will be even less broad-based than pre-war growth.[15]

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[14] The concept of 'equilibrium' is an analytical device only; we do not imply any kind of social or economic stability.

[15] Again, the type of war is critical to the outcome. If successful, a war of liberation (against colonialism) or a war of revolution, may shift assets towards the poor; post-war growth may then be more broad-based.

This raises three dangers. First, once high inequality is embedded in a country's asset distribution it is very difficult to reverse (as South Africa and Zimbabwe demonstrate). This in turn reduces the amount of poverty reduction associated with each percentage point of growth. Second, international evidence suggests that high initial inequality reduces growth (Alesina, 1998). So, post-war growth may be slower than pre-war growth when inequality rises sharply during wartime. Third, high inequality tends to increases a society's propensity to conflict (Nafziger and Auvinen, 1998).

Moreover, recall our assertion in the introduction that reconstruction should not be about recreating the past; *Gp* is unlikely to have been optimal for poverty reduction (especially in the Lusophone countries, which inherited colonial economies in which infrastructure served settlers not smallholders). To achieve broad-based growth an entirely new growth pattern will be necessary. In addition, the pre-war growth pattern may have contributed to war itself through by-passing the needs of underdeveloped regions.

2.4.5 The reconstruction-transition nexus

Thus fundamental changes in development strategy will be required in the three areas of policies, public expenditures, and institutions. This is the point at which the agendas of reconstruction and transition (reform) start to overlap. Indeed, there should be one country strategy, which integrates the two agendas effectively. This is seldom the case, however, given the range of donor agencies involved and their respective responsibilities in reconstruction and transition.[16]

Take, for example, rural development. The incidence and intensity of rural poverty are high. Thus three measures are urgent. First, revise agricultural policies; strip out any taxation of smallholders and ensure that exchange rate and trade policies maximize agricultural production incentives. This will also raise social returns to the reconstruction of rural infrastructure. Second, shift public spending towards basic social services and to infrastructure focused on smallholders. This entails reducing subsidies to wealthier households if targeting is feasible. Third, reform institutions - in local government for example - to raise efficiency in rural service delivery.

Well-designed reforms will thus shift relative returns further in favour of the *L* sector (to price line *b*). The economy will recover its pre-war level of output at a different point *Eb* on *PP*.[17] Growth will proceed along a broad-based growth path such as *Gb*. As shown, the contribution of the *L* sector to growth along *Gb* is higher than along *Gp* reflecting

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Induction into the liberation forces may also provide people with an education otherwise not forthcoming under oppression, thereby strengthening their human capital and participation in post war growth.

16 The UN and bilateral agencies are largely confined to the former, while transition is run by the IMF and the World Bank (with bilateral contributions). This division emerges from the UN role in assisting the political settlement with UN specialized agencies providing support to reconstruction projects. The Bank and the Fund dominate the transition agenda by virtue of their programme support and the associated policy conditionality.

17 The shape and position of PP is likely to change as well due to changes in the country's factor endowments (including the destruction of capital and labour) during war time.

success in raising the returns to smallholder agriculture, and other activities which are intensive in the use of the labour of the poor.[18]

2.4.6 Angola as an example

Angola provides a further illustration of some of these themes. War led to a contraction of its production frontier to one such as *WW*. Commerce serving Luanda and the wealthy elite remains vigorous, as does the 'survival commerce' of the informal sector. *L* activity contracted sharply: Angola's agricultural production is only 5 per cent of its pre-war level. Currency overvaluation also contributed to the contraction of tradable agriculture and manufacturing in the *L* sector. Growth has occurred - 8 per cent in 1997 (Table 1) - as a result of massive oil investment, but growth is not broad-based (i.e. it is on the *Gw* path).

Consequently, inequality in Angola is very high; the Gini coefficient (based on household survey data for Luanda only) is 0.62 (Stenman, 1997). Angola's Gini coefficient is comparable to the average of oil exporting countries (0.612) and to Brazil (a high-inequality society). The true coefficient (incorporating the rural areas and the incomes of the top elite) is almost certainly much higher.[19] Angola today faces the three dangers highlighted above; inequality will be difficult to reverse, it will slow growth itself (and limit its benefits for the poor), and it will maintain (and raise) social instability. This is a bleak future for a country so rich in natural resources.

TABLE 1
ECONOMIC GROWTH

	Output Growth 1990 (percentage change over previous year, 1990 dollars)			
	1990-95*	1995	1996	1997
Angola	-2.4	6.2	7.2	8.0
Eritrea	2.0	5.5	6.9	4.4
Ethiopia	2.0	5.4	11.9	5.3
Guinea-Bissau	3.3	1.6	5.8	5.2
Mozambique	5.8	1.5	6.4	6.6
Comparison Countries				
Uganda	7.5	9.6	9.4	4.2
Tanzania	4.1	3.8	4.2	4.1

* Annual Average
Source: UNCTAD (1998*) Trade and Development Report, 1998*, Geneva: UNCTAD.

18 If policy reforms alter the rates of return between activities in our *L* sector (between manufacturing and agriculture for example), our initial assumption is violated.

19 Household data are sparse for the UTR countries. The Gini coefficient for urban Ethiopia is 0.56 (Bigsten and Makonnen, 1996). There is no Gini estimate for Eritrea. But it might be lower than Ethiopia and Mozambique, given the management of its war-time economy. The results of Mozambique's first national household survey will be released soon.

2.4.7 Political economy

In assessing any country programme we must ask two fundamental questions. First, does the reconstruction of infrastructure and institutions focus sufficiently on the needs of the poor? This may require prioritising entirely new and pro-poor investments over rehabilitating existing infrastructure and institutions not targeted to the poor. Second, does the design of the transition programme maximize poverty reduction? Is the fiscal framework, for example, supportive of the necessary social investment? It is possible that some transition measures - for instance non-transparent privatizations and ill-designed liberalizations - may move the economy *away* from the broad-based growth path (see section IV).

In all cases, a focus on poverty will be diluted by measures that benefit non-poor, but influential, interest groups (including former rebels). This is a reality in all countries and, while not desirable from the perspective of poverty reduction, it may in fact be essential to secure peace (as in the case of Mozambique in the period between the ceasefire of 1992 and the elections of 1994). No country, let alone a post-conflict country, can completely maximize poverty reduction. But in the worst cases the political elite may be more concerned to maximize its personal wealth - by focusing on a key natural resource sector for example - leading to the neglect of development elsewhere. The challenge to donors is therefore to work with, and strengthen, progressive sections of the state, as well as to work through civil society organizations, and to direct aid to countries and programmes where it best reduces poverty.[20] We return to these issues in the next section.

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[20] On the need to direct aid to countries in which it is most effective in reducing poverty see the recent statement by the World Bank (1998a) as well as Collier and Dollar (1998).

III COMMUNITY RECONSTRUCTION

3.1 From humanitarian assistance to poverty reduction

UTR countries have some of the world's worst human development indicators - the result of war and a lack of policy focus on human development (Table 2). There are two challenges: deal with the immediate post-war humanitarian and security problems and accelerate programmes for longer-term poverty reduction.

War leaves a legacy of refugees, ex-combatants to be demobilized, land mines, over-crowded urban communities without basic infrastructure, and widespread food insecurity. The humanitarian agenda is further complicated by its interplay with political and commercial interests which often distort war time assistance and then post-war help (de Waal, 1997, Maren, 1997).

What must be done? Briefly, the major tasks are:[21]

(1) *Resettle displaced populations.* At the peak of their crises, populations of internally displaced people in UTR countries were: Ethiopia (1 mn), Eritrea (200,000), Mozambique (3.5 mn), and Somalia (2 million). (International Federation of Red Cross

TABLE 2
HUMAN DEVELOPMENT INDICATORS

	Life expectancy at birth (years, 1995)	Adult literacy (%, 1996)	Combined first, second, and third year level gross enrolment ratio (%, 1995)	HDI index
Angola	47.4	42.0	30	0.344
Eritrea	50.2	25.0	29	0.275
Ethiopia	48.7	35.5	20	0.252
Guinea-Bissau	43.4	54.9	29	0.295
Mozambique	46.3	40.1	25	0.281
Average for UNDP Low Human Development Group	56.7	50.9	47	0.409
Comparison Countries				
Uganda	40.5	61.8	38	0.340
Tanzania	50.6	67.8	33	0.358

Source: UNDP (1998) *Human Development Report, 1998*. New York: Oxford University Press for United Nations Development Programme.

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[21] A large body of experience and literature now exists on these issues see for instance Carbonnier (1998), Colletta et al (1996), Kingma (1996), Macrae and Zwi (1994), and World Bank (1998b).

and Red Crescent Societies, 1997). About half of Guinea-Bissau's one million people have been displaced by the fighting, either fleeing to safe areas or abroad. NGOs have provided considerable help in resettlement in all countries.

(2) *Disarm and demobilize ex-combatants, and assist their reintegration.*[22] Ex-combatants pose political and security problems (Collier, 1994). In 1993, for example, Eritrea's fighters demonstrated against government delays in paying their back pay and benefits; this resulted in rapid action to redress the problem (Cliffe, 1994). Dercon and Ayalew (1998) find that most of Ethiopia's ex-soldiers were able to reintegrate despite problems in assistance programmes. Reintegration is an immediate priority, but how much is spent relative to other community programmes is largely a political decision.

(3) *Reduce the level of violence.* Africa's wars leave large quantities of small arms in private hands; NGO programmes to remove these are generally cost-effective. More fundamentally, weapons will always be available for those who need them - the more difficult task is to reduce the causes of violent crime, urban poverty in particular. Moreover, as Nathan (1998: 7) observes, the flow of weapons is a *symptom* of the more fundamental problem of the security vacuum, which is often left by Africa's wars and which state and non-state actors try to contain or to exploit.

(4) *Remove land mines.* Land mines isolate communities, making assistance difficult and costly (see Box 3). Mines are not just a rural problem. Kuito in Angola is a high-risk area for mines. In Angola each land mine costs $300-1000 to remove; it can cost up to $5000 to clear a single hectare. The UN alone has spent at least $11 mn on demining in Angola (World Bank, 1995). New mines are now being laid; demining programmes will never finish their work while Angola's peace remains incomplete.

(5) *Protect food security.* War reduces food output by killing, disabling, displacing, and recruiting into armies the major productive factor (labour), by destroying infrastructure, and by raising market transactions costs. The scale of output loss depends on the war's duration and spread; Angola experienced the largest fall in food production of any war-affected African economy (Messer *et al*, 1998: 19). As a result, one third of Angola's population (3.5 mn people) is dependent on humanitarian assistance. Towards the end of Mozambique's war, food aid accounted for 49 per cent of per capita calorie availability, and 72 per cent during the 1992 Southern Africa drought (Tschirley and Weber, 1996).

Food aid itself is problematic. While it has undoubtedly saved many people from starvation, its diversion has financed the military - thereby prolonging conflict in some countries - and it has profited commercial interests.[23] In Mozambique, substantial rents were earned by selling food aid on the parallel market after it had leaked from official channels (Sahn and Desai, 1995). These commercial interests (and their associates in state distribution agencies) lobby for food aid to be continued after the end of war.

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[22] About 90,000 government and RENAMO soldiers were demobilized in Mozambique, 48,000 fighters in Eritrea, and nearly half a million from Mengistu's Ethiopian army (Dercon and Ayalew, 1998, Kingma, 1996). Demobilization plans for Angola cover 250,000 government troops and UNITA fighters.

[23] Duffield (1994: 63) highlights the problem 'Humanitarian intervention provides a significant amount of political and especially economic support, albeit often indirect, for the dominant political and commercial groups. When these groups are themselves allied in a predatory or sectarian structure that is connected with a process of asset transfer and inter-ethnic conflict, then relief intervention itself can become an organic part of the political economy of internal warfare'.

BOX 3
LAND MINES AND THEIR EFFECTS

Millions of land mines were sown across farmland in Angola and Mozambique. Land mines are often laid near to wells and rivers and on pathways into forests and fields to terrorize communities. In Angola – Africa's most heavily mined country – there are anywhere between 9 million and 15 million land mines in a country of 10 million people. One out of every 470 people is an amputee. Fresh mines have recently been laid as the country slides back into war.

Some 28 per cent of survivors from mine blasts lose one or both legs. This severely damages their livelihood capabilities, especially in Africa's labour-intensive household economies. Africans may suffer a more severe loss of earnings than mine victims in countries such as Bosnia and Herzegovina, where victims may have greater access to labour-substituting technologies, and may therefore be able to recover more of their lost earnings.

Mines deny smallholder farmers access to otherwise productive land (one mine can effectively deny the use of many hectares). Under Africa's shifting agriculture smallholders need access to up to 50 hectares over a five-year period as they rotate their fields. Therefore land mines probably impose greater economic costs on UTR farmers than in countries such as Cambodia where agriculture is more intensive (higher yield per hectare), and yield increasing (land substituting) inputs such as fertilizer are more readily available. Women, who are Africa's main food providers, are disproportionately victims. Land mines therefore reduce food security.

Land mines kill livestock, especially cattle that need a larger grazing area than smaller ruminants. They thereby destroy one of the main forms of household savings in Africa (cattle are especially important as savings in conflict countries because of currency uncertainty, high inflation, and the destruction of rural banking). Livestock deaths undermine food-security by reducing the acreage farmers can plough, and by cutting their income from the sale of animal products. As non-farm employment contracts, household incomes and nutrition become dependent on crops, and thus more vulnerable to drought shocks. Cattle death also damages the social capital of communities. Traditionally, prospective husbands pay cattle ('the bride-price') to their bride's family. This sets up reciprocal rights between households to help each other in times of hardship, and is one of the main foundations of the informal safety net.

Aside from their terrible human costs, land mines reduce current and future economic growth by destroying human and other forms of capital. Child deaths have a strong negative growth effect. Rural children transport water and firewood over long distances to their homes, walk to school, and play in the bush. Consequently, land mines are major child killers. This damages the household economy since children as young as seven years make significant economic contributions. Access to schooling becomes even more difficult (and schools themselves are targets). Society loses future output through the destruction of labour inputs, the reduction in human capital (via decreased schooling), and the health effects caused by war trauma and disablement.

If the poor benefit from a rationing system that sells food aid at subsidized prices, then they will be harmed by its removal after war. However, UTR rationing systems had generally limited benefits. In Mozambique, for example, poor households bought most of their food in parallel markets; the most important income effect from removing rationing was to eliminate the economic rents accruing to the entrepreneurs able to sell food aid on the parallel market (Sahn and Desai, 1995). Nevertheless, there is still an urgent need to expand the provision of targeted nutrition assistance as part of a country's strategy for longer-term poverty reduction.

Food aid must be phased out to avoid reducing producer incentives; the key issue is timing. The run down of wartime food aid must be matched by assistance to rebuild smallholder agriculture, with particular attention to female-headed households who are often the poorest (see Masefield, 1997: 14 on Ethiopia and de Sousa, 1998, on Mozambique).[24] Displaced Mozambican households were given a start-up package of agricultural inputs, including seed. Longer-term, the secure supplies of inputs necessitate private investment in agricultural marketing (see section IV).

UTR countries vary considerably in their agricultural potential. In Mozambique, food output grew rapidly in the first years of peace; by 1996/97 food aid accounted for only 2 per cent of calorie availability and real food prices were lower (Tschirley and Weber, 1996). Mozambique may one day export food surpluses. But Eritrea, which has a Sahelian Zone eco-system, is unlikely to meet its domestic consumption needs and will continue to import food for the foreseeable future (Messer *et al*, 1998: 35).

Different ministries and agencies are usually responsible for food aid, agricultural policy, and poverty reduction. Coordination is generally weak. Thus the task of ensuring that food security is protected in the transition from war to peace is too loosely connected to decisions about policy reform, and the link from both to longer-term poverty reduction is mostly tenuous. Institutional investment to correct this must be given priority.

Much more could therefore be said about the first phase of moving from war to reconstruction. But ensuring that post-war growth is broad-based is as important, and it to this that we now turn.

3.2 Post-war growth and poverty reduction

Conflict devastates communities. But people are creative in finding new livelihoods and coping as best they can. Informal trade provides one survival strategy, despite its high transactions costs, including risks to life. Angolans, for example, trade everything from fish to diamonds across their borders (Tvedten, 1997: 115). Food production in safe areas can be resilient; Maputo's 'green zones' fed the city during the war, and created much income especially for female entrepreneurs.

The possibilities open to each household in rebuilding its livelihood depend on its human capital, access to assets (such as livestock), and whether it stayed or fled during

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[24] Female headed households without remittance income from migrant males or other sources are particularly vulnerable, and this vulnerability is increased by the disruption to migrant labour flows caused by war.

conflict. As a result, post-war living standards can show substantial variations across households both nationally, but also within regions - see the study of de Sousa (1998) on Manica Province in Mozambique, for example. Poor households can get left behind in reconstruction, and are the least able to respond to the improved price incentives offered by agricultural marketing reform.[25]

The incidence and intensity of rural poverty substantially exceeded urban poverty in UTR countries before conflict. War deepened rural- relative to urban- poverty since the cities largely (but not always) escaped the fighting, and the rural poor have access to fewer survival livelihoods than the urban poor.[26] But urban poverty cannot be ignored; the numbers of the urban poor have risen along with rapid wartime urbanization. Mozambique's urban population was 26 per cent in 1995 and is expected to rise to 33 per cent by 2025. Luanda is now home to 40 per cent of all Angolans, and 64 per cent of the city's population is poor (World Bank, 1995, 1996).

The pattern of growth and livelihoods is determined by (i) the distribution of human and social capital, access and control over natural capital (including land tenure) and access to physical infrastructure (ii) the policy framework which determines the returns to household investments and (iii) the quality of institutions, including the legal framework. State socialism and conflict altered every aspect of the pattern of growth, and transition and reconstruction alters it again.

This paper does not attempt to set out a detailed strategy for poverty reduction in UTR countries; we aim to sharpen such a strategy through the UTR project itself. Here, we confine ourselves to noting some key problems, including the loss of capital by communities.

3.2.1 Human capital

The colonial education systems in Angola and Mozambique were feeble. Basic literacy has improved since independence; only 12 per of Angola's population was literate at independence. The literacy rate is now 50 per cent for men and 30 per cent for women, progress that could be accelerated if more money was committed to primary education (World Bank, 1995: 4, 1996).

Over 60 per cent of Mozambique's rural primary schools and one third of all health posts were destroyed, reflecting the deliberate targeting of social infrastructure by RENAMO (Green, 1994). In Angola more than one-half of the classrooms available at the start of the 1980s had been lost by 1992 (Tvedten, 1997: 110). In Ethiopia HDIs

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[25] Cramer and Pontara (1998) remind us that considerable differentiation existed within Mozambique's rural communities prior to war, due in part to differences in access to wage-labour opportunities under colonial rule.

[26] In the 1997 Congo civil war much of the fighting focused on the battle for the capital city, Brazzaville, which is home to one-third of the country's 2.6 mn people. In 1998 thousands fled the fighting in Guinea-Bissau's capital. In Mozambique, Maputo and Beira (the second city) became enclaves, but many rural towns were hit hard. Addis Ababa escaped fighting. Angola's conflict was largely rural based between 1975 and 1990. But large-scale urban destruction (excluding Luanda) occurred over 1992-94 (Tvedten, 1997: 110). In October 1992 at least 10,000 people, mostly civilians, died in the battle for Huambo and its aftermath. Up to 30,000 people died in the 1993-94 siege of Kuito (Human Rights Watch, 1996).

worsened during conflict as social infrastructure was destroyed and incomes fell. In Eritrea illiteracy is 85 per cent, and female illiteracy is twice that of males.

In breakaway Somaliland, the authorities have kept some schools going - 14 per cent of children in urban areas receive formal schooling - and schooling is also provided by religious institutions. But 48 per cent of all children, and 66 per cent of girls, receive no structured education of any kind. The current generation of children is significantly less educated than their parents, girls especially (Abdi *et al*, 1997). In the rest of Somalia, children receive largely ad hoc education where conditions permit.

Urban areas have become intolerably congested in Angola and Mozambique leading to the breakdown of water and sanitation systems and the spread of disease. Erratic supplies of piped water reach less than half of Luanda's households. Beira's child morbidity and mortality rates were among the world's highest during Mozambique's war. Mogadishu is the most extreme case of infrastructure breakdown.

UTR health indicators for children and women are substantially worse than the SSA averages. Infant mortality rates in Eritrea and Ethiopia are 135 and 117 per 1000 live births respectively (in comparison Tanzania's rate is 84), and their maternal mortality rates are 790 and 850 per 100,000 live births (Tanzania: 410). Infant mortality is 195 per thousand live births in Angola.

3.2.2 Social capital

By dispersing communities, conflict destroys social capital - the social networks that underpin livelihoods and provide informal safety nets. Large-scale population displacement and forced urbanization also change social values. The abandonment of children and increased domestic violence are signs of social fracture.

Refugee settlements are hives of economic activity but overcrowding and pressure on land and water supplies constrain household enterprises. Long-term refugees lose their skills and find it difficult to train their children in traditional livelihoods. Refugees become dependent on food aid and survival livelihoods such as crime and prostitution. Given the duration of UTR conflicts - 16 years in Mozambique and 20 years in Angola - the loss of skills is probably greater than in countries in which conflict was shorter (Bosnia and Herzegovina, for instance). However, Eritrea's 30-year war, which was of a different kind to that of Angola or Mozambique, saw a mass mobilization, which partly strengthened social capital.

Years of war leave combatants skilled in fighting, but de-skilled in making peaceful livelihoods. Many have no formal education at all, including thousands of child soldiers. Many ex-combatants have high and mostly unrealistic expectations of civilian life (see the survey of Angola by the Department of Humanitarian Affairs, 1995, for example). In this situation the moral and social barriers to living by predation on others are lowered while at the same time the means for doing so, weaponry, is cheap and abundant.

3.2.3 Productive assets and inputs

Livestock have been decimated in Angola and Mozambique. It will take decades for herds to reach their pre-war levels even after replacement programmes. Loss of oxen during the war was the most significant factor undermining crop production and increasing vulnerability to famine in the Ethiopian highlands (Holt and Lawrence, 1993). The short- and long- term impacts depend in part on whether assistance is provided during the war. In the case of Eritrea, wartime programmes sought to share oxen between households and to replenish stocks (Cliffe, 1994). In contrast, the Angolan government neglected smallholders and - following the Soviet example - continued to invest heavily in tractorization which benefited commercial and state farms.

Socialist rationing systems also hindered access to basic goods and inputs during war. Angola followed the Soviet model in setting up a hierarchy of shops with access determined politically; smallholders lacking ration cards were left at the back of the queue and national distribution plans discriminated in favour of the urban population (Sogge, 1994: 99).

3.2.4 Physical infrastructure

Roads, railways, power systems, telecommunications, dams, and irrigation channels must all be rebuilt, and new investments in neglected areas made. The rehabilitation of roads and new construction (especially of rural feeder roads) is particularly important. Transport costs are a significant constraint on regional market integration, including price arbitrage across regions in markets for consumer goods, crops, and agricultural inputs. Road investment encourages new private entrants into the business of trade, which reduces sales margins and therefore prices for consumers (see section IV as well).

Ethiopia illustrates the issues. In Ethiopia, 75 per cent of farmers have more than half a days walking distance to an all weather road. Only 5 per cent of the population has access to an electricity supply, which is almost non existent in rural areas (Hansson, 1998: 8). Donors are contributing $1.2 bn to roads projects, their largest single infrastructure investment in Ethiopia.

Employment Generation Schemes (EGSs) are important both as a means to reconstruct infrastructure (and to promote community ownership) and as part of drought mitigation strategies. EGSs can cheapen the costs of infrastructure rehabilitation (and maintenance) but implementation is not straightforward (see Maxwell, 1993, on Ethiopia). Their design must pay more attention to their poverty impact (both in employment and the value of the infrastructure to the poor themselves), and to their gender dimension which is often inferior (see Masefield, 1997, on Ethiopia).

3.2.5 Natural capital

Labour and natural capital are the two fundamental productive factors in low-intensive smallholder agriculture. Colonialism, socialism, conflict and now transition and reconstruction affected access to, and management of, soils, forests, fisheries, water and other natural resources.

Prime land was expropriated for settler farms in Portuguese Africa. These were nationalized at independence after their owners fled and in some cases state farms were expanded by taking in contiguous smallholder land (West and Myers, 1996). The Portuguese largely ignored village-level community organizations, but FRELIMO intervened extensively, pushing the formation of village cooperatives and giving party representatives the power to resolve local disputes (Noronha, 1994: 10).

Intervention went furthest in Ethiopia. Before the 1974 revolution up to 60 per cent (varying by region) of peasants were tenants with landlords receiving 30 to 50 percent of the crop (Hansson, 1995: 28 Krishnan and Dercon, 1995). Commercial farming in Ethiopia was limited. The Derg abolished customary and other pre-existing land rights together with the use of hired labour, formed peasant associations, and pursued forced villagization and resettlement (Cohen and Isaksson, 1988). The abolition of sharecropping was welcomed. But the net effect of the agrarian reforms was to reduce security of tenure and smallholder profitability; environmental degradation and hunger resulted (Hoben, 1995: 1012).

Conflict reduces incentives to husband natural capital such as forests, market disruption causes shortages of inputs such as fertilizer, and farming and grazing are kept close to the community. As a result, natural capital is depleted and this, together with the contraction of market activity (including the rural labour market), leads to entitlement failure and hunger. Population densities reach environmentally unsustainable levels in safe areas. Armies live off the land indiscriminately, but some environmental regeneration will occur in abandoned areas. Rural Eritrea suffered major deforestation during the war, which further weakened an already fragile eco-system.

Control over natural capital is an extremely important issue. Here, we make three main points:

(1) The use of natural capital is now subject to conflicting claims arising out of customary, colonial and socialist systems of property rights, together with the confusion created by the prolonged displacement of rural populations. This endangers both broad-based development and political stability.

(2) Given political sensitivities, states have opted to retain ownership of land, while granting usufructuary rights to communities and commercial leases. The 1994 Ethiopian constitution provides for this, although violations have occurred (Hansson, 1998: 31).[27]

(3) Both peace and economic reform raise the value of prime natural capital for agriculture, mining, timber and tourism. Political insiders can take advantage of confusion over claims, and override community rights, to further commercial interests. In Mozambique, over 20 million hectares have been granted in concessions (Myers, 1993 and 1994, West and Myers, 1996: 29). Many of the concessions incorporate communities which have customary rights and which are under threat of dispossession (Addison and Ribe, 1996: 34).

(4) Commercial development holds out the promise of more off-farm employment. But some commercial enterprises have uncertain environmental and social effects. Project appraisal and environmental assessment need to be strengthened. Mozambique's border region with South Africa has, for example, been subject to many dubious schemes.[28]

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[27] Conflicts within and between communities over resource access have occurred in both Eritrea and Ethiopia (Hansson, 1998: 31, and Kibreab, 1996). The gender dimension of resettlement is also important. During the war Eritrean women were granted equal rights, reflecting their major role in the armed forces. But many communities wanted women to return to their traditional roles after independence.

[28] Proposals have included a 32,000 hectare Eucalyptus plantation to supply the South African paper and pulp industry (eventually abandoned for environmental reasons), tourism projects ranging from Sun-City

3.3 Focusing public policy on poverty reduction

3.3.1 Setting expenditure priorities

Public money must be focused on core services of most benefit to the poor. These include primary education, basic health services and safe water and sanitation (see Addison and Ribe, 1996).

Take the health sectors of Eritrea and Ethiopia for example (Shaw, 1997). A comparison with a poor and non-conflict country such as Tanzania is instructive. Government health spending in Eritrea and Ethiopia is substantially lower as a percentage of GDP (0.9 and 1.9 per cent respectively) than Tanzania (2.5 per cent) and as a share of total government spending (2.8 per cent for Eritrea, 3.6 per cent for Ethiopia, and 8.2 per cent for Tanzania). Moreover, health resources (and other social services) must be directed to services of most benefit to human development. Curative health care accounts overwhelmingly for total health spending in Eritrea and Ethiopia (88 and 79 per cent respectively) while community services receive 2 and 5 per cent shares, and preventive services 10 and 16 per cent. In Tanzania, the shares are 57 per cent (curative), 11 per cent (community), and 32 per cent (preventive). This indicates the scale of the effort required to resource health in UTR countries, even to the level of Tanzania.

The distribution of health (and other social) spending in UTR countries reflects the wartime destruction of rural services, and histories of urban bias (which continues in some cases).[29] Shifting resources to basic services can do much for human development, but given the scale of needs, and the resource constraints, hard choices will remain within basic services themselves. For example, until revenue mobilisation rises, it may not be possible - within existing budget constraints - to reconstruct both rural education and health services destroyed during conflict and to make entirely new investments in areas which never had services. Lack of resources may force a choice of one over the other - an undesirable state of affairs. Hence, it is critical to carve out savings from other areas of the government budget in order to reduce the constraint on funding basic services. Moreover, major logistic problems remain; more money for the primary education budget is not the same as more primary schools with books and teachers. Uganda - which has been reconstructing for a longer time than UTR countries - still has major service delivery problems.[30]

In the face of these difficulties, governments and donors may be tempted to focus on highly visible social programmes which nevertheless have limited coverage, and to avoid the hard choices involved in properly resourcing basic services. Because it entails a comprehensive review of the effectiveness of public expenditure, economic reform provides an opportunity to effectively resource basic services. If done well, public expenditure reform supports the objective of social reconstruction. But this is only possible if the macro-economic framework itself - particularly its fiscal deficit target - is

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type theme parks to community based eco-tourism, and a bid for the entire region by a foreign investor with alleged war time links to RENAMO.

[29] In Angola, budget allocations to the health sector have fallen to about 3 per cent, from 4.5 per cent in the early 1990s; the share allocated to primary health care is negligible - less than $0.01 per capita (World Bank, 1995: 3).

[30] Only 36 per cent of the budget for non-salary expenditures in primary education is received by Uganda's schools; the rest is swallowed by the administration of the system (IMF, 1998: 87).

not unduly restrictive (see section V). And much more aid (together with debt relief) will be necessary to revitalize the social sectors.

3.3.2 Rewriting the aid contract to focus on poverty reduction

Aid conditionality attempts to induce a set of policy changes - the 'inputs' into recovery - through up-front commitments by government. But it is over-complex, assumes that donors have full information about what are the right policies and spending priorities, and repeated reform breakdowns show its limited effectiveness (see Killick, 1996a, and Mosley, 1987 for thorough assessments). Moreover, the domestic contest over resources provided by aid has sometimes contributed to conflict (see Maren, 1997, on Somalia, for example).

Collier *et al* (1997) suggest a new government-donor contract which places more emphasis on a small set of 'outputs' of reform - growth for example. These can be monitored by *retrospective* assessment, with good performers (adjusting for bad luck, such as external shocks) being allocated more aid. Taking this idea forward, we suggest that for countries that signal commitment to social recovery - by shifting public money to basic social services - agreed targets for key social 'outputs' (infant mortality, female enrolment etc) should be monitored and enter the 'aid contract'.[31] Until social data collection is improved, the components of the UNDP's human development index (HDI) - see Table 2 - and the associated gender development index (GDI), could be used.[32]

3.3.3 Investing in poverty information

Gathering information - to identify priority needs - is critical to sharpening the poverty focus of public policy. Timely household surveys and participatory studies clarify the social impact of reform and identify the incidence of public expenditures, which are often skewed towards the non-poor (Addison, 1997a). On this basis, poverty reduction can be embedded into public expenditure reallocations, and the targeting of nutrition assistance (to replace wartime food aid) can be enhanced. Mozambique, for example, is building a good base of poverty information using a variety of techniques. Making this information freely available, as South Africa has done, strengthens democracy by providing a base of objective information for debate within civil society.[33]

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[31] This is also of relevance to debt reduction (see section V).

[32] The HDI is not a 'perfect' measure of human progress; no such indicator exists (Anand and Harris, 1994). But it has the considerable merit that the necessary data are available for 174 countries. The GDI is available for 163 countries. Our suggestion here is to use its social components; life expectancy and measures of educational attainment, rather than the index itself (because of disagreements over its weighting) and to invest in more data collection to diversify the social indicators. Without such investment, neither governments nor their donor partners can assess the effectiveness of their policies (Addison, 1996).

[33] Such information reveals politically unpalatable facts, such as differences in regional living standards (a potential source of conflict), but hiding the facts does not ease social tensions. Governments which keep social data secret are usually hiding evidence of their own resource misallocations (Malawi under Banda is an example).

IV THE NEW PRIVATE SECTOR

4.1 Creation of the new private sector

In the colonial era the private sector was dominated by settler interests, in the state socialist era it was controlled and repressed but continued to function on a reduced scale, often illegally. But with new entrants - the consequence of liberalization and privatization - a *new* private sector is being created. Private sector actors include small and large-scale commercial enterprises, joint ventures with foreign investors including multi-nationals, and micro-enterprises in the informal sector.

Significant amounts of capital for the new private sector come from the accumulated profits of war-time activity, including the distribution of emergency relief, private enterprises run by the military and state officials, and the survival livelihoods developed during war. As a result, the post-war private sector differs significantly to the one that might have emerged 25 years ago if the state socialist road had not been taken and if conflict had not erupted.

4.2 Overcoming investment inertia

4.2.1 Uncertainty

The expectations of domestic and foreign investors have their own inertia, which can last long after conflict is resolved: investment risk falls but the expectation of high-risk remains. Uncertainty combined with doubts about policy credibility can keep private investment low in post conflict countries.

This can limit private reconstruction. In terms of Figure 5 (in section II), the economy remains stuck below its peace-time production frontier, skewed towards activity with short term returns (urban commerce), and with limited investment in production (aside from the natural resource sector). Uncertainty thereby weakens a private sector supply response which is already constrained by infrastructure destruction and the underdevelopment of the banking system.

4.2.2 Foreign investment

Since investment opportunities in post conflict countries substantially exceed domestic savings - and the gap is larger than for a non-conflict developing economy - foreign capital is needed for swift reconstruction. Potential foreign investors gather information by observing the investments of others. But if initial investment is low, potential investors have very little information to guide them. Each investor is reluctant to go in first even though the returns to first entrants may be very high *ex post*. Instead they wait for the positive informational externalities provided by first entrants.[34] This imperfect

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[34] Thimann and Thum (1998) model this problem in the context of Eastern Europe after the fall of communism. But this perspective is very relevant to post-conflict countries.

information problem can result in limited foreign investment after peace despite the reduction of risk. [35]

A country's Diaspora is better at estimating the investment risks than foreign investors; the return of human and financial capital has, for example, been important to the reconstruction of Eritrea and Ethiopia. But encouraging the return of Somalia's professional class, and their capital, will prove very difficult given the nature of the country's conflict (Adam and Ford, 1997).

The foreign investment picture in the UTR group varies significantly across countries. Mozambique received close to $1 bn of foreign investment in 1997.[36] Planned projects include the development of the offshore Pande gas field, an iron ore processing plant, an aluminium smelter, a high voltage transmission line linked to the South African grid, and an iron ore processing plant at Beira. Port facilities, cheap power (from the Cahora Bassa dam), and proximity to South Africa have encouraged this investment interest.[37]

The impact of these projects is as yet unclear; the aluminium plant creates 300 local jobs, although indirect employment creation should be much greater. The company negotiated a 25 year tax holiday, so the treasury does not benefit directly, although by raising growth, and thus the tax base, the project's revenue effect could be significant (but is unknown). Such investments may also receive a subsidy when power and water are priced at less than the marginal cost of supply.

Foreign investment in Angola's offshore oil industry is growing rapidly. The interest among international companies is such that successful bidders for licenses will have to pay non-recoverable signature bonuses of more than $100 mn to the government. Mobil alone is planning to invest a further $1 bn to expand its operations. But there is a lack of multiplier effects from this foreign investment to the domestic economy; shore based industries to serve the offshore oil sector are underdeveloped and there is no local market for natural gas, a by-product of the oil extraction. Foreign investment outside the oil sector is limited, but recently included telecommunications.

In Eritrea and Ethiopia, foreign investors show an interest, but actual investment has been limited. In Ethiopia, foreign investment is centred on the minerals sector, and is dominated by the foreign purchase of Ethiopia's principal gold mine in the largest privatization ($175 mn) to date.[38] Political uncertainty in the region has again raised the risk premium to investors.

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[35] Donors can reduce investment inertia by providing partial insurance of the political risks and by improving information flows to potential foreign investors.

[36] There is some confusion about the actual foreign investment figures; a total of $1.7 bn has been quoted in the press, but it is not clear whether this includes actual or planned investments. For example, $90 mn has been invested in exploring the offshore gas fields and if this is successful it may lead to a $1.5 bn gas pipeline to South Africa. The crisis in emerging markets is likely to reduce Mozambique's foreign investment; South Africa has raised interest rates to defend the rand and this will reduce its investment at home and abroad.

[37] South African and Portuguese investors have been the first entrants, reflecting their close knowledge of the country. In 1997, South Africa invested $ 736 mn, followed by Portugal ($14.6 mn), and the UK ($1.9 mn).

[38] In the 5 years to 1997, the Ethiopian Investment Authority (EIA) has registered only 63 FDI projects, most with a value under 0.5 mn birr. Of these the bulk belong to one company, the Ethiopian-Saudi

4.3 Privatization

Box 4 summarizes the present situation; Mozambique has gone the furthest reflecting its early start in transition and the acceleration of privatization over 1995-98 (Cramer, 1998). Many state owned enterprises (SOEs) are unattractive economic investments. State socialist projects were appraised using administered prices that deviated substantially from market prices. Currency overvaluation, import protection, and subsidized credit all affected project selection. Environmental impacts were generally neglected. In consequence, many SOEs in the productive sector sell to a limited domestic market, have poor export potential, and use inappropriate (capital intensive) and polluting technologies.

Many SOEs have uncertain finances; negative net worth, high debt to equity ratios, and wage arrears. There is a lack of basic financial information to assess profitability. Uncertainty about property rights, and the underdevelopment of commercial law and regulatory systems (reflecting a lack of state expertise), also constrain expansion. The underdevelopment of financial systems has constrained the ability of SOEs to restructure themselves prior to privatization. These problems are similar to those of the FSU.

The price that private buyers offer for a state asset reflects their estimate of the present value of the discounted stream of its future profits. The expectation of policy reversal and the risk of conflict resumption lower their estimate of the profits stream (or make it impossible to predict) and raises their private discount rates. This makes for low bids (or no bids at all). This, together with fiscal pressures to dump loss making SOEs, difficulties in raising capital from underdeveloped financial systems, and the high domestic interest rates associated with first-round stabilization programmes, can result in bargain basement prices. Nevertheless, Mozambique has raised a surprising amount of money from its privatization effort (Box 4).

Reducing country risk raises bids, increases privatization proceeds, and the presence of numerous eager bidders reduces the potential for collusive behaviour between the government and politically preferred bidders (an important consideration in avoiding crony capitalism).

4.3.1 Privatization in the financial sector

Under state socialism, banks were nationalized. They channelled domestic savings into low-interest rate loans to the state and its enterprises. Negative real interest rates reduced savings rates (real interest rates were minus 20 per cent by the end of the Mengistu regime). Financial intermediation was limited. As state socialism eroded, bank credit was redirected for personal gain. In Benin, Congo, Guinea-Bissau and Somalia, banks eventually collapsed under portfolios of bad loans.[39] Mozambique's state banking system continued to function but was insolvent without large fiscal transfers.

MIDROC conglomerate which purchased the gold mine (Source: *Africa Research Bulletin*, Vol. 35, No. 2, p. 13355).

39 The 1997 civil war in the Congo appears to have accelerated the bank privatization programme with the Government announcing that it intends to sell its stake within a year; so much damage was done to bank infrastructure that recapitalization from foreign buyers is the only way forward.

BOX 4
PRIVATIZATION

Angola. The state oil company is the most important SOE. In 1990 the state sector accounted for 30 per cent of all enterprises (but 80 per cent of large enterprises and 67 per cent of medium sized enterprises), 60 per cent of the total output of formal enterprises, and 80 per cent of employment. Slow privatization has occurred in the 1990s, mostly small and medium sized enterprises. Housing has been privatized. Agricultural enterprises and the railway authority have remained under state ownership, but have been placed under private management contracts. Attempts to speed up the privatization of large enterprises, including banks, occurred after 1995.

Eritrea. A privatization agency has been established and is selling a number of manufacturing SOEs and all state hotels. The banking sector consists of 5 institutions. The state owns the commercial bank (the largest institution), the agricultural and industrial development bank, the investment development bank and the national insurance company.

Ethiopia. In 1992, SOEs were reorganized, new management boards introduced, and directed to pursue commercial objectives. Soft budget constraints were mostly removed. A privatization agency was established in 1994. Of the 197 SOEs targeted for privatization by the end of FY 1997, 152 have been privatized, mostly small trading enterprises, and a few manufacturers. Five commercial banks have been established alongside the state banks.

Guinea-Bissau. Production by highly-import dependent SOEs collapsed in the 1980s due to foreign exchange constraints. Privatization started in the 1980s, and accelerated in the 1990s, most recently the oil and gas distribution networks. The state banking system was weak; it was restructured and merged in the late 1980s, and the first private bank (there are now two) started operations in 1990.

Mozambique. The national privatization agency has sold off 40 large parastatals for $100 mn, creating 70 new private firms whose owners have promised to invest $200 mn. Over 90 per cent of the enterprises have been sold to Mozambican investors; these have mainly bought smaller enterprises which were originally taken under state control when their Portuguese owners fled in 1974. Half the privatization revenue comes from sales to foreign investors. The state has retained a minority share in some privatized enterprises and this will be floated if a stock exchange is established

Sources: Hansson (1995, 1998), IMF (1995, 1996, 1997a), World Bank (1997), Zejan and Kokko (1998).

Conflict subsequently damaged or destroyed UTR financial institutions. Eritrea's financial system, including its central bank, is being built from scratch (Hansson, 1996). Reconstruction requires a financial sector capable of intermediating domestic and foreign savings into efficient private investment. Private traders, for example, have mostly replaced state marketing boards; they need investment and working capital to pay smallholders and loans to invest in transport and storage (see section 4.5). Communities also need facilities to save for future investments and consumption needs (and micro-credit schemes to invest in their livelihoods).

It is proving quite easy to set up private banks, but establishing a *sound* banking system is much more challenging. Recapitalizing the banking sector is expensive. In Mozambique, the state banking system was privatized after separating out commercial bank functions from central bank functions. Foreign investors, including Malaysian banks, have established joint ventures.[40] Ethiopia's financial sector remains closed to foreign investors. Five private banks have been opened alongside the existing state owned bank.[41]

Political influence can still create unsound banks - this time private rather than state - with portfolios of bad loans, as Kenya, Tanzania, Uganda and Zimbabwe demonstrate. Angola's commercial banks have more than $ 52 mn in bad debts, much of the money owed by borrowers with connections to the political and military elite.[42]

Bank failure has severe macro-economic costs (Stiglitz, 1998). It contributed to political instability and turmoil in UTR countries.[43] Yet financial regulation is rudimentary everywhere; Ethiopia's central bank established a regulatory department only last year. Its capabilities have yet to be tested by a major bank crisis.

4.4 The private sector and the state

A new private sector is emerging in UTR countries through both new investment and the privatization of state assets. A number of points can be made about the relationship between the private sector and the state:

(1) As the private sector strengthens, the phenomenon of 'straddling', whereby political leaders and key state officials invest in commercial enterprises, rises (Bigsten and Moene, 1996: 191). One motive is to fund political parties. The incentive for straddling therefore increases as countries replace one-party systems, in which the party is financed by public money, with multi-party systems.

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40 The Banco Austral, previously known as the People's Development Bank (BPD) was formerly launched this year with Malaysian capital.

41 In October 1997, the IMF suspended its $ 115 mn three year Enhanced Structural Adjustment facility (ESAF) citing the government's failure to overhaul the banking system, lift the interest-rate ceiling, and further relax exchange controls.

42 Source: *Africa Research Bulletin*, Vol. 35, No. 6, p. 13511.

43 Lack of prudential financial regulation is a major source of political instability and conflict throughout the world; the collapse of pyramid savings schemes in Albania, and the subsequent descent into turmoil, is a recent example. Indonesia may well prove to be another case.

(2) Straddling encourages state interventions to protect existing economic rents (or create new ones) for selected companies. Straddling can lead to discrimination in enterprise registration, regulation, and taxation when the responsible institutions are not protected from interference. Such discrimination is cited as a barrier to investment by Ethiopian businessmen, for example (Hansson, 1998: 23). Because straddling is associated with increased tax evasion (by the favoured) it exacerbates fiscal problems.

(3) Straddling encourages the formation of private banks and may in part drive the agenda of financial liberalization (as it has done, disastrously, in Russia and FSU). Bank regulators are subject to political pressures to overlook the formation of unsound banks. Achieving the political space for bank regulators to do their job is a critical investment in the developmental state (as East Asia now shows).

(4) The state's relinquishment of its monopolies is a highly politicized process in which the technical agenda of liberalization can overlap with the separate agendas of the peace process and also party political finance. In Angola, for example, the state diamond enterprise, ENDIAMA, has a *de jure* monopoly over production and mining, although illegal private activity is massive. Negotiations to legalize private mining in UNITA controlled areas reportedly centred around ceding ENDIAMA's de jure monopoly in those areas to a new enterprise to be controlled by UNITA, thus legalizing a de facto 'privatization' of the local mining industry carried out by UNITA (IMF, 1997b: 18).

(5) Some privatizations have been uncontrolled and non-transparent. These have typically occurred at the local provincial government level, involving state farms and state buildings. In the mid 1980s Mozambique's provincial governments started divesting state farms in an ad hoc and non-transparent process that ignored directives from Maputo, a problem which may increase with further administrative decentralization (Noronha, 1994: 11, West and Myers, 1996). Such 'spontaneous' and 'wild' privatizations are characteristic of the FSU where they have created extremes of wealth and inequality in the first year's of transition.

(6) In Somalia, the most powerful actors in the private sector are the warlords. One warlord has tried (without success) to establish a private bank in Mogadishu using Malaysian capital; the bank would also issue a currency. Warlords have at various times printed bank notes to capture the seignorage revenue which normally accrues to a state. The issuance of currency is also one of the key institutions associated with the historical development of states - the other being protection of property rights (see Aron, 1996, and North, 1997, on the importance of institutional development in general). By issuing a currency, a warlord can hope to create the institutions of the state around his private activities, thereby consolidating his position for eventual recognition as the 'Government of Somalia'.[44] This is a case of the new private sector creating the state.

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44 So far, Somalis have preferred dollars and the old notes of the failed state. Somaliland has a separate but weak currency (Mubarak, 1997).

4.5 Private investment in agriculture

4.5.1 Privatization in agriculture

Agriculture is traditionally (i.e. pre-conflict) the core sector of UTR economies in terms of output and employment. Therefore the privatization of state farms and of the agro-processing industry has potentially major effects on the prospects for broad-based development. Inconsistencies can also arise between the privatization programme and the liberalization of agricultural policy.

In economies with private land ownership, land is the principal asset (and source of loan collateral) of private agricultural businesses. UTR countries have retained state land ownership for reasons discussed in section III. But the absence of commercial ownership of land reduces the potential value of privatized agricultural business. Angola has attempted to circumvent this problem by placing a large number of Angolan agricultural enterprises under private management contracts, instead of outright privatization (IMF, 1995: 21). But it is unlikely that this arrangement will maximize investment or growth in comparison to a system of private property in land, since the private enterprises cannot offer the land as collateral.[45]

Community rights have also been ignored in the privatization of state farms. In Mozambique, most of the smallholder lands incorporated into state farm were not returned to communities. Land was grabbed by local business interests in alliance with local political leaders (West and Myers, 1996). The core of the state farms are the old colonial settler farms and this is prime agricultural land. Giving communities access to it could be important for rural poverty reduction. Priority was given instead to the creation of private farms and mixed enterprises, such as Lomaco in Gaza in which multi-national Lonhro has the majority share, the state holding the rest. Such commercial farms provide wage labour opportunities which are much valued by households (Cramer and Pontara, 1997). Nevertheless, the process of divestiture has not maximized the possibilities for poverty reduction - by giving communities access to prime land and irrigation - and has favoured private interests over the national interest.

Agricultural liberalization interacts with privatization in that it affects the profitability of privatized state farms and agro-processing industries. The protection, or disprotection, of the sector affects the value of the privatized assets and the viability of the business. Taken as a whole, agricultural policy liberalization should, through removing the implicit taxation associated with state marketing and its inefficiency, raise the profits of farming and agro-processing.

But some parts of the agricultural sector may lose protection, and this will reduce the value of the privatized assets. The cashew sector in Mozambique illustrates the issue.

Cashew farming provides a living for 1 million Mozambican farmers. It is a good crop for poor smallholders since it is labour intensive and the trees can grow in poor soils. By the early 1990s, the farm gate price had fallen to 15-20 per cent of the world price. A ban on the export of raw nuts protected the processing industry and strengthened the domestic buyer's monopsony (Addison and Ribe, 1996: 14).

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[45] In Angola land can be leased up to 45 years and leases can be renewed, transferred, and inherited, but not used as collateral.

Under agricultural liberalization, this quantitative restriction was replaced by an export tax (the rent therefore being converted into a revenue for government). In 1995 the cashew processing industry was privatized. Shortly afterwards, the World Bank persuaded the government to reduce the export tax in successive stages (it has now been reduced from 25 to 14 per cent) with the aim of phasing it out in four years under its agricultural reform programme.

The new owners complain that the value of their initial investment has been unexpectedly reduced. Trade unionists are worried about job losses in the processing industry, which employs 7,000 workers, and is Mozambique's largest industrial employer. The Bank argues that smallholders, many of whom are poor, will benefit from removing protection to processors; international buyers will compete to purchase the nuts, bid up the farm gate price, and export them to India for processing. Domestic processors argue that Indian buyers can engage in unfair competition, since the Indian processing industry is subsidized.

Whatever the relative merits of the case - and there is certainly a need to raise smallholder incomes - there is a mismatch between the policy reform and the privatization process. Liberalization has now been halted while the Bank conducts further studies of the issue.

4.5.2 Private investment in agricultural marketing

State agricultural marketing has withered. Its revitalization is highly unlikely, even if the old rent-seeking interests and inefficiencies could be removed. Fiscal pressures preclude it, and privatized banking systems will not take on the debts of state marketing as state banks once did. More fundamentally, a subsidy to state marketing is only weakly targeted to the poor and therefore difficult to justify relative to the merits of basic social services.[46] Private investment in marketing - by commercial companies, small-scale commercial traders, and micro-traders - is now critical to achieving broad-based growth and food-security.

Initially, state control over marketing pushed out private traders. In 1990, there were only 2,000 traders operating in Mozambique compared with 6,000 in the 1970s. Angola saw a mass exodus of Portuguese 'bush' traders (Stenman, 1995). Private trading was severely repressed in Ethiopia. Parallel markets, at first illegal but then tolerated, grew as state marketing began to collapse. By 1990, the Angolan government bought only 4 per cent of national maize output, mostly from its own state farms (Sogge, 1994: 100). Production slumped and in desperation governments eased controls and eventually embarked on liberalization (Tschirley, *et al*, 1996). Private marketing is now vigorous in Mozambique. In Angola it remains limited by residual controls, insecurity, and the low level of national output.

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46 Hanlon (1996) recommends Zimbabwe's grain marketing board (GMB) as a model for revitalizing Mozambique's state marketing. But while GMB has not suffered from the gross deficiencies of many other state marketing boards in Africa, its activities are only weakly targeted to the poor. Mozambique does not have the fiscal resources to finance the creation of a GMB. Zimbabwe has now commercialized GMB to reduce the fiscal subsidy and it competes in the market with commercial traders (Addison and Stack, 1997).

This is not the place for a comprehensive analysis of agricultural marketing in Africa.[47] Rather, we highlight five key issues:

(1) If private trade is competitive then inter-regional price arbitrage occurs and intra-seasonal price instability falls (provided that traders invest in storage); both will benefit poor rural households, who are typically food deficit (especially the case among female-headed households without remittance income). Dercon (1995) finds greater market integration in Ethiopia's markets. Financial reform can raise private investment by providing easier access to capital.

(2) But inevitably markets will develop unevenly. Private traders will initially concentrate on supplying the cities; these trade routes have the best transport infrastructure and are the most secure from banditry and land mines. There are now, for example, strong trade links between central and southern Mozambique (where Maputo is located). Linkages to the north are still fragmented due to poor road infrastructure. Transport is *the* major cost; it accounts for 40 per cent of the revenues of Mozambique's private traders. Road reconstruction reduces entry costs to private transport investment.

(3) The regulatory environment remains a major constraint. Entry to trading has been discouraged by ad hoc regulation, and the extraction of bribes by local officials (especially in Angola). In Mozambique, a business license costs $40-50, a large sum given the size of most businesses.

(4) The problems of remote regions far from major markets remain urgent; they often face the highest food prices (unless they are self-sufficient) and cash cropping may be unprofitable. Their poverty is often deep. In Africa, the pan-territorial prices associated with state marketing usually provide an implicit subsidy to remoter regions, although in UTR countries this was offset by the high level of producer taxation.

These regions are the least profitable for private trade, and monopsony rather than competition leads to low producer prices and high food and input prices. When rainfall is good, and national output high, traders may be able to source their main markets entirely from high potential areas, and remote sellers may have few buyers. These regions should be prioritized for road investment to stimulate private trade. However, difficulties will still remain if the remote region has low agricultural potential; in this case other means for poverty reduction must be accelerated.

(5) There is much scope for community-based projects to, for example, help households collaborate together to transport crops in bulk to major regional markets and to provide them with standardized weights and measures to avoid cheating by private traders. In this way, communities can get better prices for their crops, lower prices for their inputs, and can themselves enter local trade.

[47] Instead see Jayne and Jones (1997) and Seppälä (1998).

V THE DEVELOPMENTAL STATE

5.1 The new state agenda

A critical task is to construct a developmental state. This is a set of democratically accountable institutions capable of effective policy design and implementation. The new state agenda is compared to the old agenda in Box 5. The new agenda is ambitious, controversial, and resource intensive.

Civil service reform is one of the most important tasks. Since independence, public employment has expanded rapidly across Africa, and accounts for especially large shares of formal employment in post-conflict countries where private employment has collapsed. In Angola, for example, the public sector accounts for 75 per cent of formal employment. Usually the civil service is underpaid (the average state wage in Guinea-Bissau is less than half that of a hotel waiter) and low morale reduces the quality of public services.

In some countries, staff are now being retrenched; civil service reforms aim to improve the quality of services (in part by raising pay), and to carve out savings for use elsewhere, particularly to strengthen basic social services. Eritrea, for instance, reduced its public workforce by one-third shortly after independence, one of Africa's most rapid and comprehensive retrenchments, and doubled the pay of some its employees (IMF, 1997a).

Civil service reform yields savings, but it is not a panacea for budgetary crisis. Raising civil service wages to market levels (to retain key staff and raise efficiency) is expensive. The professional labour market in post-conflict countries is thin, and the state must compete with aid donors and a revitalized private sector for scarce skills.

Limited public revenues will require new innovations; Mozambique, for example, put out its customs service to competitive contract, and the newly reorganized service must meet higher revenue targets. Such a radical recasting of state operations appeals to proponents of the 'minimal state'. But overhauling budgetary institutions and planning systems, regional decentralization, and delivering basic social services - to name just three critical tasks - will be resource and skill intensive. Thus, the new developmental state will eventually look very different to the old state, but it is unlikely to absorb fewer resources.

Rent seeking is a real danger and interventions have often enriched elites by taxing the poor. And every dollar wasted on unnecessary bureaucracy is a dollar less for reconstruction and poverty reduction. Therefore, the onus is on democratic governments to prove that they provide value for money to communities and entrepreneurs.

BOX 5
THE STATE: OLD AND NEW AGENDAS

OLD AGENDA	*NEW AGENDA*
Political and state organization	
• one party, centralized states	• multi-party, decentralized states
• property rights vested in the state, politicized judiciary	• private property and human rights protected within an independent legal framework
• large predatory military	• professional military
• state media	• independent media
State owned enterprises	
• loss-making SOEs in production, commerce and utilities	• privatization, commercialization, foreign and domestic purchase of equity; regulatory system for privatized SOEs
• state financial system, directed and politicized credit allocation	• privatization or commercial banks permitted to operate alongside state banks
Budgeting and planning	
• weak budgetary and planning process; budget overruns, capital spending not matched by recurrent spending, O and M crises	• tight budgetary and planning process to coordinate sector plans/budgets to overall development strategy, and focus public money on core expenditures
• non-transparent budgeting and planning, weak financial control, expenditures and revenues off budget, debts incurred outside normal Treasury procedures	• greater transparency: accountability to new legislatures, all expenditures and revenues brought within the budgetary framework; strict debt reporting procedures
Public administration	
• centralized public administration	• decentralized public administration to match political decentralization
• large civil service, favouritism in hiring	• smaller scale and more professional civil service, elimination of 'ghost workers'
• underpaid and demotivated state employees: narrow salary range, real wage decline	• public wages commensurate with private sector; real wages increased
• over-complex bureaucratic rules and regulations linked to corruption.	• straightforward and clearly understandable system fairly applied
Tax and customs authorities	
• weak and corrupted tax and customs authorities	• restructured tax and customs authorities, customs service put out to private contract
Central bank	
• weak voice in macro-policy decisions relative to government and political leadership	• increased autonomy
• politicized financial regulation	• strong powers to regulate and supervise the financial system
Government statistical service	
• weak capacity to collect social and economic data, culture of data secrecy	• investment to ensure regular data collection for policy making

5.2 Overcoming the fiscal crisis

The new state agenda will remain a wish list unless it is properly financed; which it is not present. Reconstruction expenditures are high, revenues are low (war reduced tax bases) and distorted (over dependence on trade taxes). Countries are severely indebted; almost all Africa's conflict/post-conflict countries are classified as 'Heavily Indebted Poor Countries'.

5.2.1 The 'peace dividend'

Demobilization and the creation of a smaller and professional military are both expensive. Badly paid armies typically live off the land during conflict; civilians bear much of their cost, a 'tax' which is also highly regressive. The post-war state must take over these costs, otherwise they remain as a burden on community reconstruction. This, and the other costs of war-to-peace transition, absorb considerable amounts of public money, thereby limiting the size of the fiscal peace dividend in the immediate post-war years (Azam *et al*, 1994, Bevan, 1994).

In Eritrea, for example, government incurred large one-off extraordinary expenditures on demobilization, reintegration, back pay to ex combatants, and payments to 'martyrs' families' who suffered casualties in the war. These expenditures peaked at 7.3 per cent of GDP in 1995, and payments to martyrs' families alone accounted for 13 per cent of total recurrent expenditures. Establishing a new peace-time defence force was also expensive: the salary costs of this amounted to 2.9 per cent of GDP in 1996, including increased pay for the armed forces (IMF, 1997a: 7).

Nevertheless, some countries have experienced a fiscal peace dividend. In the three years prior to the end of the war, the Ethiopian government spent on average 46.6 per cent of total current expenditures on defence, while social spending accounted for 17 per cent. In the first three years of peace the defence share fell to 16.4 per cent, and the social expenditure share rose to 23.5 per cent (Colletta, *et al*, 1996: 20).

But the size of the peace dividend is limited if insecurity remains high after the formal end of war (Azam, *et al*, 1994). In some cases, peace has been temporary and conflict has taken new forms - Angola may be in this situation now. Peace is an international public good; securing it will permit resources to be redeployed to social need.

Tragically, an arc of conflict and instability presently extends from southern Sudan, Somalia and the Horn down through the Great Lakes region and into DRC, Congo and Angola. The international community's efforts to keep the peace are not seen as credible; witness the disastrous interventions in the Great Lakes region and Somalia together with the under-funding of UN peace-keeping operations. And the regional powers in Africa are displaying a worrying competitiveness, as the recent events in DRC show (Herbst, 1998).

This insecurity keeps military budgets high across Africa. Eritrea and Ethiopia have now embarked on a potentially calamitous path which threatens to derail plans to raise social spending.[48] Until peace is secured in Africa, military expenditures will continue to take a large slice out of the region's public spending.

5.2.2 Budgetary institutions

These are weak at mobilizing revenue and allocating it to priorities, particularly poverty reduction. Planning systems produce wish lists, use incremental budgeting rules, and hard choices about resource allocation are avoided (Foster and Merotto, 1997). This is compounded by off-budget donor projects which siphon recurrent spending away from core programmes (Wuyts, 1996). There is also a mismatch between sector budgeting and the macro-economic framework, particularly the setting of targets for the fiscal deficit. Consequently, capital investments are made without sufficient recurrent funds (leading to schools without books etc.). These problems are common to low-income countries, but they are particularly acute in post-conflict economies, given their depressed starting points. Movement to a sector investment approach - to draw all contributions to a sector's finance into a common framework - are an important step forward; Mozambique's health sector is an example (Marshall, 1998: 169).

5.2.3 Non-transparency

Improper use of public funds is highly correlated with a country's vulnerability to conflict. Somalia is an example; the budget was kept unclear to siphon off public money and aid '... the structure of the budget of Somalia renders it essentially useless as a tool for analyzing government expenditures' commented a World Bank public expenditure review shortly before the civil war (World Bank, 1991 cited in Coolidge and Rose-Ackerman, 1997). Donors, although aware of the problem, maintained aid flows despite clear evidence of corruption and a growing contest for aid which contributed to the eventual conflict (Maren, 1997).

Non-transparency is particularly problematic in countries rich in natural resources, with the exception of Botswana which has successfully used its mineral rents to fund development. In oil rich Angola, Congo, and Equatorial Guinea, oil revenues are largely kept outside the state budget, and their use is unclear.[49] The main sticking point in Angola's relations with the IMF is accounting for the use of the oil revenues accruing to Sonangol, the state oil company. Oil revenue finances about 90 per cent of Angola's state budget (World Bank, 1995).

5.2.4 Debt relief

Conflict countries have built up considerable debts which they are unable to fully service from meagre export earnings (Killick, 1996b). In most UTR countries the problem is one of official debt (see Box 6). However, Angola (and Congo) also have

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48 In the 1998/99 Ethiopian Government budget announced in June 1998, some 995 mn birr has been allocated to defence, 257 mn for the social sectors, and 257 mn for economic development. The prime minister commented at the time that the defence budget is marginally larger than 1997 reflecting the border conflict (Source: *Africa Research Bulletin*, Vol. 35, No. 7, p. 13545). It is to be hoped that this remains the case, and that military spending can be cut again.

49 In Angola, the overvalued exchange rate is also used to calculate the domestic currency value of the dollar oil earnings, which lowers the value of the transfer to the state treasury.

BOX 6
THE DEBT PROBLEM

There are 40 'Heavily Indebted Poor Countries'. With the exception of Eritrea, a new nation, all UTR countries are classified as HIPCs by the World Bank. HIPC debt consists mostly of long term debt to official creditors, although Angola has a substantial commercial debt problem.

The net present value of the debt-to-exports ratio is a key indicator of an economy's ability to service its debt over the medium to long run. The World Bank estimates that if the ratio exceeds 200 per cent then full-debt service is impossible even in the long run; exports would have to grow at an unachievable compound rate. Before the recent announcements of debt reduction measures, the median ratio for the HIPC group was 438 per cent. Mozambique's ratio was 1,020 per cent (the highest ratio for any HIPC undertaking economic reform). This reflects the collapse of the agricultural export base and the aid inflow after 1986. Conflict's effect is shown by comparing Mozambique with Tanzania, a low income HIPC which did not undergo conflict, and whose ratio is 634 per cent. Mozambique owes $ 1.44 bn. In comparison, Uganda, another post conflict country (but not in the UTR category), owes $ 347 mn.

HIPCs pursuing reform continue to receive large positive aid transfers on concessional terms, and therefore do not face a 'cash flow' problem (a foreign-exchange constraint on their imports) despite their debt servicing. But a large debt overhang does reduce the incentive to reform since creditors receive most of every export dollar earned if full repayment is made. The associated uncertainty discourages domestic private investors (who fear higher taxation to service public foreign debt) and foreign investment (which fears macro-economic instability and the effect of debt servicing on profit repatriation). Debt service accounts for a significant share of public expenditures, thereby reducing the sums available for social and infrastructure investments. Constant debt renegotiations place further demands on state capacity.

Over the last five years, bilateral debt has been retrospectively converted into grants, thereby enabling HIPCs to fully service their multilateral debts. The HIPC initiative aims to rationalize the process, and to cut the multilateral debt burden. In early 1998 Mozambique and Uganda received some modest relief under the HIPC initiative.

The successful completion of two ESAFs (i.e. sustained adjustment for six years) is required, a condition which only Uganda has so far met. Guinea-Bissau is becoming eligible, but the suspension of Ethiopia's ESAF in 1997 has delayed its eligibility. The Bank and the Fund are now reconsidering this requirement, which is unduly restrictive given the position from which economies, especially post-conflict, start. Somalia's debts remain on the books of the donors, and a complete write-off must be considered.

Under new proposals, launched in mid 1998, Mozambique will get new relief amounting to a 57 per cent reduction in the present value of its debt, with a completion date of mid 1999, to achieve a debt/export target of 200 per cent. But one new problem has arisen; the Asian and Russian crises will cut the value of Africa's commodity exports this year (and the South African economy, a major market, is slowing down as interest rates rise to defend the rand against speculative attack). Thus, the new round of debt relief is unlikely, ex post, to achieve the 200 per cent target. Further debt relief is therefore called for.

large commercial debts raised on the security of their oil wealth. Given the country risk involved, these are mostly on highly unfavourable terms (short periods and high interest rates). Borrowing to buy arms has mortgaged away a substantial amount of these countries' export earnings, thus reducing their availability to finance reconstruction.[50]

A key priority is to shift spending on debt service into core social expenditures (Addison, 1997b). Those opposing writing off official debts argue that there is no guarantee that resources will be redeployed to social recovery. This is a further reason to build a democratically accountable state (a measure that can also prevent the recurrence of unsustainable debt accumulation). Responsible governments are trying to signal their commitment. Uganda, for example, has unilaterally ring fenced debt relief for poverty reduction through primary education and basic health services, and will open its accounts to prove that the commitment is met. Such commitment deserves more donor support.

5.3 The fiscal framework

In summary, reconstruction expenditures are large and the tax base is low. As a result, the fiscal deficit *before grants* is very high in post-conflict countries; it was between 20 and 30 per cent of GDP in Mozambique in 1990-95. Consequently, these countries are very dependent on programme aid for budget finance (White, 1996). Mozambique has received $8 bn in aid since 1990 (see Table 3). Its fiscal deficit after grants has ranged between 5 and 12 per cent of GDP since the war's end.

Eritrea was initially cautious in accepting aid, but it is now more aid dependent than Ethiopia (see Table 2).[51] Despite the aid inflow, its fiscal deficit *including* grants still amounted to 18 and 16 per cent of GDP in 1995 and 1996 respectively, a rise from 7 per cent in 1993-94, reflecting the acceleration of reconstruction expenditures and war-related extraordinary expenditures (IMF, 1997a: 7).

Before economic reform, countries financed their large fiscal deficits by borrowing from the state financial system at low (administered) interest rates - thereby crowding out the private sector - and by monetizing the remaining (unfunded) deficit, thereby creating high inflation (still the situation in Angola). Together with external terms of trade shocks this reduced growth by causing macro-economic instability.

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[50] The amounts and terms of borrowing against oil are unknown since the deals are conducted outside the framework of normal financial reporting. This is a further sticking point in negotiations with the IMF.

[51] Breakaway Somaliland, which is not an internationally recognized state and which therefore receives very little aid, illustrates the fiscal problems of trying to reconstruct without aid. Export taxes (principally livestock exports) and the limited seignorage from the issue of the (weak) currency finance public expenditures. Security and general administration expenditures accounted for 59 per cent of the 'Government' of Somaliland's total budgeted expenditures in 1998, leaving little for social and development expenditures (Source: *Africa Research Bulletin*, Vol. 35, No. 2, p. 13363).

TABLE 3
AID INFLOWS FOR SELECTED CONFLICT, POST-CONFLICT
AND NON-CONFLICT COUNTRIES

	Total Net Official Development Assistance (ODA) Received, 1996 (net disbursements)		
	US $ millions	As % of 1995 GNP	Per Capita (US $)
Angola	544	19.4	51
Eritrea	157	22.8	44
Ethiopia	849	14.6	15
Guinea-Bissau	180	72.9	168
Mozambique	923	72.2	57
Sierra Leone	195	24.1	46
Uganda	684	12.0	36
Average for UNDP Low Human Development Group	--	3.3	11
Non-Conflict Comparison Countries			
Ghana	654	10.8	38
Tanzania	894	23.2	30
Zimbabwe	374	6.0	34

Source: UNDP (1998) *Human Development Report, 1998*. New York: Oxford University Press for the United Nations Development Programme.

5.3.1 The fiscal deficit

The IMF typically requires a recipient of its ESAF lending to cut the primary deficit (expenditures excluding debt service minus taxes) and eventually achieve a primary surplus.[52] This also implies a cut in the deficit before grants so as to reduce the crowding out of private investment in domestic financial markets and to end high inflation.

Nobody seriously questions the principle of fiscal prudence. But for countries which have demonstrated a commitment to restoring the public finances, it is likely that the IMF's fiscal policy conditionality is too tight, and therefore an impediment to reconstruction since it unduly limits public investment and the financing of associated recurrent costs. Certainly many in the donor community are critical of this aspect of IMF conditionality. For example, Joseph Stiglitz (the chief economist of the World Bank) concludes in a recent and thinly disguised critique of the IMF position that:

> 'For the last several years Ethiopia has run a deficit of about 8 per cent of GDP. Some outside policy advisers would like Ethiopia to lower its deficit. Others have argued that the deficit is financed by a steady and predictable inflow of highly concessional foreign assistance, which is driven not by the necessity of filling a budget gap but by the availability

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[52] The Enhanced Structural Adjustment Facility (ESAF) is the Fund's most important instrument for low-income countries (Abed, 1998). Post-conflict countries which currently have ESAF arrangements in place include: Congo (suspended), Ethiopia (suspended), Mozambique, and Uganda.

> of high returns to investment. Under these circumstances – and given the high returns to government investment in such crucial areas as primary education and physical infrastructure (especially roads and energy) – it may make sense for the government to treat foreign aid as a legitimate source of revenue, just like taxes, and balance the budget inclusive of foreign aid' (Stiglitz, 1998: 10),

In effect many investment projects with high social returns may be left on the shelf if the fiscal deficit before grants is severely cut, in which case there is a basic incompatibility between the fiscal aspect of reform - when it involves an over-tight fiscal deficit target - and the reconstruction objective. Moreover, if two projects are complementary (for example, a basic health care project and a primary education project), but the budget constraint permits only one investment, then the social rate of return for the single project is lower.[53] This implies both lower growth and slower social recovery.

Starting from a point of low post-war investment, and provided that sound investments are chosen, their realized returns should exceed the cost of concessional borrowing. The tax base rises with growth, and more revenue can be mobilized as investments in tax institutions take effect. Budget balance (or surplus) before grants in future years can then offset a high fiscal deficit in the early years of reconstruction. To put in place such a longer-term fiscal framework we need to move beyond the restrictive five-year term of the ESAF instrument. But of course, such a longer-time framework will only work in countries committed to fiscal responsibility, and in which appropriate institutions are being built.

The IMF's financial-programming framework is largely a set of accounting identities rather than a true forecasting model (Tarp, 1993). It is therefore very limited as a means for devising a fiscal framework for reconstructing economies when much of the future fiscal position will be driven by the rate of return on post-war investment and the recovery of the tax base (i.e. dynamic effects). Unfortunately, we do not have anything better, and building policy models that capture these dynamic effects (and collecting the data for them) is an essential technical input into improving fiscal policy.

5.3.2 Aid financing

The argument over whether the IMF's fiscal conditionality is too tight partly depends on our view of aid, and its trend (Foster and Thomas, 1998). The IMF's fiscal caution arises in part out of its view that total aid is in long-term decline and therefore aid-financed expenditures may not be sustainable. Aid flows can also cause instability in government expenditures (for example when donors fail to disburse after commitment).[54] The IMF therefore advises governments to eventually try and match their recurrent revenue (which excludes the one-off proceeds of privatization) to their recurrent expenditure.

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[53] There is considerable evidence that social sector projects are complements to each other - for instance improving female education raises the effectiveness of health care services because women are the main health care providers in the household.

[54] In an independent study, Gemmell and McGillivray (1998) find that aid is a relatively unstable form of government finance.

Any aid shortfall will therefore reduce public investment (and therefore growth), but not recurrent spending and core state functions.[55]

Is the IMF being too pessimistic about aid? Is aid to post-conflict countries such as Ethiopia and Mozambique steady and predictable? Certainly aid is in decline in aggregate. Aid to SSA fell from $18.9 bn in 1994 to $16.8 bn in 1996. But aid to countries which are committed to reform and poverty reduction may nevertheless increase (Foster and Merotto, 1997 discuss the implications). Indeed, the recent external evaluation of ESAF by a group of independent experts (IMF, 1998: 32) points out that aid flows to these countries are likely to rise, because donors will increasingly focus their aid on countries with a conducive policy environment (aid is only effective when this is the case, see Burnside and Dollar, 1997).[56] Once a target for the fiscal deficit before grants is set, any increase in donor aid must in effect be saved rather than spent by government; this implies the reduction of domestic public debt rather than spending the aid on building schools, or other reconstruction needs.

At times this has led to criticism of the IMF by bilateral donors; their parliaments vote aid for it to be spent on schools and clinics, not to be saved in the recipient's accounts. Mozambique is an example of donor disquiet. Mozambique's fiscal deficit before grants was reduced from 29.2 per cent of GDP in 1990 to 22.2 per cent in 1993, the year after the end of the war. Mozambique also managed to reduce inflation from 150 per cent at the start of the 1990s to under 50 per cent at the war's end, as monetization of the deficit was reduced and as output started to recover (see Ubide, 1997). To many observers this ranks as good performance for a country just coming out of 16 years of civil war (Addison and de Sousa, 1998). Inflation is now just 6 per cent.

Increased aid flows in the run up to the 1994 elections reduced the fiscal deficit after grants from 12.3 per cent of GDP in 1990 to 5.2 per cent in 1993. But the fiscal deficit before grants rose again to 29.7 per cent in 1994 (8.2 per cent after grants) reflecting a surge in recurrent spending matching the increase in aid-financed capital spending, as well as spending on resettlement, demobilization and the elections. In 1995, the IMF, dissatisfied with fiscal policy, threatened to suspend lending. Many donors protested that the IMF's fiscal deficit target was too harsh and that it would stall aid disbursements if the government could not match aid-financed capital expenditures with recurrent funding (Hanlon, 1996). The IMF for its part, seems to be more cautious than bilateral

[55] Given their limited access to international commercial borrowing and their thin domestic debt markets, SSA countries are unable to use fiscal policy in the normal way - to smooth consumption over time by borrowing to finance variations in the fiscal deficit across the business cycle. Fielding (1997) finds a close correlation between *current* government revenue and *current* expenditure for a sample of 12 SSA countries for the period 1970-89. Hence the low-income countries of SSA are subject to a degree of fiscal inflexibility which would be unacceptable in the conduct of fiscal policy in developed countries.

[56] But perhaps we are too optimistic about the way the world works. Alesina and Dollar (1998: 2) find that cross section differences in the amount of aid received by countries are dominated by political factors such as colonial links and strategic alliances. Their time series evidence shows that at the margin changes in aid flows tend to reward democratization and economic reform. A typical democratizing country gets a 50 per cent increase in aid. But the pattern of aid distribution at any point in time is dominated by political factors.

donors and the World Bank about the ability of countries to absorb aid (to translate funding into actual infrastructure).[57]

More attention must given to incorporating realistic expenditure estimates into the macro-economic framework and to looking again at the division of responsibilities and coordination between the respective agencies. Until this is done the agenda of fiscal reform will only match imperfectly the agenda of reconstruction. The current position imposes costs on both donors and countries.

Before leaving this critical issue entirely, we must briefly make three final points:

5.3.3 Taxation

A tight fiscal deficit target implies higher taxation. Until investment in improving tax institutions takes effect, this implies greater taxation of the existing tax base using existing tax instruments (which are often distortionary and regressive), thereby discouraging private investment and slowing reconstruction. This problem often manifests itself in the continuation of high trade taxes when, from an efficiency and welfare perspective, it is desirable to reduce and rationalize them. Uganda is among the countries experiencing this problem (see IMF, 1998: 32).

5.3.4 Improving budgeting

A very tight fiscal deficit target encourages governments to keep expenditures off budget (and in practice bilateral donors may collude in this if they decide that the IMF target is over-tight). This undermines budgetary management, and thereby the focus of public money on core expenditures. There is considerable evidence, from both developing and developed countries, that over-rigid fiscal rules act as a disincentive to investments in improving budgetary institutions (see, for instance, Alessina and Perotti, 1996). This has been a problem in Mozambique; donor projects have proliferated and it is very difficult to obtain a clear picture of what is spent, where it is spent, and by whom it is spent (government, donor, NGO) - see Wuyts (1996).

5.3.5 Democratization

Democratization - preparing constitutions and organizing elections - is demanding of resources. These demands compete with those of economic reconstruction. Moreover democratization requires political and administrative decentralization which complicates budgetary reform. For example, the construction of Ethiopia's federal system involves the creation of matching budgetary processes to allocate powers and responsibilities between the centre and regions. The investment costs involved in creating these institutions are greater than those in non-federal states but are necessary to secure the political settlement. The creation of a decentralized administration in Mozambique also takes time and resources. There is potentially an inconsistency between very tight fiscal frameworks and successful democratization if decentralization cannot be properly funded.

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[57] In Ethiopia the IMF suspended ESAF disbursement in 1997, while the World Bank and bilateral donors continued disbursement. This indicates fundamental differences in the macro-economic views of donors, a highly undesirable state of affairs.

VI CONCLUSIONS

State socialism in Africa lasted less than a decade, but it nevertheless had pervasive effects. Together with conflict its legacy is confusion in property rights, distorted economies, weak human capital and fragile institutions. This paper has only touched on some aspects of reconstruction and its relationship to economic reform. To end, we make three final recommendations, which relate to Africa as a whole.

- *Decentralize political and economic power*

Centralisation is the means by which predatory states channel assets and resources towards their ruling elites. The political and economic dimensions of decentralisation run alongside each other, and intertwine. Decentralisation brings decision-making closer to those most affected by it - a key ingredient of democracy - and offers the hope that political processes and policy-making will focus on the poor. But decentralisation is no panacea; local political processes can be run to favour local elites. Local democracy needs as much institutional investment as national democracy.

The number of secessions - attempted (southern Sudan), internationally recognized (Eritrea) or de facto (Somaliland) - will rise if Africa's over-centralized states continue to fail to meet local needs. Secession may resolve tensions, and provide the basis for starting reconstruction. But it can also lead to new tensions; for example over the division of assets between successor states - including natural resources, water, and geographical assets (coastlines and ports) - as well as tensions in trade relations. The war between Eritrea and Ethiopia offers a tragic example of this.

- *Minimize macro-economic shocks*

Countries have very different abilities to tolerate adverse internal and external economic shocks. Rodrik (1998) shows that many of the sharpest falls in growth occur in divided societies (as measured by income inequality and ethnic fragmentation, for example) with weak institutions of conflict management (the rule of law, democracy, and safety nets). This a compelling explanation of why similar sized shocks (such as a commodity price fall or a drought) can cause only temporary recession in some countries but outright collapse in others. Looking around Africa we can see - after nearly two decades of crisis and adjustment - considerable differences between societies in their ability to withstand adverse events.

Two conclusions follow from this. First, investing in democratic institutions and deepening civil society is, aside from its intrinsic merit, good economics - countries cope better with economic adversity. Second, in fragile societies the costs of getting policy wrong - delaying reform but also errors in designing reform itself - are much higher than in more secure societies. Therefore, advocating drastic medicine - fast financial liberalisation for example - carries higher risks in fragile societies (as does avoiding any reform at all).

- *Prevent conflict through broad-based development*

Since the start of 1998, the outlook for Africa has grown grimmer. Signs of growth and democratization have in many cases been extinguished. Old conflicts continue (Sierra Leone, Somalia and Sudan) or threaten to resume (Angola). The Great Lakes region remains highly unstable. The new DRC government has largely failed to take up the challenge of development, and the DRC's crisis has drawn in major regional powers. Uneasy peace reigns in Guinea-Bissau and Congo. Reconstruction in Eritrea and Ethiopia has been set back by years. Of the UTR countries, only Mozambique seems to be progressing towards a secure future.

The human, economic, and financial costs of failing to keep the peace in Africa are immense not only for Africans themselves, but also for the United Nations and the wider international community. In 1993, for example, the United States Government spent nearly $2bn on 'Operation Restore Hope' in Somalia, an amount almost twice that year's bilateral aid budget for the African continent, and five to six times greater than total US development assistance to Somalia for three decades (Weiss, 1997, Veit *et al*, 1997: 7). Some $1.55 bn was budgeted for the subsequent UN operation in Somalia, UNOSOM II (de Waal, 1997: 185). Emergency assistance in Rwanda was at least $ 1bn in 1994 (and probably much more), amounting to 2 per cent of total overseas development assistance that year (Weiss, 1997: 216). Failing to prevent conflict has very high costs.

But, preventing conflict by broad-based and democratic development requires hard choices over resource allocations and public policy. Nevertheless, these choices are a great deal easier to make than those involved in ending a conflict and initiating reconstruction. *Ex ante* action - good economic policy - is always better and cheaper than *ex post* crisis management.

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