

How to involve the private sector in peacebuilding processes

Programme and policy support to promote private sector development (PSD) is not only vital for post-conflict economic recovery, but also for peace consolidation.¹ Yet, peacebuilding and stabilization efforts have generally focused on humanitarian assistance, rebuilding the security sector and supporting democratic processes, leaving economic issues and PSD rather vaguely described and for later on in the peacebuilding process.² Where it *has* been addressed, donors have often directed work towards the public rather than the private sector and have rarely adapted programmes to the volatile conditions of fragile environments.³ Early engagement of the private sector is essential in order to address the full range of economic conflict factors and positively contribute to the peacebuilding process, including the creation of visible peace dividend for the local population.

This policy brief presents a number of policy considerations on *how* to better involve private sector actors in peacebuilding efforts in fragile and conflict affected environments. The recommendations are based on research projects carried out and/or coordinated by the Clingendael Conflict Research Unit in 2009.⁴ The suggestions are not exhaustive, but rather aim to add to the ongoing donor debate on the operationalisation of PSD in fragile states.

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1. Policy considerations: PSD programming as part of peacebuilding efforts

a) Recognize the role of PSD in peacebuilding and stabilization processes. It is widely acknowledged that improved security encourages the private sector to operate and expand. It is also recognized that economic instability is a conflict driver and that without economic recovery and related job creation, stability will not be effective or lasting. What is less understood, however, is that PSD can be a *tool to foster peacebuilding processes*.⁵ First, PSD

can significantly contribute to the creation of a peace dividend for the local population (amongst others) through the creation of employment. Second, the private sector tends to be one of the few sectors during wartime that continues to function (albeit in different ways), maintains a certain supply of goods and services and retains relationships with other actors across conflict lines. Third, peacebuilding programmes that overlook their impact on the private sector and market development may distort market prices, slow the recovery of domestic markets, work against the formalization

¹ On this topic, see also: UK Department for International Development (DfID) "Stabilisation through Economic Initiatives: private sector development", issues note 2009; *Employment Creation, Income Generation and Reintegration in post- conflict settings*, UN system-wide policy paper, May 2008. Donor Committee on Enterprise Development, *Private sector development in post-conflict countries: a review of current literature and practice*, 2008, p. 15; De Vries, H., Specker, L., *Early Economic Recovery in Fragile States: priority areas and operational challenges*, Clingendael Conflict Research Unit, November 2009.

² De Vries, H., Specker, L., *Early Economic Recovery in Fragile States: priority areas and operational challenges*,

Clingendael Conflict Research Unit, November 2009.

³ Donor Committee on Enterprise Development, *Private sector development in post-conflict countries: a review of current literature and practice*, 2008, p. 15.

⁴ The content of this policy brief is largely based on: De Vries, H., Specker, L., *Early Economic Recovery in Fragile States: priority areas and operational challenges*, Clingendael Conflict Research Unit, November 2009 and; *Public Private Cooperation in Fragile States: synthesis report*, forthcoming 2010, Millennium Working group.

⁵ See also: DfID, *Stabilisation through Economic Initiatives: private sector development*, Issue Note Stabilization Unit, 2009.

of businesses (as privatizing the economic sector too quickly may paradoxically incentivize the more powerful unofficial actors), undermine the local tax base and artificially inflate wages. Fourth, elements of the domestic private sector often have wide social networks, maintained across conflict divides and as such can be key partners in peacebuilding processes.⁶ PSD can also play a critical role in demobilization and reintegration (DDR) processes by providing job opportunities for former combatants at relatively short notice.⁷ The informal private sector and smaller formal entrepreneurs can, for instance, provide additional vocational training programmes.⁸ In most cases, it is best to start with PSD as soon as possible in a peacebuilding process, although it will depend heavily on the context *how* to do so.⁹ Yet, without improvements in the investment climate, the private sector is often restricted in participating in reconstruction processes.

Generally, two types of private sector actors in fragile states can be distinguished. The first group consists of large enterprises (often multinationals), which deal in much-wanted goods (such as telecommunications or beer) or rely on quick gains in high-stake, semi-official goods like mineral resources. Such investors often get by because they have the resources and the (political) impact to deal with corrupt government influences.¹⁰ The population in fragile environments generally

has unpredictable income streams (subsisting on daily wages) and purchases only what it needs for that day. Responding to these specific needs, several multinational companies have started producing single-serve packaging.¹¹ The second group is the great multitude of small local businesses run by families or individuals including the informal sector, roughly defined as the total of unregulated entrepreneurs who operate outside of a judicial framework and pay no taxes.¹² A critical question for policy makers is how to formalize these kinds of enterprises. Also, conflict-affected environments are often characterized by a 'missing middle ground' of small and medium-sized official enterprises (SMEs) (see section 2a).

b) Base PSD programming on political economy analyses and market assessments. Economic context analyses are essential to mitigate the inherent (political) risks involved in PSD in fragile environments. First, PSD programming should take into account that private sector actors may be politically active themselves, either to gain benefits from these connections or simply because power brokers will want a piece of the pie. Even though private actors may be willing to use their political clout to influence national politicians for the better, contributing to a more equitable society is usually not the core objective of most businesses. Second, promoting market development should be based on an understanding of the political and economic relations of products and input markets as well as the social relations through which these are structured. This could also mitigate the risk of crowding out local private sector involvement by international aid actors as a result of the lack of a level playing field for commercial competition.¹³

⁶ DfID, *Stabilisation through Economic Initiatives: private sector development*, Issue Note Stabilization Unit, 2009, p. 3; De Vries, H., Specker, L., *Early Economic Recovery in Fragile States: priority areas and operational challenges*, Clingendael Conflict Research Unit, November 2009.

⁷ Specker, L., *R-phase of DDR processes: an overview of key lessons learned and practical experiences*, Clingendael Conflict Research Unit, September 2008. DfID, *Stabilisation through Economic Initiatives: private sector development*, Issue Note Stabilization Unit, 2009, p. 11. Banfield, Jessica, Canan Gündüz and Nick Killick (eds.) *Local Business, Local peace: the peacebuilding potential of the domestic private sector*, International Alert 2006.

⁸ Douma, P., Klem, B., *The struggle after combat: the role of NGOs in DDR processes*, Cordaid Synthesis Report, 2008, p. 60.

⁹ DfID, *Stabilisation through Economic Initiatives: private sector development*, Issue Note Stabilization Unit, 2009; IFC CASA seminar, September 2009, The Hague.

¹⁰ This was clearly indicated during the economic mission of Dutch companies to DRC. See *Public Private Cooperation in Fragile States: case study DRC*, Millennium Workinggroup, forthcoming 2009, <http://www.clingendael.nl/psdn/>.

¹¹ In fact, the 'bottom of the pyramid' of which fragile states are a part, is a huge potential market: 4 to 5 billion underserved people and an estimated economy of more than \$ 13 trillion. Prahalad, C.K.: *The Fortune at the Bottom of the Pyramid; eradicating poverty through profits, enabling dignity and choice through markets*, Wharton School Publishing, 2006, pp. 23-46.

¹² This is the default position of any entrepreneur when there is no government to regulate his business, and *not* to be confused with the criminal economy.

¹³ De Vries, H., Specker, L., *Early Economic Recovery in Fragile States: priority areas and operational challenges*, Clingendael Conflict Research Unit, November 2009.

c) **Encourage and assist national and local governments in improving the business-enabling environment.** Priority areas for physical infrastructure are security (by safeguarding transport on main roads), the removal of mines from agricultural land, the removal of roadblocks and improving key infrastructure (roads, power, water, transport etc). An important institutional priority area is the improvement of land and property rights,¹⁴ which are often highly politicized and contested. The certainties that land registration provides, even in its most basic form, will make people less reluctant to invest in their property. Using one's (registered) land as a mortgage can also be a basis for micro-finance projects.¹⁵ It is worth mentioning the IFC Conflict Affected States in Africa (CASA) programme here, which is particularly aimed at providing technical support to the private sector during early post-conflict phases, including support to SMEs.¹⁶

d) **Involve the private sector during the planning stages of PSD programming** if they are to have a more substantive role.¹⁷ Doing so will be vital in order to better fit donor programmes with private sector needs. NGOs could be supported by donors to involve their local business networks in multilateral planning. Market mapping could be used to identify quick opportunities by giving a visual overview of possible market opportunities in credit, electricity and phone services.¹⁸

¹⁴ On land rights, see also the country reports Southern Sudan and DRC of the project *Public Private Cooperation in Fragile States*, 2009, on <http://www.clingendael.nl/psdn/>.

¹⁵ See for instance: Specker, L., Briscoe, I., *Early Economic Recovery in Fragile States: case study Burundi, challenges to project implementation*, forthcoming 2009.

¹⁶ IFC CASA aims at improving the environment for business by aiding regulatory reform and supporting financial institutions, chambers of commerce and banks. It also gives indirect financial support to SMEs (by way of SME Ventures) and attempts to involve the private sector in rebuilding infrastructure. The programme is now being piloted in the Central African Republic (CAR), DRC, Liberia and Sierra Leone. Togo, Côte d'Ivoire, Burundi and Zimbabwe are all under consideration for future CASA start-up programmes.

¹⁷ Banfield, Jessica, Canan Gündüz and Nick Killick (eds.) *Local Business, Local peace: the peacebuilding potential of the domestic private sector*, International Alert 2006, p. 148.

¹⁸ UNDP, *Creating value for all: strategies for doing business with the poor*, 2008, p. 9.

2. Policy considerations: involving the local private sector

a) **Support small and medium-sized enterprises (SMEs).** The majority of private businesses in fragile states are usually rather small, but this need not necessarily diminish their potential to contribute to peacebuilding. First, SMEs are usually more interested in making a difference in peacebuilding than large enterprises are, as they suffer much more from conflict than larger companies do. Second, SMEs tend to be more labour-intensive than large firms, depend less on imports and maintain more linkages with other local enterprises. Third, they are more likely to have *sub-national* urban centres as their base, providing a stimulus for regional development (as large firms tend to be clustered in the capital cities). Individually they represent less economic power and are easier to deal with for national and local governments. Fourth, as SMEs operate less internationally, they are not so 'footloose' and are more likely to invest and expand *locally*. Support for SMEs can be in the form of financial subsidies, provided that their proposed business activities conform to market trends.¹⁹ *New* entrepreneurs may need skills training to respond to pressing needs in local labour markets, support in developing business plans and start-up capital. *Existing* entrepreneurs may be able to expand their business by training, financial aid or loans. NGOs are often well equipped to facilitate such training processes. In addition to that, the international community, i.e. peacekeeping missions, should strive to make use of the local or national private sector for their supplies as much as practically possible.

b) **Consider the provision of resources (i.e. cash vouchers) to consumers.** By providing people with the resources to purchase inputs and services, they might stimulate local economic activity by becoming potential customers of service providers. Generally, vouchers are considered more secure and allow for closer monitoring than direct cash transfers. They may also be more appropriate than in-kind aid if roads are unsafe and when it is difficult to transport goods. At the same time, cash transfers can be useful as a mechanism to stimulate productive

¹⁹ De Vries, H., Specker, L., *Early Economic Recovery in Fragile States: priority areas and operational challenges*, Clingendael Conflict Research Unit, November 2009.

activity and can be vital for creating demand as citizenry is often poor and cash-strapped.²⁰

c) Start up a business incubator to boost private sector competition. Business incubators offer a central place for entrepreneurs to gather information and receive support to set up or continue their businesses. It facilitates the sharing of costs for services (internet, operating costs etc.) and lobbying for reforms. Support packages are generally a mix of financial investment and technical assistance. Business incubators can be privatised,²¹ but it may be a challenge to convince entrepreneurs on a budget to pay for the incubator's services. Linking the incubator to (micro-)credit opportunities can negate these difficulties.

3. Policy considerations: involving international investors through linking the public and private sector, and civil society

Foreign direct investment (FDI) can bring many advantages to fragile states. Generally, such business relations will be governed by the economic interest of private companies, but 'win-win situations' do indeed exist. There is a growing interest, also within business circles, in responsible business operations that benefit peacebuilding processes. Apart from the overall contribution to economic growth, FDI can contribute to local PSD through the exchange of skills and knowledge. However, even though FDI in fragile states has dramatically increased,²² primarily export-oriented FDI provides only limited opportunity for employment creation.

Joint activities by Dutch public and private sector actors and civil society in fragile states²³ have indicated that the high risk environment and the

political uncertainty of fragile states often *require* cooperation between actors for the private sector to become involved, rather than having just a mere added value. Examples of cooperation models are risk coverage for the private sector by donor governments or NGOs providing working-level information to companies and supporting companies' acceptance within communities. Cross-sector cooperation should be considered as a potentially *useful instrument* to involve the private sector, but should not be a goal in itself: a viable business case remains critical for any private sector actor.²⁴

a) Consider setting up investment facilities and risk coverage schemes to encourage private investments.

The Netherlands' government has, for instance, recently adjusted its PSD funding programmes to better suit fragile states' circumstances. The *Private Sector Investment Programme* (PSI) is a subsidy programme offering financial support to partnerships between Dutch and local companies, aiming to achieve transfers of technology and knowledge, and positive spin-off effects for local economies.²⁵ To address the risks of investing in fragile states, PSI Plus was developed to offer extra facilities for risk management and insurance. PSI Plus allows investors to deal with a wider range of local partners or enterprises which are not officially registered as companies (which is common in countries without functioning Chambers of Commerce).²⁶ Finding suitable local partners in

²⁰ UNDP workshop *Post-conflict Economic Recovery*, Bujumbura, October 2009.

²¹ The Netherlands Ministry of Foreign Affairs and USAID are currently working on setting up a Burundi Business Incubator (BBI). The BBI will be based on an *innovative model* that aims to share risk, stimulate investment and support the development of enterprises of different capacities, scale and geographic mix. The BBI is designed to sustain itself and increase development impact over time through a *business-oriented model*.

²² In 42 fragile and conflict-affected countries FDI flows have more than quadrupled from USD 5 billion in 2000 to USD 20.9 billion in 2006. UNDP workshop *Post-conflict Economic Recovery*, Bujumbura, October 2009.

²³ The project Public Private Cooperation (PPC) in Fragile States, has been initiated under the 2007 Millennium Agreement 'Network for Peace, Security and Development', <http://www.millenniumakkoord.nl/agreements/00030-network-peace-security-and-development.nl>. The initiative identified how tripartite partnerships can contribute to sustainable economic development in fragile states and increase trust and understanding between the sectors in practice.

The project included small economic missions by Dutch private actors to a number of fragile states. Full project reports and an overview of the project partners can be found at: <http://www.clingendael.nl/psdn/>.

²⁴ See *Public Private Cooperation in Fragile States: synthesis report* on <http://www.clingendael.nl/psdn/> for a more in-depth discussion on the added value of cross-sector cooperation.

²⁵ The contribution to a project in one of the PSI countries is 50 percent of the project budget, with a maximum contribution of EUR 750,000. For fragile states the grant is 60% (with a maximum of EUR 900,000).

²⁶ Budgetary guidelines for PSI Plus proposals offer the possibility to include (extra) investments in security. In addition, extra budget is made available from MIGA/SIP for political risk insurance premiums.

fragile states remains a major challenge, though.²⁷ Additional research assessing the impact of these programmes is encouraged. One potential fall-back of the current instruments is that they do not differentiate between types of companies. So far, few specific efforts have been made to tailor the instruments to (Dutch) SMEs which may have the best potential to contribute to the creation of a peace dividend for the poor in fragile states.

b) Facilitate a better understanding of business opportunities in fragile states. Donor governments could consider the organisation of short economic missions in order to familiarize the Dutch private sector with investment opportunities abroad.²⁸ When risk coverage programmes for PSD in fragile states are present, such missions can stimulate the use of such instruments. Also, ensuring specialized, in-country facilities such as a person or company serving as a ‘business incubator’ could contribute to a better understanding of local business opportunities.

c) Encourage NGOs to adopt a more business-oriented approach. Most NGOs are currently not linked to or working together with the private sector, generally as a result of a lack of trust and

knowledge about each other’s capabilities and expertise. NGOs are encouraged to increase their level of knowledge concerning local business activities and to extend their local network to include contacts within the private sector from the outset (i.e. during assessments or early stages of project planning/involvement).²⁹ Developing internal guidelines on how to cooperate with the private sector will also benefit this process.

²⁷ A second instrument is the Development-Related Infrastructure Improvement Facility (**ORIO**). ORIO contributes to the development, construction and/or renovation, operation and maintenance of public infrastructure by the private sector, and is open to fragile states as well. Grant applications are submitted by the central government. For more information, see: <http://www.evd.nl/home/index.asp>.

²⁸ The joint consortium of Dutch public, private and civic sectors organized the first ever Dutch economic missions to Southern Sudan and DRC, coordinated by the Netherlands African Business Council (NABC) in 2009. For the outcomes of the missions, see the full country reports on: <http://www.clingendael.nl/psdn/>.

²⁹ Contacts with the (local) private sector are often not included when projects are started.

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The views expressed here are those of the authors and are not necessarily those of the Clingendael Institute or its staff members.



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