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STRATEGIES FOR DEVELOPMENT IN CONFLICT-AFFECTED COUNTRIES IN THE ESCWA REGION:

THE ROLE OF THE STATE AND PRIVATE SECTOR

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Preface

This study on private sector resilience in conflict-affected countries in the ESCWA region is part of a series of publications, which examines mechanisms and policies for development in spite of conflict. The studies include policy recommendations that are aimed at enhancing the capacity of policymakers in countries experiencing conflict and political tensions to develop appropriate strategies and programmes for the region to attain social and economic development goals, including the Millennium Development Goals.

The study recognizes the important role of the State as an engine of growth in achieving development goals, including its fundamental role in the development of the private sector. This is particularly relevant in countries affected by conflict in the ESCWA region due to the weak nature of the private sector and, therefore, the need for an increasingly responsible role of the State during the period of transition to a more resilient and developed private sector. The private sector in this region is still too small to be solely relied upon to generate high investment rates and to absorb unemployment. Indeed, political instability and fragile security impede foreign direct investment and discourage private investment. The role of the developmental State is crucial in harnessing resources for development, which includes private investment, especially in post-conflict countries.

While focusing on the impact of conflict on private sector resilience in the ESCWA region, the study attempts to understand the importance of the role of the State and its ability to create an enabling environment for development and for enhancing the resilience of the private sector within conflict-affected countries in this region, while presenting an analysis of two case studies, namely Iraq and Palestine. Through this analysis, the study proposes recommendations for Iraq, Palestine, regional countries and the international community on the development of regional/national policies and programmes to support private sector development while mitigating the impact of conflict on growth and development in the region.

CONTENTS

ABBREVIATIONS

CPI	Corruption Perceptions Index
CSR	Corporate social responsibility
DAD	Donor Assistance Database
DDR	Disarmament, demobilization and reintegration
FDI	Foreign direct investment
GCC	Gulf Cooperation Council
GCF	Gross capital formation
GDP	Gross domestic product
GNI	Gross national income
GTZ	German Agency for Technical Cooperation
HDI	Human Development Indicators
IFC	International Finance Corporation
ILO	International Labour Organization
ISRB	Iraqi Strategic Review Board
MDGs	Millennium Development Goals
MENA	Middle East and North Africa
NGOs	Non-governmental organizations
NID	New Iraqi Dinar
ODA	Official development assistance
OECD	Organisation for Economic Co-operation and Development
PCBS	Palestinian Central Bureau of Statistics
PMA	Palestine Monetary Authority
R&D	Research and development
SIGIR	United States Office of the Special Inspector General for Iraq Reconstruction
SMEs	Small and medium-sized enterprises
SOEs	State-owned enterprises
SWAP	Sector-wide approach
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNHCR	United Nations High Commissioner for Refugees

Executive summary

Economic growth, business investment and employment are deeply interconnected to peace and conflict. Armed conflict clearly has a major impact on economic activity: it destroys access to infrastructure, land, workplaces, labour, skills and markets. Moreover, and particularly when there is little expectation of return, public and private sector investments decline and employment opportunities become scarce.

Security and the rule of law are necessary conditions for the growth of the private sector and the economy as a whole, yet the intensity of conflicts and their durations vary even within the countries affected by conflict and in many cases allow some normalcy in economic activities. That said, however, the absence of markets and adequate levels of demand, as well as the presence of high risks and costs, limit to a great extent the benefits in growth and development that would ordinarily be hoped for from an active private sector. This leaves a gap in the role of the private sector in employment generation and goods and services provision that puts further pressure on countries affected by conflict.

The experience of the past decades has demonstrated the significant failures of policies prescribed within the Washington Consensus to translate economic growth into sustainable human development due to its reliance on the private sector as the engine of growth. This is particularly the case for countries in conflict and, therefore, a new consensus has emerged, known as a post-Washington Consensus, which recognizes the important role of the State in achieving development goals as an engine of growth, including its fundamental role in the development of the private sector. The private sector in this region is still too small to be solely relied upon to generate high investment rates and to absorb unemployment. Indeed, political instability and fragile security impede foreign direct investment and discourage domestic investment.

Insecurity and conflict create environments which are not conducive to development and growth while posing obstacles to increasing investment and strengthening the private sector. It is during that critical period that the State must play an important role in creating an enabling environment for sustained growth which in itself should foster development.

This is particularly relevant in countries affected by conflict in the United Nations Economic and Social Commission for Western Asia (ESCWA) region given their low levels of development and due to the weak nature of the private sector. There is a need, therefore, for an increasingly responsible State role during the period of transition to a more resilient and developed private sector.

The private sector has a vested interest in working towards a prosperous society, which includes striving towards equality. Prosperity requires political stability and peace, which can only be achieved if the root causes of conflict are addressed and the elements that compromise long-term stability are dealt with. Equitable economic growth remains the key to any sustainable development exercise. Business leaders provide an able resource for development actors since the private sector is within the core function of the economy and because of its vested interests in economic recovery, political security/stability and the administrative efficiency of State institutions.

In the case of peacebuilding and mitigating conflict, the private sector can contribute significantly to stabilization efforts through its classic role in income creation, reconstruction, and filling gaps in public service provision. Another dimension of private sector contribution stems from growing evidence about its contribution to State-building, conflict resolution and peacebuilding. Indeed, a thriving social and ecological market economy has the potential to reduce disparities and social tensions, which are often root causes of violent conflicts. Private sector development is a key approach that offers Palestinians to address conflict causes, lessen grievances, and support continuous economic and social progress.

For the past few decades, the private sectors in most countries of the ESCWA region have been performing far below potential. One of the main reasons for this underperformance is the environment of ongoing conflict in the region. Armed struggle and political conflicts have been permanent features of the ESCWA region for many years. Inter-State wars, civil conflicts, occupation, international boycotts and border closings have occurred frequently during the last four decades in various parts of the region. This has created a precarious and unpredictable environment that has not been conducive to fostering economic activities. Inevitably, production, employment, investment and trade were frustrated by long periods of high risk and uncertainty, immense damage inflicted on infrastructure, and the frequent disruption of the movement of people and goods. The protracted nature of conflicts in the region and episodes of violence have particularly disrupted economic activity and distorted development in general, including the development of a viable private sector.

Through a comparative analysis of socio-economic indicators in ESCWA member countries, the negative impact of conflict on the private sector becomes evident, with conflict-affected countries scoring far less on development indicators than non-conflict-affected countries. This is particularly evident for such sectors as health and education which are essential for the development of human capital, an important factor of private sector resilience. Distribution of income is another important indicator which clearly shows inequality in war-torn societies in this region. The private sectors in conflict-affected countries in this region suffer relatively more from lack of simplified business regulations, weak property rights and inefficient credit information systems. Furthermore, countries in the region do not focus enough on promoting research and development (R&D) activities, which are essential for long-term economic growth; this is especially the case for countries in conflict.

In Palestine and Iraq, the protracted conflict has had direct negative impacts on the physical systems of the two countries (water, land and the environment) as well as on the social system (socio-economic activities, urban-rural settlement patterns, and internal and external migration). The private sectors in both countries are currently operating below potential.

In Palestine, the prolonged Israeli occupation has imposed a process of de-development on the economy. This has been manifested by restrictions on resource use, business activities, and domestic and international trade. It has substantially weakened the traditional productive sectors of the Palestinian economy and has caused a general reallocation of factors of production, combined with the reorientation of trade flows, to the benefit of Israel.

In Iraq, the war, which began in 2003, caused further damage to the main infrastructure, including highways, bridges, electricity installations, water networks, railways and oil refineries. The subsequent large-scale displacement resulted in a significant brain drain of highly skilled persons. The economic instability that ensued created large-scale unemployment and devastated the private sector. Despite reforms in recent years, the share of the private sector in gross fixed capital declined sharply due to insecurity and the high risk of doing business, which ultimately deter both domestic and foreign investors.

In both Palestine and Iraq, the principle impediments to private sector development are unproductive activities, such idle resources as labour, the inhospitable business environment due to insecurity, complicated and non-transparent regulations, and weak financial systems and banking sectors. The growing dependency of both countries on aid also represents significant obstacles to a resilient private sector. These sources of inefficiency and distortion have resulted in poverty, the contraction of economic activities, distorted macroeconomic structures, social disarticulation and a shift towards informal economic activities, ultimately leading to the demise of the private sector and its inability to contribute to sustainable long-term growth and development.

Evidently, sustainable economic development in spite of conflict and instability requires an environment that assures security, supports inclusive development, provides an adequate infrastructure, protects property and investment from predation, ensures predictable and fair taxes and incentives, and reduces the costs of doing business while improving the investment environment. This implies that good governance and State capacity are enhanced especially during the crucial “interim” period when the private sector is not robust enough to take on a critical role in equitable growth which would trickle down to ensure sustainable development.

The study concludes that an appropriate developmental conception of the State would be one that engages directly with the profound market failures from which conflict-affected countries suffer; this includes increasing public investment with the aim to attract private investment as well as fill the shortage of private investment and lack of credit. The implementation of industrial policies in the aftermath of conflict is also an essential element of successful post-conflict economic development. This includes forms of import substitution policies, as were the case for the East Asian Tigers, which would then lead to more open types of trade and industrialization policies once the private sector is strong and resilient enough to play its role in contributing to long-term economic growth and sustainable development.

I. THE ROLE OF THE STATE AND PRIVATE SECTOR IN CONFLICT SITUATION

A. Overview

The social and economic consequences of conflict in the ESCWA region are tremendous. The legacy of conflict includes substantial loss of livelihoods, employment and incomes, debilitated infrastructure, collapse of State institutions and rule of law, continuing insecurity and fractured social networks. Conflict has severe direct economic and productive costs on countries affected by it. The direct loss of life and the physical destruction of basic infrastructures, damages the productive capacities of these countries to a great extent, including the ability of the private sector to generate income and create jobs. Within this context, it is important to ensure that effective policies are put in place to promote growth and development in spite of war. Moreover, strengthening the private sector and its capacity to operate, thrive and survive in conflict-affected countries is increasingly regarded as a potential driver for development, mainly due to the essential role played by the private sector in generating income, creating jobs and mitigating the impact of conflict on socio-economic development, as well as an effective tool for peacebuilding.

It is important, however, to point out the significant failures within the past decades of policies prescribed within the Washington Consensus in driving economic growth to sustainable human development. This is particularly the case for countries in conflict and, therefore, a new consensus has emerged, known as a post-Washington Consensus, which recognizes the important role of the State in achieving development goals as an engine of growth, including its fundamental role in the development of the private sector. This is particularly relevant in countries affected by conflict in the ESCWA region due to the weak nature of the private sector and, therefore, the need for an increasingly responsible role of the State during the period of transition to a more resilient and developed private sector. The private sector in this region is still too small to be solely relied upon to generate high investment rates and to absorb unemployment. Indeed, political instability and fragile security impede foreign direct investment (FDI) and discourage domestic investment. The role of the developmental State is crucial in harnessing resources for development, which includes private investment, especially in post-conflict countries.

Barbara (2008) argues that by subjecting prematurely rebuilt countries to the vicissitudes of the market, neo-liberal State building has undermined international efforts to construct viable States.[1] Indeed, studies have shown[2] that the neo-liberal

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[1] Barbara, 2008, p. 310.

[2] UNCTAD, 1997.

policies of the 1980s and 1990s, which placed the emphasis on a minimal role of the State, greater reliance on private initiative and market forces, and increased openness and greater integration into the world economy, have negatively affected the macroeconomic environments of developing countries, increased marginalization, and contributed to poverty and inequality. Conflict-affected countries, which by definition are even more vulnerable due to weak institutions and lack of proper investment, have not benefited from such policies either.

Much of the research and policy attention has focused on the role of external actors in post-conflict State building, rather than on the role of the domestic players in fashioning their own institutional capacities for economic recovery.[3] Furthermore, the research has been exclusively centred on the private sector as the engine of growth without consideration for the role of the State. Indeed, in conflict settings, while the State has first and foremost an essential role in ensuring security, it also has the function of creating a professional public administration, rebuilding representative and inclusive political institutions, and establishing accountability mechanisms.[4] In addition to the challenges of rebuilding State structures, war-torn societies must institute the attributes of legitimacy, authority and effectiveness, which have been destroyed by the conflict.[5]

Insecurity and conflict create environments which are not conducive to development and growth while laying obstacles to increasing investment and strengthening the private sector. It is during that critical period that the State must play an important role in creating an enabling environment for sustained growth which in itself should foster development.

The objective of this study is to examine and provide recommendations on the characteristics of resilience of the private sector in conflict-affected countries, including the role of the State in enhancing that resilience and contributing to development in the ESCWA region, with a particular focus on Palestine and Iraq. Chapter I provides a theoretical and conceptual overview of the developmental characteristics of conflict, the role of both the private sector and the public sector in development and the important part played by the private sector in peacebuilding and conflict mitigation. Chapter II examines the socio-economic impact of conflict on the ESCWA region and the consequences of that impact on the private sector with a brief analysis of the role of the State including its failures in contributing to private sector development and resilience, and equitable growth. Chapter III provides an analysis of the private sectors of both Palestine and Iraq, which includes an overview of the types of conflict-related impediments to the development and growth of the private sector in those two countries.

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[3] UNDP, 2008, p. 145.

[4] Ibid., p. 145.

[5] Ibid., p. 147.

As an example of good practices for private sector development and resilience in the ESCWA region, the case of Lebanon is analysed. Chapter IV examines the challenges and coping mechanisms of private sector development in conflict. This section then draws conclusions and offers policy recommendations for improving the resilience of the private sector in contributing to development and peace as well as the role of the State in providing an enabling environment for the private sector to thrive.

B. THE ROLE OF THE STATE IN DEVELOPMENT

Conflict-affected countries find themselves caught in what Dorward, Kydd, Morrison, and Poulton (2005) have described as low-level equilibrium traps.[6] They suffer from such profound governance and economic deficits that they remain impervious to orthodox economic policies designed to stimulate growth by constituting free markets. The short- and medium-term private sector prospects of these countries are bleak due to their small market, high costs, low skills base, poor physical infrastructure and fragile legal institutions, as well as their position on an uneven international playing field.[7] The economic environments of conflict-affected countries provide extreme examples of market failure. Indeed, it is difficult to envisage more complicated and unattractive economic environments.[8] Furthermore, the spillover effects of the consequences of conflict onto neighbouring countries present significant challenges to the development and private sectors of these countries too.

The private sector in conflict-affected countries faces two main sets of challenges. The first set are the high risks and costs involved in doing business in a conflict environment. Businesses face the risk of losing investments as a result of the physical destruction or damage of assets and loss of human resources. Funding becomes scarce and very costly due to these high risks. Access to markets is interrupted or blocked and operation costs increase, particularly transportation, communication and forced payments.[9] Some businesses incur large costs in contracting private security services. Moreover, businesses are faced with indirect costs as a result of closure and lost opportunities. Large and foreign businesses respond to high risks by transferring their investments to safer regions or countries. Small and medium-sized enterprises (SMEs) are more vulnerable to this kind of risk due to their small investment base and as a result of weakened social services and safety nets. As a result, heightened risks lead to the development and spread of informal business which is considered an adaptation or way out strategy.

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6 Dorward, Kydd, Morrison and Poulton, 2005, p. 3.

7 Barbara, op. cit., p. 312.

8 Ibid., p. 311.

9 See GTZ, 2008a.

The second set of challenges consists of such existing shortcomings in the business environment common to many developing countries as the absence of open market mechanisms and suitable commercial regulations, the challenge in attracting private investment as well as FDI, including the lack of infrastructure and availability of credit. In many cases these shortcomings existed before the conflict.

Although security and the rule of law are necessary conditions for the growth of the private sector and the economy as a whole, the intensity of conflicts and their duration vary even within countries affected by conflict, and in many cases allow some normalcy in economic activities. That said, however, the absence of markets and adequate levels of demand, as well as the presence of high risks and costs, as explained earlier, limit to a great extent the benefits in growth and development that would ordinarily be hoped for from an active private sector. This leaves a gap in the role of the private sector in employment generation and goods and services provision that puts further pressure on countries affected by conflict. There are also high risks from heavy reliance on the private sector in the provision of public services that become scarce or deterred by lack of security, namely, health, telecommunications and transportation, as well as other services which are normally considered a responsibility of the State.

There is a growing consensus that Governments can play a vital role in successful development efforts, while recognizing that the wrong kind of Government intervention can be highly detrimental.[10] Leadership and good governance are needed to ensure that the productive energies and assets of households, communities and enterprises are adequately channelled towards the recovery effort. The leadership of the State is also needed to foster and protect an environment that enables economic activity and that can promote both security and growth.[11] Without the policymaking, administrative capacity and good governance to generate economic activity, protect investments and provide basic social services, however, Governments will remain vulnerable to the dual traps of poverty and violence. An appropriate developmental conception of the State would be one that engages directly with the profound market failures which conflict-affected countries suffer; this includes increasing public investment with the aim to attract private investment as well as filling the shortage of private investment and lack of credit. The implementation of industrial policies in the aftermath of conflict is also an essential element of successful post-conflict economic development. This includes forms of import substitution policies, as was the case for the East Asian Tiger economies, which would then lead to more open types of trade and industrialization policies once the private sector is strong and resilient enough to play its role in contributing to long-term economic growth and sustainable development. It is also

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[10] Stiglitz, 1998, p. 2.

[11] UNDP, 2008, op. cit., p. 145.

recognized in recent development literature that civil organizations play a crucial role in resolving conflict and in promoting State and market efficiency and social equity.

Indeed, Government incentives to enact sound policies are essential to economic success.[12] Hall and Jones (1999) have shown that countries with a better institutional environment have a much higher level of labour productivity.[13] There is enough exogenous variation in structural policies and institutions to identify a causal link from institutional quality to productivity.

The broader peacebuilding community now generally recognizes the indispensability of a functioning State to post-conflict stability and recovery, as set out by the Organisation for Economic Co-operation and Development (OECD) in its 2005 Principles for Good International Engagement in Fragile States and Situations.[14] It is also recognized that such a functioning State will contribute to a strengthened private sector.

It is for this reason that the international community has prioritized assisting war-torn countries to rebuild their institutions and capacities for accountable and effective governance and, in some cases, to redress the legitimacy and capacity deficits that contributed to armed conflict in the first place.[15]

In recent years, particularly as a consequence of the Paris Declaration on Aid Effectiveness, growing attention has been paid to the provision of direct budget support. If this type of support is provided early and with minimum control, it can reinforce economic recovery and peace consolidation.

Most conflict-affected countries rely heavily on external aid, at least initially, for the resources they require for the recovery of the economy and the provision of public services. Ultimately, however, sustainable recovery requires that such Governments develop the institutional, administrative and fiscal means to directly underwrite the provision of these services. This depends in turn on the ability of the State to mobilize, allocate and spend domestic revenues. Hence, the size of the public revenue relative to the national income is a good indicator of the relative strength or weakness of the State. The objectives of revenue mobilization in post-conflict settings, as in all settings, are to pay civil servant wages and to underwrite public services, as well as to finance capital expenditures and reduce aid dependence. Additionally, the capacity to mobilize revenue

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[12] Tabellini, 2004, abstract.

[13] See Hall and Jones, 1999.

[14] OECD, 2005.

[15] UNDP, 2008 op. cit., p. 145.

is an essential characteristic of an effective tax administration.[16] As a result, the strengthened ability of the State shall translate into a more resilient private sector, ultimately contributing to growth and development.

International donors are often exacting in requiring strong and transparent expenditure management and/or policy conditionality, but these create reciprocity and either accountability (or corruption) between Government and donors, rather than between Government and society. Conflict-affected countries face unique challenges in establishing and strengthening public finance systems. In the course of the war, armed groups, both official and unofficial, are likely to have gained access to taxes, rents, or foreign aid of various kinds to finance their military and political activity and, often, to enrich their key personnel.[17]

Another challenge, and one that is widely recognized, is the unacceptably high administrative costs as Government agencies cope with multiple donors. Coordinating them and staying on top of their agenda can be quite a challenge for the typically weak post-conflict Government. Thus, one of the most important reasons for recovery assistance is to build as quickly as possible the capacity of the local leadership to "own" the recovery process of the country.[18]

Aid dependency, suffered by most conflict-affected countries, remains an impediment to recovery and development, including an obstacle to building capacity of public institutions to independently strengthen the economy and the private sector and contribute to sustainable development.

For most conflict-affected countries, official development assistance (ODA) is the best short-term option for recovery finance. Aid gives national authorities additional resources and discretion to restore policymaking capacities, and the crucial political space to work on building an internal consensus on overall recovery strategy. In both cases, transparency and accountability in Government expenditure are essential to improving governance. Equally important, a good image makes a country more attractive to both public and private investment and donor support.[19]

Conflict-affected countries suffer from significant capacity deficits in those very areas where State capacity is most needed, including the lack of capable and authoritative bureaucracies. Many conflict-affected countries continue to suffer from

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[16] Ibid., p. 163.

[17] O'Donnell, 2005, p. 3.

[18] UNDP, 2008 op. cit., p. 162.

[19] Ibid., p. 152.

political disunity and the lack of an authoritative political elite that is able to effectively promote national developmental goals.[20]

Public finance – the collection, allocation and expenditure of public resources – is one of the defining functions of a State. In post-conflict circumstances building capacity for public finance faces multiple challenges: States tend to be weak, illegitimate, and unaccountable, societies tend to be polarized with competing informal systems of taxation, and much immediate public expenditure is undertaken by international donor agencies rather than the national Government.[21]

Rebuilding fiscal institutions in the wake of conflict involves creating the appropriate legal and regulatory framework, establishing a central fiscal authority for mobilizing revenues and for coordinating external assistance, and installing mechanisms for deciding on and implementing revenue and expenditure policies.[22]

Without an effective capacity to translate gains from economic growth into gains for public finance, State coffers are unlikely to benefit from post-conflict economic growth when it does occur. Governments should provide public goods, correct market failure, reduce inequalities in income and opportunities, and stabilize excessive economic fluctuations.[23]

Given the weakness of the indigenous private sector in many conflict-affected countries, State development strategies should include efforts to revitalize successful State-owned enterprises (SOEs) and restructure sick industries as part of a comprehensive industrial policy as a basis for building private sector capacity. SOEs usually account for a significant part of post-conflict economies and often occupy strategically important economic positions. This also points to the fact that a head long rush to privatization should be avoided during this critical development.

In the case of Iraq, in 2004, the desire of the coalition provisional authority to privatize the estimated 190 SOEs saw them starved of desperately needed capital, preventing them from being used effectively as critical economic beachheads in broader efforts to revitalize the Iraqi economy.[24] According to Barbara (2008), a more sensible developmental approach towards SOEs would focus on their quick revitalization under

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[20] Barbara, op. cit., p. 315.

[21] O'Donnell, op. cit., p. 1.

[22] Gupta et al., 2007, abstract.

[23] Tabellini, op. cit., p. 1.

[24] International Crisis Group, 2004, p. 6.

State control as a basis for the development of national industrial hubs, including an export and import substitution focus.[25]

In the absence of growth led by the private sector, rebuilt neo-liberal States lack the material means to redress regional disparities or to promote redistributive policies that might reduce horizontal inequities, a major potential cause of conflict.[26] Public employment, for example, is a particularly efficient instrument to achieve targeted redistribution.[27]

The other side of public fiscal management lies in the Government's capacity to plan and implement public expenditure. For the conflict-affected State, it is particularly important to view public expenditure priorities through the lens of conflict risk minimization. To help peace consolidation, public expenditure must be distributed fairly and contribute to reducing horizontal inequalities and enhancing the well-being of the poorer segments of the population.[28]

While government is needed to regulate financial institutions, not only to ensure competition, but also to maintain the safety and soundness of the financial system, it is, however, important to restrict Government interventions in areas in which there is evidence of a systematic and significant influence of special interests. This strategy is to reduce the allure of "rents" by limiting Government action in areas where special interests have had strong sway, and where the benefits of special interest legislation are limited.[29] Indeed, conflict-affected countries, in general, carry significant opportunities for rent-seeking behaviour due partly to the wartime economy. The problem is often compounded by the weak capacity for budgetary management and fiduciary oversight.[30]

According to Stiglitz (1998), policymakers in post-conflict settings should concentrate on enhancing competition. Government restrictions on competition, almost always associated with a decrease in welfare, are one of the most common symptoms of undue influence by special interests. Although most would agree that promoting competition and acting as a referee in the market economy are key Government roles, the State often succumbs to pressure to reduce competition.[31]

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[25] Barbara, op. cit., p. 314.

[26] Ibid., p. 310.

[27] Tabellini, op. cit., p. 10.

[28] UNDP, 2008 op. cit., p. 167.

[29] Stiglitz, op. cit., p. 11.

[30] UNDP, 2008 op. cit., p. 151.

[31] Stiglitz, op. cit., pp. 12-13.

The East Asian Tigers are often referred to as successful examples of countries whose Governments have taken the lead in promoting development and strengthening the private sector during critical periods of their development stages.[32] The development of Sweden in the nineteenth century and the important role of the State as an engine of equitable growth during that period is another example of effective Government policies.

In conflict-affected countries there is no single institutional locus for the political struggle over the allocation of public funds and implementation of public programmes. Information about allocation of resources is often closely held, as it has great political value.[33]

Indeed, secrecy, or restricted information, is often used to curb outside participation in decision-making. The resulting exclusivity of the decision-making process increases both the influence and the rents. Limitations on information, in effect, restrict competition in the decision-making process.[34]

As has been analysed above, the State thus plays an important role in creating an enabling environment for development and growth during the crucial period of weakness of the private sector in conflict-affected countries. While the State needs to intervene, however, and put in place effective policies for private sector resilience and growth, the private sector also has an important part to play in development, as well as peace and conflict mitigation.

C. THE ROLE OF THE PRIVATE SECTOR IN DEVELOPMENT IN CONFLICT-AFFECTED COUNTRIES

Economic growth, business investment and employment are deeply interconnected to peace and conflict. Armed conflict clearly has a major impact on economic activity: It destroys access to infrastructure, land, workplaces, labour, skills and markets. Where there is little expectation of return, public and private sector investment declines and employment opportunities become scarce.

The private sector does not, however, disappear during conflict. Indeed, it is often remarkably resilient. What is more, the presence of a functioning private sector is hugely beneficial as it provides livelihoods and, thus, alternatives to fighting. The private sector may be one of the few sectors during wartime that acts to maintain relationships and security, as well as the supply of goods and services, often across the

[32] UNCTAD, 1997, op. cit.

[33] O'Donnell, op. cit., p. 3.

[34] Stiglitz, op. cit., p. 14.

conflict divide. International business can have a vital role to play in creating investment and jobs. The private sector as a whole can represent an important constituency for peace, and has often played an important role in peace negotiations, or talks to prevent conflict, as in El Salvador and Guatemala at the beginning of the 1990s, as well as in Sri Lanka and South Africa.[35] On the other hand, we know that some private sector activities, either wittingly or unwittingly, can increase tension or provoke conflict, as seen in the Democratic Republic of Congo in the mining sector.

Indeed, during conflict, businesses continue to operate by adapting to the conflict situation, through engaging in illicit activities, or more severely through engaging in economic activities to support and sustain conflict. The lack of a business environment conducive to the private sector exists in many cases even before the conflict takes place. Businesses operate in a difficult environment in the absence of both security and the role of the State as a regulator and supporter. In such environments, war economies occur as alternative systems of production and exchange of both licit, illicit, and conflict-related goods and services. As the role of the State becomes weak or absent, the alternative system assumes parts of this role by collecting taxes and providing social services and safety nets.[36]

Pugh et al. (2004) differentiates three types of war economies, namely, combat, shadow and coping economies. The combat economy is run by such groups engaged in fighting as State and non-State militants, rebels and weapons dealers with the purpose of funding the fighting and achieving such military objectives as gaining wealth and power. The economic expenditure of this type is focused on conflict-proliferating activities involving arms, militants, and mercenaries. The money to finance these expenditures comes from the control or looting of such natural resources as oil, diamonds and narcotics.[37] Other important sources of finance, however, include such normal activities as the cultivation of vast lands for high value commodities.[38] Rebel or military groups also rely on taxation, extortion and various types of legal and illegal economic activities in areas where they have control to get external funding and support.[39]

The shadow economy is motivated by profit and dominated by businesses, profiteers and traffickers. These economic actors operate in a very high level of

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[35] For a more comprehensive account of the direct involvement of the business community in peace processes, see Tripathi and Gunduz, 2008.

[36] Taylor, 2004, p. 5.

[37] Pugh, Cooper, and Goodhand, 2004, pp. 58-68.

[38] Humphreys, 2003.

[39] Pugh et al., op. cit., pp. 58-68.

informality outside the law and State regulation. They engage in economic activities that can range from such licit activities as telecommunications and extractive industries, to illicit activities like smuggling commodities, and narcotics production and trafficking. Family and clan networks play an important role in supporting and propagating this form of activity by creating employment, providing loans and facilitating access to education and other services to loyal members of the network. The provision of social services by similar groups and the spread of informal activity increase when the State is weak or absent.[40]

The coping economy is formed of families, households and communities that rely on low-risk economic activities or savings to maintain livelihoods and who, out of choice, vulnerability, or lack of networks, have not become active actors in shadow and combat types of economic activity. Some of the main economic activities of this group of actors include small-scale businesses in commerce, agriculture and trade.[41] These activities are essential to such vulnerable groups as the poor when formal economic frameworks for production and employment are inaccessible or destroyed by conflict. Aid and remittances are also main sources of income for this group.[42]

In addition to the potential negative impact of these types of war economies on stability, economic growth (or collapse) also has an impact on stability and peace. Collier (2004) has estimated that economic growth significantly reduces the chances of post-conflict countries falling back into instability.[43] It is the poorest countries that are at most risk of instability. Of particular relevance today, however, is a recent finding that serious economic shocks in fragile States are typically associated with a 50 per cent increase in the risk of conflict in the following year.[44]

The private sector has a vested interest in working towards a prosperous society, which includes striving towards equality. Prosperity requires political stability and peace, which can only be achieved if the root causes of conflict are addressed and the elements that compromise long-term stability are dealt with. Equitable economic growth remains the key to any sustainable development exercise. Business leaders provide an able resource for development actors since the private sector is within the core function of the economy[45] and because of its vested interests in economic recovery, political security/stability and the administrative efficiency of State institutions.

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[40] Ibid., pp. 60-61.

[41] Ibid.

[42] Ballentine and Nitzschke, 2005, p. 18.

[43] Collier, 2004, p. 3.

[44] Ibid., p. 8.

[45] Banfield, Gunduz and Killick, 2006, Chapter II, p. 78.

The Secretary-General declared: “The United Nations has developed a profound appreciation for the role of the private sector, its expertise, its motivated spirit, its unparalleled ability to create jobs and wealth ….In a world of common challenges and common vulnerabilities, the United Nations and business are finding common ground.”[46]

D. THE PRIVATE SECTOR IN PEACEBUILDING AND CONFLICT PREVENTION

Given the large influence of the private sector in the dynamics of conflict and peace, it is only reasonable to explore the avenues through which it can become a constructive actor. Within that context, it is important to note that peacebuilding is multitasked and requires diverse needs that are mostly and readily available in the capacities, skills and resources of the private sector. Researchers and development actors agree that the private sector, through its economic influence, political contacts, financial resources, skilled workforce and its link to all levels of society, is ideally poised to be a positive actor in bringing about peace.[47]

Local SMEs are often victims of violent conflicts and have a strong interest in ending such conflicts. Local business people are, therefore, particularly well-suited partners for peacebuilding.[48] Since the overwhelming majority of companies are negatively affected by conflict, most business actors have an inherent interest in peace and stability. Local business people can play an important role in peacebuilding. The concept of peace entrepreneurship covers a range of interventions by domestic business seeking to promote peace in a variety of conflict settings.[49]

Private sector development can alleviate some post-conflict problems, and no lasting economic recovery is possible without it. At the same time, it needs to be remembered that peace processes are inherently and inevitably political. Skilful economic initiatives can support but not replace the political process.[50] On the other hand, for example, the private sector can play an essential role in disarmament, demobilization and reintegration (DDR) projects, particularly the reintegration of ex-combatants in post-conflict situations, by providing jobs, transferring skills or even supporting self-employment. It is also important for the private sector to incorporate

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[46] Kofi Annan, Message to the Business-Humanitarian Forum, Geneva, 27 January 1999, as quoted in Gerson, 2001, p. 106.

[47] Bray, 2006, p. 2, and Killick, Srikantha and Gunduz, 2005, p. 4.

[48] Bray, 2009, p. 6.

[49] International Alert, 2006, p. 31.

[50] Bray, 2009, p. 22.

specific components that would strengthen the role of the State in the process of DDR.[51] Even in conflict, the private sector continues, through decent work, to provide a cushion against the worst falls into de-integration and de-development. This is true for most local businesses that continue to work and earn income.

By supporting the public sector in its peacebuilding task, the private sector contributes to strengthening the legitimacy of the State.[52] Business can lead to more or less conflict through either direct or indirect engagement in conflict, as explained earlier. Recent studies and experiences have exposed the positive aspect of private sector engagement in conflict, especially the developmental dimensions brought by the sector. The private sector can contribute significantly to stabilization efforts of the public sector through its classic role in income creation, reconstruction, and filling gaps in public service provision. Another dimension for private sector contribution stems from growing evidence about its contribution to State-building, conflict resolution and peacebuilding.

Initiatives for engaging the private sector in conflict resolution and peacebuilding should clearly define the role of the private sector and take into consideration the interests of businesses in peace. As explained earlier, despite their different incentives, most business enterprises, particularly the local ones, have a vested interest in peace. There are two main groups of views or approaches concerning the level of engagement required by the private sector. The first group holds the view that the private sector in conflict should continue to do what it is best at doing and that is earning profit and creating jobs. The private sector is not required to have direct involvement in conflict resolution and peacebuilding dialogue and processes.[53] According to Bray (2009), the most important contribution that companies can make to peacebuilding is to concentrate on the responsible fulfilment of their core commercial activities, whether these concern telecommunications, financial services or mineral development, thus increasing wealth and creating the economic conditions for post-conflict recovery.[54] Bray further States that wealth creation is not in itself sufficient to resolve conflict. Indeed, it may actually help to create the conditions for conflict if the benefits of short-term economic recovery are unevenly distributed.[55] Furthermore, business is most effective when it avoids the appearance of partisanship in the sense of supporting one particular actor or political party, but instead points to the economic costs of failing to end conflict – and to the

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[51] Government of Sweden, 2006.

[52] OECD, 2008.

[53] Bray, 2009, op. cit., pp. 1-26.

[54] Ibid., p. 17.

[55] Ibid.

dividends that accrue from achieving peace.[56] Enterprises should, however, be conflict sensitive and realize that they might have a significant impact on conflict. While some enterprises engage in unlawful or conflict-sustaining activities as explained earlier, many enterprises affect the conflict situation unknowingly. This might occur when a business excludes one or more community groups from business opportunities due to difficulty of access or lack of expertise. The concept of "do-no-harm" is based on understanding how enterprises affect conflict with the aim of preventing them from contributing to the escalation of conflict or hindering peacebuilding.[57]

A number of practices and tools were devised around the do-no-harm principle. The United Nations Global Compact designed a guide for conflict impact assessment and risk management to assist enterprises better understand the risks they face when doing business in conflict areas and developing strategies to minimize their negative impact on the conflict situation. The guide provides a checklist of key conflict factors in a number of important areas, including governance, economics, human rights and security.[58] These practices highlight the importance of an inclusive approach, transfer of benefits to the local community and a supplementary role of enterprises in the provision of basic public good. A more detailed approach was provided by the guide by the German Agency for Technical Cooperation (GTZ) on private sector development in conflict. The guide introduces a spectrum of tools that vary from do-no-harm to full engagement in conflict resolution and peacebuilding. International Alert has also developed a practical guide for extractive industries to apply these principles in countries where they operate. The various tools share the important view that enterprises should carry their activities in a way to promote inclusive socio-economic growth. More equitable recruitment and profit-sharing strategies are recommended. Enterprises should also pay attention to not engage in or support corrupt public practices.

The second approach goes beyond the do-no-harm principle, proposing a direct role for the private sector in conflict resolution and peacebuilding processes. This group of views suggests that the private sector possesses powers, resources and skills that can be harnessed in peace processes. The private sector interests influence public policy, including peace talks, and have a destabilizing power if not met.[59] Synergies can be drawn upon, whereby private enterprises can bring their negotiation skills, local knowledge of conflict and community, and networks of contacts to peacebuilding

[56] Ibid., p. 21.

[57] Based on the concepts introduced by GTZ, 2008a.

[58] United Nations Global Compact, 2002.

[59] International Alert, 2006, p. 42.

initiatives.[60] Enterprises have a role in State-building and -strengthening in conflict settings. The private sector can also act as a “connector”, bringing in people and reducing the divides amongst them.[61] Where most social relations are damaged in conflict settings and high levels of mistrust prevail, business relations, including doing business with the enemy, can provide communication channels amongst conflicting groups.[62] The OECD introduced a set of principles for international engagement in fragile States that can provide important insights for international as well as domestic enterprises. By engaging in peace initiatives as well as addressing such essential areas as rights, democracy, and governance, the private sector, along with other actors, can serve State-building and State legitimacy.[63] The private sector can also support the public sector in building capacity for its core functions of security, basic service provision, and creating an enabling environment for business.[64]

Corporate social responsibility (CSR) is one of the significant tools for positive enterprise engagement in conflict that can combine either or both approaches. Based on the concept of mutual respect and concern between business and the society, it has emerged as a corporate response to a number of social and environmental concerns of the community. CSR policies are voluntary and mostly adopted by large enterprises and multinational corporations. In conflict settings, CSR can be broadened to take into consideration the impact of businesses on conflict and their possible role in conflict mitigation. Enterprises are advised to adapt their CSR policies to ensure that at least the do-no-harm principles are reflected in these policies and that enterprises do not end up fuelling conflict due to inequitable distribution of benefits or lack of understanding of the conflict situation.

The role of private sector actors in peacebuilding varies depending on the scale and motive of different actors. Local businesses situated outside the capital or large urban areas, which are mainly small-scale, not directly connected to the ruling elites and not as affluent, are great assets for peacebuilding and development efforts. Local businesses away from urban concentrations are more likely to be in tune with the dynamics of conflict and developmental needs, for the mere reason that they are closer to the population and the war. Thus, they are ideally placed to exert positive influence on the ground, if rightly encouraged and equipped. Local business leaders in small urban or rural areas are also well-situated to act as community leaders, bridging

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[60] Ibid., p. 31.

[61] GTZ, 2008a, op. cit., pp. 12-13.

[62] Ibid.

[63] OECD, 2009.

[64] Ibid.

differences, providing employment and promoting reintegration of opposing combatants or displaced persons.[65]

More than any other sector, the private sector is an expert in publicity and media campaigns. This capacity could easily be utilized for awareness-raising and social mobilization on vital issues that would support peacebuilding and development efforts, in particular getting public acquiescence to a peace process. The powerful media tool could also assist in shifting mindsets amongst the broader society or pressuring political elites into brokering an agreement. Businesses have historically funded awareness-raising campaigns aimed at stressing the suffering and destruction of conflict, the cost of war and influencing voters to support peace-oriented parties or individuals.[66]

The private sector, particularly large institutions, is close to political decision-making circles and has ample political contacts amidst the ruling elite or even warring factions. Business people are known to have played important roles as insiders as part of a negotiating team, or as outsiders helping to build trust between warring factions, or through conducting the necessary research as well as cost estimates related to peace negotiations. Their assets, expertise and knowing how and when to compromise could prove to be of crucial support in the implementation of peace accords.[67]

The potential represented by business people could be invested in providing assistance in the formulation of a system-wide strategy comprised of meetings of business leaders with security, military, Government and non-Government representatives whereby the private sector expresses its views regarding such vital issues as security, corruption and tax revenues. Business people could also assist in overcoming divisions based on conflicting institutional cultures or mandates. A neutral third party, as represented by the private sector, could bridge differences among regional or multilateral organizations.[68]

Aside from its involvement in the various negotiating phases of a peace process, the private sector also has a vital role to play in monitoring the implementation of peace agreements that could face obstacles due to ill intent or lack of resources. Here again, the private sector plays a crucial role in raising the required social and economic resources, assisting or implementing reconstruction of vital infrastructure, creating the necessary jobs and raising awareness.[69]

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[65] Killick et al., op. cit., pp. 14-16.

[66] International Alert, op. cit., p. 58; and Killick et al., op. cit., pp. 11-13.

[67] International Alert, op. cit., pp. 42-44, 47-48, 50-52, 60; and Gerson, op. cit., pp. 110 and 112.

[68] Gerson, op. cit., p. 113.

[69] International Alert, op. cit., p. 62.

A number of important limitations face the active role of the private sector in peacebuilding. The first limitation is brought by the fact that the priority for enterprises is profitability and survival. This might not leave them with much time and effort beyond their daily business operations to work on peacebuilding initiatives.[70] Though the concepts proposed reflect a high level of ethics and good intentions, the role of the economic actors and private sector is very new even within the realms of research. The work of Anderson and Olson stresses the need for effective peacebuilding programmes and tools. Effective private sector development and peacebuilding efforts reflect local ownership and are initiated by local communities, enhance the capacity of political institutions in addressing conflict-inducing inequalities, and lead to resisting violence and enhancing security.[71]

[70] GTZ, 2008b, p. 14.

[71] Ibid.

II. AN OVERVIEW OF THE SOCIO-ECONOMIC IMPACT OF CONFLICT ON DEVELOPMENT IN THE ESCWA REGION

A. CONFLICT AND DEVELOPMENT IN THE ESCWA REGION

Conflict has serious implications for development in countries affected by it, not only in terms of the difficulty of implementing development policies, but also because it leads to more poverty and lower growth, which are very serious root causes of conflict. In addition, the spillover effects of conflicts into neighbouring countries, as is the case in the ESCWA region, has tremendous implications for development and private sector resilience in those countries. Indeed, for quite some time, the private sectors in most countries of the ESCWA region have been performing far below potential. One of the main reasons for this underperformance is the environment of ongoing conflict in the region. Armed struggle and political conflicts have been permanent features of the ESCWA region for decades. Inter-State wars, civil conflicts, international boycotts and border closings have occurred frequently during the last six decades in various parts of the region. Most of the conflicts in the region lasted for more than five years (see chart 1), notably the Arab-Israeli conflict which started in 1948, the war on Iraq and the two preceding Gulf wars, and the internal conflicts which existed and continue to exist in some parts of the region.

Though the number of conflicts in the region has notably declined since 1997, chronic conflicts continue to exist and to devastate the lives and economies of the people in the affected countries (and, to a lesser extent, on non-conflict-affected countries) as shown in chart 2. Naturally, this has created a precarious and unpredictable environment that has not been conducive to fostering economic activities. Gross domestic product (GDP) growth has been severely impacted by conflict as seen in chart 2. In the case of Iraq, GDP contracted by almost one third with the onset of the war in 2003.[72] There has been a similar GDP decline in Palestine with intensified episodes of conflict; it contracted by 8.6 per cent in 2001 after the start of the second uprising and intensified Israeli military incursions, and by 4.7 per cent in 2006[73] as a result of the blockade imposed by Israel over the transfer of funds, the movement of goods and persons, and growing internal conflicts. The war on Lebanon in 2006 resulted in no growth according to a conservative estimate. Inevitably, production, employment, investment and trade were frustrated by long periods of high risk and uncertainty, immense damage inflicted on infrastructure, and the frequent disruption of the movement of people and goods. The protracted nature of conflicts in the region and

[72] ESCWA calculations based on United Nations, National Accounts statistics database, accessed in May 2009.

[73] Ibid.

episodes of violence have particularly disrupted economic activity and distorted development in general, including the development of a viable private sector.

Chart 1. Conflicts in the ESCWA region (1948-2008)

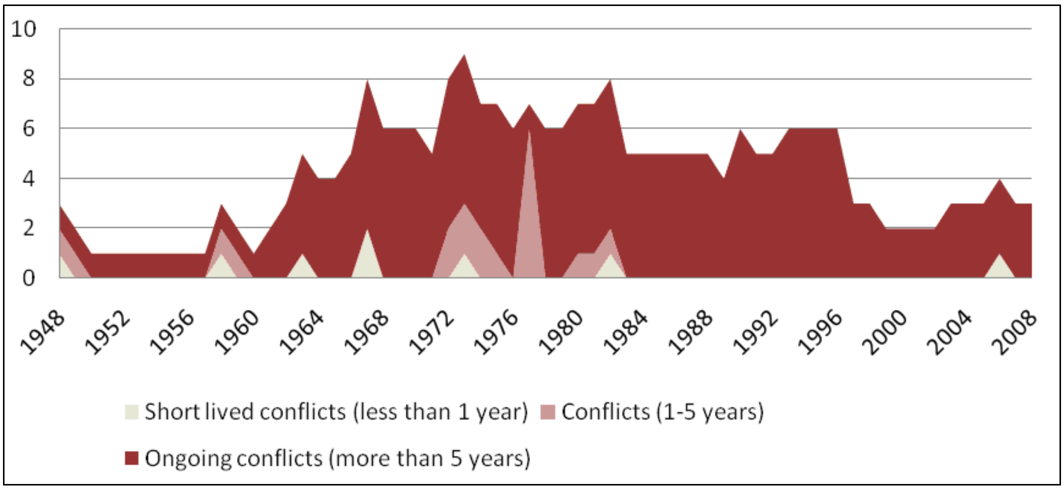
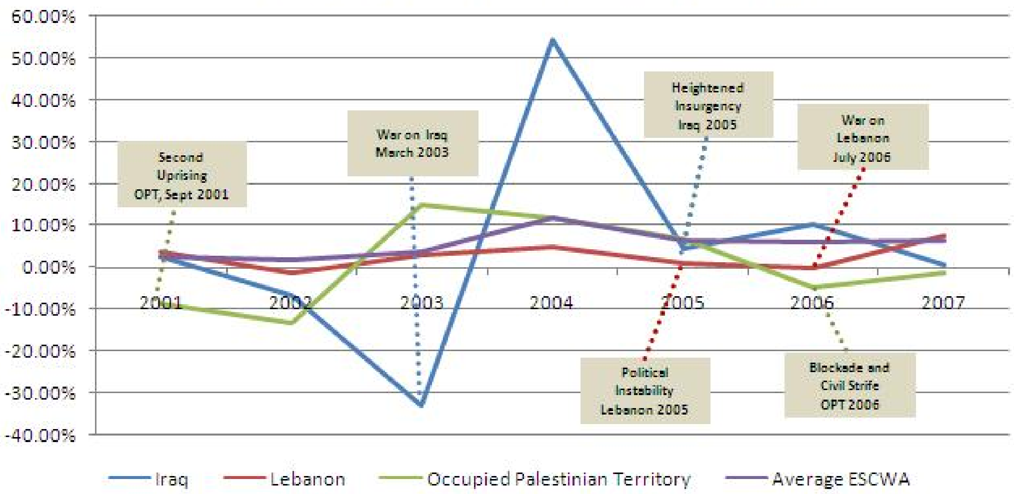


Chart 2. Conflict and GDP growth (at constant 1990 prices) in selected conflict affected countries in the ESCWA region, 2001-2007



Source: ESCWA calculations based on United Nations, National Accounts Statistics database, accessed in May 2009.

Note: Real GDP growth for ESCWA was calculated from GDP statistics at constant 1990 prices, for the period 2000-2007, for the 14 ESCWA member countries namely: Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Oman, OPT, Qatar, Saudi Arabia, Sudan, Syrian Arab Republic, United Arab Emirates, and Yemen.

B. Socio-economic impact of conflict on countries in the ESCWA region

For many years, all the economies of the ESCWA countries have suffered from the adverse impact of an environment of armed conflict. During the last decade, armed conflicts have taken place in Iraq, Lebanon, Palestine, the Sudan and Yemen. Evidently, the economic performance of those countries has suffered from this direct exposure to instability. This is reflected in three facts. First, real per capita income has been declining in recent years, while that of the other countries has grown (table 1). Second, the unemployment situations of the five directly affected countries are disconcerting. Third, gross capital formation (GCF) as a percentage of GDP is less in the five countries directly affected by conflict than in the other countries; the average for 2007, for instance, is 18.2 per cent of GDP for the conflict-affected countries and 24 per cent for the other countries (table 2). In conflict-affected countries, a significant percentage of GCF is used to reconstruct and rehabilitate destroyed structures and infrastructure rather than to build such productive capacity as machinery and equipment or R&D, as explained in more detail in the country sections. The reconstruction process is also a recurrent process due to the protracted nature of conflicts; many areas in Palestine and Lebanon have been reconstructed more than once.

Development was severely hampered by conflict in many countries in the region. Development benchmarks, including the Millennium Development Goals (MDGs), are particularly hard to attain in countries affected by conflict. Moreover, countries affected by conflict in the ESCWA region scored less than the average for countries in the same income group on the Human Development Indicators (HDI), as is the case for Palestine, Iraq and the Sudan.[74] The HDI rank of Palestine deteriorated from 102 in 2003 to 106 in 2006.[75] It is estimated that almost one half of the population of Palestine and one third of the Iraqi population live in poverty.[76] Absolute poverty also affects a significant portion of the population of the Sudan.[77] Indeed, conflict has led to a sharp drop in per capita income and an increase in unemployment, which are two of the main factors behind high levels of poverty in Palestine after 2000 and in Iraq after 2003.

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[74] UNDP, 2007.

[75] UNDP, 2005, p. 220 and 2007, p. 278.

[76] ESCWA and League of Arab States, 2007, p. 20.

[77] Ibid., p. 14.

TABLE 1. RATE OF GROWTH IN GDP PER CAPITA AT CONSTANT 2000 US DOLLARS[a/]

Country	1970s	1980s	1990s	2000-2007	Unemployment rate[b/]
Bahrain	..	-2.09	2.51	3.67	5.2 (2001)
Egypt	4.06	3.47	2.36	2.75	10.7 (2004)
Iraq	..	..	26.07	..	17.5 (2006)
Jordan	11.04	0.14	0.55	3.30	12.4 (2004)
Kuwait	-3.91	-5.19	..	4.56	1.7 (2004)
Lebanon[c/]	..	-42.88	7.53	1.77	10.2 (2007)
Oman	1.33	4.90	1.14	4.06	..
Palestine	..	..	4.23	-5.28	31.5 (2008)
Qatar	..	..	..	2.79	3.9 (2001)
Saudi Arabia	8.88	-5.97	0.58	1.52	5.2 (2002)
Syrian Arab Republic	6.55	-0.76	2.88	1.72	12.3 (2003)
The Sudan	1.01	0.48	1.80	5.26	18.7 (2002)
United Arab Emirates	-2.84	5.24	-0.09	2.11	2.3 (2000)
Yemen	..	..	1.57	1.00	..

Source: ESCWA calculations based on World Bank, World Development Indicators database, accessed in July 2009.

a/ Straight line average of real GDP growth rates.

b/ Unemployment rates reflect the latest available rate for each country. The year is indicated between brackets.

c/ Unemployment rate in Lebanon was taken from UNDP, ILO and Republic of Lebanon. 2008. *Living Conditions of Households 2007*;

(..) Indicates that no data is available.

There is also a great concern that higher levels of poverty and unemployment have led to higher dependence on aid. Indeed, the level of aid dependency of Palestine is very high as over one third of income in Palestine comes from aid, as measured by the aid-to-gross national income (GNI) ratio that reached 34.6 per cent in 2006.[78] Conflict has also led to deterioration in the provision of and access to education and health services. School enrolment rates have dropped by over six percentage points since 1990 in Iraq and by over 16 percentage points since 1999 in Palestine, particularly as a result

[78] World Bank Development Indicators database, available at: www.worldbank.org/data/countrydata/countrydata.html, accessed in May 2009.

of limited access to schools due to insecurity and blockades.[79] Health services also suffer from reduced staff and medical supplies; people cannot access these services and a number of health indicators have worsened in countries affected by conflict, notably the spread of cholera in Iraq.

TABLE 2. GROSS CAPITAL FORMATION[80] AS A PERCENTAGE OF GDP*

Country	2003	2004	2005	2006	2007
Bahrain	20	24	23	25	22
Egypt	17	16	17	19	20
Iraq	15	8	20	20	17
Jordan	21	25	31	31	32
Kuwait	16	15	17	16	21
Lebanon	20	21	22	14	15
Oman	16	21	16	19	21
Palestine	23	25	24	21	22
Qatar	30	30	34	32	30
Saudi Arabia	18	17	17	17	27
Syrian Arab Republic	23	24	24	21	23
The Sudan	20	22	24	25	23
United Arab Emirates	22	21	19	20	20
Yemen	13	15	14	14	14
China	39	41	41	41	41
Korea	30	30	29	29	29
Singapore	24	23	22	23	25
Hong Kong	21	22	21	21	21

Source: United Nation Statistics Division, National Accounts, September 2008.

* The ratios are calculated by using real magnitudes with 1990 as a base year.

During the period 2003 to 2007, which witnessed the oil boom, per capita income of the region grew at a rate less than that of the developing countries in such other parts of the world as Asia and some countries in Africa. As mentioned above, the ESCWA region has also failed to attract enough FDI, and, in some years, outflow of that

79 ESCWA and League of Arab States, op. cit., p. 14.

80 Definition of gross capital formation: According to the System of National Accounts, gross capital formation is measured by the total value of the gross fixed capital formation, changes in inventories and acquisitions less disposals of valuables for a unit or sector. Gross fixed capital formation consists of the acquisitions of resident producers, less disposals, of fixed assets during a given period plus certain additions to the value of non-produced assets realized by the productive activity of producer or institutional units. Fixed assets are tangible or intangible assets produced as outputs from processes of production that are themselves used repeatedly, or continuously, in processes of production for more than one year.

investment was more than the inflow (table 3). More importantly, the growth in per capita income associated with the oil boom was a jobless growth. The fact that the average unemployment rate for the ESCWA region (11.8 per cent) is currently almost double that of the world (6 per cent) underscores the seriousness of the situation.[81] Paired with this high rate of unemployment is a relatively high rate of inflation (9.8 per cent in 2008 compared to 2 per cent in the European Union the same year),[82] which has resulted in the region succumbing to the problem of stagflation.

TABLE 3. ESCWA'S SHARE OF FDI RELATIVE TO DEVELOPING COUNTRIES AND THE WORLD*

	2002	2003	2004	2005	2006	2007
	Inflows					
Developing countries	3.50	4.27	5.84	12.73	13.94	12.70
World	0.80	2.10	2.70	4.20	4.10	3.50
	Outflows					
Developing countries	1.52	(2.09)	5.71	9.61	10.57	16.88
World	0.10	- 0.30	0.90	1.30	1.70	2.10

Source: UNCTAD World Investment Prospects Survey 2007-2009.

* ESCWA calculations based on FDI data for individual ESCWA member States from UNCTAD World Investment Prospects Survey (2007-2008).

Conflict has also impacted intraregional aid and investment. Total intraregional aid flows in Arab countries amounted to US$2.8 billion in 2007.[83] It is believed that a significant proportion of these funds was spent in conflict-related emergency relief and reconstruction. Though ODA and other forms of aid are essential forms of support in conflict-affected countries, as explained earlier in the study, the protracted nature of conflicts undermines the effectiveness of aid and raises the costs of development in the region. In the absence of conflict, aid funds could have been channelled into long-term developmental projects that could have benefited both home and host countries. Insecurity also weighs heavily on the investment climate of the region and particularly conflict-affected countries. Growth in FDI inflows to ESCWA member countries dropped from 43 per cent in 2006 to 10 per cent in 2007, which is below the 21 per cent rate of growth achieved by developing countries.[84] Low rates of investment are usually

81 ESCWA, 2008, table 2, p. 2.

82 Ibid., table 1, p. 1.

83 ESCWA calculations based on Arab Monetary Fund, 2008, p. 201.

84 ESCWA calculations based on UNCTAD, 2008, annex A table B1, pp. 254-256.

attributed to an inadequate investment climate, but conflict has been a major deterrent to higher rates of investment in the ESCWA region. The share of countries affected by conflict, notably Iraq and Palestine, in overall FDI inflows in the region was a meagre 0.7 per cent and 0.03 per cent respectively in 2007.[85] Moreover, neither country received any intraregional investments in 2007.[86]

In comparing the ESCWA region to South East Asia, differences in the political economy of the two regions might shed some light on their different growth experiences. In the post-war period, Governments in East Asia, whose survival was threatened by internal conflict, worked to widen the base of their political support via policies that favour the poor. Such policies included land reform, public housing, investment in rural infrastructure, and, most importantly, widespread high-quality education. In the ESCWA region, during the 1960s and 1970s, most Governments adopted a central planning approach to development, in which priorities were given to policies for redistribution and equity. The strategy included nationalization of many industrial and commercial establishments, protection of import-substitution industries, and huge resources directed to improving social conditions. The strategy had strong payoffs in terms of improving health and education services for the poor, but it eventually ran into problems: over-centralized public sectors, strong protection of inefficient industries, and lack of accountability and transparency rendered the approach very costly. Following the stagnation of the 1990s, many countries in the region embarked on programmes of macroeconomic stabilization and structural reform aimed at promoting the private sector as an engine of growth. Indeed, the modest success of these reforms in achieving some macroeconomic stability was bought at a very high price, in terms of permitting a very high rate of unemployment and aggravating an already poor distribution of income.

Another important impact of conflict and instability on the ESCWA region, which has affected development and private sector resilience, is corruption. In a report in 2008, Transparency International found that levels of corruption existed in the ESCWA region especially in the areas of regulation, authorization and permits, taxation, transfers and subsidies, and the financial sector.[87]

It is well known that the eradication of corruption requires enhancing the democratic participation of the citizens and paying more attention to accountability and transparency. It should be emphasized, however, that while the environment of conflict

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[85] Ibid.

[86] ESCWA calculations based on the Arab Investment and Export Credit Guarantee Corporation, 2007, p. 22.

[87] See Transparency International, *Corruption Perceptions Index (CPI) 2008*, at: www.2008cpi/surveys_indices.com, accessed in April 2009. The index does not include Palestine.

in the region provides a very fertile soil for corruption, conflict is also aggravated and prolonged by the spread of corruption. Both conflict and corruption tend to raise the transaction costs and uncertainty in the economy, as well as undermine State legitimacy and the rule of law. It is no coincidence that corruption in Iraq and Somalia, which have been affected by conflict for decades, was perceived by their businessmen in 2008 to be the worst in the world.[88]

While levels of corruption are closely linked to the ease of doing business in a particular country, table 4 shows substantial differences among the ESCWA countries regarding their ranking in the latest World Bank survey comparing the ease of doing business in 181 countries.[89] Whereas all the Gulf Cooperation Council (GCC) countries rank in the highest third, Iraq, Palestine, the Sudan and the Syrian Arab Republic rank in the lowest third. This demonstrates that the private sector in these countries is in need of reforms which simplify business regulations, strengthen poverty rights, streamline import and export regulations and improve the credit information system. It should be noted that both Egypt and Yemen achieved some improvement in their ranking during the last year. The improvement in the former is due to reforming its property registry, and in the latter is due to the elimination of the minimum capital requirements for starting a business.[90]

TABLE 4. RANKING THE EASE OF DOING BUSINESS

Country	2008	2009	Country	2008	2009
Bahrain	17	18	United Arab Emirates	54	46
Saudi Arabia	24	16	Oman	57	57
Qatar	38	37	Kuwait	49	52
Lebanon	98	99	Egypt	125	114
Jordan	94	101	Syrian Arab Republic	140	137
Yemen	123	98	Palestine	132	131
The Sudan	142	147	Iraq	146	152

Source: Doing Business 2009: Comparing regulation in 181 economies. World Bank Publications.

[88] According to the 2008 Corruption Perceptions Index (CPI).

[89] The ranking is based on the following ten criteria: starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing a business. See World Bank (2008), www.doingbusiness.org/documents/fullreport/2009/overview.pdf, table 1.3, p. 6.

[90] Ibid., pp. 7 and 3, respectively.

C. THE ROLE OF THE STATE IN THE ESCWA REGION FOR PRIVATE SECTOR DEVELOPMENT

It must be recognized that one of the principle reasons for the relatively by poor socio-economic performance over such a long period of time, as analysed above, is indeed the environment of conflict. This has prevented the region from developing along the lines of regional integration and cooperation. Developing countries in other regions of the world have open for the regional integration route, after realizing that in a globalizing economy their policy space is reduced, and the multilateral framework lacks a strong development dimension. Regional integration involves the provision of regional coordination and a reconfiguration of policy space. It accomplishes this by improving regional infrastructure and, thus, enhancing production and trade by cultivating the gains from comparative advantage, economies of scale and reducing the need for protection by increasing intra-industry trade through further division of labour, by increasing competition and, thus, enhancing the ability of member countries to further international competitiveness, and by increasing the bargaining power of a region in its trade relations. The unstable environment in the ESCWA region has rendered most aspects of intra-regional economic cooperation dependent upon shifting alignments in the region, and between regional and external powers. Correspondingly, the long-term perspective for regional investment and trade is understandably fraught with risks and uncertainty. Another factor which has contributed to the failure of regional economic integration is the weak State of the physical, financial and administrative infrastructures for regional trade. Some of this is evident in inadequate transportation facilities, complicated and time-consuming customs procedures, complex and diverse exchange rate controls and the virtual absence of regional clearing and payment arrangements. This testifies to the lack of serious attention paid by some Governments of the region to the need for such pillars of regional integration, where time, energy and resources are occupied with conflict-related issues and their regional spillover effects.

Economic theory assigns three proper functions for the State in the economy:

- Production of goods and services whose production in the private sector would be sub-optimal. These include public goods like national defence and domestic security. Regulating the prices of goods and services whose markets are not competitive, which include such natural monopolies as telephone, water and electricity networks;
- Subsidizing infant industries and the production of goods and services that are considered to be semi-public goods. These include health, education and social security;

- Adopting policies that ensure: (a) Social harmony by creating a fair distribution of income; (b) Competitive and efficient markets by proper anti-trust regulations; (c) Stable macroeconomic conditions by appropriate fiscal, monetary and exchange rate policies; and (d) Economic growth by providing the incentives to accumulate physical capital, human capital and promote technological progress.

In understanding the proper role of the State in conflict-affected countries in the ESCWA region, it is essential to identify those traditional functions that the State has failed to perform, and which are either partially responsible for the conflict or could be considered as potential causes of future conflicts. They include the following:

- Failure of the State to engender a fair distribution of income that allows for the inclusion of the marginalized and the disenfranchized;
- Failure of the State to enforce regulations that curtail corruption and allow markets to develop in a competitive and efficient manner;
- Failure of the State to adopt economic policies that ensure stability at the macro level and efficiency at the micro level;
- Failure of the State to create an economic environment conducive to the accumulation of physical capital.

Some policy failures in this region have been the failure to allocate the proper resources for an optimal accumulation of human capital. Tables 5, 6 and 7 illustrate clearly that the ESCWA region has not allocated enough resources for the accumulation of human capital. Two features of these tables are especially worth noting.

1. Even though the Middle East and North Africa (MENA) region (which includes the ESCWA countries) has made great progress in the two components of human capital, health and education, in the last half century, it is still below the world average. As a percentage of GDP, expenditures on health in the ESCWA region are less than the world average. Existing data for conflict-affected countries also show low expenditures of both health and education.

2. Available data shows that the region does not focus enough on promoting R&D activities, which is essential for long-term economic growth (table 7). This is also evidenced in table 8, which shows that most of the countries in the region are not achieving any technological progress.

As this section has attempted to demonstrate, conflict in the ESCWA region has had a tremendous negative impact, relative to other factors, on development indicators, the performance of the State and on regional integration as well as economic cooperation. This has, in turn, quite significantly affected the resilience of the private sector and its ability to contribute to sustainable growth and development. Chapter III will provide an analysis of the private sectors, including the various gaps to its resilience within the context of two conflict-affected countries, Palestine and Iraq.

TABLE 5. YEARS OF SCHOOLING FOR POPULATION AGED 16 YEARS AND ABOVE

Country	1960	1970	1980	1990	2000
Bahrain	1.04	2.78	3.62	4.97	6.11
Egypt	..	..	2.34	4.26	5.51
Iraq	0.29	1.36	2.66	3.27	3.95
Jordan	2.33	3.25	4.28	5.95	6.91
Kuwait	2.89	3.13	4.53	5.75	6.22
Syrian Arab Republic	1.35	2.15	3.65	5.11	5.77
ESCWA	..	..	2.69	4.27	5.3
East Asia	2.83	3.8	5.1	5.84	6.71
South Asia	1.51	2.05	2.97	3.85	4.57
Latin America	3.3	3.82	4.43	5.32	6.06
Sub-Saharan Africa	1.74	2.07	2.39	3.14	3.52
Middle East and North Africa	1.23	2.07	3.29	4.38	5.44
High income countries	7.06	7.56	8.86	9.19	9.76
World	4.64	5.16	5.92	6.43	6.66

Source: Barro and Lee quoted in ESCWA, The impact of Economic Variables on the Social Dimensions of Development: Education and Health, 2005.

Note: (..) indicates that no data is available.

TABLE 6. PUBLIC EXPENDITURES ON HEALTH AND EDUCATION AS A PERCENTAGE OF GDP

	Education	Health
Country	2005	2006
Bahrain	..	2.46
Egypt	4.79	2.61
Iraq	..	2.73
Jordan	..	4.20
Kuwait	4.74	1.72
Lebanon	2.64	3.90
Oman	3.55	1.89
Palestine	..	..
Qatar	3.28	3.36

TABLE 6 (*continued*)

Country	Education	Health
	2005	2006
Saudi Arabia*	6.75	2.54
Syrian Arab Republic	..	1.86
The Sudan	..	1.40
United Arab Emirates	1.35	1.76
Yemen	..	2.07
World	4.57	5.86

Source: World Bank, World Development Indicators database, accessed in July 2009.

* 2004 education figure.

Note: (..) indicates that no data is available.

TABLE 7. EXPENDITURES ON R&D ACTIVITIES AS A PERCENTAGE OF GDP (2005)

Country	Percentage of GDP
Egypt*	0.19
Kuwait*	0.20
Syrian Arab Republic*	0.18
China	1.31
Singapore	2.15
United States of America	2.60
Korea	2.64
Japan	3.15
Israel	4.93
World	2.36

Source: World Bank. World Development Indicators 2007.

* These percentages are the averages for 1996-2002.

TABLE 8. AVERAGE ANNUAL PERCENTAGE CHANGE IN TECHNOLOGICAL PROGRESS (1980-2000)

Country	1980-1990	1990-2000	1980-2000
Egypt	-0.14	1.9	0.8
Jordan	-2.7	1.2	-0.9
Oman*	-1.9	0.5	-0.7
Saudi Arabia*	-0.9	- 0.2	-0.5
Syrian Arab Republic	-2.8	1.4	-0.9
Japan	-1.9	0.8	-0.5
United States of America	-0.2	0.6	0.3

Source: ESCWA, 2005.

* Measures of productivity are confined to non-oil sector.

III. THE PRIVATE SECTOR IN CONFLICT-AFFECTED COUNTRIES: ANALYSIS OF PALESTINE AND IRAQ

The role of the private sector in countries affected by conflict, as analysed in chapter I, varies significantly from one country to another due to differences in the prevailing economic structures before and during conflict, and the nature of the conflict affecting each country. Indeed, the indirect costs of conflict are less visible than the direct costs of rebuilding destroyed infrastructure, for example. The harmful impact of conflict on the growth and development of countries affected by war is deep and long lasting. Most of the indirect costs of violent conflicts in the region are caused by denied access to markets and resources, due either to enforced closures and blockades or lack of security. Productive sectors undergo periods of inactivity and perform much below their potential. As demonstrated in chapter II, this has led to economic contraction and deterioration, particularly during intensified conflict situations.

In the case of Palestine and Iraq, the private sectors in both countries are currently operating below potential. While there are marked differences between the two countries, there are some similarities regarding the negative impact of the prolonged conflict on the environment within which the private sector is operating in each country.

A. Palestine

In Palestine, the prolonged Israeli occupation has imposed a process of de-development on the economy. This process has been manifested by restrictions on resource use, business activities, and domestic and international trade. It has substantially weakened the traditional productive sectors of the Palestinian economy and, combined with the reorientation of trade flows to the benefit of Israel, has caused a general reallocation of factors of production. It has caused the economy to suffer from an infrastructure gap where basic systems, like roads, electricity, water and wastewater are barely operational. At the same time, health and education services are in dire straits. This process of de-development is taking place within the context of the continuing processes of uprooting and displacing the Palestinian people.

Due to the wars of 1948 and 1967 and the Israeli occupation policies, out of an estimated population of ten million, between five and seven million Palestinians are refugees barred by the Israeli Government from returning to their place of origin.[91] During the last decade, Palestinians have experienced recurring waves of emergency displacement. The construction of the separation wall by Israel inside the West Bank, which has been deemed illegal by the International Criminal Court, has already caused

[91] Abu-Libdeh, 2007, p. 14.

the displacement of about 15,000 persons.[92] During the Israeli invasion of the Gaza Strip between 27 December 2008 and 18 January 2009, 500,000 Palestinian civilians, including 280,000 children, had to flee their homes. The economic and infrastructural costs of this war amounted to 70 per cent of the US$1.3 billion total cost of the war.[93] Thousands of Gazans remained homeless as of February 2009.[94] Israeli restrictions on movement inside the West Bank have caused a sizable internal migration from rural areas to urban centres, especially to the Ramallah metropolitan region.[95] The Israeli policies aimed at changing the demographic structure of the city of Jerusalem have resulted in cutting off East Jerusalem from its natural and national hinterland. The concentration of Palestinian Authority activities in the Ramallah area has deeply affected the function and articulation of the Palestinian hierarchy. Furthermore, recent studies have shown that a sizable segment of Palestinian professionals, particularly in the health and higher education sectors, are seeking job opportunities in other countries, especially in the Gulf States, USA and Europe.[96]

The growth of GDP in Palestine declined by 6.4 per cent in 2001 and 3.7 per cent in 2002 after the onset of the second uprising (intifada) and Israeli military incursions, as mentioned in chapter II.[97]

In 2006, GDP severely declined by 8.8 per cent and experienced no growth in 2007[98] due to the blockade on the movement of goods, persons and financial resources. Continuous land confiscation and building the separation wall have also negatively affected growth, and internal strife has complicated the situation. Unemployment was also noticed to increase almost twofold after the second uprising from 14.5 per cent in 2000 to 26 per cent in 2008.[99] The Palestinian Central Bureau of Statistics (PCBS) estimated that productive institutions, including the private sector, will have indirect

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[92] Human Rights Situation in Palestine and Other Occupied Arab Territories. Report of the Special Rapporteur on the situation of human rights of the Palestinian territories occupied since 1967 (A/HRC/7/17), paragraph 38.

[93] Palestinian National Authority, 2009.

[94] International News and Analysis (IRIN), available at: www.irinnews.org, accessed on 17 February 2009.

[95] Palestine Economic Policy Research Institute (MAS), 2008.

[96] Mataria, Abu Hantash and Amer, 2008, p. 68.

[97] United Nations. National Accounts online database, http://unstats.un.org/unsd/snaama/Introduction.asp, accessed May 2009.

[98] Ibid.

[99] World Bank Development Indicators database, www.worldbank.org/data/countrydata/countrydata.html, accessed on 29 April 2009.

costs of US$804 million due to losses from suspension of daily economic activities in 2009 in the aftermath of the 2008-2009 war on Gaza.[100]

The private sector in Palestine plays a significant role in the economy. It is composed of 105,880 SMEs that represent almost 100 per cent of enterprises.[101] The ratio of enterprises per 1,000 people reached 28, which is the second highest rate in the region after Lebanon. Private enterprises contributed 29 per cent of GDP in 2007. Households, including informal business activities, also contributed 47 per cent of GDP in 2007, bringing the overall contribution of the private sector to 76 per cent of GDP for the same year (chart 3). The current contribution of the private sector to GDP has, however, declined from 85 per cent in the period 1967-1995.[102] The conflict situation has led the performance of the private sector to deteriorate significantly over the past four decades. The private sector is dominated by small-scale enterprises that operate at suboptimal levels. It has also lost much of its industrial base as many enterprises and industrial establishments have shut down, leading to lower demand for labour. A number of factors led to this deterioration, mainly the decline in olive cultivation due to land confiscation and the destruction of olive trees, the growing intensity of Israeli military incursions in 2001-2002, stricter restrictions on access and movement, and land confiscation for the establishment of the separation wall.[103] While the private sector is the major source of employment in Palestine, accounting for 60 per cent of total employment in 2008,[104] high unemployment and aid dependency levels prevail due to the limited capacity of the sector to absorb the labour supply.

Palestine saw a significant fall in gross fixed capital formation by almost 40 per cent, from US$2.0 billion in 1999 to US$1.2 billion in 2007, endangering the prospects for long-term growth.[105] Investment to maintain or add productive infrastructure has declined during 2004-2005 and most investment, 61 per cent in 2004, was focused on buildings and reconstruction rather than building productive capacity (chart 3). The main challenges facing private sector development in Palestine are the security situation and the restrictions on access of products, people and capital to markets outside Israel. Despite that, many SMEs continue to survive through adopting strategies to enhance their resilience.

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[100] Palestinian Central Bureau of Statistics. *Online Statistical Abstract 2008*. www.pcbs.gov.ps, accessed in June 2009.

[101] Ibid.

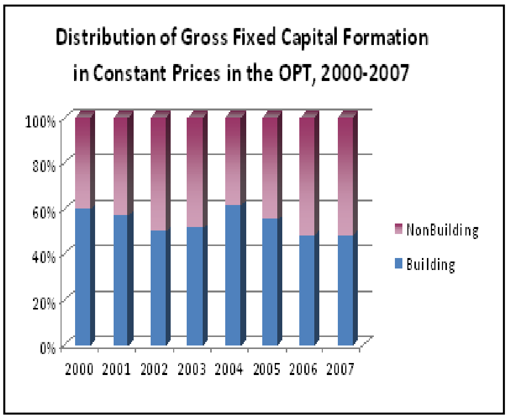
[102] Palestine Economic Policy Research Institute (MAS), 2007.

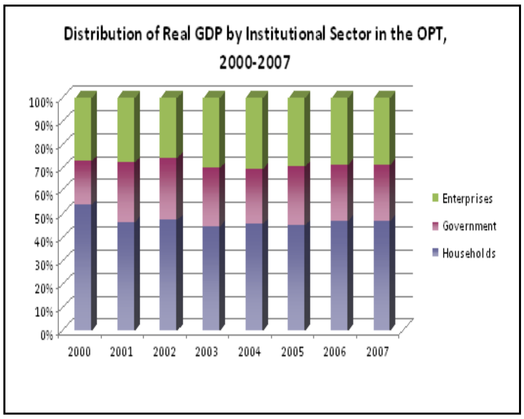
[103] Ibid.

[104] Palestinian Central Bureau of Statistics, op. cit.

[105] Ibid.

Chart 3.





Source: ESCWA calculations based on data from the Palestinian Central Bureau of Statistics, Statistical Abstract 2008.

There is a marked difference between the policy space in Palestine and Iraq. Palestine has no national currency, so the instruments available for its monetary policy are very limited.[106] Transactions in the economy are carried out by a multiple currency standard that includes the US dollar, the Jordanian dinar and the Israeli shekel. In fact, this multiple currency system combines some of the worst aspects of the two polar-type exchange rate regimes. On one hand, the absence of a national currency renders monetary policy ineffective as in a fixed exchange rate regime. On the other hand, the existence of a three-currency standard has the potential for increasing those costs associated with fluctuations in exchange rates typical of a flexible exchange rate regime. In addition, a multiple currency regime tends to reduce the ability of commercial banks to perform their function of transforming debt maturities because of the problem of currency mismatching inherent in portfolios. This discourages banks from extending long-term loans, which are essential for investment and growth.[107] The Palestinian

[106] Monetary concerns in the West Bank and Gaza Strip are the responsibility of the Palestine Monetary Authority (PMA). It is entrusted with the job of licensing all banks operating in the West Bank and Gaza Strip, holding their reserves, and regulating their operations with regard to solvency, liquidity and stability. It is allowed to operate a discount window to advance loans to commercial banks and act as a lender of last resort. It has some control over the money supply by using certain instruments. These include the management of Government deposits, open market operations in foreign currency and the discount window. It should be noted, however, that these instruments are useful in the short run, and only for moderate operations. A major excess demand for reserves cannot be met by any of these tools, unless the PMA is willing to borrow heavily from foreign countries and in doing so place a burden on the fiscal system.

[107] The problem is illustrated when commercial banks find themselves with liabilities in an appreciated currency while assets are mainly constituted in a depreciated currency. The risk of this will inhibit banks from performing the function of maturity transformation; accepting short-term deposits and extending loans over longer terms.

economy also has a weak fiscal system. Currently, tax revenues of the Palestinian Authority do not amount to more than 38 per cent of GDP, whereas public expenditures are around 70 per cent of GDP. The gap is filled by foreign assistance from donors, leading to aid dependency that is subject mainly to geopolitical factors.[108]

B. IRAQ

In Iraq, the ongoing conflict is the culmination of events of almost a third of a century, including two major wars, a number of internal conflicts and the burden of international economic sanctions for a couple of decades. A multinational force, led by the USA, invaded Iraq in March 2003, brought down the regime and remained in the country fighting against a number of resistance groups in an attempt to stabilize Iraq and contribute to sustainable political, social and economic development in the country. During the war, the main infrastructure, including highways, bridges, electricity installations, water networks, the telecommunications system, railways, and oil refineries were damaged. More importantly, there was a complete breakdown of public institutions and the rule of law following the dissolution of the national army and the security forces by the occupation authority.

War and the breakdown of the security system have brought about high levels of internal displacement and refugees: In 2007, there were 2.2 million internally displaced Iraqis and two million had fled the country.[109] Internal displacement is undermining Iraqi national identity as it is consolidating territories along the lines of sectarian identity. Most of the Iraqis who fled the country are living as refugees in neighbouring countries. It is estimated that 1.2 to 1.4 million are in the Syrian Arab Republic,[110] 450,000 to 500,000 in Jordan,[111] 100,000 in Egypt,[112] 200,000 in the Gulf States,[113] an estimated 54,000 in Iran[114] and 50,000 in Lebanon.[115] The economic repercussion of this refugee problem is twofold. First, it represents a loss of human capital as it includes substantial numbers of highly educated persons who fled Iraq after a campaign of assassination succeeded in killing hundreds of scientists, engineers, university professors and other professionals. Secondly, it presents a substantial burden on the

[108] Palestine Economic Policy Research Institute (MAS), 2009, table 4, p. 7.

[109] UNHCR, 2008, p. 307.

[110] UNHCR, 2007, p. 25.

[111] FAFO, 2007, p. 3.

[112] ESCWA, 2009, p. 25. Government of Egypt contribution to study on displacement (estimates), December 2008; UNHCR estimates this figure to be up to 70,000.

[113] UNHCR, 2007, op. cit., p. 25.

[114] Ibid.

[115] Danish Refugee Council, 2007, p. 10.

economies of the host countries, especially those of the Syrian Arab Republic and Jordan, which already face problems of employment, housing and very limited resources for the provision of public services.

As a direct cost of the war, over 109,000 civilians lost their lives between May 2003 and December 2008. The war has cost Iraq billions of dollars.[116] The reconstruction efforts of the International Reconstruction Fund Facility for Iraq in 2004 were stalled by the security situation. The reconstruction process restarted in 2005 and 2,500 projects worth US$5.7 billion were initiated.[117] This process is still very conservative taking into consideration the enormity of the damage to the Iraqi economy.

Before the 2003 war, Iraq had a centralized economy whereby most of the productive sectors were totally or partially owned or controlled by the State.[118] The private sector was active in trade and commerce, transportation and agriculture, while banking, insurance and industry were run by public enterprises.[119] External debt is another major legacy of the ousted Iraqi regime. It is estimated that over 80 per cent of this debt has been cancelled.[120]

As an oil exporter, the situation in Iraq, compared to Palestine, might seem a bit different where higher prices of oil boosted economic growth in 2006. A closer look, however, shows that the Iraqi economy was devastated in 2003 and that succeeding rates of growth started from a low base, indicating a certain level of recovery. Iraq has some of the most serious challenges arising from conflict, including a high degree of economic instability. When compared with the growth achieved in other oil producing countries, it is found that Iraq relies heavily on oil and that the infrastructure for the development of other productive sectors is still inadequate.[121] Unemployment in Iraq reached 17.5 per cent in 2006.[122] The intensity of insurgent activities was a serious threat to security and the main factor behind displacement and huge capital outflows.

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[116] ESCWA calculations based on the data in O'Hanlon and Campbell, 2009, at: http://www.brookings.edu/saban/iraq-index.aspx.

[117] Government of Iraq, 2007, p. 3.

[118] Dr. Sanaa Al Omary and Dr. Qussay Ibrahim "Private sector in Iraq: overview", April 2004 (In Arabic).

[119] Ibid.

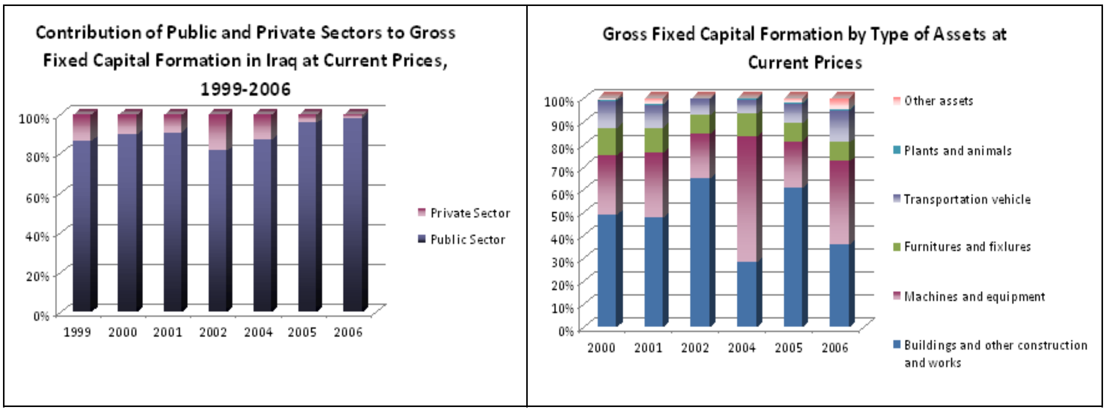
[120] Weiss, 2008, p. 4.

[121] ESCWA, 2008, op. cit., p. 15.

[122] World Bank Development Indicators database available at: www.worldbank.org/data/countrydata/countrydata.html, accessed on 29 April 2009.

After the 2003 war, "economic reforms" were introduced to push the economy in an open market direction. Restrictions on trade were removed and a new investment law was introduced to promote foreign and domestic private investments. The private sector did not, however, grow as anticipated. The share of the private sector in gross fixed capital formation declined sharply between 2004 and 2006 and stood at only 1.7 per cent in 2006 (chart 4). This can be attributed to many factors, but mostly to the lack of security and extremely high risks of doing business. Both domestic and foreign investors are very reluctant to invest in Iraq. Moreover, the costs of business operations are very high and the procedures for doing business are burdensome, particularly the formal entry and exit procedures.[123] The sectoral distribution of investments shows that construction accounted for 46 of gross fixed capital formation over the period 2000-2006 (chart 4). This relatively high rate is common in conflict-affected countries where investment is needed to reconstruct damaged structures and houses. It also shows that little goes to such productive capacities as machinery and equipment, indicating limited investments in businesses. Information is not available on the number and size of enterprises, but studies reveal that they comprise the majority of private sector enterprises.[124]

Chart 4



Source: ESCWA calculations based on data from the Central Organization for Statistics and Information Technology, Government of Iraq.

In Iraq, post-war monetary policy was used for the sole objective of stabilizing the New Iraqi Dinar (NID) and the rate of inflation. The objective was achieved as the NID appreciated vis-à-vis the US dollar, from around NID 2,220 per dollar in 2003 to around NID 1,450 in 2004; it has stabilized around NID 1,200 since that time.[125]

[123] ESCWA, 2007.

[124] Ibid.

[125] The average for 2008 was NID1,172 for US$1. See EIU at: www.eiu.com, accessed in March 2009.

Similarly, the rate of inflation has been cut from 33 per cent in 2003 to around four or five per cent since 2004. The price of this achievement, however, was to consign monetary policy to the sole role of stabilizing the exchange rate and leaving the role of managing effective demand entirely to fiscal policy. The fiscal account in Iraq is, however, not stable as it is determined by the oil revenue. It is expected to move from an estimated surplus of US$12 billion (14 per cent of GDP) in 2008 to a deficit of US$23 billion (33 per cent of GDP) in 2009, reflecting the sharp fall in oil prices.[126] Taxes do not play their economic function of raising revenue, providing an automatic stabilizer and as an instrument for the redistribution of income, as the total amount of taxes is less than two per cent of the total revenue of the Government.[127] The public expenditure system is not yet redesigned according to developmental needs and more than 75 per cent of the Government budget is allocated to current expenditures.[128] The availability of public services is still very low.[129]

C. TYPES OF CONFLICT-RELATED IMPEDIMENTS TO GROWTH AND DEVELOPMENT OF THE PRIVATE SECTOR IN PALESTINE AND IRAQ

This section begins by identifying and analysing four different forms of waste and inefficiency created by the protracted conflicts that impede the growth of the private sector in Palestine and Iraq. It then identifies the results of those conflict-related impediments on the private sectors in both countries.

1. *Impediments to growth and development of the private sector*

(a) *Unproductive activities*

The most important type of inefficiency created by conflicts is the widespread practice of diverting resources from productive to unproductive activities. This takes place whenever individuals are earning income from activities which have no economic value to the society as a whole. Theft, smuggling and paying individuals for "protection" against illegal appropriation are examples of unproductive activities that are illegal.[130] More importantly, however, are the unproductive activities that involve

[126] Ibid.

[127] According to the IMF estimation, total taxes (direct and indirect) equalled 1.16 per cent of total revenue in 2006 and 1.68 per cent in 2008. See IMF, 2009.

[128] Current expenditures were 67 per cent and 78 per cent of total expenditures in 2006 and 2007 respectively. See ibid.

[129] A recent study estimates that in February 2009, the percentage of population with access to public health, potable water, 12+ hours of electricity per day and sanitation are 30 per cent, 45 per cent, 50 per cent and 20 per cent, respectively. See O'Hanlon and Campbell, op. cit.

[130] These types of unproductive activity are widespread in countries going through conflict, resistance against occupation and wars. It has become an important part of the cost of business in Iraq since the start of the invasion in March 2003.

the use of laws to secure State-generated privilege. These activities are known to increase in a conflict-affected environment as legal authorities are undermined by the emergence of illegitimate "non-State actors" who have an interest in prolonging the conflict.

(b) *Idle resources*

A very important source of inefficiency in Palestine and Iraq results from the fact that a sizeable portion of the factors of production are idle and not involved in producing goods and services. In the case of labour, the unemployment rate in Palestine reached high levels in 2008, with 44.8 per cent in the Gaza Strip, which was the highest in the world.[131] Iraq also has a chronic unemployment problem, reaching 17 per cent in 2006 (as shown in chapter III). Underemployment, where a worker has a job but spends a fraction of his/her work time engaged in productive activities, is widespread in Iraq and Palestine. Currently, it is estimated to involve more than one third of those employed in Iraq. It is quite widespread in the public sector in Palestine, which is considered the employment source of last resort. Capital also suffers from the problem of idleness, as factories run at less than full capacity.[132]

(c) *Inhospitable business environment*

Another important source of inefficiency in the private sector in Palestine and Iraq results from the fact that the conflict in both countries has not allowed them to implement the business environment reforms that have taken place in other ESCWA countries during the last two-and-a-half decades. They still have very complicated regulations that make it hard to start a business and operate it. Their legal system is ineffective in enforcing business contracts and protecting property rights. Their financial system makes it very hard for small firms to get the start-up and operation capital they need.

Resulting from this inhospitable business environment is the misallocation of factors among sectors or firms. In other words, inefficiency is caused by factors being used not in their optimal place. In Iraq and Palestine, this inefficiency occurs because of barriers to mobility or disincentives to mobility. In many cases, labour mobility between sectors is not easy because of violence and lack of security. Optimal employment might be located in rural areas or small cities, but labour prefers to stay in sub-optimal employment in the larger cities because of security considerations. In both Iraq and Palestine, the prolonged conflict has resulted in production being organized in small farms and small industrial firms operated by family members who do not receive formal

[131] Palestine Economic Policy Research Institute (MAS), 2009, op. cit., table 12, p. 16.

[132] Ibid.

wages according to their marginal products. Instead, they receive payments according to their average products, so a difference between sectors in the marginal product of labour will not automatically translate into a difference in wages. Consequently, workers will not have an incentive to move between sectors.

(d) *Growing dependency on aid*

Since its establishment in May 1994, the Palestinian Authority has been dependent on external financial assistance.[133] During the period of limited self-rule (1994-2000), most of that assistance was used in rehabilitating infrastructure and building institutions, and little was used in humanitarian relief and budget support.[134] As the economic situation has worsened since 2001, aid witnessed a substantial increase and a complete shift in direction. Disbursements doubled from an average of US$530 million per year in 1999-2000 to over US$1 billion per annum in the period 2001-2007.[135] The increased funds, as well as what was previously pledged for development assistance, were totally allocated to emergency relief and budget support. As the economic development in the West Bank and Gaza continues to be stymied by Israeli restrictions on trade and movement, the Palestinians are becoming more dependent on foreign aid (table 9). A recent World Bank report stated that "massive aid to the Palestinians can slow economic decline, but won't revive their private sector sufficiently to gradually ease their need for external support".[136]

Table 9 shows that Iraq has received more than US$23 billion in foreign assistance during the period 2004-2007. The bulk of this aid came from the US but no less than 40 other countries have also contributed. The majority of the assistance was given mostly through bilateral channels and implemented in the form of projects.[137] Early reports in US media suggesting that reconstruction funds were being squandered led to the establishment by the US of the Office of the Special Inspector General for

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[133] Immediately after the signing of the Oslo Accords, an international conference of 43 countries convened in Washington in October 1993 and pledged to help in financing the Palestinian programme of reconstruction and development.

[134] Most observers would agree that the Palestinian Authority would not have been able to survive without the financial aid from donors, but that aid was not effective in changing the internal or external conditions obstructing development. See UNCTAD (2006) and Brynen (2000).

[135] World Bank, 2009, available at: http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/AHLCJune09 Reportfinal.pdf.

[136] World Bank press review, 4 June 2009, available at: http://web.worldbank.org/WBSITE/EXTERNAL/ NEWS/0,date:2009-06-04~menuPK:34461~pagePK: 34392~piPK:64256810~theSitePK:4607,00.html#Story3.

[137] Presentation on challenges and lessons of donors' aid management process in Iraq. October 2007. Ministry of Planning, at: www.mop-iraq.org.

Iraq Reconstruction (SIGIR) in November 2003. A quarterly auditing report and frequent project assessments have been issued by the office. As a result of these reports, hundreds of millions of US dollars of the reconstruction funds were not accounted for, and subsequently several US citizens were criminally charged with respect to the handling of these funds. The latest quarterly audit report issued by SIGIR painted a grim picture of the "deteriorated security situation, waste, fraud and frustration in the Iraqi reconstruction effort".[138] A 2007 study commissioned by the Iraqi Ministry of Planning analysing the Donor Assistance Database (DAD) criticized the existing bilateral-project modality of aid and recommended various changes.[139] Most of these changes aimed at gradually transferring ownership of the aid management process to the Government of Iraq by strengthening the role of the Iraqi Strategic Review Board (ISRB), which is mandated to oversee all aid projects. In this regard, it was recommended to consider replacing the project form of aid with more manageable forms, like direct budget support, sector-wide approaches (SWAPs) or others. Given its present capacity and the security situation, the Iraqi Government has indicated its preference for SWAPs as a modality.[140]

TABLE 9. FOREIGN FINANCIAL ASSISTANCE TO PALESTINE AND IRAQ

	1999	2004	2005	2006	2007
Palestine					
Foreign assistance (US$ million)	497.0	353.0	636.0	1019.0	1322.0
Percentage of GDP	11.0	8.4	13.9	23.6	29.2
Percentage of gross Investment	23.9	34.5	50.2	76	101
Iraq					
Foreign assistance (US$ million)		2319.7	9475.1	6853.9	5785.8
Percentage of GDP		9.1	27.9	12.5	8.3
Percentage of gross investment		36	101	56	49

Source: The data for Palestine is calculated from The Economic and Social Monitor (May 2009) of the Palestine Economic Policy Research Institute (MAS), and for Iraq is calculated from the Development Assistance Data published by the Iraqi Ministry of Planning, www.mop-iraq.org/dad.

[138] For analysis of the SIGIR reports see Tarnoff, 2009. For summary of the last report see IRIN, 21 June 2009, at: www.newsite.irinnews.org.

[139] In 2005, the Iraqi Ministry of Planning and Development, with the help of the UNDP, established the Donor Assistance Database (DAD).

[140] Proliferation and fragmentation of donor aid to Iraq. May 2007, at: www.mop-iraq.org/dad.

2. *Impact of the conflict-related impediments to private sector development*

The above sources of waste, inefficiency, distortion and dependency have created an inhospitable economic environment in Palestine and Iraq that has resulted in poverty and the contraction of economic activities, distorted macroeconomic structures, sectoral disarticulation and a shift towards informal economic activities, ultimately leading to the demise of the private sector and its inability to contribute to sustainable long-term growth and development.

(a) *Poverty and contraction of economic activities*

In the last few years, the West Bank and Gaza have witnessed an unprecedented spread of poverty. According to a 2007 household survey, 80 per cent of households in Gaza, and 45 per cent of households in the West Bank, were living below the poverty line.[141] This massive spread of poverty reflects the continuing deterioration of the general economic condition. This is manifested in the fact that Palestinian real per capita income declined from being equal to 88 per cent of real per capita income in Jordan in 2000 to 43 per cent in 2007.[142]

Similarly, available evidence indicates that around ten per cent of Iraqi households live in absolute poverty and that another 12-15 per cent are very vulnerable to falling below the poverty line.[143] It is also worth noting that poverty in Iraq exhibits a distinct regional pattern: The households in the southern region have a very high poverty rate whereas households in the northern Kurdish region are more affluent.[144]

(b) *Distorted macroeconomic structure*

Years of intense conflict have markedly increased the risks associated with investment in Palestine and Iraq. In both countries consumption rather than investment has become the dominant economic activity. In 2007, consumption and investment in Palestine were equal to 144 per cent and 22 per cent of the GDP, respectively. Underlying this poor economic performance are three major macro-imbalances.[145] First, there is a resource gap displaying a large import surplus equivalent to 66 per cent of GDP. The second macro-imbalance is related to the labour market. This exhibits a

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[141] IMF, 2009, op. cit., p. 2.

[142] Palestine Economic Policy Research Institute (MAS), 2009, op. cit.

[143] Iqbal, 2006, p. 4.

[144] Ibid.

[145] Palestine Economic Policy Research Institute (MAS), 2009, op. cit.

chronic inability to provide a satisfactory level of employment for a labour force growing at a high rate. In 2007, the labour force was growing at three per cent annually, and less than 75 per cent of its members were absorbed in the domestic economy.[146] The third imbalance involving Government expenditures and revenues reveals the degree of dependence on external financial assistance, and is reflected in a large deficit in the Palestinian Authority budget. This deficit reached around 32 per cent of GDP in 2008, up from 28 per cent in 2007, and was responsible for frequent delays in paying the salaries of the Palestinian Authority employees.[147]

In Iraq, the situation is different owing to the oil revenue which provides more than 60 per cent of GDP. Immediately after the war in 2003 and the huge decline in the export of oil, Iraq suffered from a resource gap equivalent to ten per cent of GDP, but with the increase of oil exports it was closed in 2006 and turned to a surplus equivalent to 21 per cent of GDP in 2007.[148] Needless to say, such a surplus also represents a macro-imbalance as it implies a surplus of national saving over national investment.[149] This shortage of national investment is responsible for the second macro-imbalance involving the labour market which exhibits a chronic two-digit rate of unemployment.

(c) *Sectoral disarticulation*

The macro-imbalances outlined above are the aggregate expressions of distortions and fragmentation at the sectoral level. Decades of conflict have created fundamental structural deformity that has prevented agriculture and industry from developing along normal paths in both Palestine and Iraq. During the last two decades, the contribution of agriculture and manufacturing (excluding oil) to GDP has stagnated in Palestine at around 15 per cent (five per cent for agriculture and ten per cent for manufacturing) and around 12 per cent (10 per cent for agriculture and 2 per cent for manufacturing) in Iraq. Had the two economies developed along the lines experienced by comparable economies, the contribution of agriculture and manufacturing to GDP would have been at least double its current level in both countries.[150]

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146 The rest were either unemployed (26 per cent) or employed in Israel (11.5). See Palestine Economic Policy Research Institute (MAS), 2009, op. cit.

147 Ibid.

148 United Nations, National Accounts online database, at: http://unstats.un.org/unsd/snaama/Introduction.asp, accessed May 2009.

149 The national economic identity implies that: (I-S) + (G-T) = (M-X), where I, S, G, T, X, and M represent investment, saving, Government expenditures, taxes, exports and imports respectively. According to the United Nations National Accounts (Main Aggregates), in 2007, Iraq had the following aggregates as percentages of GDP: S= 36, I=17, X=63, M=42. This implies that the saving surplus was equal to 19 per cent of GDP and the deficit of the Government budget was 2 per cent of GDP.

150 The average contribution for middle-income developing countries is around 25-35 per cent.

Both countries suffer from another important imbalance regarding the relative shares of the private sector versus the public sector. Four decades of Israeli occupation have diminished the public sector in Palestine leaving behind a very poor infrastructure, weak public services and an obsolete legal and institutional framework. It is estimated that 50 per cent of education services and 80 per cent of health services were provided by the private sector at the turn of the new century.[151] Inefficiency in these services is partly explained by the fact that they are produced privately, since they are by their very nature "public good". Naturally, the legacy of the previous regime of centralized economic management in Iraq is quite the opposite. The imbalance in Iraq is tilted on the side of the public sector. In 2006, the public sector produced around 70 per cent of GDP and financed almost all investment expenditures (98 per cent).[152] There are hundreds of inefficient SOEs that would be improved by being reorganized as public-private partnerships.

(d) *Shift toward informal economic activities*

The last few years witnessed the substantial growth of the informal sector in both Palestine and Iraq. In Palestine, due to long periods of internal and external closures,[153] curfews and siege following the eruption of the Al-Aqsa Intifada in September 2000, informal economic activities have become the indispensable mechanism for survival. The formal economy was not able to absorb all workers who lost their jobs in Israel and workers who lost their jobs in the private sector due to a huge drop in private investment. Many of those were absorbed in informal activities, thus substituting waged labour for family labour, relying increasingly on credit, resorting to subsistence farming and reducing cash transactions to a minimum.

In Iraq, the informal sector has grown considerably since the war of 2003. The collapse of the security system and the spread of violence have destroyed a lot of the activities in the formal economy. A substantial portion of small-scale urban services have been overtaken by the informal sector. There was also a huge surge in criminal activity. Some estimate the size of the informal economy of Iraq to be around 65 per

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[151] UNCTAD, Prospects for Sustained Development of the Palestinian Economy: Strategies and Policies for Reconstruction and Development" UNCTAD/ECDC/SEU21 Aug 1996 footnote 33 page 103.

[152] These figures are calculated from the National Accounts in Iraq as published by the Iraqi Central Organization for Statistics and Information Technology, 2007-2008, Ministry of Planning and Development, Iraq, tables 14/8, 14/10 and 14/11, at: http://cosit.gov.iq/english/index.php, accessed in May 2009.

[153] The Israeli army practices both internal and external closures in the Palestinian territory. Internally it closes the roads between cities and villages inside the territory and externally it closes the borders with Jordan and Egypt.

cent of GDP, with the involvement of 80 per cent of the labour force.[154] It should be noted that the inhospitable business environment, as discussed above, is a primary reason for the growth of the informal sector in both Palestine and Iraq. Faced with a legal system that is incapable of enforcing contracts or protecting property rights, and with very complicated regulations that make it hard to start a business, people prefer to stay in the informal sector.

D. GOOD PRACTICES IN PRIVATE SECTOR RESILIENCE IN THE ESCWA REGION: THE CASE OF LEBANON

In addition to its basic role of providing security, one of the strategies the State can follow to support private sector development in conflict is the provision of emergency funding. A case in point is the public support programme for the private sector in Lebanon. The private sector in Lebanon plays an essential role in economic activity. The relatively open market policies encourage entrepreneurship and the growth of private enterprises. The private sector is dominated by SMEs, totalling an estimated 193,000 in 2008.[155] Lebanon has a ratio of 54 enterprises per 1,000 people which is the highest in the region.[156] The private sector is an essential source of investments, contributing 90 per cent of gross fixed capital formation in 2007.[157] The private sector is also the main source of employment, accounting for 83.3 per cent of total employment in 2007.[158]

Private sector enterprises underwent huge losses as a result of the July 2006 war and the trade blockade imposed on Lebanon for almost two months. More than 850 private enterprises experienced total or partial direct physical damage.[159] Total direct damage to the commercial, industrial and agricultural sectors amounted to US$590 million.[160] The private sector experienced much larger indirect losses from closure and loss of business opportunities. One of the immediate needs of the private sector that emerged as a consequence was to reconstruct what had been physically damaged and to support enterprises financing working capital and outstanding obligations to banks. The Government mobilized a total of US$1.5 billion to support the private sector as part of the Paris III scheme.[161] Part of the funds was used for the enlargement of existing subsidized public lending schemes to the private sector. Soft loans were extended to private enterprises with the support of the Central Bank and through commercial banks.

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[154] Looney, 2006, p. 15.

[155] World Bank Development Indicators database 2008, at: www.worldbank.org/data/countrydata/countrydata.html, accessed in May 2009.

[156] Ibid.

[157] Government of Lebanon, 2007, table 24, p. 41.

[158] UNDP, ILO and Republic of Lebanon, 2008.

Measures were taken to assist private enterprises in resuming their activities and lending conditions to enterprises affected by conflict were eased and relaxed. Examples of the measures taken are shown in box 1.[162]

Box 1. Lending conditions provided by the Government of Lebanon to private sector enterprises after the July 2006 war

For enterprises suffering severe direct damage:

- Broaden access and extend maturity of subsidized loan programmes;
- Increase loan ceiling;
- Extend subsidized loans to cover more assets;
- Extend the grace period (to two years) and loan maturity (to ten years) in order to facilitate the rescheduling of existing loans.

For enterprises with indirect damage:

- Extend loan facilities to more economic sectors and activities: distribution, transport, storing, trading, education, health, etc;
- Expand trade finance facilities through the expansion of existing trade finance lines (International Finance Corporation (IFC), European Investment Bank (EIB), etc.

Public support to the private sector in the aftermath of the 2006 war also came in the form of tax incentives, grace periods, tax credits and exemptions to ease the tax burden of enterprises. Moreover, regional organizations contributed significantly to the support of the private sector through cooperation with the Government. The Arab Monetary Fund along with its subsidiary, the Arab Trade Financing Program, provided budgetary support and lines of credit amounting to US$250 million, 17 per cent of total funds to trade and commercial activities of the private sector.[163]

Public sector support for the private sector has reinforced the role of the State as an ultimate supporter and facilitator of the private sector, thereby contributing to its resilience. An impact evaluation of the financing scheme for the private sector is not available; however, the programme has contributed to easing the financial burden of private enterprises as well as that of the financial sector during 2006 and 2007. It could

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[159] Rebuild Lebanon, 2006, p. 11.

[160] Ibid.

[161] Government of Lebanon, 2008.

[162] For more details, see ESCWA, 2007, op. cit., Ministry of Finance, Republic of Lebanon, Lebanese Government's programme of support to the private sector presentation.

[163] Ibid.

have also contributed to reducing the number of enterprises shut down for financial reasons. Public policies for long-term private sector development have also been envisaged, though at a relatively modest pace. Lebanon ranks eighth in the ESCWA region in the ease-of-doing business index, ninety-ninth out of 181 countries.[164] The Government has embarked on an SME development plan that is still in its early stages. In an effort to reduce burdensome regulatory requirements on the private sector, a project was implemented with the International Finance Corporation, which has reduced the time for business registration from 46 to 11 days, thereby enhancing the efficiency of the public services provided in the process and reducing time and costs for private enterprises. Private sector development policies to reduce and enhance regulatory procedures are necessary for private sector growth, particularly in the areas where Lebanon lags behind many developing countries, namely, starting and closing a business, handling construction permits, enforcing contracts and registering property, as indicated from the rankings in table 10.

TABLE 10. LEBANON'S RANKING IN THE EASE-OF-DOING-BUSINESS INDEX

Business regulations indicators	Rank out of 181 countries	Business indicators	Rank out of 181 countries
Overall ranking			
Starting a business	98	Investor protection	88
Construction permits	121	Taxes	45
Employment	58	Trade	83
Property registration	102	Contract enforcement	118
Access to credit	84	Business closure	121

Source: World Bank, Doing Business in the Arab World 2009.

164 World Bank, 2008, p. 67.

IV. CONCLUSIONS AND RECOMMENDATIONS

A. CHALLENGES AND COPING MECHANISMS

Two central ideas have emerged from the analysis in this paper. The first is the double causation which exists between conflict and development. Conflict impedes development and development restrains conflict. With the passage of time, this process takes on the character of an adverse path dependency: Conflict sets in motion a process of de-development in the economy which, in turn, aggravates the political situation and adds fuel to the conflict. In other words, the incompatibility between “conflict” and “development” creates a vicious circle of poverty and violence. The second central idea of the paper is the lack of space to manoeuvre for the public sector and the frailty of the private sector, which is common in conflict-affected countries.

The above analysis has clearly demonstrated that decades of living under conflict and political violence has meant that the economies of both Palestine and Iraq have been shaped by an adverse path dependency.[165] In other words, inhibiting institutions and policies that were formed in conflict-affected environments have locked in a particular evolutionary path in the two countries; a path characterized by a vicious circle of poverty and violence. Freeing the two countries from this predicament, so that the debilitating path dependence is overcome and replaced by qualitatively new conflict-free growth-augmented path dependence, can only be achieved by the proper working of both the private and public sectors and the coordination between them which has to be articulated and monitored by the direct and indirect interactions of civil society organizations and citizens together with public institutions and business establishments.

Repeated experience of countries going through conflict has demonstrated that conflict retards economic development and, conversely, economic development restrains conflict. Development, however, does not mean simply the achievement of economic growth. Experience has shown that some types of growth can aggravate conflict rather than moderate it. Conflict-promoting growth is associated with large inequality, concentrating the gains in income in the hands of a powerful elite and excluding the majority of the poor people. This exclusion is bound to add fuel to the conflict and increase the risk of becoming caught in a “conflict trap” in which conflict

[165] Path dependence is an increasingly used term in economic literature. It emphasizes the important role which historical events and historically formed institutions have in determining the future range of possibilities for a country. It implies that once institutions have been formed, they tend to lock in a certain evolutionary path for the country. In other words, history matters, and the weight of history continues to play a role in shaping the path of economic and social change of the future. Accordingly, the past must be carefully understood, including the past related to the origin of conflict, in order to comprehend the nature of the challenges and limits which the country in conflict now confronts. See Boas, 2007.

wrecks the economy and increases the danger of further conflict. Conversely, experience has also shown that “pro-poor growth”, which reduces absolute poverty while simultaneously reducing existing inequalities in income distribution, could generate a virtuous circle in which the country become progressively safer from violent conflict, making subsequent growth easier and contributing to the resilience of the private sector by investing in human capital.

It was shown in chapter II that the countries in the ESCWA region have fallen behind other regions in the world in adopting the regional route to integrating their economies into the world market. There is a need to activate regional cooperation and coordination among all the countries in the region as they are facing various challenges which no country is capable of solving alone. Regional integration will promote the rationalization of production, intra-industry trade through further division of labour, and product differentiation; it will also bring about an increase in the bargaining power of the region in its trade negotiations with other regions of the world. More importantly, most conflicts in the area have a regional dimension and cannot be resolved without regional coordination. In particular, a successful resolution to the conflicts in both Palestine and Iraq requires a new regional arrangement based on economic integration. Currently, Palestine is predominantly dependent on Israel, and measures taken by Israel in recent years have caused the Palestinian economy to lose the income of one third of its labour force and interrupt 70 per cent of its imports and 90 per cent of its exports. Accordingly, the disproportionality, in what might be called the cost of dissociation, renders the current Palestinian-Israeli economic relationship inherently unstable and must be corrected if sustained economic development in Palestine is to be achieved.[166] Currently, the Palestinian private sector is producing at a very high cost due to restrictions imposed on it by being in a de facto customs union with Israel. This has caused significant trade diversion away from neighbouring Arab countries and the rest of the world towards concentration with the Israeli market. This raised the cost of capital and intermediate goods to Palestinian producers and effectively wiped out their competitive edge in foreign markets. The Palestinian economy needs to be integrated with the other Arab economies so as to end its harmful dependence on one economy.

In Iraq, it is obvious that a concomitant to reconciling differences among the different factions of the Iraqi people is the normalization of relations between Iraq and its neighbours. It should be emphasized that such normalization is not an artificial arrangement. It complements and cultivates strong and persisting bonds of history,

[166] Economic arrangement between two countries is sought for the gains it confers on each country. Discontinuation of the arrangement, therefore, entails the cost of dissociation, which represents not only forgone gains but sunk costs arising from association. A skewed distribution of these costs between the two countries could be a destabilizing factor. A country with disproportionately higher dissociation costs will be vulnerable to the other stronger bargaining power to extract economic or political concessions.

culture and religion, resting on a common language and shared values. Moreover, millions of Iraqis are refugees living in neighbouring Arab countries. Regional integration will also allow Iraq to benefit from sharing in the building of regional infrastructure projects needed in the areas of water, energy, transportation and telecommunications. Promoting joint ventures in investment and intra-regional trade requires fiscal harmonization between Iraq and its neighbours. The removal of capital tax differences among the countries and the abolition of tax obstacles to cross-border activities are essential to such harmonization.

Additionally, economic recovery is one of the most important fields to contribute to peacebuilding. Income and employment opportunities are vital for the stabilization of many post-conflict environments; as a peace dividend they can help former conflicting parties to gather support for peace in fragile transition periods. A thriving social and ecological market economy has the potential to reduce disparities and social tensions, often root causes of violent conflicts. Private sector development in particular is a key approach that offers Palestinians to address conflict causes, lessen grievances, and to support continuous economic and social progress.[167]

Thus, cutting through the vicious circle of poverty and violence in Palestine as well as in Iraq will not be accomplished solely by concentrating efforts on either reaching a political settlement to the conflict or improving the economic conditions. Political reconciliation and economic progress should be brought about by the creation of a new socio-economic and political environment capable of utilizing all resources and managing the economy in such a way that the majority of the citizens feel that they are equal partners and have a stake in promoting conflict resolution and political stability.

B. POLICY RECOMMENDATIONS

1. *Conflict-affected countries in the ESCWA region*

Public policies in conflict-affected countries should be geared to have a positive impact on preventing or reducing conflicts. Some of the factors associated with a higher incidence of conflict include low levels of education, reliance on natural resources and lack of governance. Public policies should also aim to channel business activities in constructive directions. This can be done by promoting an enabling business environment through providing structures and frameworks that support legitimate business activities. Research suggests that the best State policies regarding conflict are the ones that reduce horizontal inequalities. Some of the proposed policies include:

[167] GTZ, 2008b, op. cit.

(a) *Providing public goods*

- Producing goods and services whose production in the private sector would be sub-optimal, which include public goods like national defence and domestic security; regulating the prices of goods and services whose markets are not competitive, which include such natural monopolies as telephone, water and electricity networks; subsidizing the production of goods and services that are considered to be semi-public goods, which include health, education and social security.

(b) *Building fiscal capacity*

- Rebuilding fiscal institutions in the wake of conflict involves creating the appropriate legal and regulatory framework, establishing a central fiscal authority for mobilizing revenues and for coordinating external assistance, and installing mechanisms for deciding on and implementing revenue and expenditure policies. Government is needed to regulate financial institutions to not only ensure competition, but also to maintain the safety and soundness of the financial system.

(c) *Reducing horizontal inequality*

- A pro-poor growth strategy should be based on sustained efforts aimed at improving the human capital of the poor through employment-intensive programmes. Such an approach is key to reducing poverty through increased income and productive capacity. Achieving this goal calls for a comprehensive reform of the tax system and a major reallocation of public expenditures aimed at adopting two sets of policies. The first is a short-term policy designed to subsidize the private sector in establishing labour-intensive industries to generate employment for unskilled and semi-skilled labour in both rural and urban areas. The second is a long-term policy designed to expand the active participation of the poor in private sector activities and civil society. This will empower the poor by enhancing their human capital through greater access to education and health care, improvements in their physical and social infrastructure and by allowing the poor easier access to credits;

- Adopting policies that ensure social harmony by creating a fair distribution of income and inclusive political representation of all groups within society.

(d) *Committing to transparency and accountability*

- Promoting transparency and accountability in the management of national resources and the provision of public goods is also a policy tool that can promote both private sector development and conflict prevention.

(e) *Enhancing the business environment*

- Enhancing competition by introducing proper anti-trust regulations;
- Stabilizing macroeconomic conditions by appropriate fiscal, monetary and exchange rate policies;
- Promoting economic growth by providing the incentives to accumulate physical capital, human capital and enabling technological progress;
- Promoting formal business practices by reducing complicated business procedures and reforming and putting in place commercial laws and regulations conducive to private sector development;
- Putting in place measures to reduce or cut resource flows to illegitimate economic activities and enforcing sanctions against illegal practices.

(f) *Regional economic integration*

- Certain economic challenges cannot be solved by any country in the region by itself. These challenges are not confined to the obvious ones associated with trade and the need to integrate the region into the world markets on an equal footing with other regions, or the need to build new regional infrastructure networks, but also include the need to coordinate economic policies at the regional level so as to encourage joint venture investment and to remove tax induced distortions in the capital market. Regional integration, therefore, should not be confined to opening the borders for regional trade, but it should be aimed at rationalizing the production structure at the regional level, creating new opportunities for profitable domestic and foreign investment and ensuring macrostability and microefficiency through the coordination of economic policies. The ultimate goal of regional economic integration is to strengthen the private sector in each country in the region by allowing it access to a larger market and the advantages of economies of scale, specialization and production at lower costs. This is very important for the private sectors in Palestine and Iraq as both are currently operating at high cost due to their lack of integration into regional and world markets. It should be emphasized, however, that the success of a new regional economic arrangement requires the full support of the international community at large.

(g) *Harnessing private sector contribution in peacebuilding*

- The public sector can engage the private sector in conflict resolution and peacebuilding by promoting its role as a peacebuilder while demonstrating its added value in bringing about peace and development.

(h) *Do no harm*

- Enterprises should become conflict-sensitive and realize that they can have a significant impact. They implement their activities in a way to promote inclusive socio-economic growth. More equitable recruitment and profit-sharing strategies are recommended. Enterprises should also pay attention not to engage in or support corrupt public practices.

(i) *Peacebuilding*

- Beyond doing no harm, the private sector can contribute negotiation skills, local knowledge of conflict and community, and networks of contacts that could be beneficial to peacebuilding initiatives. To be effective, common business interests in peace should be coupled with building a broad coalition of firms, enterprises, chambers of commerce, syndicates and prominent business leaders. Prior to such an undertaking, the private sector needs to be made aware of its responsibilities and, more importantly, the great potential and impact of its interventions. As such, the key in this regard is the identification of a collective goal for businesses. International, regional and national initiatives, through programmes or funds promulgating eventual greater profit for the private sector, could provide the necessary impetus for collective action. Within that context, it would be beneficial for the private sector to strengthen its ties with international donor and development organizations and non-governmental organizations (NGOs).

2. *Palestine and Iraq*

Policy recommendations for both Iraq and Palestine are focused on the principle that the State has an important role to play in contributing to the resilience of the private sector through creating an enabling environment conducive to growth and development:

(a) *Palestine*

- A public strategy for growth should be founded on three basic fundamentals. The first is to link the emergency relief efforts with the long-term developmental objectives. This could be achieved by the Palestinian Authority initiating public works that satisfy the requirement of both generating employment and expanding the infrastructure to support the private sector. These should include programmes to stimulate production in both agriculture and industry. The former could include land reclamation, aimed at augmenting the area suitable for cultivation and increasing the supply of water by renovating artesian wells, drilling new wells, and constructing reservoirs. Stimulating industrial activities requires an increase in the supply of electricity, the improvement of transport facilities, and large investments to modernize communications. The focus of these efforts should be to expand the productive sectors of the economy, thereby generating enough production and trade to absorb the labour force. This will bring about a structural transformation whereby the Palestinian economy substitutes exporting labour for exporting goods and gradually reduces its dependence on external aid;

- The Palestinian Authority should consider a reallocation of public expenditures aimed at improving the health and education of the poor and promoting their inclusion in the political structure of the country. This will ultimately lead to improving human capital and skills to ensure a more resilient private sector;

- A pro-poor fiscal reform should aim at enhancing the legitimacy of the Palestinian Authority by paying more attention to equity. The tax system should be reformed by increasing the reliance on progressive income taxes, restructuring the property tax and introducing presumptive taxes. A pro-poor financial reform should promote the creation of a widespread network of financial institutions that pave the way for an expanded and more equitable flow of funds to impoverished locations and to small and resource-poor business and microenterprises.

(b) *Iraq*

- Iraq is in need of structural economic reforms to dismantle the legacy of the over-centralized economy and engender a new market economy with a vibrant private sector. In this regard, it is important to conduct the task of privatizing the several hundred SOEs with caution and prudence. Experience in other countries has demonstrated that hasty privatization results in the phenomenon of “asset stripping” and the decline of productive capacity, as well as the creation of an instant wealthy class laden with corruption. In other words, successful reconstruction needs to ensure that asset values will not be artificially depressed by vested interest. This is also important for the good economic governance of revenue-generating privatization process as opposed to one that undermines output capacity and may well create the phenomenon of robber barons;

- As part of a diversification strategy, the Iraqi Government should allocate part of the oil revenue to expand agriculture, manufacturing and the tourism sector, which are labour intensive. After many years of neglect, the agriculture sector is in urgent need of investment to breathe new life into such Iraqi specialities as date production and fish farming. The sector also needs large investment in irrigation facilities, agricultural education and the introduction of new value-added varieties. The expansion of agriculture requires a parallel expansion in agro-industries as an outlet for agricultural surpluses and as a supplier of processed food, which could reduce the reliance on imported food. Furthermore, initiatives could be introduced to expand such other manufacturing areas as textiles, leather, pharmaceuticals and building materials industries. At the same time, expansion in services, especially financial services, and the modernization of construction, requires the existence of industries employing highly skilled labour and using advanced technology, like engineering designs;

- Another important sector in Iraq which has suffered from the ongoing conflict is the tourism sector. Iraq has both holy cities that attract hundreds of thousands of pilgrims annually and ancient Babylonian cities that are considered among the wonders of the world. Expansion of the tourism industry requires major improvements in the transport system, tourist information, travel agencies and the availability of hotels and restaurants, as well as building human capital to improve service delivery;

- High priority should be given to reforming the educational and health systems, ensuring universal basic education and health services for all. There is also an urgent need to embark on radical and comprehensive reform of the Iraqi higher education system.

3. *International community*

(a) *Providing ODA*

- For most conflict-affected countries, ODA is the best short-term optimal for recovery finance. Aid gives national authorities additional resources and discretion to restore policymaking capacities alongside crucial political space to work on building an internal consensus on overall recovery strategy.

(b) *Supporting State-building*

- The OECD introduced a set of principles for international engagement in fragile States that can provide important insights for international as well as domestic enterprises;

- International and United Nations State-building support includes the development of capacity-building programmes for officials from various key ministries in an effort to promote good governance practices and build skills to develop and implement policies to improve service delivery and to create an enabling environment for the private sector to thrive.

(c) *Supporting private sector development*

- Multilateral organizations and donor countries should actively engage the private sector in peacebuilding and development interventions. Such an engagement should take place at the very early stages of their involvement. If properly trained and guided, the private sector could prove to be a useful partner in the disbursement of humanitarian and development aid, capacity-building and good governance programmes and regulatory reform, as well as contributing to peacebuilding efforts.

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