International Companies and Post-Conflict Reconstruction

Cross-Sectoral Comparisons

John Bray
Summary Findings

The role of international companies in post-conflict reconstruction is an essential complement to the work of international aid agencies. However, if policymakers are to secure the maximum benefits from private investment, they need to understand how different companies and sectors view opportunity and risk, and take account of their overall impact in post-conflict settings.

In development circles, the debate about the role of business in conflict-affected regions has tended to focus on petroleum and mining. This paper begins with a review of the extractive industries, but then broadens the discussion to discuss three other sectors: mobile phones, construction and commercial banks. It cites examples from Afghanistan, Bosnia and Herzegovina, Iraq, Somalia, Sierra Leone and Timor-Leste.

The four sectors vary in the scale of investment that they need, and the time-frame in which they expect to make returns. These calculations in turn influence their attitudes to conflict-affected countries. ‘Junior’ petroleum and mining companies are willing to take on high political and security risks in the hope of making major discoveries before their larger, more risk-averse competitors. However, ‘major’ companies in the extractive industries normally expect a reasonable prospect of long-term stability before committing to large-scale projects which may last for 20-30 years.

By contrast, mobile phone companies make smaller investments, and start getting a return as soon as the first subscriber makes a call: they may be able to recover their initial outlay within two or three years. Construction and engineering companies will take on short-term reconstruction contracts, but will hesitate to commit to long-term investment—for example in utilities—unless there is a stable government and legal system. Banks will not set up operations unless there are viable banking laws and foreign exchange regulations. Initially, they tend to concentrate on international customers, such as diplomats and aid workers, and may not develop a retail market for many years after the end of the conflict.

Large companies—the truly global players—will seize opportunities in post-conflict countries if these are commensurate with their size and capabilities, for example in Iraq. In smaller economies, large international companies are rarely willing to take high risks for returns that—on the scale of their balance sheets—are likely to be marginal. The most active foreign investors will be niche players with a higher tolerance of risk, or regional companies with regional development strategies.

Most larger international companies now emphasize corporate social responsibility including charitable programs. However, companies’ most significant social impact will come from the way that they conduct their core activities and in particular from their relationships with local communities and sub-contractors. Greater awareness of the risk of ‘doing harm’ has increased interest in the concept of conflict impact assessment as a sub-category of social impact assessment. International Alert and other NGOS are now developing tools to assist with this process.
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John Bray
# Table of Contents

Acronyms................................................................................................................................. iii
Foreword........................................................................................................................................ iv
Executive Summary ...................................................................................................................... v

**INTRODUCTION** ..................................................................................................................... 1

1. RISKS AND OPPORTUNITIES: COMMON THEMES ............................................................... 2
   The Politics of Post-Conflict Reconstruction .............................................................................. 2
   Investments, Timeframes and Commercial Opportunity ............................................................. 3
   Security Risks .............................................................................................................................. 4
   Political and Regulatory Risks .................................................................................................... 5
   Corruption Hazards ..................................................................................................................... 6

2. PETROLEUM AND MINING .................................................................................................... 7
   The Business Case ....................................................................................................................... 7
   Security and Regulatory Risks .................................................................................................... 7
   Structure of the Industry ............................................................................................................ 8
   Making the Right Call ................................................................................................................ 8
   Oil, Minerals and Conflict .......................................................................................................... 9
   Corporate Responsibility and Social Impact ............................................................................. 10
   Implications for Other Industries ............................................................................................ 12

3. MOBILE PHONES .................................................................................................................... 12
   The Business Case .................................................................................................................... 13
   Regional and Niche Players ...................................................................................................... 13
   Security Risks .......................................................................................................................... 15
   Political and Regulatory Issues ............................................................................................... 15
   Supply Chain Issues ................................................................................................................ 16
   Corporate Responsibility and Social Impact ............................................................................ 16
   Case study: Telstra reconnects post-conflict Timor Leste ......................................................... 18
   Case Study: Mobile Phones and State Failure in Somalia ......................................................... 19
   Case Study: Celtel’s Commercial Expansion in Sierra Leone .................................................. 20

4. CONSTRUCTION AND ENGINEERING COMPANIES .......................................................... 22
   The Business Case ................................................................................................................... 23
   Structure of the Industry .......................................................................................................... 23
   Finance and Political Risks ...................................................................................................... 24
   Security Risks .......................................................................................................................... 24
   Integrity Hazards ....................................................................................................................... 25
   Corporate Responsibility and Social Impact ............................................................................ 25
   Case Study: British Companies and International Commercial Rivalry in Kosovo ................ 27
   Case Study: Strategic Road Construction under Fire in Afghanistan ....................................... 29

5. INTERNATIONAL COMMERCIAL BANKS ............................................................................. 31
   The Business Case ................................................................................................................... 31
   Political and Security Risks ...................................................................................................... 32
   Corporate Responsibility and Social Impact ............................................................................ 33
Case Study: Austrian Banks’ Regional Expansion into Bosnia-Herzegovina ........................................ 33
Case Study: Hawala and ATMs in the Afghan Market Place ................................................................. 36
Case Study: Continuing Conflict Delays Commercial Banks in Iraq ..................................................... 38

6. LESSONS LEARNT AND RECOMMENDATIONS ........................................................................... 40
   Global, Regional and Niche Players ................................................................................................. 40
   Timing and Sequencing of International Commercial Interest ......................................................... 41
   Creating an Enabling Environment ................................................................................................. 42
   Doing No Harm ............................................................................................................................. 43
   Conflict Impact Assessment ......................................................................................................... 44
   Corporate Responsibility and Peace-Building .................................................................................. 45

References ........................................................................................................................................ 46

Tables
Table 1: Companies Deterred from an Otherwise Attractive Investment on Account of a Country’s Reputation for Corruption, by Sector ........................................................................................................ 6
Table 2: Sectors Where the Biggest Bribes are Likely to be Paid ......................................................... 25
# Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>AIB</td>
<td>Afghan International Bank</td>
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<td>AKFED</td>
<td>Aga Khan Fund for Economic Development</td>
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<td>ARC</td>
<td>Afghan Reconstruction Company</td>
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<td>BOT</td>
<td>Build-Operate-Transfer</td>
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<td>BTA</td>
<td>Basic Telecommunications Agreement</td>
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<tr>
<td>CBBH</td>
<td>Bosnia-Herzegovina’s Central Bank</td>
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<tr>
<td>CNPC</td>
<td>China National Petroleum Company</td>
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<tr>
<td>CPA</td>
<td>Coalition Provisional Authority</td>
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<tr>
<td>DAB</td>
<td>Da Afghanistan Bank (Afghanistan’s Central Bank)</td>
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<tr>
<td>DIA</td>
<td>Danish Institute of Human Rights</td>
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<td>DRC</td>
<td>Democratic Republic of Congo</td>
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<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<tr>
<td>GAM</td>
<td>Gerakan Aceh Merdeka (Aceh Freedom Movement)</td>
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<tr>
<td>GeSI</td>
<td>Global e-Sustainability Initiative</td>
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<tr>
<td>HDZ</td>
<td>Croat Democratic Union</td>
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<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IPPs</td>
<td>Independent Power Projects</td>
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<td>ITU</td>
<td>International Telecommunications Union</td>
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<tr>
<td>KM</td>
<td>Konvertibilna Marka</td>
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<tr>
<td>KYC</td>
<td>Know Your Customer</td>
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<tr>
<td>MCT</td>
<td>Monaco Telecom International</td>
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<tr>
<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
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<td>OPIC</td>
<td>Overseas Private Investment Corporation</td>
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<tr>
<td>PTI</td>
<td>Portugal Telecom International</td>
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<td>REFS</td>
<td>USAID’s Rehabilitation of Economic Facilities and Services</td>
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<tr>
<td>RUF</td>
<td>Revolutionary United Front</td>
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<tr>
<td>SFCG</td>
<td>Search for Common Ground</td>
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<tr>
<td>SIERRATEL</td>
<td>Sierra Leone Telecommunications Company</td>
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<tr>
<td>SMEs</td>
<td>Small and Medium Enterprises</td>
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<td>SPLA</td>
<td>Sudan People’s Liberation Army</td>
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<td>SSSI</td>
<td>Strategic Security Solutions</td>
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<td>STA</td>
<td>Somali Telecom Association</td>
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<tr>
<td>UAE</td>
<td>United Arab Emirates</td>
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<tr>
<td>UN</td>
<td>United Nations</td>
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<tr>
<td>UNTAET</td>
<td>UN Transitional Authority for East Timor</td>
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<tr>
<td>USACE</td>
<td>United States Army Corps of Engineers</td>
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<td>USAID</td>
<td>United States Agency of International Development</td>
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Foreword

This paper draws on the experience of international companies as a guide to future policy-making. What factors have guided investment decisions in post-conflict countries? How do different companies in different sectors perceive political and security risks? How do they manage these risks? What are the lessons both for the private sector and for policy-makers?

The paper was commissioned by the Conflict Prevention and Reconstruction (CPR) Unit and produced by International Alert, a peace-building NGO, as part of the latter’s wider program of work on business and conflict, which includes field- and policy-level engagement with local and international companies, as well as governments, civil society organizations and other relevant actors. Future work at International Alert will address public policy options across different dimensions of post-conflict reconstruction. This will include strategies to mobilize appropriate private sector investment, and to ensure that companies have the most positive social impact. The paper is part of the Bank’s Governance of Natural Resources Project, funded through the Norwegian Trust Fund for Environmentally and Socially Sustainable Development. We are grateful for the generous support of the Government of Norway for this Project.

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International Alert would like to thank the World Bank’s CPR Unit, the Swiss Department for Foreign Affairs Human Rights Section, the UK Department for International Development Conflict and Humanitarian Affairs Department, and Swedish SIDA for their financial support. Special thanks from the author to Andrew Cartwright, Arno van Dijken, Miyoko Kobayashi, Juriaan Lahr, Mark Lethbridge and Murali Shanmugavelan for advice and support.

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Manager
Conflict Prevention and Reconstruction
Executive Summary

The role of international companies in post-conflict reconstruction is an essential complement to the work of international aid agencies. However, if policy-makers are to secure the maximum benefits from private investment, they need to understand how different companies and sectors view opportunity and risk, and find ways to assess their overall impact in post-conflict settings.

In development circles, the debate about the role of business in conflict-affected regions has tended to focus on natural resources, particularly petroleum and mining. This paper begins with a review of the extractive industries, but then broadens the discussion to the impact of three other commercial sectors: mobile phones, construction and engineering, and commercial banks. It cites examples from Afghanistan, Bosnia-Herzegovina, Iraq, Somalia, Sierra Leone and Timor-Leste.

Opportunities and Timeframes

The four sectors vary in the scale of investment that they need, and the time-frame in which they expect to make returns. These calculations in turn influence their attitudes to conflict-affected environments.

- For petroleum and mining companies, location is everything. If the geological opportunities are attractive, they will consider how to deal with political and security risks. ‘Junior’ companies are particularly willing to take high political and security risks at the exploration stage in the hope of making major finds before their competitors. However, the emphasis of companies’ risk calculations changes at the production stage. Large projects require hundreds of millions or billions of dollars of investment and may continue for 20 or 30 years. In principle, although not always in practice, the major Western investors who have access to this kind of finance look for countries that will be stable and secure throughout this period.

- Mobile phone companies make smaller investments and get quicker returns. The initial outlay may be of the order of tens of millions or the low hundreds of millions of dollars. Companies start getting a return as soon as the first subscriber makes a call. Emerging markets—including conflict-affected areas—are attractive because they are far from ‘mature’ and may scarcely have been touched by competitors. Investors may be able to pay off their initial outlays in two or three years, even in conflict regions.

- In the immediate post-conflict phase, major construction and engineering projects tend to be financed by bilateral or multilateral aid. International companies can be confident of being paid from this source. The political risks obviously increase to the extent that they are involved in operating projects—for example running power stations or toll roads—rather than simply building them. In that case, they will want to be confident of longer periods of stability to ensure the security of their profits.

- Initially, the most promising clients for international banks are likely to be internationals, for example diplomats and NGOs. The prospects for domestic retail banking are likely to be slim for several years after fighting ends.

International commercial interest is commonly very limited in the immediate aftermath of conflict. The companies most likely to be active are those that, like the construction companies, are directly involved in physical reconstruction or are serving international diplomats and aid agencies. By the third or fourth year after the conflict, there may be greater interest from investors who are prepared to make long-term commitments.

Security Risks

Security risks affect different companies in different ways. Mines and petroleum wells represent expensive fixed assets, and their protection is of strategic importance both to the companies themselves and—in most cases—to the host government. Mobile phone companies are less exposed and the fact that
they provide a public service means that they make less attractive targets for opposition movements. Construction projects are more like the extractive industries in that they too represent substantial fixed assets although they may be in locations that are easier to protect. Commercial banks, by the nature of their operations, are always located in large cities. However, the presumed Al-Qaeda bomb attack on the HSBC bank in Istanbul in November 2002 serves as a reminder that foreign banks may be targeted because they are seen as representative symbols of their home countries. Security is a major factor in bankers’ investment decisions.

**Political Risks and Corruption**

Even if there is no renewed fighting, investors can face significant regulatory obstacles. Often, officials lack the skills and experience to cope with the requirements of a new commercial environment, or are not in full control of their territory. At the same time, many countries emerging from lengthy conflicts retain outdated laws and regulations that might otherwise have been revised. At the international level, reputational risks and debates around legal liability of companies under international humanitarian law pose further threats.

In the aftermath of conflict, physical reconstruction understandably tends to be one of the most pressing immediate objectives. Moreover, if national reconciliation is a priority, both host governments and donors will hesitate to crack down on vested interests that represent powerful political constituencies. Delays in necessary reforms carry a high price. High levels of corruption discredit the reconstruction process, and increase the risk of renewed conflict. Particularly if combined with an outdated legal framework, corruption impedes both domestic and international business.

**Global and Regional Companies**

Large companies—the truly global players—will seize opportunities in post-conflict countries if these are commensurate with their size and capabilities, for example in Iraq, but this is relatively unusual. In smaller economies, particularly in the first year or two after the conflict ends, the larger companies are rarely willing to take high risks for returns that—on the scale of their balance sheets—are likely to be marginal.

In practice, the most active foreign investors in the smaller post-conflict states are niche players with a higher tolerance of risk, or regional companies with regional development strategies. Mobile phone companies provide an example in sub-Saharan Africa, including the post-conflict countries in the region. The leading operators are either European niche-companies, or regional companies based in South Africa or Egypt. Standard Bank is a major international bank with a particular specialty in emerging markets. It has been one of the first to open a branch in Afghanistan, and has operated in Sierra Leone since colonial times. However, in other cases—for example Austrian banks in Bosnia, ANZ Bank in Timor Leste and Stanbic in the Democratic Republic of Congo—banks set up operations in post-conflict countries because this fits in with their regional strategies.

Diaspora investors—people who originated in the host countries but have established themselves abroad—also play a particularly important role. Celtel, a Netherlands-based mobile phone company which operates in 13 sub-Saharan African countries, was set up by an entrepreneur who was born in Sudan and wished to ‘give something back’ to his home region. Much of the foreign investment in Afghanistan comes from Afghan-Americans.

If policy-makers wish to encourage foreign investment in post-conflict economies, they need to take special consideration of the needs of smaller and regional companies. Among other things, these companies may need better access to finance.
Conflict Impact Assessment
Both business development and aid aspire to promote economic recovery. However, individual projects may, if badly designed, exacerbate social and political tensions rather than alleviating them.

Greater awareness of the risk of ‘doing harm’ has increased interest in the concept of conflict impact assessment as a sub-category of social impact assessment. The UN Global Compact, which was formally launched by UN Secretary-General Kofi Annan in 2000, took up this theme in one of its first dialogues between the UN and representatives of the private sector. In 2002 the Compact published its Business Guide to Conflict Impact Assessment and Risk Management in Zones of Conflict. Meanwhile, researchers and NGOs have been taking this idea forward by developing new conflict impact assessment tools. For example, International Alert will soon publish both a Macro-level and Project-level Conflict Risk and Impact Assessment tool as part of its forthcoming Conflict-Sensitive Business Practice Toolbox for Extractive Industries.

Corporate Responsibility and Peace-Building
Like development projects, international companies may contribute to either peace or war, but on their own will serve neither as the sole source of conflict nor the sole remedy. The most important questions are how to minimize the risk of causing harm, and how to maximize the social benefits of their activities.

Most of the larger international companies now emphasize the importance of corporate social responsibility and this often includes charitable endeavors such as corporate sponsorships of education or health programs. Such initiatives are important in their own right, but companies’ most significant social impact will come from the way that they conduct their core activities, and in particular from their relationships with local communities and sub-contractors.

International companies may be larger or smaller players in local commercial ecosystems. They may act as predators, or they may provide a catalyst to other companies and entrepreneurs. In the worst cases, companies can inadvertently fuel the structural causes of the conflict, undermining prospects for recovery. However, by presenting a vision of a different kind of future, where personal success comes from entrepreneurial initiative rather than military expertise, international companies and their local partners can help find a way out of cycles of deprivation and conflict.
INTRODUCTION

The majority of the world’s conflicts are now civil wars, but the protagonists rarely operate in isolation—almost all contemporary armed conflicts are at least to some degree international. A series of recent studies has shown how some rebel groups finance their campaigns through international trade in goods such as drugs, diamonds and coltan (e.g., Collier 2004, Collier and Hoeffler 2001, Ballentine and Sherman 2003). Meanwhile, there have been cases where government revenue from foreign companies—particularly in the natural resources sectors—has made military expenditure more affordable, thus serving to prolong conflict.

If civil conflicts are in part international, so is post-conflict reconstruction. Most obviously, the international presence includes the contributions of aid agencies, multilateral institutions and NGOs. It also includes representatives of the private sector whether as contractors, service-providers or investors. International companies bring expertise and finance. If they also bring lasting commitment, they can make a major contribution to sustainable recovery. Post-conflict aid contributions tend to tail off four or five years after a conflict ends (Collier et al. 2003; Schwartz et al. 2004). If all goes well, international investment should increase once stability returns, thereby compensating for the decline in aid.

So far, most of the debate about the role of business in conflict-affected regions has focused on natural resources, particularly petroleum and mining (e.g., Collier et al 2003, Bannon and Collier 2004). There are good reasons for this. Many of the most attractive new opportunities for the extractive industries are in ‘frontier’ areas, and these often include politically unstable or conflict-affected regions. Depending on the local geological possibilities, petroleum and mining companies therefore have a greater incentive to enter high-risk countries. Once their projects come into production, they bring in revenue that could—if properly managed—help kick-start other economic sectors. However, all too often, natural resources have been seen as a ‘curse’, reinforcing the authority of corrupt dictatorships, and promoting rather than alleviating conflict. International debate has therefore focused on the means to lift this curse, including measures to promote greater transparency in the reporting of natural resource revenues (e.g., Ross 2001, Global Witness 1999, 2004).

This paper was commissioned by International Alert, an NGO that focuses on conflict transformation and peace-building, including a program promoting a positive role for business in conflict-affected countries. The paper draws on interviews with a selection of business executives, desk-based research and the author’s experience as a political risk consultant for international companies. It reviews the current debate about the role of the extractive industries, but then broadens the discussion to analyze the role of three other commercial sectors that operate in post-conflict economies:

- **Mobile phone companies** have shown a pattern of spectacular entrepreneurial initiative in setting up operations as soon as—or even before—conflicts end. Their success is often seen as a trailblazer for other foreign investors both because they demonstrate that it is possible to achieve commercial success in post-conflict economies, and because their services make it easier for other companies to operate.

- **Construction and engineering companies** compete for aid-sponsored reconstruction contracts—rebuilding roads and reconnecting essential power and water supplies. Without this basic infrastructure, nothing much else can happen. Many construction and engineering companies
move on once their immediate projects are completed; others stay on as operators. In either case, the way that they conduct their initial work has lasting repercussions.

- **International commercial banks** tend to come later, but provide a further ‘building block’, facilitating the work of aid agencies, foreign investors and—in due course—domestic companies.

Among countries, the paper concentrates on states that have failed or where there has at least been a break in institutional continuity as a result of conflict, citing examples from Afghanistan, Bosnia-Herzegovina, Timor-Leste and Sierra Leone. Iraq is also included: it is exceptional because of the sheer scale of the reconstruction program, the extent of its economic potential, and the fact that the conflict is far from over. However, there are important parallels with other conflict-affected economies and state-building endeavors, and Iraq’s prominence in the wider geo-political debate about business and conflict makes it impossible to ignore. Somalia is also included in the discussion—it is still a failed state but mobile telephony has been able to flourish with the help of international suppliers, and this makes it an instructive contrast with the other case studies.

The paper begins with a discussion of risks and opportunities. It then reviews the experience of petroleum and mining companies as a basis for comparison, before turning to each of the other three sectors in turn. It addresses three main questions:

- What is the business case for commercial engagement? How do different kinds of companies assess risk? How do their assessments tend to change according to their sector, size and country of origin? At what stage are they most likely to engage?

- What kinds of social impact do they have? How does their presence reinforce conflict recovery? In what circumstances might it contribute to renewed tensions?

- What are the policy implications? What can be done—by governments, multilateral institutions and the companies themselves—to make sure that businesses reinforce peace rather than war?

The paper is selective rather than comprehensive—the contrasts it identifies make clear that there is no single post-conflict model that can or should be applied to all cases. Rather, its aim is to identify common themes, provoke debate, and inspire more detailed research on specific countries, sectors and companies.

### 1. RISKS AND OPPORTUNITIES: COMMON THEMES

Post-conflict states are by definition weak states, and are therefore associated with significant political and security risks. The extent to which companies are prepared to take these risks depends on their individual strategies and, above all, their assessment of commercial opportunity. This section reviews the political complexities of post-conflict states, and discusses the contrasting commercial strategies of the different business sectors.

**The Politics of Post-Conflict Reconstruction**

Failed states have risen up the international policy agenda both for humanitarian reasons and because the repercussions of their failure impinge on the geo-political interests of more prosperous countries. The September 11 terrorist attacks are the starkest illustration of a wider point. A weak or failed state—in this case Afghanistan—may provide a refuge for terrorists. It may also serve as a headquarters for narcotics smugglers; it will be a source of refugees in neighboring states; and, as Collier and his colleagues (2003:27-29) point out, African civil wars have contributed to the spread of infectious diseases such as
HIV/AIDS. Civil war is ‘development in reverse’. It increases local human suffering, and leads to instability and violence both locally and—albeit with diminishing impact—in neighboring states and further afield. There is therefore an emerging international trend in favor of external intervention to prevent failure and promote recovery.

Nevertheless, there remains widespread dispute about the form that external intervention should take, the resources that should be devoted to it, and the extent to which it can achieve its objectives. External military interventions have ended civil wars or led to regime change in Bosnia (1995), East Timor (1999), Kosovo (1999), Afghanistan (2001) and Iraq (2003-). However, military expeditions—even by great powers—have not always achieved even their immediate objectives: the US intervention in Somalia in 1993 was notably unsuccessful. Even when military objectives are achieved, the task of establishing an effective government, or ‘nation-building’, is bound to prove more complicated and more time-consuming. US academic Francis Fukuyama (2004) speaks for many when he comments that the question of how to promote governance of weak states, improve their democratic legitimacy, and strengthen self-sustaining institutions has become ‘the central project of contemporary international politics’.

No would-be state builder ever starts with anything approaching a blank slate. The political complexities that led to failure are likely to survive in some form. More subtly, but perhaps even more importantly, parallel war economies are also likely to persist both locally and regionally (Pugh and Cooper 2004). In Bosnia-Herzegovina, ethnically-based, nomenklatura-style political interests continued to dominate both private and notionally state-owned economic institutions long after the end of the war in 1995 (Cox 2001). In Afghanistan, as Lister and Pain (2004) point out, the informal market is far from being ‘free’ because a small but powerful group of traders continue to benefit from the backing of local strongmen, using their influence to dominate markets and exclude new entrants.

International agencies find it difficult to challenge these parallel economic and political networks even when—as in Bosnia, Kosovo and Iraq—external powers have exercised political authority. In part this is because of a lack of local knowledge, compounded by the constraints imposed by their own political imperatives, finite financial resources and limited local support. The task of state-building requires sustained political and economic investment over a period of years.

The success or failure of state-building initiatives helps determine the extent to which the host country provides the right ‘enabling environment’ for business. Among other qualities, this environment should ideally include basic security, a competent judiciary, a legal system that protects property rights, a balanced taxation system, and a more-or-less predictable policy outlook. These conditions are unlikely to apply in the immediate post-conflict phase, and often for some years afterwards. Adverse political conditions affect all companies but—as will be seen—the impact is greater on some sectors than on others.

**Investments, Timeframes and Commercial Opportunity**

Different commercial sectors vary in the scale of investment they need, and the timeframe in which they expect to make returns. These calculations in turn influence their attitudes to conflict-affected environments.

- For petroleum and mining companies, location is everything. If the geological opportunities are attractive, they will consider how to deal with political and security risks. Many of the most attractive geological opportunities are in ‘frontier’ regions, including conflict-affected areas. In both sectors, ‘junior’ companies are particularly willing to take high political and security risks at the exploration stage, in the hope of making major finds before their competitors.
It may take as much as ten years between initial exploration and a project coming into production. At this point, the emphasis of companies’ risk calculations changes. Major projects typically require hundreds of millions or billions of dollars of investment, and are likely to continue to produce for 15, 20 or even 30 years. In principle, although not always in practice, the major Western investors who have access to this kind of finance look for countries that will remain stable and secure throughout this period.

- Mobile phone companies make smaller investments, and get quicker returns. The initial outlay may be of the order of tens of millions of dollars, or the low hundreds of millions. Companies start getting a return on their investment as soon as the first subscriber makes a call. Emerging markets are attractive because they are far from being saturated, and conflict-affected regions may scarcely have been touched by competitors. The most successful investors may be able to pay off their initial outlays in two or three years.

- In the immediate post-conflict phase, major engineering construction projects tend to be financed by bilateral or multilateral aid. International companies involved in reconstruction projects can be confident of being paid from this source. The risks obviously increase to the extent that companies are involved in operating projects—for example running power stations or toll roads—rather than simply building them. In that case, they will want to be confident of longer periods of stability to ensure the security of their profits.

- Initially, the most promising clients for international banks are likely to be internationals, for example diplomats and NGOs. The prospects for domestic retail banking are likely to be slim for several years after fighting ends. International banks come in late and in practice will only form part—albeit an important part—of the country’s financial infrastructure. Other agencies—for example micro-credit institutions—are also needed.

Security Risks

The most obvious risks relate to security, but these affect different companies in different ways, depending on their industry, their location and the stage that their project has reached.

- Mines and petroleum wells represent expensive fixed assets, and their protection is of strategic importance both for companies themselves and—in most cases—for the host government. It is possible to provide fortress-like enclave security for major projects, but in the long term these are unlikely to be sustainable without the support—or at least acquiescence—of local communities. It is almost impossible to provide full security for oil and gas pipelines running through remote areas. Instead, companies concentrate on systems that detect breaches early so that they can make rapid repairs.

- Mobile phone companies are less exposed. As will be seen, they tend to concentrate in the first instance on national capitals and the main towns, and these tend to be relatively well-protected. Engineers are vulnerable when setting up phone masts in more remote areas, and the masts themselves are fixed assets that are vulnerable to sabotage. However, they are relatively easy to replace. Moreover, the fact that the companies provide a public service means that they make less attractive targets for opposition movements.

- Construction and engineering projects vary widely in size and location. Again, many of the most important initial projects are likely to be in or around main cities, and are therefore likely to be in more secure areas. Road-building projects typically require the deployment of expensive heavy
equipment, but this of course is only temporary. As recent experience in Afghanistan has shown (see case study), contractors may be vulnerable to guerrilla attacks, particularly when traveling, but the main construction operations can be protected relatively easily. Power stations have some characteristics in common with oil installations—it is generally possible to secure the power station itself, but not transmission lines.

- Commercial banks, by the nature of their operations, are always located in main cities. International banks are well-versed in the security measures needed to reduce the risk of common bank robbery. Bomb attacks are of course more problematic and the presumed Al-Qaeda bomb attack on the HSBC branch in Istanbul in November 2002 serves as a reminder that foreign banks may be targeted because they are seen as representative symbols of their home countries. Security is a major factor influencing banks’ decisions on whether or not to invest.

Political and Regulatory Risks

The most basic political risk is the possibility of renewed conflict, and there is likely to be a high degree of uncertainty for some time after a conflict ends. Even if there is no renewed fighting, investors are likely to face significant political and regulatory obstacles. Often, officials lack the skills and experience to cope with the requirements of a new commercial environment, or are not in full control of the territory. At the same time, many countries emerging from lengthy conflicts retain outdated laws and regulations that might otherwise have been revised. Bosnia-Herzegovina is simultaneously a post-conflict country and a post-socialist ‘transition economy’, facing similar problems to other Eastern European states in updating its legal system. The current legal system in the Democratic Republic of Congo (DRC) reflects both the Belgian colonial legacy and an arbitrary mixture of decrees issued in the era of former President Mobutu.

Different companies and sectors vary in the extent to which they feel able to operate without clearly defined legal and regulatory systems.

- Junior petroleum and mining companies have a record of entering countries (for example in much of Africa during the 1990s) before there is a mining or petroleum code. By going in early, they calculate that they will be able to establish good relations with the host government, and may be able use their influence on the design of whatever code eventually emerges. However, as noted above, the risk calculations for oil and mining production are different from exploration. Large projects require large-scale finance. Neither the major producers nor their financial backers will be prepared to invest unless there is a well-drafted code, and a reasonably stable government.

- The approach of mobile phone companies is different. Historically, most countries’ telecommunications systems were dominated by state-owned operators who were reluctant to let foreign companies into their territory. One of the main obstacles to the initial expansion of the industry was therefore an excess of regulation rather than the lack of it. In Somalia (see case study) domestic mobile phone companies drawing on foreign suppliers have been able to operate comparatively successfully despite a total lack of government regulation. In general, international companies favor liberalization and deregulation, provided that the legal system works. Some of the more adventurous international companies adopt a similar approach to the junior mining companies, and are willing to make at least initial investments even in countries with poorly developed legal infrastructures.

- The concerns of construction and engineering companies depend on who is paying them and how long their contracts require them to stay in-country. The regulatory risks attached to short-term reconstruction projects will be more easily manageable if they are financed by international
agencies. Companies considering involvement in the management of utilities such as electricity and water in, for example, Iraq, will be concerned at the possibility of a change of the rules imposed by whatever kind of Iraqi government eventually emerges from the current transition period.

- The position of the international banks is clear. Well-drafted banking laws and foreign exchange regulations are a pre-requisite without which they will not begin operations.

Corruption Hazards

Post-conflict environments almost inevitably engender high corruption risks. The host government’s institutional controls are almost certain to be weak both because of the immediate legacy of conflict and, in many cases, because of the still unresolved failings of the pre-war political order. In Sierra Leone, political leaders’ exploitation of the diamond industry was one of the main factors that led to conflict. Post-war Bosnia-Herzegovina has had to cope simultaneously with the challenges of physical reconstruction, the transition from socialist economics, and the complexities of the national constitution established by the 1995 Dayton accord. These complex political structures have in themselves provided opportunities for high levels of corruption.

In 2002 Control Risks Group commissioned a survey of attitudes to corruption among 250 international companies based in the UK, the US, Germany, The Netherlands, Hong Kong and Singapore. The survey showed that corruption was a significant factor in investment decisions: some 39% of companies had been deterred from otherwise attractive investments on account of a host country’s reputation for corruption. The Control Risks survey pointed to significant differences between sectors.

Table 1: Companies Deterred from an Otherwise Attractive Investment on Account of a Country’s Reputation for Corruption, by Sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil, gas and mining</td>
<td>52.2%</td>
</tr>
<tr>
<td>Public works, construction</td>
<td>44.2%</td>
</tr>
<tr>
<td>Banking and finance</td>
<td>39.2%</td>
</tr>
<tr>
<td>Power generation/transmission</td>
<td>37.5%</td>
</tr>
<tr>
<td>Telecoms</td>
<td>27.3%</td>
</tr>
</tbody>
</table>


A variety of factors influence the calculations of the different sectors:

- Oil, gas and mining companies are notoriously exposed to corruption because they are closely regulated, and the large amounts of revenue that they produce increase the temptations to ‘rent-seeking’ political leaders and officials. The Control Risks survey suggests that a history of past problems deters a significant number of companies although, as will be seen, ‘majors’ are more likely to be deterred than ‘juniors’.

- Telecoms companies are most exposed to corruption when they are applying for the issuing or renewal of licenses. Thereafter, they are less exposed to government rent-seeking than, for example, the petroleum sector. Intense competitive pressure is encouraging telecoms companies—notably mobiles—to move into new markets even if there are high non-commercial risks.
• The international construction industry is vulnerable to corruption both during the tendering process and at the implementation stage (for a general discussion see Transparency International UK 2004).

• Tighter international anti-money laundering regulations have sensitized banks to corruption issues. All banks are supposed to implement strict Know Your Customer (KYC) procedures to ensure that they do not take on clients who are, for example, associated with the international narcotics trade. Such regulations are more difficult to apply in post-conflict countries both because it is harder to get detailed information on customers who may have little record of mainstream business, and because there is a greater likelihood that prominent local figures acquired their wealth by unorthodox means such as sanctions-busting.

Except in the most dire circumstances, neither high levels of corruption nor political and security risks serve as an absolute deterrent to foreign investment. However, as the following sections show, they do influence which companies in each sector invest, and when.

2. PETROLEUM AND MINING

The role of the extractive industries in alleviating poverty and reducing the risks of conflict is fiercely contested. In theory, natural resources should provide the economic basis for balanced development and political stability. Among developing countries, Botswana, whose economy depends heavily on diamonds, is a positive example. However, Botswana contrasts with Sierra Leone, a country with a similar mineral endowment, where the struggle to control the diamond industry contributed directly to a long-running civil war. Other countries, where oil or minerals appear to have contributed to conflict, rather than alleviating it, include Angola, DRC, and Sudan. It has become commonplace to refer to petroleum and mineral endowments as a ‘curse’ rather than a ‘blessing’.

The all-too-evident problems of the extractive industries have led to a series of policy initiatives to try to resolve them, and these involve governments, multilateral institutions and civil society, as well as companies. This section discusses the role of international companies in conjunction with other social and political actors. It analyses the distinctive characteristics of the extractive sectors, reviews the lessons learnt, and discusses the extent to which they can be applied to other commercial sectors.

The Business Case

As discussed above, in the extractive sectors, the business case for engaging with conflict-affected countries is clear. Geology and geography are crucial, politics is important but secondary. The most easily accessible resources in politically stable countries are already being exploited. The most attractive new resources are to be found in frontier areas. In much of West Africa—for example in offshore Equatorial Guinea, Sao Tomé e Principe, and Mauritania—the frontier is both technical and political.

Petroleum and mining companies have a culture of risk-taking. The prime risks are technical—exploration is expensive, particularly when it involves drilling test wells for oil, and there is a high failure rate. However, successes can be spectacular. Similarly, they take pride in solving problems: primarily technical problems but also—arguably with less success—social and political ones.

Security and Regulatory Risks

Companies’ risk exposure changes in the course of the project cycle. In the initial stage, exploration teams face security risks when operating in remote areas: they need to make sure that local leaders know who
they are, and are prepared to tolerate their presence. However, once companies have secured an exploration license, the short-term political risks are relatively low. The host government generally welcomes them because of the prospect of future wealth. Local communities may be suspicious, but any drilling or digging will be on a relatively small scale, and the limited environmental impact is less likely to spark a hostile reaction.

Security, political and regulatory risks all increase at the production stage. The company now has to protect fixed assets. The environmental impact is all too clear, particularly in the case of large open-cast mines, which means that there is more likely to be opposition from host communities. Community expectations of the benefits from the project may well have been raised by earlier contact, often unrealistically. Moreover, now that the company is making a financial return, the host government is more likely to think of renegotiating its license in the hope of winning a greater share of the profits.

Structure of the Industry

Companies’ willingness to take these risks depends on who they are. It also depends on the stage the project has reached in the development cycle, and on the potential reputational issues.

The largest companies (‘majors’ in industry parlance) are primarily interested in developing large-scale projects commensurate with their size. These typically require hundreds or even billions of dollars worth of investment, and the company will look for returns over a period of 10, 20 or 30 years. They will not commit investment on this scale unless there is a well-crafted mining or petroleum law, and there is a reasonable prospect of political stability and manageable security risks over the period of the project. However, there are no absolute rules. If the prospects are sufficiently enticing, companies will look for ways of managing the political and security risks. NGO activists lament that companies such as BP were perfectly aware of the problems that they would face in Angola, but went in anyway. Similarly, the size of the potential opportunities in Equatorial Guinea evidently has overridden any concerns that Exxon Mobil and other international companies may have had about that country’s poor human rights record.

Majors approach high-risk countries with care, junior companies rejoice in them. Juniors tend to be primarily interested in exploration, and present themselves to their own shareholders as niche players who operate in high-risk markets in the hope of making a high return in the event of a major discovery. Part of their comparative advantage lies in their willingness to take risks that would be unacceptable to a major. However, once they have made a proven discovery, and the project reaches the production stage, they typically will sell out to a major or enter into a joint-venture agreement.

Many state-owned companies from developing countries follow a similar strategy to Western juniors. They face the challenge of establishing a niche against competition from the established European or US-based international companies, and believe that their greater willingness to take political and security risks may be an advantage. A further factor is that their home governments may see a strategic interest in gaining access to energy or mineral supplies. Malaysia’s Petronas is an example: its international operations include Myanmar, Sudan and Chad, while India’s ONGC-Videsh has recently moved into both Sudan and Angola, and the China National Petroleum Company (CNPC) also is operating in Sudan.

Making the Right Call

The juniors’ risk-taking calculations mean that conflict-affected countries—and particularly post-conflict countries—fit squarely into their strategies. However, they have to make the right judgment call. The ideal host country is one with a history of past problems that is now getting better. If juniors move in early, possibly before the host country is entirely stable, they can seize opportunities that are beyond the reach of risk-averse majors. Once their projects come into production, they have the choice of continuing
to develop them themselves or, provided the wider political environment continues to improve, selling out to a major. But they have to get the timing right. Sudan and Afghanistan in the 1990s are examples of conflict-affected countries where this calculation has not worked out entirely as intended.

**Oil Exploration and Production in Sudan**
The latest phase in the history of Sudan’s oil industry came in 1996 following the Khartoum Agreement between the government and six ethnic Nuer groups who had broken away from the opposition Sudan People’s Liberation Army (SPLA). The Agreement did not end Sudan’s civil war, but it did establish a local ceasefire, thus making it possible to resume exploration in the Unity Province/Western Upper Nile region. However, even at a local level, the ceasefire proved more transitory than originally hoped. It was not so much a turning point as one in a series of defections and counter-defections by rival Nuer groups in an ongoing civil war. Talisman (Canada) and other international companies therefore found themselves operating in a conflict zone rather than a post-conflict environment. Worse, NGO critics accused the companies of contributing to the conflict locally because of their association with government troops, and nationally because the oil revenue they provided was thought to help finance the government’s military expenditure (see Human Rights Watch 2003).

**The Afghanistan Pipeline**
In Afghanistan’s case, the issue was not oil or gas production, but rather the construction of a pipeline from Turkmenistan across Afghanistan to Pakistan. In the mid-1990s, the US company Unocal was among a group of Japanese, Saudi Arabian, South Korean and Pakistani companies in the Central Asian Gas consortium which planned to build the pipeline (Rashid 2001). When Unocal joined the project in the mid-1990s, it was regarded as one of the most ‘audacious’ in the region—in an industry where audacity is much admired (Levine 1998). The Taliban takeover of Kabul in 1996 at first appeared to be a positive development because, regardless of their ideology, the movement seemed able to bring a degree of enforced stability to Afghanistan.

However, in 1998 Unocal was forced to withdraw for a combination of reputational, political, and economic reasons. The project faced intense opposition from the US women’s movement who were incensed at the idea of a US company doing business with the anti-feminist Taliban; the US had just fired Tomahawk missiles on Osama bin Laden’s presumed refuge in Afghanistan; and the price of oil had dropped to US$12 a barrel.

**Oil, Minerals and Conflict**
The Central Asian Gas pipeline has never been built, and its social and political impact therefore remains unproven, but it would at best have been ambivalent. In principle, the pipeline might have brought a source of income to a country that desperately needed development funds. At the same time, however, it would have reinforced the authority of the Taliban, with uncertain consequences. This ambivalence is characteristic of the petroleum and mining sectors. It is not just that they may suffer from the consequences of political instability and conflict. In the worst case, they may well contribute to it.

If mismanaged, the extractive industries can contribute to conflict at several different levels. Both petroleum and mining are capital-intensive industries that offer limited employment opportunities. They create immense wealth, but for a few rather than for many. Local communities suffer from the environmental consequences but, depending on the governance of the country concerned, receive limited development benefits because the revenue goes to the national government. Ogoniland in southern Nigeria is a much-cited example of a region where local resentment at these apparent disparities has made it impossible for the operating company, in this case Shell Petroleum and Development Corporation, to operate.
Mineral wealth has a tendency to make bad governments worse. Both the mining and the petroleum industries are heavily regulated and, once revenue streams begin to flow, there are both opportunities and temptations for official corruption. Nigeria’s President Sani Abacha and President Mobutu Sese Seko of Zaire (now DRC) are each believed to have stolen some $5 billion from their country’s exchequer. Authoritarian political leaders can use the funds to buy off political opponents and to finance their own security forces. Moreover, mineral revenue makes taxation less necessary. At first sight paradoxically, this is a disadvantage rather than a benefit for ordinary people. Governments that impose taxation need to secure the consent, or at least the acquiescence, of their citizens. If there is no need for political negotiation, oppressive regimes feel able to rule with impunity. If there is no prospect of removing corrupt leaders by democratic means, there is a greater risk of armed rebellion and civil war.

Research by Paul Collier and his colleagues at the World Bank (2003:60-61) presents statistical evidence of an increased risk of civil war in countries where the natural resource endowment is twice the average—the risk of an ideological war is 3.1% greater and the risk of a secessionist war is 8.2% greater. This is because the possibility of controlling the resources in question gives an economic incentive to secede, in addition to whatever political motivations there may be. Examples include the Gerakan Aceh Merdeka (Aceh Freedom Movement – GAM) in Indonesia, and the Cabindan separatist movement in Angola.

Natural resources provide a motive for rebellion and they may also help finance rebellion, particularly in the case of ‘lootable’ resources such as diamonds which are both valuable and easy to transport. ‘Conflict diamonds’ have been a major source of revenue for rebel movements in Angola and Sierra Leone, while the struggle to control Coltan supplies has been a war aim of rival armed groups in Eastern DRC. Rebel groups also have been able to benefit from less lootable resources by imposing ‘revolutionary taxes’ and other extortion demands on mainstream companies, for example in the Colombian oil sector.

Corporate Responsibility and Social Impact

The ‘curse’ of minerals is a particular concern for countries that nominally are ‘post-conflict. Collier and his colleagues (2003:83) present statistics suggesting the typical post-conflict state faces a 44% risk of returning to conflict within five years. Mineral resources, if poorly managed, make weak states weaker, and may contribute to outright failure. The task of removing the ‘curse’ is therefore all the more urgent, and requires the participation of both companies, governments, multilateral institutions and NGOs.

Risk Assessment

For companies, the first requirement is an assessment of the political, economic and social issues that could contribute to conflict. Environmental and social impact assessments are now mandatory for all projects sponsored by the World Bank’s International Finance Corporation (IFC), although these do not tend to address conflict specifically. In 2002 a group of leading banks signed the ‘Equator Principles’ committing themselves to the same environmental and social safeguards as IFC. The banks that have signed up to the Principles include leading institutions such as ABN Amro, HSBC, Standard Chartered Bank and Bank of America. IFC automatically classifies extractive sector projects as ‘Category A’, which means that they require particular care in environmental and social management.

Local Consultation

There is a heightened risk of local conflict if communities believe that they are not consulted, and are not benefitting from extractive industry projects. Companies increasingly recognize the need to involve local communities, and many conduct or sponsor local development projects. However, they are often reluctant to take on what they regard as the role of governments, and many argue that they do not have the right skills to manage social development projects. Emerging best practice is to foster collaborative ‘tri-sectoral’ alliances between companies, government agencies and civil society groups. The Business Partners for Development project, which ran between 1998 and 2002, documented many examples of best
practice (see www.bpdnaturalresources.org). Managers of social projects need to ensure that these do not serve to reinforce local tensions or conflict.

Security Issues
Security issues are particularly sensitive in the extractives sector. Companies have a right to security and generally take responsibility for guarding the perimeter of their projects. However, in their own strategic interests, governments typically deploy their own security forces to protect major installations in conflict-affected areas. Companies are not responsible for giving orders to government security forces, but are nonetheless liable to face accusations of complicity if those forces are accused of involvement in human rights abuses. There have been accusations of company complicity in human rights cases in Nigeria, Myanmar, Sudan and Colombia.

The Voluntary Principles on Security and Human Rights is an attempt to address this problem. The discussions that led up to the Principles were jointly sponsored by the US and UK governments in 2000, and involved both company and NGO participants. The principles cover three areas: risk assessment, relationships with government security forces, and relationships with private security. Companies undertake to uphold human rights, for example by using their influence to make sure that individuals or units that have been involved in past abuses are not deployed to protect their properties, and by reporting and seeking resolution of any current abuses. More needs to be done to widen and strengthen this process, but it could develop into an important initiative.

The Kimberley Process Certification Scheme is a collaborative initiative to stem the flow of ‘conflict diamonds’, defined as ‘rough diamonds that are used by rebel movements to finance wars against legitimate governments’. Like the Voluntary Principles, it is a joint initiative involving governments, companies, and NGOs. Its objective is to ensure that rough diamonds entering the international market have proper certification confirming their origin.

Revenue Transparency
The way that governments use the revenue that companies contribute is another important issue. In 2002 Global Witness joined with the Open Society Institute, Transparency International-UK and other NGOs to launch the ‘Publish What You Pay’ campaign. The campaign argues that publicly listed companies should face a mandatory requirement to publish the revenues they pay to host governments. The argument is that, once the governments’ income from natural resources is established, it will then be easier to hold them to account for they way that they spend the money.

Also in 2002, UK Prime Minister Tony Blair announced the Extractive Industries Transparency Initiative (EITI) at the Johannesburg World Summit for Sustainable Development, and this was formally launched in London in June 2003. EITI is a voluntary initiative involving governments, companies and civil society to foster transparency in revenue reporting. One of the main challenges is to secure the active participation of governments in oil- and mineral-producing states. Several such governments have agreed to participate, notably including Nigeria.

OECD Guidelines for Multinational Enterprises
The OECD Guidelines for Multinational Enterprises, a revised version of which was issued in 2000, establishes a basic set of standards for responsible conduct in international business. The Guidelines do not deal specifically with armed conflict, but their ‘general principles’ are applicable to all companies operating in complex international environments, and include recommendations on sustainable development and the promotion of human rights. Adherence to the Guidelines is voluntary. However, member governments have formally endorsed the document, and it provides for a complaints procedure via government-sponsored National Contact Points in cases where companies are accused of falling short of the principles.
Between 2001 and 2003, the UN Panel of Experts on the Illegal Exploitation of Natural Resources and Other Forms of Wealth in the Democratic Republic of Congo issued successive reports on foreign companies’ activities in Eastern DRC. The companies’ involvement implied that they were in some measure helping finance rebel movements in DRC’s civil war, and the panel argued that their activities were incompatible with the OECD Guidelines. The report led to a series of complaints to OECD National Contact Points in Belgium, Canada, Finland, Germany, The Netherlands, the US and the UK, but no legal action was taken against any of the companies.

**Voluntary Initiatives and Regulation**

In recent years, the UN Security Council has imposed mandatory sanctions on trade with rebel movements such as the Revolutionary United Front (RUF) in Sierra Leone and UNITA in Angola. However, as demonstrated by the controversy surrounding the UN Panel of Experts reports, there are still gaps in international law concerning the activities of foreign companies in conflict-affected areas. In practice, most initiatives in this area have been voluntary rather than mandatory. Voluntary initiatives such as the EITI may nonetheless prepare the way for future regulation. Meanwhile some important research and case law is evolving around the liability of companies under international humanitarian law (see Fafo AIS 2004, www.fafo.no/liabilities/).

**Implications for Other Industries**

All these initiatives count as ‘work in progress’, and their long term impact has yet to be proved, but they do at least convey a sense of momentum. It is too early to say that the curse of minerals has been resolved, but it is at least being addressed.

The extractive sectors contain many characteristics that make them hard to compare with other sectors, notably the sheer size of the financial investment required, the scale of the environmental impact, and the political implications of the revenue that they bring to host governments. Nevertheless, many of the lessons of their experience can be applied to other sectors.

In particular these include the need to be aware of the wider social and political implications of any kind of external intervention. It is wrong to think of projects in isolation, either locally or nationally, without considering the impact that they will have on existing power relationships. Major petroleum or mining projects may arguably be in the national interest, but do not benefit everyone equally either at the national or the local levels. The disparities between ‘winners’ and ‘losers’ provide a source of tension that needs to be managed and mitigated so that it does not lead to open conflict. This in turn points to the need to plan in advance, a process which requires risk assessment—asking the right questions—and careful monitoring.

**3. MOBILE PHONES**

World Bank research shows that mobile phone companies quickly set up operations in post-conflict countries to the extent that their presence can be taken as one of the early signs of private sector recovery (Schwartz et al. 2004:13). In October 2003, some 200 consortia of companies applied for three two-year phone licenses in Iraq. There are now two cellular telephone companies in Afghanistan, and four in Liberia. In Sierra Leone, according to a recent report ‘handsets have replaced guns as the new must-haves’ (Sesay 2004).

In 2002 the global number of mobile subscribers exceeded the number of fixed-line subscribers for the first time (Sristastava 2004:4), and this was true not only of high-tech economies such as Finland, the UK
and Japan, but also of most of sub-Saharan Africa, and in countries such as Cambodia. Cellular technology has the advantage that—unlike fixed lines—it is quick and easy to set up, even in difficult terrain, and this makes it ideal for post-conflict regions.

An effective communications network is essential for economic recovery. Humanitarian agencies are often among the first customers, but the economic contribution of mobiles go well beyond this. They offer the possibility of improved local communications, for example between farmers and markets, as well as more long-distance calls to friends and relatives abroad. In due course, they may be integrated into a more sophisticated ICT infrastructure, including the Internet.

However, the full social implications of what is still a new technology are only just beginning to emerge. Despite the rapid expansion of mobile technology, Africa’s share of the world’s mobile subscriptions has remained very low—only 3% in 2002 (Sristastava 2004:6). The question is not so much whether mobile phones are socially beneficial, but rather who benefits most? How far are companies’ commercial objectives compatible with post-conflict countries’ social requirements? How can more people in remote areas benefit more quickly?

The Business Case

Among mobile phone companies, there is intense competitive pressure to enter new markets. Many Western markets arguably are close to ‘maturity’, and companies are more likely to expand by introducing new applications to existing customers rather than by gaining new subscribers. By contrast, in most developing countries there is still ample opportunity to gain new customers. The Finnish company Nokia (2004) argues that ‘in the next five years more than 80% of the growth in global mobile subscriptions is expected to come from emerging markets with relatively low levels of current penetration and high populations’. Nokia goes on to refer to markets such as China, India, Russia and Brazil, but its argument applies equally to Africa, including the region’s post-conflict countries. Indeed, the opportunities in post-conflict countries are all the greater because the mobiles market starts from a very low or non-existent base—the market can only grow. Despite Africa’s comparative poverty, African telecoms operators enjoy substantial profits because each phone is typically used by several people. In 2000 the world average revenue per main line was $942 per year—in Africa it was $868 (Shanmugavelan 2004:7). The same principle applies equally to mobile phones.

Nokia is one of several European and North American telecommunications companies who provide the equipment, ranging from the phones themselves to GSM base stations, to operating companies across the world. Other major players in this field include Ericssons, Alcatel and Siemens. As will be seen, these companies work with a variety of local operators.

Regional and Niche Players

The great majority of mobile telecoms operators in emerging and post-conflict economies are either ‘Northern’ niche players or regional companies who are aiming to extend their regional networks. Their strategy is reminiscent of the extractive industry juniors in that they hope to establish themselves in niche markets ahead of the more risk-averse majors. However, they contrast with the extractive industries in that there is a relatively low initial investment (initially tens or the low hundreds of millions rather than billions of dollars) and they start to recover their initial outlay almost straightaway. The business model of most emerging markets operators is to sell pre-paid cards, which means that there are no collection problems. It is often possible to move into profit within two to three years, much earlier than in the case of an oil or mining project where there might be a gap of as long as ten years between initial exploration and production.
The Luxembourg-based Millicom International SA is an example of the niche-player strategy. According to Marc Beuls, the company’s chief executive, its business model is straightforward:

*Find an emerging market where mobile phone licenses are being distributed and fixed line penetration is limited. Team up with a local partner who knows the country. Acquire a license at low cost. Charge low prices to gain market share. Then wait for subscriber numbers to rise as the middle class swells* (Brown-Humes 2003).

As with the extractive industries, it is important to make the right call. Millicom was forced to pull out of DRC because of renewed civil war, and in Cambodia it was caught up in accusations of bribery because a government minister was on the board of its subsidiary. Undeterred, it is now operating in 16 emerging markets in Asia, Latin America and Africa. Among post-conflict economies, it is operating in Sierra Leone where it competes with the UK-based Mobitel and the Anglo-Dutch company Celtel (see case study). Mobitel has a similar portfolio to Millicom—it is operating in Cambodia, Sudan and Kosovo as well as Tanzania, Slovenia and Sri Lanka. Celtel operates in 13 African countries including Sudan (in a joint venture with Mobitel), the Republic of Congo (Brazzaville) and DRC. The introduction of cellular technologies to the two Congos has a particular resonance—they are now able to communicate directly rather than routing fixed-line calls via France.

The major regional operators in sub-Saharan Africa include two South African companies, MTN and Vodacom. These are fierce competitors in their home country, and have now expanded to the north as the rest of the continent has opened up to South African companies. Vodacom, which is 35% owned by the UK-based company Vodafone operates in Lesotho, Tanzania and DRC. MTN, which was founded in 1994, moved into Rwanda, Uganda and Swaziland in 1997-1998; it has since entered into Cameroon, Eastern DRC and, most profitably, Nigeria. Rwanda had barely recovered from the 1994 genocide when MTN first went into the country in July 1998; it formed a joint venture partnership with the state operator Rwandatel and Tristar Ltd, a local investment company. From MTN’s point of view, its move made sense both because of the opportunity to break into a new market, and because there was in any case some overlap with Uganda. By 2002 it had invested some $30 million in Rwanda, and had 60,000 subscribers.

Further to the north, Cairo-based Orascom Telecom is another example of an expanding regionally-based multinational. The company was established in 1998, and initially operated the MobilNil network in Egypt. It has now expanded to cover Algeria, Pakistan, Tunisia, Congo, Chad, Zimbabwe, DRC and, since late 2003, central Iraq.

Iraq’s mobile network is divided into three regions: a Kurdish-Iraqi company Asia-Cell won the two-year license for the northern region; and Atheer, a Kuwaiti company which has a partnership agreement with Vodafone, won the license for the southern region. A 2003 estimate by an expert in Iraq’s Coalition Provisional Authority (CPA) suggested that the three together could be worth between $80 million and $200 million, depending on the number of subscribers (Open Society Institute 2003). It is scarcely surprising that there were so many companies bidding for the licenses.

The two mobile phone companies in Afghanistan are both examples of niche operators with diaspora connections. Afghan Wireless Communications Company is a joint venture between the Afghan Ministry of Communications (20%) and the US company Telecommunications Systems International (TSI), which owns 80%. TSI was founded by Ehsan Bayat, a US-based entrepreneur who was born in Kabul but left for the US in 1980. Bayat has ‘felt a tremendous calling to help the people of his homeland’, and made a previous attempt to set up a mobile network there when he entered negotiations with the Taliban government in the late 1990s. Investments to date include a $14 million upgrade of its switching platform by Siemens (Network Dynamics 2004).
Roshan, the rival Afghan mobile phone company, is a consortium led by the Aga Khan Fund for Economic Development (AKFED 51%), Monaco Telecom International (35%), MCT, a US telecom holding company (9%), and Alcatel (5%). The Aga Khan’s Ismaili community is widely dispersed across Pakistan, Afghanistan and Central Asia, and AKFED is widely respected for its development initiatives. It is also a shareholder in the Afghanistan International Bank (see below). It plans a total investment of at least $120 million.

Security Risks

Security risks—particularly personal security risks—are an obvious concern for any telecoms company moving into a conflict-affected area. One tragic example was the fate of a New Zealander and three British engineers who were kidnapped and killed in Chechnya in 1998 while working for the UK-based Granger Telecom. Telecommunication installations may be targeted in insurgencies, for example by Maoist guerrillas in Nepal who aspire to disrupt government services. In December 2004 the head of Iraqna, Orascom’s subsidiary company, said that he was considering halting operations because of continuing violence (Pelham 2004). Mobile phones also may be used by opposition groups to co-ordinate violent campaigns, or even to set off bombs, and for that reason were banned in India’s Kashmir Valley for many years.

Nevertheless, overall, mobile operators are much less exposed to security threats than are petroleum or mining companies. They have fixed assets in the form of base stations and masts, but these need not figure prominently on the local landscape. There is typically an overlap between the areas covered by masts so, if one is destroyed, it does not necessarily lead to an interruption of service, and they can usually be repaired quickly. In any case, mobile phones provide a public service. International companies often work with national joint venture partners, and therefore acquire a ‘local’ identity. They do not make popular targets for opposition groups or terrorists in the same way as petroleum installations or even international banks might do.

Political and Regulatory Issues

From the company’s perspective, the most important requirement is to win a license. The award and renewal of licenses are the stages at which they are most vulnerable to corruption demands. Once the licenses are awarded, their day-to-day activities are less exposed to ‘rent-seeking’ by corrupt officials. However, they are not immune from political risks. Once they have rolled out their networks and are coming into profit, governments may try to renegotiate the initial agreement. At this point, the companies’ negotiating position will be weaker because they will have invested heavily in imported equipment.

The recent expansion of the mobile phones sector benefits from an international trend toward greater economic liberalization. In the past, the greatest obstacle to international companies has been from state-owned companies who often served as a source of patronage for political leaders, and did not wish to open up their markets to foreign competitors. In 1998, the World Trade Organisation’s Basic Telecommunications Agreement (BTA) came into force (see Shanmugavelan 2004). The BTA is itself part of the 1994 General Agreement on Trade in Services (GATS). Under the terms of the BTA, WTO member states have pledged to open up their telecommunications markets to foreign competition, allowing foreign companies to buy stakes in domestic companies and abide by common rules.

The BTA is intended to promote deregulation by stages, and the first stage has often been to issue a license for mobile phones which has in any case been beyond the technical capabilities of many state providers. However, governments still have the task of determining realistic license fees, neither too high nor too low. The licenses typically specify commercial targets, for example that the license-holder should
undertake to achieve a certain number of subscribers, and build up an appropriate geographic coverage, by a particular target date.

In practice the degree of liberalization continues to vary. Among post-conflict states, Bosnia-Herzegovina has been slow to liberalize its telecommunications markets. In Sierra Leone, the facilities provided by the state provider have been so badly damaged during the civil war that there is no realistic alternative to opening up the country to foreign companies.

Somalia is an example of a conflict-affected country where the absence of a viable national government has de facto resulted in complete liberalization (see case study). Unfettered by the demands of bureaucracy, local mobile phone companies have been able to flourish, using equipment purchased from abroad. Local competition means that the prices even for international calls are among the lowest in the region. Companies have agreed to a degree of self-regulation through the Somali Telecom Association, which is based in Dubai. However, the absence of a viable national government means that there is limited scope for foreign investment. International companies benefit from deregulation, but not from anarchy.

**Supply Chain Issues**

A separate set of questions concerning the mobile phone industry’s relations with conflict-affected areas arises from its supply chain, particularly the trade in coltan from Eastern DRC. Coltan is a mineral which can be refined to produce tantalum powder, a key ingredient in the production of mobile phones and computer chips. Most of the world’s supply—valued at $6 billion a year in 2001—comes from Australia, Canada and Brazil. However, in the early 2000s a rise in global demand also prompted an expansion in the trade in coltan mined in Eastern DRC at a time when it was still embroiled in civil war (for a summary of the issues see Essick 2001). Like ‘conflict diamonds’ in Angola and Sierra Leone, coltan appeared to be funding rebel groups, and was directly linked both to human rights abuses and environmental damage.

The industry-sponsored Global e-Sustainability Initiative (GeSI) responded by sponsoring a report by the NGO Fauna and Flora International (Hayes and Burge 2003). The report states that all tantalum-using industries should recognize that ‘there is undoubtedly a direct relationship between the illegal exploitation of coltan and the conflict in the DRC’. Rather than calling for an outright ban, it calls for regulation of the industry, but so far few concrete steps have been taken in this direction. These supply chain issues are an important aspect of the industry’s overall relationship to conflict.

**Corporate Responsibility and Social Impact**

The leading international mobile phone companies operate corporate responsibility programs in the countries where they operate. For example, MTN set up a charitable MTN Foundation in South Africa in 2001, and has since announced that it will do the same in all the countries where it operates, with the recommendation that each of its affiliated companies contribute 1% of their post-tax profits to social investment projects (Business Day 2004). Typically, these projects are in the fields of education, health and economic empowerment. MTN-Uganda has recently set up a ‘Grameen Village Phone’ program in association with the Grameen Foundation USA and five local NGOs. The scheme draws on the Grameen Bank concept of micro-finance to provide equipment to village operators, thus enabling them to run small businesses providing phone services to their neighbors.

As part of its corporate citizenship activities, the Swedish company Ericssons operates a response program known as ‘first on the ground’ in partnership with UN agencies and NGOs. The purpose of the program is to use private sector resources to bring telecommunications to humanitarian relief operations. Ericssons’ teams have responded both to natural disasters, such as earthquakes and the 2004 Southeast
Asian tsunami, and to post-conflict emergencies, for example in Afghanistan in 2002 and Liberia in 2003. In both cases it worked in partnership with the UN’s World Food Program. Ericssons is one of several corporate partners working with Telecoms sans Frontières, a humanitarian NGO specialising in emergency telecommunications. Other private sector partners working with the organisation include Immarsat, Vodafone, Cable & Wireless, France Telecom, AT&T and Alcatel.

Social development and emergency response projects are worthwhile in themselves. They also serve a commercial objective by improving the company’s image among actual and potential subscribers, and may give companies an added edge when applying for new licenses. However, the prime social impact of mobile phones derives from the way that companies run their core services.

Their impact has been all the greater because existing communication services were so poor. The expansion of companies such as Celtel, MTN and Vodacom serves as an encouraging model for other international companies who might otherwise be tempted to dismiss the whole sub-Saharan region apart from South Africa. Even more importantly, the existence of the new networks benefits both the larger domestic and international companies and smaller entrepreneurs. One of the key ‘social’ tests of international investment is the extent to which it benefits and interacts with local business—mobile phone companies certainly qualify.

Nevertheless, there are still questions about precisely who benefits. From a commercial perspective, the most important and easily served markets are in the cities. A single urban base station will serve a much larger number of subscribers than would be the case in rural areas. License agreements typically include a requirement to roll out services to rural areas as well, but recent research suggests that companies may in practice be slow to achieve their targets (Shanmugavelan 2004). In some cases, poor security may be a significant deterrent, for example in northern Uganda which is still plagued by a long-standing insurgency (Lamwaka 2003).

The comparative neglect of rural areas will be all the more sensitive from a post-conflict perspective if—as is often the case—these are the regions where rebel groups were previously based. If former rebels or their constituencies are seen to be losing out on opportunities for economic recovery, there will be an increased risk of renewed fighting. One hopeful example comes from Sierra Leone (see case study), where the first mobile phone networks were set up in the capital Freetown, but are now gradually being extended to the rest of the country—including the diamond regions which were among the main strongholds of anti-government forces during the civil war.

The high cost of mobile phone calls is often another concern. It typically takes more time and money to set up land-lines, and in conflict regions they are especially vulnerable to sabotage. However, calls made on landlines are significantly cheaper, and this makes them more suitable for users with limited funds. Moreover, international companies often charge in dollars or other foreign currencies, at least initially, because they need to import equipment which is paid for in hard currency. This will be another factor increasing costs to the customer if there is a local currency devaluation.

In practice, many of these disparities may iron themselves out as mobile phones become more established. Prices are likely to fall as new companies enter the market, and industry sources point out that, although the main profits are to be made in the cities, it is in their own long-term interest to expand their rural networks. Many city-dwellers have relatives in the countryside, and will therefore choose the phone companies with the best country-wide networks. Improved communications of this kind is a major contribution to the reduction of conflict risks.
Case study: Telstra reconnects post-conflict Timor Leste

The experience of the Australian company telecoms company Telstra in Timor-Leste (formerly East Timor) illustrates both the commercial benefits, and the political and reputational risks of operating in post-conflict regions. Timor-Leste’s period of outright conflict in 1999 was relatively brief, but nevertheless resulted in the destruction of some 70% of the territory’s public buildings, together with the displacement of more than two thirds of its population. Telstra was widely praised for helping restore the territory’s telecommunications, but subsequently faced political and social controversy. It eventually decided not to bid for a new operating contract administered by the newly independent Timor-Leste government in 2002.

Reconnecting the Phones

PT Telkom, the Indonesian state telecommunications provider, was responsible for running Timor-Leste’s phones until international intervention in 1999. Telstra took over the telephone network under an interim arrangement with the UN. At first, the operating environment was chaotic but, as one of Telstra’s engineers observed, this might have had its advantages because ‘the bureaucrats naturally don’t move into an area until the useful people have restored the basic services’ (Obrowski 1999). The results were effective and Major General Cosgrove, the commander of the UN forces in Timor-Leste, commended Telstra and its sub-contractor NDC for their work in restoring communications quickly and efficiently.

Having solved the immediate problems, Telstra went on to introduce further improvements. The widespread destruction of the territory’s landline network increased the attractiveness of mobile phones, and Telstra’s mobile phone network rapidly became the most reliable means of communication within Timor-Leste, although it did not extend to all rural areas. The company also joined forces with Compaq Computer Australia to set up an Internet service through a satellite link.

Social and political issues

Telstra’s initial successes did not protect it from subsequent controversies, similar to those faced by telecommunications companies in other developing countries. In Telstra’s case these were all the more sensitive because it was exposed to accusations that it was exploiting its near-monopoly situation in the country.

One of the most significant issues concerned pricing. Telstra priced its services in US dollars, the currency commonly used by the UN Transitional Authority for East Timor (UNTAET). The price for local calls and access fees reflected pre-1999 Indonesian pricing, but the fee for mobile calls was similar to those in Australia. This was well within the means of the thousands of UN employees in Timor Leste, who formed Telstra’s main market, but problematic for the local population given that local incomes were much lower. In June 2001, an Australian Aidwatch researcher argued that this pricing structure was unjust, and suggested that Telstra might cross-subsidize its Timor-Leste operations from more profitable parts of its network (Tim Anderson 2001). A Telstra spokesman responded that the company’s presence in Timor-Leste was a commercial operation—it planned to make a profit while also believing that it was making a significant contribution to the territory’s reconstruction. He thought that cross-subsidies from other Telstra operations would have been ‘inappropriate’.

A second social issue concerned the marketing of phone cards. Dili, the capital of Timor-Leste, had hundreds of street children, many of whom scraped a living by selling cigarettes, smuggled VCDs—and Telstra phone cards. Telstra insisted that it did not see the employment of children as part of its commercial strategy: unauthorized importers of its cards were using street-kids to bypass its official distribution channels. The company sought to contribute to Timorese child welfare by a different route, contributing the profits of a special set of phone cards with Timor-Leste motifs to the Mary MacKillop Institute, an educational charity working in the country. These cards were sold both in Timor-Leste and in Australia.
The company also ran into political risks. One problem arose as the result of the regulatory gap in the UNTAET interim administration. UNTAET reinstated Indonesian law as the law of the country until a democratic government was elected. However, Indonesia law stated that any foreign telecommunications company had to enter a joint venture with a local partner, and Telstra was not doing this (Australian Broadcasting Company 2001).

A Short-Lived Involvement
Ultimately, Telstra decided not to bid for a long-term operating license with Timor-Leste’s new government, in line with a revised company strategy of abandoning marginal operations and services. In July 2002 the newly-independent government selected a new operator, Timor Telecom, which is owned by Portugal Telecom International (PTI). Timor Telecom has a concession to operate fixed and mobile telephones for a 15-year period starting in March 2003.

Case Study: Mobile Phones and State Failure in Somalia

Somalia represents an extreme example of the problems—but also the opportunities—of working in a failed state that arguably has yet to reach the post-conflict stage. The country has not had an internationally recognized government since 1991, and there is therefore no state regulator of telecommunications, or anything else. However, despite (or because of) the lack of a national regulatory framework, the telecommunications sector has been remarkably successful. In 1991, Somalia had about 17,000 fixed lines, the majority of which were in the capital Mogadishu. Since then, local operators have invested some $68 million, and the country now has approximately 112,000 fixed lines and 50,000 mobile subscribers (Bhalla 2004).

Setting up the Networks
In the early 1990s, Somali exiles returning from Norway installed limited satellite-based telecoms links in partnership with the Norwegian company Telenor (Hassan 2003). Later, returnees from the Gulf States and the US set up an ‘earth station gateway’ in association with the US-based Starlight Communications. Another Somali venture, Al-Barakaat, set up a partnership with the US Company AT&T. Al-Barakaat also managed a foreign exchange remittance network and subsequently gained unwanted international notoriety when the US government closed down its US bank accounts following the September 11 terrorist attacks because it suspected that it had links with Al Qaeda.

There are currently eight major operators. One of the largest cellular providers is Telsom Mobile, which was established in 2001 as a result of a merger between two telecommunications companies, Somatel and Telcom Somalia. Telsom has recently expanded its GSM network using technology from the US-based Tecore Wireless systems. Other cellular providers include Nationlink Telecom which is part of the Somali Telecoms Group, and uses equipment bought from InterWAVE, whose headquarters is in Silicon Valley in the US.

Mobile phones companies use pre-paid charge cards. Fierce competition between rival companies has driven down communications costs, and international calls on mobile phones cost $1 per minute or less, among the cheapest in Africa (O’Reilly 2003). Mobile phones therefore play an essential role in maintaining communications between members of the Somali diaspora and their homeland, and in assisting the transfer of funds via the informal hawala network. Somalia’s diaspora of some two million people send between $500 million and $1 billion to Somalia in this way every year (Nenova and Harford 2003).

In 1998 UNDP and the International Telecommunications Union (ITU) organised a series of meetings between rival operators, leading to the formation of the Somali Telecom Association (STA). The fact that
it is based in Dubai means that it can plausibly claim to be free of regional favoritism. STA serves as an informal regulator, and has been able to broker an agreement between rival operators in Mogadishu, making it possible for the users of different networks to communicate with each other. However, there is as yet no such agreement in the northern Somaliland region, where there is a breakaway local government, and this means that local users need to subscribe to more than one mobile company to gain anything like full coverage. The lack of an official government regulator also means that no one collects taxes from the mobile phone companies, despite their comparative prosperity, or their international partners. As Hassan (2003) points out, ‘almost every dollar made by foreign telecoms companies is a dollar that leaves Somalia’, despite the country’s desperate need for revenue to rebuild its infrastructure. Their longer-term contribution to reconstruction is therefore clearly limited.

Abdigani Jama, the secretary-general of the Somali Telecom Association, suggests that the absence of government bureaucracy might initially have been an advantage, but that a central government is now necessary if it is to expand further:

*We need a government to regulate and provide necessary legislation as well as ensure security and peace which would attract much needed foreign investment to the sector* (Bhalla 2004).

**Case Study: Celtel’s Commercial Expansion in Sierra Leone**

During its 1991-2002 civil war, Sierra Leone became a byword for internecine violence. It is now slowly beginning to recover, but faces major challenges in the rebuilding of its national road, energy and communications infrastructure.

The Netherlands-based Celtel International is currently working in 13 sub-Saharan African countries, and it appears to be a successful example of a niche player taking advantage of the pent-up demand for mobile phones in sub-Saharan Africa. It first set up operations in Sierra Leone in September 2000. Its operations there are profitable, and it has since invested more than $30 million in the country.

**Celtel’s Pan-African Strategy**

Sierra Leone at first sight appears to be an unpromising country for foreign investment but fits into Celtel’s wider international strategy.

The company was founded by its current chairman, Dr. Mohammed Ibrahim, who was born in Sudan in 1946. He began his professional life working for Sudan’s national phone operator for six years, before winning a scholarship to study in the UK, where he rose to become technical director of BT Cellnet. He left in 1989 to start his own company, MSI Plc, a telecoms consultancy firm. MSI Cellular—later renamed Celtel—was launched in 1998 when it split off from the MSI parent. Starting in Uganda, it has since expanded into 12 other African countries: Burkina Faso, Chad, DRC, Republic of Congo (Brazzaville), Gabon, Kenya, Malawi, Niger, Sierra Leone, Sudan, Tanzania and Zambia.

Ibrahim’s motives for setting up an African mobile phone network are partly personal: ‘I am from Africa and wanted to give something back’ (Simon 2004). One of Celtel’s regional companies—a joint venture with Mobitel—is in Sudan, and in that respect he fits in with the widespread pattern of diaspora investors putting money back into their home countries. At the same time he argues that there are sound business reasons for setting up mobile phone companies more widely in Africa: its poorly developed communications infrastructure means that—albeit from a small base—it is the world’s fastest growing mobile phone market.

This strategy appears to be working. In the first six months of 2004 Celtel reported a 63% rise in customer numbers, and a 47% increase in revenue to $296.5 million (Budden 2004). In October 2004
Celtel announced that it would seek a listing on the London stock exchange with a possible secondary listing in Johannesburg. Bankers estimated that the company’s stock market value could be up to £1.1 billion.

Celtel has been caught up in regional instability and conflict, notably in DRC and Sierra Leone, and this obviously has slowed down the company’s growth in those countries. However, Ibrahim says that the company has not been targeted directly:

*We try not to take risks. Fortunately our service is seen as universal and various parties to any conflict benefit from what we do. They see it as just like water or like air, so we have never been harmed or targeted* (Cronin 2004).

He also argues that mobile phones in the long term will promote good governance:

*There is a massive need for mobile telephony in Africa. Where you have good telecommunications you usually have democracy. If you have a phone in your hand, then you have a voice.*

**Business Challenges in Sierra Leone**

The landline network of the state operator Sierra Leone Telecommunication Company (Sierratel) was badly damaged during the civil war, and is only slowly being repaired. As in other parts of Africa, this situation provides obvious opportunities to mobile operators. However, there are both practical and institutional obstacles to address.

There is a limited pool of local engineers, so the company has to recruit expatriates at significantly higher costs (Eghobor 2003). It also has to import expensive equipment, and it is difficult to transport this across the country’s poor road network. The poor electricity network is a further problem. When setting up a new station in the north of the country, Celtel at the same time found it necessary to install a generator capable of providing a 24-hour electricity supply.

The main regulatory concern has been Sierratel’s combined role as a provider of telecommunications services—which may eventually include mobiles—and at the same time the national regulator. Celtel’s Sierra Leone commercial director Wayne Taylor argues that ‘you cannot have the regulator as a player in the game which it referees’, and the company has called on the government to set up an independent regulator (Eghobor 2003).

Celtel was the first foreign operator to set up in Sierra Leone, but now competes with the Luxembourg-based Millicom, and the UK-based Mobitel.

**Corporate Social Responsibility**

Celtel emphasizes the need for high standards of ethics among its employees. In October 2004, IFC awarded Celtel its first ‘Client Leadership Award’ for its contributions to sustainable development, noting that the company had ‘achieved its business goals while committing to strong corporate governance and the betterment of local communities. Its social contributions included refurbishing schools and health centers, providing scholarships and sponsoring the Africa Education Journalism Award (IFC press release, October 5, 2004)

In Sierra Leone, according to the company’s local website, its local contributions have included donations to a number of local bodies: a 26-seater bus to the Fourah Bay College Students’ Union; 20 wheelchairs for war victims at a hospital in Goderich; 300 dustbins to Freetown City Council; and 500 gallons of paint to the Ministry of Education for painting schools. In rural areas it has sunk deep water wells to provide access to safe drinking water. In October 2004 it also donated 15 phones to Sierra Leone’s Acting Chief
of Defence Staff to help establish a hotline for civilians making complaints about possible corruption in
the army (Kamanda 2004).

_Social Impact_

The company’s greatest social impact in Sierra Leone will be through its core services. Sesay (2004) cites
the example of a fish seller in a coastal village who no doubt speaks for many of Africa’s new mobile
subscribers: “I can now not only do business with ease and speed, but also call my relatives abroad
whenever I want to.” Mobile phones provide obvious advantages to local as well as international
businesses.

As in other post-conflict countries, there have been questions about the extent to which phones are
accessible to the poorer sections of the community. One issue has been the mobile phone companies’
practice of charging in dollars, which means that the price goes up whenever the local currency
depreciates. From the companies’ point of view this practice made sense because their equipment has had
to be imported, and therefore paid for in foreign currency (Sesay 2004). However, Celtel has now decided
to end dollar-based transactions when charging for its services inside Sierra Leone.

Another concern has been the extent and breadth of the company’s network. Celtel naturally has begun
with Freetown, the national capital, and other main towns. However, the map showing the company’s
operations of Sierra Leone still shows only relatively small patches covered by its network, and large
tracts of rural areas that are still untouched. This uneven coverage touches on political sensitivities in a
country still recovering from civil war because it raises the risk that former opposition strongholds will
feel unfairly neglected.

Celtel has been able to begin addressing these concerns. In July and August 2003 the company launched
its mobile phone network in the northern towns of Makeni and Mile 91, as well as the diamond mining
town of Kono. Makeni and Mile 91 are predominantly occupied by the Temne, a minority ethnic group,
whereas the government tends to be dominated by Mende. Kono was one of the regions worst-affected by
Sierra Leone’s civil wars which were partly funded by diamond trading.

At the launch of the local networks in these areas, Celtel formed a partnership with Search for Common
Ground (SFCG), a US-based conflict resolution NGO. SFCG organized radio programs publicizing the
launch and highlighting the importance of communications in bringing together people of different ethnic
and linguistic groups. As this example shows, the expanded phone network has the potential to be one of
the main instruments of revived national integration.

4. CONTRUCTION AND ENGINEERING COMPANIES

Countries emerging from conflict often have to cope with a legacy of severe damage and neglect: in
Timor-Leste, as much as 85% of the infrastructure had been destroyed by the time that UN peacekeeping
forces entered the country in 1999. Without a viable transport, power and water infrastructure, it is
difficult for other commercial sectors to operate, and there certainly will be no sense of post-war
normality. International construction and engineering companies have the potential to play a vital role in
post-conflict recovery.

Nevertheless, as recent experience in Iraq demonstrates, the international construction industry can
engender fierce controversy. At the centre of the controversy are hard practical questions. Who can do the
best job most quickly? Is it right to sacrifice quality for speed? What is the right balance between local
and international participation? Above all, how can limited financial resources be spent most effectively?
The Business Case

Post-conflict reconstruction opportunities are of obvious interest to companies that already have international experience. First, the amounts of money available may be substantial. Lebanon received some $10 billion worth of aid in the first ten years after its conflict ended; Bosnia-Herzegovina, a much smaller economy, has received some $5.4 billion since 1995; and Kosovo has received $2.3 billion since 1999. At the Madrid conference on Iraq in October 2003 representatives from 73 countries and 20 international organizations pledged a total of $33 billion for the country’s reconstruction, although only a small proportion of this has been disbursed. Press commentary on such figures repeatedly uses the word ‘bonanza’.1

A second factor which makes reconstruction opportunities all the more attractive is that they typically are financed either by bilateral aid or by multilateral institutions, and this means that there is very little risk of not being paid. Third, in a variation of the principle of ‘first-mover advantage’, companies hope that if they go in early they will be able to build up local experience and connections, and that this will make it easier to gain repeat business as the country becomes more stable.

References to bonanzas may overstate the attractions of post-conflict economies to large companies. It is notable how few of the 400 largest international contractors in a list compiled by the *Engineering News Record* in May 2004 were working in post-conflict countries.2 Eight companies were working in Iraq; two in Bosnia-Herzegovina; one each in Sierra Leone and Rwanda; none in DRC; and Timor-Leste was not even on the list.3

Structure of the Industry

The major international players include US-based companies such as Bechtel, Fluor, Parsons, and Kellogg, Brown & Root, all of which are used to handling projects worth hundreds of millions of dollars on a more or less routine basis. Their European counterparts include Balfour Beatty, AMEC and Costains from the UK; Bouygues from France; and Dragados from Spain. Japanese companies such as Kajima, Taisei and Kumagai-gumi have extensive operations across Asia and beyond. All these companies have extensive international portfolios on major projects ranging from highways to power stations and hydroelectric dams. However, even the largest companies rarely work in isolation. Major projects usually consist of consortia where the partners are chosen for their different sources of expertise, sources of finance, and, often enough, political connections. The main contractors work with a wide variety of designers and other specialist, and they typically employ dozens of local firms as sub-contractors.

As with petroleum and mining, the established Western and Japanese companies face increasing competition from ‘new’ international companies. South Korean companies are operating across south-east Asia. In September 2004 Cemex, the Mexican cement manufacturer, acquired the British building firm RMC for $2.3 billion. Chinese companies are involved in major road and hotel construction projects in Ethiopia, Botswana and South Africa, part of a wider Chinese commercial expansion across sub-Saharan Africa. Chinese companies are all the more competitive because they are often backed by soft loans. Unlike their Western counterparts, they face no pressure from domestic NGOs, for example on account of investment in countries with poor human rights records. Chinese construction and engineering companies

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1 A Google search on the words ‘post-conflict’ and ‘bonanza’ on December 4, 2004, came up with 931 ‘hits’. Almost all were press articles citing the opportunities for construction companies in the aftermath of war.
2 The list is on: www.enr.com/people/topLists/topContractor/country/default.asp downloaded on November 25, 2004.
3 However, two companies were listed as working in the ‘Antarctic/Arctic’, a categorization that allows for a considerable margin of geographical error.
are also working in Afghanistan, as are large contingents from—among others—Turkey, Uzbekistan and India. Small-scale projects, such as the reconstruction of domestic housing, will almost always be the work of domestic companies.

Particularly in conflict situations, the most strategically-placed engineers may be those working for military organizations such as the US Army Corps of Engineers (USACE) or the British Army’s Royal Engineers. In Iraq, USACE has been responsible for administering a large proportion of reconstruction contracts. In Kosovo (see case study), the Royal Engineers were responsible for ensuring a basic power supply until they were able to hand over to civilian contractors.

Finance and Political Risks

The availability of finance is critical. In the past, most major projects were financed by governments and development agencies. More recently companies have looked for various combinations of public and private finance. In the 1990s there was an expansion of various forms of public-private partnership including ‘Build-Operate-Transfer’ (BOT) schemes where the private contractor builds the project—for example an electricity utility or a toll-road—runs it for long enough to ensure that it makes a profit and then transfers ownership to the local authorities.

In the early 2000s it was harder to secure private funding for major infrastructure projects. This was partly because of the rising costs of insurance against a background of heightened security threats and also because of greater awareness of the political risks. Independent power projects (IPPs) resemble petroleum and mining projects in that they require the operating company to commit substantial ‘sunk costs’ when building the power station. However, the political risks are even greater. Petroleum and mining projects create wealth for the host country. By contrast, power projects depend on the willingness of host governments and their citizens to commit to paying for electricity at a specified price, and they may be tempted to renege on this commitment once the power station is built. In the 1990s and early 2000s, international companies running IPPs have found themselves in dispute with host governments in India, Pakistan, Indonesia and China who wished to cancel or renegotiate the terms of the original investment.

These political risks apply in relatively stable developing countries but they apply even more in post-conflict states. International companies are reluctant to take on long-term commitments, for example a BOT contract for a power station, until there is a stable and relatively predictable political environment. In Iraq, there is understandably great uncertainty about policy continuity under whatever government replaces the interim administration. In Iraq and other post-conflict regions, a further factor is that the laws governing investment are often outdated and it may take time to revise them.

All this means that—as in other industries—there is a clear sequence in the pattern of business activity, and there is an important distinction between construction and investment. Short-term reconstruction financed by governments and multilateral institutions comes first. Investment in utilities comes later; and local, diaspora and regional investors are likely to come ahead of ‘global’ companies. In post-conflict Cambodia, the main providers of electric power have been small local entrepreneurs and Thai companies (Schwartz 2004). The political and regulatory risks for the major international firms are too high.

Security Risks

Roads, water and electricity are essential to economic development, and it might therefore be expected that they would be welcomed by government and opposition supporters alike. This does not necessarily follow.
Roads are particularly sensitive. On the one hand, they facilitate economic development because they make it easier to bring goods to market. On the other hand, they are of obvious benefit to military as well as civilian users, and they may make it easier for settlers from other regions to enter areas previously dominated by indigenous minority groups. Road projects linked to petroleum projects in southern Sudan have been deeply controversial, and in north-east India rebel groups affiliated with ethnic minority groups have regularly blown up bridges. In Afghanistan, insurgents have attacked road construction workers because they see them as agents of the Kabul government and its Western supporters in their attempts to pacify the country. A similar logic applies to insurgents in Iraq who have attacked contractors working on all kinds of infrastructure.

The sense of insecurity in Iraq and Afghanistan is all the more unfortunate because it means that foreign contractors are likely to be much more cut-off from local people than they otherwise would be. If contractors are living in fortified compounds of tents or portacabins, there is little opportunity for more than the most superficial interactions with their local neighbors. Conditions are easier in Bosnia-Herzegovina, Kosovo and Timor-Leste where the main security threats are—to varying degrees—unexploded ordnance and crime, rather than political violence.

**Integrity Hazards**

Construction contracts are susceptible to corruption at every stage. In 2002 Transparency International commissioned a survey of attitudes to corruption in 15 emerging markets. Among other questions, respondents were asked in which sectors the largest bribes were paid. Public works and construction came out top by a large margin.

<table>
<thead>
<tr>
<th>Sectors where the Biggest Bribes are Likely to Be Paid.</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public works/construction</td>
<td>46%</td>
</tr>
<tr>
<td>Arms and defense</td>
<td>38%</td>
</tr>
<tr>
<td>Oil and gas</td>
<td>21%</td>
</tr>
<tr>
<td>Banking and finance</td>
<td>15%</td>
</tr>
<tr>
<td>Real estate/property</td>
<td>11%</td>
</tr>
<tr>
<td>Pharmaceuticals/medical care</td>
<td>10%</td>
</tr>
<tr>
<td>Power generation/transmission</td>
<td>10%</td>
</tr>
<tr>
<td>Telecoms</td>
<td>9%</td>
</tr>
</tbody>
</table>


The risks are all the greater in post-conflict economies where political and judicial systems are poorly established. In Iraq, USAID and the US Corps of Engineers are expected to select US companies as the prime contractors, although they may use non-US sub-contractors. Contracts awarded to Halliburton have been particularly controversial, leading to accusations of political favoritism. Meanwhile, British politicians have been lobbying their Washington counterparts to ensure that UK companies receive a share at least of the sub-contracts.

In practice the greatest integrity concerns may come when the prime contractors deal with sub-contractors, particularly locals, who may be required to pay kickbacks to secure business. Anecdotal evidence suggests that this is a significant problem in Iraq.
Corporate Responsibility and Social Impact

All the larger Western companies now have codes of business principles, and many sponsor charitable foundations. For example, Arup in the UK sponsors the Arup Foundation in memory of its founder, with a particular focus on education. On occasion, companies and individual employees offer *pro bono* work in crisis situations. RedR—which originally stood for ‘Registered Engineers for Disaster Relief’—is an international charity with branches in the UK, Australia, Canada and India. It helps provide engineers, often on secondment from major companies, to work on relief operations caused by natural disasters or war. RedR started in the UK and several major UK based companies such as Arup and Mott Macdonald are among its patrons. Another UK-based NGO, Engineers Against Poverty, is working to identify partnership opportunities between development agencies and commercial companies.

However, most companies would argue that their prime social responsibility—and their most important social impact—comes from conducting their core activities efficiently and to the highest standards of integrity.

Construction and engineering companies typically have limited freedom of maneuver in that they work primarily as contractors. They are responsible for technical designs, but do not normally decide whether the project is desirable in itself and—except in the case of BOT contracts—their involvement often ends when it has been built. They can therefore argue that the prime responsibility for social impact assessment lies with the client—often a government agency—rather than themselves. Nevertheless, there is growing awareness within the industry that the manner in which they go about their work can help mitigate negative social impacts.

The oil and mining industries distort local economies through a ‘gold-rush effect’, attracting migrant workers hoping to benefit from lucrative opportunities. Major construction projects can have a similar impact, albeit for much shorter periods. The UK engineering company Balfour Beatty has designed a software-driven ‘Opportunities and Risk Management Framework’, and this includes an assessment of social impact (Warner et al. 2004). In future, there may be scope to adapt emerging conflict impact assessment models to engineering companies (see Section 6). Contractors can make use of these kinds of analysis both to guide their own operations and in discussions with their clients. There may be a commercial advantage from doing so. A demonstration of greater social awareness may give them a competitive edge when bidding for new contracts. ‘Local content’—a commitment to employ and, ideally, to transfer skills to local companies—already plays a major role in such negotiations.

In post-conflict environments there is a sense of urgency, which may appear to limit the opportunities for detailed social analysis or risk mitigation. However, in a situation where there are already serious tensions, it is all the more important to be sensitive to the social implications of decisions on suppliers and sub-contractors. Employment is likely to be scarce, and almost any kind of job opportunity will therefore be welcome. In Timor-Leste in 2000, an Australian company won a contract to repair 50 km of road, and planned to give five months of work to 100 local laborers and plant operators, plus five engineers. The project manager was able to report a gratifying response:

> We’ve given the East Timorese a written employment contract, which is something they never got from the Indonesians. A lot of pride has been restored. They are not now dependant on aid and they are very happy with the terms and conditions (Dodd 2000).

Similarly, an engineer from the US company Parsons looks back at work in Bosnia-Herzegovina in the late 1990s:

> There had been 50 years of state-run government... The locals didn’t know how to bid. I had mayors come in and want contracts for their brothers-in-law (Korman et al. 2003).
However, things improved when workers and sub-contractors saw that they would be paid on time and in cash rather than in ‘diesel fuel and in cabbages’. The engineer was able to claim, that his company had provided employment, boosted the economy, and showed local firms how to compete in a world market.

In both Iraq and Afghanistan, the primary international contractors are encouraged to use local employees and sub-contractors where possible. For example, Bechtel’s website reports that as of November 2004 the company had awarded 184 subcontracts out of a total of 279 subcontracts for services. But local companies often complain that they can perform faster, more cheaply, and more effectively than international companies—and therefore argue that they should win the bulk of reconstruction contracts. Obviously, individual decisions depend on the technical complexity of the project concerned. For major projects, such as the construction of a national highway or a power station, the argument often revolves around the standards that are appropriate. Does the road or facility need to meet US or European standards? Or would a cheaper, quicker job be sufficient? Judgments on such questions must be made on a case-by-case basis, but it is always desirable—and cost effective—to make maximum use of local companies.

**Case Study: British Companies and International Commercial Rivalry in Kosovo**

The experience of British companies in Kosovo immediately after NATO’s military intervention in 1999 illustrates the mixture of humanitarian concern, commercial rivalry, and administrative confusion that are often characteristic of post-conflict environments.

Many British companies believed that they had failed to win an appropriate share of reconstruction contracts in Kuwait after the 1991 Gulf War, or in Bosnia-Herzegovina after the 1995 Dayton Peace Accord. Responding to these concerns, British Trade International, a newly reconstituted government agency, formed the Kosovo Taskforce in May 1999, even before the conflict had ended. The members of the Taskforce came from both the public and private sectors. Its chairman was Nigel Thompson from the engineering consultancy Ove Arup & Partners. The Taskforce’s objective was to make sure that British industry was kept informed of potential opportunities in Kosovo, and was prepared to respond quickly.

In explaining the role of the Taskforce, Nigel Thompson drew an explicit link with Britain’s participation in the political and military aspects of the Kosovo campaign.

> Britain has played a fairly leading role—along with America—in getting the Serb military out of Kosovo. And what we want to do is to make sure British companies play their fair share in any reconstruction work that is necessary (Market Place 1999).

On June 28–29, UK Energy and Industry Minister John Battle led a group of six businessmen to Kosovo to make an initial reconnaissance. On July 1, representatives of some 250 construction-related companies from all over the UK attended a Taskforce debriefing session in London. Thompson pointed out that the companies ‘who work in Kosovo initially will gain the necessary experience needed for longer term projects.’ However, as the *Contract Journal* (1999a) commented, it was not clear whether those who were successful were ‘more likely to gain kudos rather than cash.’ The unknowns included:

- Who was in charge? There was at that point still no governing body to co-ordinate the reconstruction process, and the situation was particularly confused following the flight of Serb officials who had dominated the local bureaucracy.
- What materials were available locally?
- How much were individual reconstruction packages worth?
- If the ultimate plan was to replace outdated technology in Kosovo with new technology, who exactly would pay?
Peter Teeton, the technical director of Gibb (a major consulting engineering company) commented that it was still too early to know the full extent of the work, and added:

At the moment Kosovo is in limbo and there is no substantial aid. What is needed there is a sovereign government (Contract Journal 1999a).

Repairing the Power Sector
By August, the Taskforce had identified the power sector as an area where there was both a practical need and a potential commercial opportunity. Kosovo’s power stations were in disarray—they had not been hit during the bombing campaign, but the machinery was outdated and they had suffered from years of neglect. In the early 1990s ethnic Albanian staff in the state-owned utility KEK had lost their jobs—now the problem was reversed. As Brian Stone, principal engineer of the engineering consultancy Mott MacDonald, observed:

The main difficulty is the disappearance of senior Serb management and skilled staff. Just this week the director of the electricity authority disappeared... This leaves a vacuum of management and skilled operatives (Gordon 1999).

The British Army’s Royal Engineers were working to ensure essential energy supplies on a temporary basis, but there were serious concerns that these would not be sufficient in the winter months. One of the territory’s two power stations—‘Kosovo A’—was far below British technical and safety standards, and Stone thought that it should ultimately be demolished. The ‘Kosovo B’ power station was not working because its water supply had been cut off, although this was now being repaired.

There were still problems with the contracting process. The Taskforce team wanted to begin work at once in order to have the power supply working properly by the winter. By now the EU had taken over the administration of construction contracts on behalf of UNMIK, but EU officials wanted a competitive tender to a restricted list of five companies: the British team; an unnamed consortium of Danes, a Swedish consortium, a German consortium and Electricité de France (Gordon 1999a). This would have delayed the award of the contract until mid-September at the earliest.

The dispute was resolved with the help of the British government, and the interim management project was awarded to the British consortium. The British government provided a grant of £450,000, approximately half of the total cost of the contract, while the EU provided the remainder. Mott MacDonald led the consortium in association with three other UK companies: Scottish and Southern Energy, National Grid, and Taylor Woodrow. The government’s motivation was commercial as well as humanitarian—it hoped that the experience gained on the power management contract would help British companies win other opportunities. In particular, British companies hoped that they might have a chance to compete for the construction of the projected ‘Kosovo C’ power station, which might cost as much as a £1.6 billion.

Subsequent Developments
From a British point of view, the taskforce appears to have been at least a qualified success. On October 1999 UK Trade Minister Richard Caborn commented that:

We were criticised in Kuwait and Bosnia when we did not get our act together, but we got in very quickly in Kosovo (Gordon 1999b)

The government estimated that the Taskforce was instrumental in winning some £24 million for British business in the first year after the conflict, and it repeated the same model by setting up a similar body—also chaired by Nigel Thompson—for Serbia in 2000.
British energy companies have continued to win business in Kosovo. For example, in June 2000 a consortium led by the UK company National Power won a 40 million Euro contract to refurbish part of the ‘Kosovo B’ power station. The other members of the consortium included the French company Alstom Power and the Japanese-English Mitsui Babcock. In February 2003, British engineering company Innogy was part of a consortium led by Alstom which won a 38 million Euro contract for further refurbishment of ‘Kosovo B’.

Despite this refurbishment, Kosovo still suffers from power shortages. A fire in ‘Kosovo B’ in 2002 was a major setback. Fraud has been another problem. In June 2003 a German court sentenced Jo Trutschler, a German official who had been appointed to KEK, to three years in prison for embezzling some $4.5 million. At a day-to-day level, KEK still suffers from weak management, resulting in low maintenance standards and inadequate bill collection from customers.

The projected ‘Kosovo C’ power station has still not been built. There is a sound commercial case for its construction because it would export power to neighboring regions as well as serving Kosovo itself. The project would most likely be a public-private partnership requiring project finance from a body such as the World Bank or the European Bank for Reconstruction and Development (EBRD). Even with this backing, it may prove difficult to obtain private investment as long as Kosovo’s constitutional status remains unresolved. The territory still lacks the sovereign government which British businessmen felt was so important in 1999, and major infrastructure investments are therefore associated with significant long-term political risks.

Case Study: Strategic Road Construction under Fire in Afghanistan

Louis Berger Group is a leading US engineering company with an extensive portfolio of work in developing and post-conflict economies. In Afghanistan, it is implementing USAID’s Rehabilitation of Economic Facilities and Services (REFS) program. So far the main component of the program has been the construction of a $250 million road from the national capital Kabul to Kandahar in the south of the country. Afghan President Hamid Karzai says that road building is essential to the country’s economic recovery, and the highway has been a flagship of the reconstruction program.

The company was founded by Dr. Louis Berger, a soils and mechanics engineer, in 1953. It has been based in East Orange, New Jersey, since shortly after its beginnings but now has 140 offices and 3,000 employees in the US and internationally. The company’s first international project was the construction of a highway between Rangoon and Mandalay in Burma (now Myanmar) in 1959. The following year it began work on the construction of a road between Calabar and Ikom in Nigeria. Projects in developing countries continue to be a major part of its portfolio, and it frequently recruits staff with backgrounds in development or diplomacy as well as engineering.

Berger emphasizes that the financial aspects of its work in complex international environments are not as risky as they might seem. There is little payment risk when the client is an international bank or a US agency. Foreign governments may be slow to make the first payment, but the flow of money is usually reliable (Korman 2003).

USAID awarded Berger the REFS project in Afghanistan in September 2002, and it is scheduled to continue through December 2006. Key elements of the program include: provision of water and sanitation; the repair of electricity transmission and distribution systems; and the repair and construction of schools, clinics and government facilities. However, the centerpiece of the project is road repair and construction, particularly the roads linking Kabul and Kandahar, and Kandahar and Herat.
The 482km Kabul-Kandahar road was first built with US government aid in the early 1960s. The first few kilometers immediately south of Kabul were in relatively good order but the rest of the road fell into serious disrepair in the 1980s and 1990s. USAID provided approximately $250 million for the repair of 389 km of the highway. The Japanese government took on responsibility for the final stretch to Kandahar.

Upon completion, the road was to have a paved surface 7m wide; 2.5m shoulders on either side; and a total asphalt depth of 20-30cm. There are 46 bridges, 25 causeways, and more than 2,500 culverts, and most of these had to be repaired or rebuilt. Much of the material needed to construct the road had to be flown in by helicopter, and it has been the largest single reconstruction project in post-war Afghanistan.

The Kabul-Kandahar road took on immense significance as a symbol of national unity, and a tangible sign of post-conflict reconstruction. Jim Myers, the head of Berger’s Afghan operations, commented that it was the most ‘political’ project that he had ever done (North 2004). Berger was under intense pressure to finish the first phase of the project as soon as possible, and the official re-opening ceremony in December 2003 was attended by Afghan President Karzai, US Ambassador Zalmay Khalizad and USAID Administrator Andrew Natsios.

Contractors and Employees
Berger has employed five main contractors on the Kabul-Kandahar Road. These are: ARC, an Afghan-American venture; BSC/C&C (India); and three Turkish companies—Kolin Nafter, Culsan-Cukurova and Mensel. In addition, the project has involved working with dozens of sub-contractors. The list of ‘participants’ on Berger’s Afghanistan website (www.bergerafghanistan.com) includes a substantial proportion of companies from Afghanistan and Turkey as well as others from Cyprus, Denmark, Egypt, India, Kazakhstan, Oman, Romania, Singapore, South Korea, United Arab Emirates (UAE) and Vietnam. The list of suppliers displays similar diversity.

Berger employed approximately 2,000 Afghan laborers and semi-skilled workers, plus some 500 Turks and Indians in the construction of the Kabul-Kandahar road.

Security Threats
The political (and indeed military) significance of the Kabul-Kandahar road inevitably attracted the attention of Taliban and other opposition forces. The southern part of the road towards Kandahar was considered particularly high-risk. The Afghan Interior Ministry allocated 1,100 guards to protect the project, and Berger gave them an extra $5 a day as a food allowance.

Despite this protection, more than 30 construction workers or other employees of different nationalities were killed during the road’s construction (North 2004). Casualties included six Afghan Interior Ministry guards killed in August 2003, and an Australian helicopter pilot who was shot and killed in February 2004. In October 2003 an American engineer narrowly escaped death when his car was ambushed. In the same month a Turkish engineer was kidnapped but later released, and two Indians were kidnapped in December 2003. This is part of a wider pattern of violence across Afghanistan. Aid workers for NGOs and humanitarian agencies also have been targeted with increasing frequency (Sandford 2004).

Apart from the risk of direct attacks, Berger and its partners had to remove more than 120 mines and 900 other pieces of unexploded ordnance from the road.

Social Impact and Corporate Responsibility
Before the Kabul-Kandahar road was repaired, it took two to three days to drive between the two cities—the journey has now been cut to five to six hours. Some 35% of Afghanistan’s population of 20 million
live within 50km of the highway. Its obvious economic and social benefits include greater speed in getting goods to market as well as more rapid access to health and educational facilities.

People with the technical skills needed for Berger’s engineering work are hard to find in Afghanistan and, as discussed, it has had to recruit heavily from outside the country. The company nevertheless emphasizes that one of the goals of the REFS program is to maximize Afghan business opportunities and employment. As far as possible, it has aimed to give Afghan employees and partners training as well as employment. In the less technical parts of the REFS contract, for example the schools and clinics reconstruction program, it has used locally-available building materials and construction methods as much as possible, while also including improved designs to make the buildings more earthquake resistant.

5. INTERNATIONAL COMMERCIAL BANKS

Countries recovering from conflict require a broad architecture of financial institutions to promote economic recovery. Typically, the most urgent requirements will be to revive key government institutions such as the central bank, and to establish a financial regulatory structure that makes it possible for the private sector to operate. Other urgent requirements will include raising finance, and managing external aid contributions.

International commercial banks can be an important part of this financial architecture and, as with other parts of the private sector, their importance will increase as international aid decreases. In particular, they will play a vital role in facilitating foreign investment. Many international companies will hesitate to invest in a new market without a friendly international banking partner. This section discusses the factors that motivate, deter or prevent commercial banks from setting up operations in post-conflict countries.4

The Business Case

When considering whether to set up operations in a post-conflict country, banks will ask the same sorts of questions as they would for other emerging markets: what is the size of the market? Are our existing clients likely to be interested? What are the prospects for external trade? What is the regulatory environment? Does it fit into our strategic plan? And is it safe? Emerging markets may be financially attractive because banks can charge higher margins than they would in established markets, and in some cases there may be a ‘first-mover advantage’—they hope that they will be able to enhance their long-term prospects by winning customers early, and building up their confidence.

Standard Chartered Bank, which was founded in the 1850s, has long-standing historical connections with Asia and parts of Africa. It sees itself as a specialist in emerging markets, and many of its clients are the kinds of people who operate in such places: diplomats, NGOs and developing agencies. Standard Chartered has operated in Sierra Leone since colonial times, and re-opened after the conflict as soon as it was safe to do so. It was also among the first foreign banks to set up operations in Laos and Cambodia. It is now in Afghanistan (see case study) and is actively interested in Iraq.

In other cases, a decision to open a new office in a post-conflict country may form part of a regional development plan. In 2001 ANZ became the first foreign bank to open a branch in Timor-Leste (East Timor) following its split from Indonesia (Callick 2001). Timor is a small market, but fits into ANZ’s regional portfolio. Its strategy was similar to Standard Chartered’s in Afghanistan: it expected that most of its initial customers would be international—mainly UN and NGO staff—but it would hope in due course to expand into the domestic market. When the branch opened in Dili, the capital of Timor, it was

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4 This paper focuses on in-country banking investment in post-conflict settings. UNEP/IISD (2004) offers a broader discussion of the role of the financial sector in relation to conflict.
staffed by two Australians, an expatriate contractor and 10 Timorese. It offered checking and savings accounts, term deposits, foreign exchange and import and export letters of credit.

A third example is Stanbic Bank from South Africa. It has a network covering 17 countries in sub-Saharan Africa, including DRC. Its branch in Kinshasa was established in 1973 as Grindlays Bank (Zaire) and, according to its website, it now serves as a ‘small niche bank servicing the upper end of the commercial market’. Its clients include subsidiaries of multinational companies, major airlines, hotel groups and diplomats.

Iraq has obvious long-term economic potential (see case study), and therefore is of long-term interest to a wide range of commercial banks. However, the markets and external trade prospects in many of the other countries considered in this paper—Bosnia-Herzegovina, Timor-Leste, Rwanda—are likely to remain small, and this makes it harder for the larger banks to justify the political risks of entering them. In practice, the banks most likely to do so are often regional players. Austrian banks in Bosnia-Herzegovina (see case study) provide an obvious example. If Iraq continues to be unstable, it is more likely to be able to attract regional Middle Eastern banks from neighboring countries rather than the larger international banks. In Afghanistan, Pakistani and Iranian banks are setting up operations alongside Standard Chartered.

Banks’ commercial expansion in post-conflict economies typically follows a sequence.\(^5\) Initially, as with ANZ in Timor-Leste and Standard Chartered in Afghanistan, they may earn most of their income from international money transfers on behalf of diplomats and aid agencies. Then, as the economy starts to recover, they begin to work on import deals, for example of reconstruction equipment for large international companies with recognized credentials. Later on, they may extend their services to high net-worth individuals, for example successful members of an international diaspora who want to invest in their home country. Then come infrastructure finance and loans to small and medium enterprises (SMEs). Retail banking tends to come last—especially in a country like Afghanistan—although it may appear earlier on in a country with a more established banking tradition, or where the foreign bank takes over an existing local bank. However, retail banking is a desirable long-term objective for banks who wish to establish a long-term presence in the host country.

**Political and Security Risks**

Bankers are risk-averse by professional training and possibly by nature. Clearly-defined banking laws are an absolute precondition without which it is impossible to operate. This presents an obvious contrast to junior mining companies who are often prepared to start exploration before a mining code has been prepared. Further critical requirements include the need for clear foreign exchange control regulations, without which it can be almost impossible to operate; and proper bankruptcy regulations. Banks will be reluctant to lend if they cannot pursue defaulting borrowers. More broadly, in advertising as well as in conversation, bankers emphasize the importance of local knowledge when entering difficult markets. If they feel they lack such knowledge or cannot easily acquire it, they will be reluctant to set up operations.

Local knowledge is especially important because of international money-laundering regulations and the requirement to ‘know your customer’ (KYC). This requirement may initially be difficult to apply, especially in countries where many of the most prosperous potential local customers have built up their wealth by exploiting the underground economy—smuggling in the case of Bosnia-Herzegovina and Iraq, and the drugs trade in Afghanistan. A sense of caution inspired by the KYC principle makes foreign

\(^5\) Thanks are due to Arno van Dijken, Director of Business Development for ING Institutional and Government Advisory Services for elaborating on this point.
banks reluctant to expand their local lending portfolios, to the frustration of government officials and development agencies who wish to promote more rapid private sector development.

By providing professional, regulated channels for international money transfers, banks will in due course form part of the solution to money-laundering. However, commercial bankers point out that they are primarily interested in performing such services for companies rather than for individual migrant workers. The latter do not make attractive clients because there is little prospect of selling them other services. In countries such as Afghanistan and Somalia, it will take many years before the formal banking sector comes close to replacing the informal hawala network.

Security has always been an important consideration, and is now even more so. The presumed Al Qaeda terrorist attack on the HSBC branch in Istanbul in November 2003 served as a reminder that banks are often seen as commercial symbols of their home countries and targeted accordingly. The recent memory of this attack is one of the factors that has discouraged foreign banks from setting up in Iraq. The proportion of expatriate staff in international banks such as HSBC is much lower than it used to be, but banks have a responsibility to protect their staff regardless of their countries of origin.

**Corporate Responsibility and Social Impact**

Banks, like many other businesses, may sponsor charitable and philanthropic activities. For example, Standard Chartered celebrated its 150th anniversary in 2003 by raising $700,000 to combat blindness in poor communities. In Africa and Asia, the bank is sponsoring a range of community initiatives to combat HIV/AIDS and Malaria. Such initiatives serve a commercial as well as a purely altruistic purpose in that it brings them positive publicity.

However, the international banks’ most important contribution in post-conflict states derives from their technical expertise and their access to finance, which in turn can stimulate other parts of the economy. The commercial objectives mean that—at least initially—they are likely to concentrate on larger companies and high-profile individuals. To that extent, the benefits that they bring are likely to be distributed unevenly. Other kinds of institutions—for example micro-credit specialists—will always be needed to cater for the needs of individuals and small local businesses.

In addition commercial banks may provide technical expertise to government or other international agencies. For example in Iraq, JPMorgan Chase and Co is leading an international consortium to manage the Trade Bank of Iraq. ING’s Institutional and Government Advisory Services (ING-GA) provides banking and insurance-related services for both public and private institutions, and is currently running the Afghan International Bank (AIB) in Kabul (see case study). ING-GA normally provides its services on a commercial basis, but ING nevertheless sees it as part of its broader social contributions to society. In some cases banks may provide technical advice or other services on a pro bono basis.

**Case Study: Austrian Banks’ Regional Expansion into Bosnia-Herzegovina**

Since the end of the debilitating war in Bosnia-Herzegovina in late 1995, the country has received some $5 billion in foreign aid. However, long-term economic recovery will depend on the development of the private sector, including foreign direct investment (FDI). Here the country’s performance has been disappointing. Between the end of the war and 2000, Bosnia-Herzegovina received only some $400 million worth of investment. Since then investment flows have begun to pick up, but by late 2003 the

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6 This case study draws in part on interviews conducted in Bosnia-Herzegovina on behalf of MIGA (World Bank) in May 2003 (see Bray 2004 for further details) and for the US development NGO, CHF, in November 2003.
total amount of post-war FDI was still only some $1 billion. In this respect, Bosnia-Herzegovina compares poorly with neighboring Croatia, and now even with Serbia.

There has been some favorable news, with Bosnia-Herzegovina’s Central Bank (CBBH) one of the country’s post-war success stories. Financial sector reform has made Bosnia-Herzegovina more attractive to foreign banks, and according to the Bosnia-Herzegovina Foreign Investment Promotion Agency, banking now accounts for 16.7% of all FDI into the country. Among these, Austrian banks have been the most conspicuous and successful. This case study discusses the factors that have made Bosnia-Herzegovina attractive to Austrian banks, and the wider social and developmental implications of their investment.

Obstacles to Investment

Bosnia-Herzegovina is a small market of some 3.7 million people, and this in itself would limit its attractions to major external investors. A senior American financier consulted for this paper commented that Bosnia-Herzegovina did not even figure on his bank’s world map. However, its small size is far from being the only problem.

The 1995 Dayton Peace Agreement brought an end to the war between the country’s Bosniac (Bosnian Muslim), Serb and Croatian factions, but left it more divided than it had ever been. Political leaders in all three communities claimed to be motivated by ethnic nationalism but, in a style reminiscent of their communist predecessors, exercised a nomenklatura-like control over economic institutions which provide a source of funds and patronage. This control extended to banks and socialist-style Payment Bureaux, which had a monopoly of cash transactions. For example the Hercegovaska Banka was under the control of the Mostar-based HDZ (Croat Democratic Union) party. The official political and economic structure was complicated enough—it was made still more complicated by the existence of unofficial ethnic-dominated structures which operated in parallel and in many cases had links with organized crime.

This complex political environment combined with stifling bureaucracy—another socialist legacy—to constrain both domestic and international entrepreneurship (see Bray 2004).

Economic Reforms

The CBBH opened in 1997 and for most of its history has operated under the Governorship of Peter Nicholl, a New Zealander who has now been granted dual Bosnia-Herzegovina citizenship. One of its early tasks was to formulate and manage the country’s monetary policy by issuing a new domestic currency, the Konvertibilna Marka (KM). This was initially linked to the Deutschmark and now to the Euro, and is fully convertible. The introduction of the new currency had political as well as economic implications. The RS leadership favored economic and ultimately political integration with Serbia, which meant that the Serbia dinar was widely used in their territory, while many Croats had similar aspirations towards Croatia. The KM is now universally accepted throughout Bosnia-Herzegovina, and is therefore a tangible sign of national integration.

Subsequent banking reforms included the abolition of the Payment Bureaux in early 2001; the introduction of minimum capital requirements for banks of KM15m at the end of 2001; and the requirement for banks to qualify for deposit insurance by August 2003. Another symbolic turning point was the changeover from the Deutschmark (the most favored foreign currency in Bosnia-Herzegovina) to Euros in early 2002. Bosnia-Herzegovina citizens produced some DM6.2 billion ($4.3 billion) worth of banknotes, which previously had been hidden under mattresses and in other safe places. One third was of the total was deposited in local banks, a sign of greater confidence in the financial system.
These reforms made the country more attractive to foreign banks, and by 2004 some 70% of Bosnia-Herzegovina’s banking system was under foreign ownership. Many of the smaller domestic banks faced closure or takeover because they were unable to meet the requirements of new banking regulations.

*The Austrian Banks*

Austrian banks are interested in Bosnia-Herzegovina because it fits into their wider regional strategic plans. The Austrians argue that their greater regional knowledge gives them a comparative advantage as well as a greater sense of commitment, and their expansion into Bosnia-Herzegovina was paralleled by similar moves into neighboring countries.

The four Austrian banks are:

- **Raiffeisen Zentralbank Oesterreich AG** entered the market in 2000, when it acquired a controlling share of Market Banka, and then purchased 100% of the Mostar-based Hrvatska Postanska Banka in May 2001. Initially it focused on the Federation, but in the last two years has expanded its network to RS. It now has a staff of 1,000 people and operates 60 branches across the country. Among other services it offers Internet banking, and has its own securities brokerage firm—Raiffeisen Brokers.

- **Volksbank** set up in Sarajevo in 2000. It has expanded by setting up new offices from scratch and now has two branches in Sarajevo and seven in other parts of the country.

- **Hypo Alpe Adria Bank** is based in Klagenfurt, Austria, and—as its name suggests—aspires to expand throughout the Alpine and Adriatic region. It began in 2001 by acquiring Auro Banka in Mostar. In 2002 it acquired a controlling share of the loss-making Kristal Banka in Banja Luka, the capital of RS, for a price of one Euro.

- **In October 2003 Bank Austria Creditanstalt** acquired Central Profit Banka in Sarajevo, and has since merged it with HVB Bank, its local subsidiary, to form HVB Central Profit Banka. With 33 branches, this is the third-largest commercial bank in Bosnia-Herzegovina.

*Wider Social and Economic Implications*

The Austrian investment has brought tangible benefits in the form of smartly refurbished office buildings and a proliferation of ATM machines which, in Bosnia-Herzegovina as in many other emerging markets, are taken as a welcome sign of modernity. However, their practical and symbolic importance goes beyond this.

The refurbished office buildings convey a sense of commercial professionalism which goes beyond ethnic particularism. This is an important point in a country still riven by ethnic dividing lines. Aura Banka and Kristal Banka, which were both acquired by HAAB, arguably were Croat and Serb banks respectively. Now they are part of a national and international network, they can claim that they are not ethnic banks, but professional banks.

As the banks expand their networks they will become increasingly important as sources of loans for local businesses as well as domestic customers, and this is in itself an important social contribution. The banks are of course not the sole providers of credit and, for small businesses in particular, there is still an important role for micro-credit institutions.

Finally, as an Austrian banker in Sarajevo commented, banks are among the ‘building blocks’ that are needed by other international investors. First, it is important to have a clearly defined regulatory environment. Then you need the financial institutions, and then other investors will follow.
Case Study: Hawala and ATMs in the Afghan Market Place

Since the fall of the Taliban in 2001, Afghanistan has been at work to rebuild its economy and political institutions. An effective commercial banking network is crucial for the country’s economic recovery and private sector development. In the 1970s, the then socialist government nationalized Afghanistan’s private commercial banks. The state bank network survived through two decades of conflict, but more in form than substance. After the collapse of the Taliban regime in 2001, there were still six state-owned banks but, in the view of one technical expert, their ‘principal activity was drinking tea’ (Burnett 2003b).

In September 2003, the Afghan government introduced new banking laws, thus making it possible for a select group of foreign commercial banks to enter the Afghan market. The main question for the future is whether they will be able to help develop a broad-based domestic banking network, or whether their services will be concentrated on a small circle of international customers.

The Impact of the Conflict on the Financial Sector
All financial institutions—including the Da Afghanistan Bank (DAB, the country’s Central Bank)—have suffered from an acute lack of technical skills, a lack of software, and inadequate telecommunications networks (Pernia, Bell and Maimbo 2004). Businesses, aid agencies and NGOs wishing to transfer funds in or out of the country have been forced either to rely on the informal hawala system, or to carry large amounts of cash into the country by hand—an activity that raises obvious security concerns.

The hawala network has existed for centuries in South Asia and, with variations, in much of East Asia and the Middle East. Money-exchange dealers based in the bazaars of Kabul and Kandahar arrange transfers of funds (hawala means ‘transfer’ in Arabic) via their counterparts elsewhere in Afghanistan, in Pakistan and in international financial centers such as Dubai, London and Tokyo. The system is based on trust—the hawaladars at either end are often close relatives. It is fast—transactions are commonly completed in six to 12 hours, but can be concluded even faster if hawaladars and their customers at either end can be connected by phone. Fees are usually in the range of 1 to 2%, and the system is capable of handling significant amounts of money. The larger NGOs and aid agencies have made individual transactions of $1 million at a time, and the total amounts transferred since the fall of the Taliban are certainly measured in hundreds of millions of dollars.

In Kabul, hawaladars have organized themselves into a self-regulating market. In early 1983 more than 300 dealers had registered with the DAB (Maimbo 2003:3). Estimates of the number of unregistered dealers ranged from 500 to 2,000. Among international policy-makers, one of the main concerns is that the system is open to abuse by money-launderers. This, of course, is also true of the formal banking system—the main difference is that hawaladars keep limited amounts of documentation, making it much harder to follow any ‘money trail’. Policy makers will need to consider means of regulating hawala (Maimbo 2003:15-17). However, whatever its deficiencies, it fulfils an obvious need so efficiently that it is likely to co-exist for some time alongside whatever formal banking system eventually emerges in Afghanistan.

Meanwhile, DAB has begun the process of restoring and reforming Afghanistan’s formal financial system. In January 2003, it transformed the old worthless afghani currency into a new one, and currency rates have remained relatively stable since then. In September 2003 the government ratified a set of new commercial and central banking laws. According to Anwar ul Haq Ahadi, the Governor of the Central Bank (since replaced by Noorullah Delawari), the government’s objective is to establish a system of privately-owned banks driven by competition (Burnett 2003a). Banks are required to have a minimum capital of $5 million. There is no limit in the stake that a foreign company may hold in a bank, and new local and foreign banks are able to take deposits, perform international money transfers and offer trade
finance. DAB was expected to withdraw from commercial banking activities—such as holding deposits and performing international currency transfers—by the end of September 2004.

DAB has now liquidated three out of six surviving state-owned banks, and given operating licenses to the two—Pashtani Bank and Milli Bank—that met the standards laid out in the new banking laws.

**International Players**

The introduction of the new banking laws in September 2003 made it possible for foreign banks to consider applying for licenses, and a variety of regional and international banks have responded.

- **Regional Banks**
  The National Bank of Pakistan opened its Kabul branch in a private house in October 2003, and has been offering basic commercial banking services. In May 2004, it opened a second branch in Jalalabad. The Habib Bank, also from Pakistan, opened a branch in Kabul in April, and it has now been followed by the National Bank of Punjab from India.

- **Standard Chartered Bank**
  Standard Chartered is a British bank which already has a strong regional presence in South Asia and the Middle East. It opened its Kabul branch in January 2004, and the services that it offers include taking deposits, money transfers and payroll services, as well as the country’s first ATM. It was not initially offering loans, but could extend letters of credit to select Afghan clients (Burnett 2004). One future possibility was that it might offer a training program for local banks.

- **Afghanistan International Bank**
  The Afghanistan International Bank (AIB) opened in March 2004. It is managed by the ING Institutional and Government Advisory group (ING-IGA); which is a unit of the Dutch bank ING, specializing in bank advisory work for both private and sovereign clients. ING-IGA has made a three-year commitment to run the bank and provide senior executives. AIB’s services include inward and outward financial transfers, current accounts, foreign exchange facilities, and trade finance. In due course it hopes to provide online banking facilities. After the first year it also hopes to open seven further branches outside Kabul. AIB is capitalized at $10 million. Its shareholders consist of a consortium of Afghan and American investors. These include Afghan Reconstruction Company (ARC), Constellation Business Group Inc, Rahmat Group, and Marco Polo Gulf Trading FZE. The Asian Development Bank (ADB) has also taken an equity share, and the US-based Overseas Private Investment Corporation (OPIC) reportedly is considering providing political risk insurance.

- **First Micro-Finance Bank of Afghanistan**
  The First Micro-Finance Bank is a small loan provider backed by the Aga Khan Foundation for Economic Development (AKFED), and this was expected to start in early 2004. It aims to provide small loans of up to $5,000 to local businesses. The bank received an initial $650,000 grant from the World Bank under a project for capacity building. The project has been coordinated by the Japan Social Development Fund.

**Security Risks**

Standard Chartered says that it spent two months weighing up the risks and benefits of investing in Afghanistan, and notes that the question of physical security was crucial (BBC News 2004). Local security concerns in Kabul evidently were considered manageable under current conditions, although they imposed a certain constraint on expatriate lifestyles. Stuart Horsewood, Standard Chartered’s country manager in Kabul was a keen long-distance runner, but reportedly had to practise his hobby inside his
house: “The only place with any distance is a figure-of-eight loop round the dining table and to the TV and back” (Harris 2004). Meanwhile, AIB reports that it has contracted a UK-based private security company, Strategic Security Solutions (SSSI), to provide security management, armed security and armored cash-in-transit services (Business Wire 2004).

**Commercial Opportunities and Risks**

International banks see a variety of reasons for moving into Afghanistan. The first and most obvious is that they are following—or anticipating—their customers. Standard Chartered has an extensive existing clientele of international businessmen, diplomats and aid workers, and these kinds of customers have now moved into Kabul. As Standard Chartered’s regional manager explains, ‘We bank those people all over the world, so we’re following them’ (Burnett 2003a). It may also see a first-mover advantage in entering the Afghan market ahead of its competitors. A similar rationale applies to regionally-based banks such as the National Bank of Pakistan.

One of the most important potential clienteles is the extensive Afghan diaspora, many of who have achieved a degree of prosperity in their new countries of residence. They often wish to make a personal contribution to their home country’s revival. They may also see a commercial opportunity arising out of their special knowledge and personal connections within Afghanistan. The Afghanistan International Bank combines commercial and developmental objectives on the part of its US and overseas Afghan shareholders. From ING’s point of view, the bank also offers an opportunity to gain experience of what is currently a niche market but—if all goes well—will ultimately expand into a more flourishing economy. ING-GA is providing a service to the AIB, and ING almost certainly would not have entered the Afghan market independently at this stage in the country’s development.

The Afghan economy will not flourish until its domestic entrepreneurs can set up business. Commercial banks in future will provide an important source of loans to the domestic market, but at least initially, domestic loans scarcely figured in the international banks’ portfolio. In a country notorious for its drug economy, it is difficult to apply the ‘know your customer’ principle, and the commercial and political risks are high. In July 2004, the Multilateral Investment Guarantee Agency (MIGA)—the World Bank’s political risk insurance agency—announced plans to provide political risk insurance to foreign banks making domestic loans, and this may remove one obstacle to such loans.

However, for the time being, the main source of credit to small Afghan businesses is likely to be from institutions such as the First Micro-Finance Bank whose objectives are as much developmental as commercial. As noted above, the First Micro-Finance Bank is backed by development agencies rather than by commercial institutions. International banks have established a presence in Afghanistan but the political, security and commercial risks to mainstream retail banking remain high.

**Case Study: Continuing Conflict Delays Commercial Banks in Iraq**

Iraq’s commercial potential is clear: it holds 11% of the world’s proven oil reserves, second only to Saudi Arabia which has 24%. It is currently engaged in a massive reconstruction program costing billions of dollars. It has a long trading tradition, and it has a large population which, despite the depredations of the last 25 years, includes a significant proportion of well-educated professionals.

These characteristics mean that it has obvious appeal as an emerging market for international commercial banks. However, foreign banks have so far established no more than a limited presence in the country, mainly because of high continuing political and security risks.
The Iraqi Banking System

Iraq nationalized its banking industry and expelled foreign banks in 1964. The state banking machinery functioned reasonably efficiently in the 1960s and 1970s but, like other parts of the economy, has been devastated by the accumulated impact of the Iraq/Iraq War in the 1980s, the two wars with the US and its allies, and more than a decade of UN sanctions.

The Iraqi Central Bank remains at the hub of the financial system. In addition there are two state-owned commercial banks; Rafidain (founded in 1941) and Rasheed (1974); four smaller state-owned banks specializing in agriculture, real estate and industry; and seventeen private commercial banks which were set up in the 1990s. The six state-owned banks between them hold 82% of all banking deposits. Most ordinary Iraqis have limited faith in the formal banking system, and have preferred to keep whatever savings they have in cash or other assets. All Iraq’s financial institutions suffer from antiquated equipment, an inadequate communications structure, and poorly trained human resources.

The US-led Coalition Provisional Authority (CPA) and the Iraqi authorities have instituted a series of reforms to reform the banking system. These include the liberalization of foreign trade and investment rules, the passing of a new Central Bank Law and a Banking Law, the establishment of an Iraqi stock exchange and an ambitious program to send 500 Central Bank employees for training abroad. The authorities introduced new currency notes (no longer decorated with portraits of former President Saddam Hussein) between October 2003 and January 2004.

In 2003 the CPA also set up the Trade Bank of Iraq to facilitate the import and export of goods and services for an initial period of one year which has since been extended. The Trade Bank had start-up capital of $100 million ($5 million from the CPA and $95 million from the Iraq Development Fund managed by the UN) and is run by a consortium of 13 banks led by JPMorgan Chase and Co. The other members of the consortium are: ANZ Banking Group, National Bank of Kuwait, Standard Chartered, Akbank, Banco Comercial Portugues, Bank Millenium, Bank of Tokyo Mitsubishi, Caja de Ahorros y pensiones de Barcelona, Credit Lyonnais, Gruppo San Paolo IMI, Standard Bank, Royal Bank of Canada. The management of the Trade Bank is in itself an important contribution from the international commercial banking community.

Foreign Commercial Banks

Iraq’s new banking laws permit foreign banks to set up operations in Iraq, subject to the rules and monitoring of the Central Bank. In late 2003, 15 banks applied for licenses. In January 2004, the authorities announced that Standard Chartered, HSBC and National Bank of Kuwait would receive permission to set up operations in Iraq. The conditions were a minimum capital requirement of $25 million, and an undertaking to open their offices formally by the end of 2004. By late 2004, none of them had actually done so—although they insisted that they had not abandoned their plans—and the Iraqi authorities had extended the deadline until March 2005. The main reason for the delay was that the security situation was much worse than originally expected.

In November 2004 the Central Bank announced that it had awarded licenses to two regional banks: the Arab Bank (Jordan) and the Arab Banking Corporation (Bahrain). It also gave initial approval to the Export Bank of Iran, the Agricultural Bank of Iran and the Bank of Agriculture (Turkey).

Prospects

Iraq meets two of the basic requirements for foreign banks: high market potential, and well-crafted banking laws. To date it has fallen short on a third requirement—a secure operating environment—and the long-term political prospects remain uncertain. Banking commentators say that there is little doubt that the major international as well as regional banks will eventually expand their operations inside Iraq. The outstanding question is when they will be able to do so in reasonable assurance of their own safety.
6. LESSONS LEARNT AND RECOMMENDATIONS

The main premise of this paper is that the role of international companies in post-conflict reconstruction is an essential complement to the work of international aid agencies, and that the importance of the private sector will increase as aid flows continue to decline. However, if policy-makers are to secure the maximum benefits from private investment, they need a clear understanding of the variations within the private sector: who invests, and why? What can be done to ensure the maximum social benefits? The answers naturally vary in different regions and sectors but an overall pattern has begun to emerge.

Global, Regional and Niche Players

The first point concerns the balance between large companies—the truly global players—and smaller regional firms. Large companies will invest if the conditions are right, but post-conflict countries are much more likely to attract smaller companies with a higher tolerance of risk.

Large companies are primarily interested in large projects commensurate with their size, importance and long-term aspirations. These companies’ particular qualities include the ability to raise large amounts of finance, and to generate corresponding returns. At the same time, their greater public exposure, and the fact that they typically are publicly listed, means that they are more exposed to reputational damage. This does not mean that they never invest in post-conflict regions. However, particularly in the first year or two after the conflict ends, it is rarely worth taking high risks for returns that, on the scale of these companies’ balance sheets, are likely to be marginal. In practice, the most active foreign investors are therefore likely to be niche players, or regional companies with regional development strategies.

The structure of the petroleum and mining industries illustrate this broad spectrum of attitudes. Collectively, individual companies across both industries pride themselves on their ability to manage risks. However, the biggest risk-takers are the junior exploration companies who explicitly market themselves to shareholders on the basis of high risks with the potential of high returns.

Similarly, the mobile phone sector offers examples of European-based niche players, such as Millicom, Mobitel and Celtel, all of whom operate in post-conflict states in Africa. They are competing with two South African companies, Vodacom and MTN, who are highly regarded in their home country as entrepreneurial companies who have taken the lead in expanding into ‘Africa’. In North Africa and the Middle East, the leading regional player is Orascom, a Cairo-based company. In Timor-Leste, the Australian company Telstra was the first to set up operations in the country after the Indonesian withdrawal in 1999.

Among construction companies, the huge Iraqi projects managed by US companies such as Bechtel and KBR are obvious examples of global players taking on projects of commensurate size and importance. However, this is only part of the story. The US companies who have taken the lead in Iraq and Afghanistan necessarily employ an extensive network of hundreds of sub-contractors, including companies from Iraq, the wider Middle East and further afield.

Iraq definitely is of interest to major international banks and, as has been seen, in early 2004 HSBC, Standard Chartered and the National Bank of Kuwait received licenses to set up operations there. However, by the end of the year they had not actually done so because of continuing security concerns. In November the Central Bank announced that it had awarded licenses to banks from Jordan and Bahrain, as well as giving initial approval to two Iranian banks and a Turkish one. Again, it looks as though regional operators may be taking the lead, as they already are in Austria, Timor-Leste and much of Africa.
When considering niche players, a special mention should be made of diaspora investors: people who originated in the country concerned, but have established themselves—and built up funds—abroad. These people have a special motivation to invest in post-conflict countries and may have the in-country expertise (provided that it is up-to-date) to manage risks effectively.

Many diaspora-sponsored companies are SMEs, but by no means all. Dr. Mohammed Ibrahim, the founder of Celtel, was born in Sudan and explicitly cites the desire to ‘give something back’ to his home region as one of his motivations for setting up his network of companies across 13 countries in Africa (see case study). Similarly, Afghan-American investors have provided a substantial proportion of the backing for the Afghanistan International Bank, which is managed by ING (see case study). In Somalia, expatriate returnees have used their funds and their external contacts to help set up their country’s mobile phone networks. Diaspora investors may be a major asset to countries that otherwise find it difficult to attract international commercial interest.

Timing and Sequencing of International Commercial Interest

The second point is that there are distinct patterns in the involvement of both aid agencies and business according to the different stages of post-conflict recovery. As Collier (2003:157) points out, countries typically benefit from widespread publicity and international goodwill immediately after the end of a conflict. This leads to a substantial increase in the flow of aid in the first two years (although, as Afghanistan’s recent experience shows, the overall aid budget is often small compared to the costs of continuing international military activities). However, aid flows begin to decline by the third or fourth year. This decline is counter-productive in that the host country’s ability to absorb and make best use of the aid is likely to be highest toward the middle of the first decade after the conflict has ended.

By contrast, international commercial interest is likely to be very limited in the immediate aftermath of conflict. The companies most likely to be active are those who, like the construction companies, are directly involved in physical reconstruction. By the third or fourth year, there may be greater interest from investors.

Within this overall pattern, there are significant variations between different sectors and types of company:

- Junior petroleum and mining companies are generally willing to begin exploring as soon as it is physically safe to do so. The larger independent companies and the Asian state-owned companies may be prepared to begin producing in countries such as Myanmar and Sudan that are still caught up in conflict. Major Western companies will hesitate to make substantial new investments until well after a conflict is over. However, they will try to maintain existing operations in countries that descend into violence.

- Mobile phone companies have shown themselves willing to move into post-conflict economies as soon as the fighting ceases. Initially, international aid agencies and NGOs may be among their most important clients, but they will move quickly to set up a local customer base.

- Construction and engineering companies will work on the rebuilding of physical infrastructure such as roads, water and energy supplies in the immediate aftermath of conflict. However, there will be very little foreign private investment in, for example, power generation in the first two to three years. Schwartz et al. (2004:12) show that private investment in infrastructure tends to peak six years or so after the end of the conflict. Investments (as distinct from short-term
reconstruction contracts) typically often come from small local or regional companies rather than major international firms.

- Foreign commercial banks typically start by focusing on international clients such as resident diplomats and members of the aid community. They are unlikely to move into the domestic retail market until economic recovery is well under way, if at all.

Similar patterns may apply in other sectors that are beyond the scope of this study. For example, the TAYL Investor Group (TAYL Ltd), which has Afghan-American and Turkish Partners, has begun the construction of a five-star hotel in Kabul, which is to be managed by Hyatt International. The hotel is located opposite the US embassy, and in the first instance its clientele is most likely to come from the international diplomatic and aid communities. In due course, the Afghan tourist industry may begin to include special interest groups, such as archaeologists, who are more interested in particular sites than their material comfort.

Creating an Enabling Environment

The apparent time-lag between the end of conflict and the acceleration of foreign investment raises the question: What can policy-makers do to attract international companies earlier rather than later? And what can be done to attract the ‘best’ international companies?

The first part of the answer is in the broad sense ‘political’, and it applies equally to domestic and international business. Companies obviously need basic security in order to flourish. More than that, they need to be able to operate in an environment where there is political and social consensus on the role of the private sector in economic recovery, and the policy measures that are needed to promote it. In interviews that this author conducted in Bosnia-Herzegovina in November and December 2003, it was striking to find that local, small-scale entrepreneurs made the same complaints as would-be foreign investors: bureaucratic procedures were too slow; corruption was a continuing problem; and local officials had yet to emerge from a post-socialist mentality that was unsympathetic to the private sector. Foreign companies will be all the more reluctant to invest if the domestic private sector lacks confidence in its own economy.

International companies working in partnership with local leaders and organizations may be able to play a role in establishing a consensus on what is needed to fulfill the host country’s economic potential. One example from the 1990s was the Mont Fleur scenario process in South Africa (Le Roux et al. 1992). In 1991 South African academic Peter Le Roux assembled a multi-disciplinary team of 22 political leaders, academics, trade unionists and business people to draw up four scenarios for South Africa in the ten years to 2002. Adam Kahane, a scenario specialist from Shell International, acted as facilitator. The team came up with four agreed scenarios: these showed that political negotiation was essential, and that a weak coalition government would not work. Populist economic policies implemented by a new elected government also would be counter-productive. However, a scenario of inclusive democracy and economic growth—symbolically entitled ‘Flight of the Flamingos’—was achievable. The scenarios helped achieve a shared understanding between different political groupings about what was possible and what was not, and what was needed to achieve the most positive outcomes.

Ceasefires do not in themselves bring about this kind of shared understanding on economic issues. Immediately after the end of a conflict, official priorities tend to focus on physical reconstruction and political reconciliation. ‘Political reconciliation’ in practice often looks like a sharing of the spoils.

7 The interviews with local businesses were conducted on behalf of the US NGO, CHF International, in connection with their Stable Societies Project.
between rival parties, rather than a concerted plan to create the conditions for sustainable development. It remains to be seen whether Sudan will be a positive or a negative example in this respect following the January 2005 ceasefire between the Sudanese government and the Sudan People’s Liberation Army (SPLA). One of the key tests of the ceasefire’s success will be the two sides’ management of the country’s oil revenues, and the extent to which they use them to foster broad-based development rather than building up their personal patronage networks. Uncertainty on such questions—and the continued impact of the Darfur crisis—means that would-be international investors will continue to treat Sudan with caution.

The effect of conflict is often to postpone much-needed economic and administrative reforms, and post-war political maneuvering may lead to further delays. Again, Bosnia-Herzegovina is an example. The 1995 Dayton Accords ended the country’s civil war, but left it with a socialist bureaucracy whose shortcomings were compounded by an unwieldy political structure. There is now a consensus in the country on the need to improve the regulatory environment for business, and a number of reforms are under way. However, this process did not begin until several years after the end of the conflict. One of the lessons of Bosnia-Herzegovina’s experience is that it is desirable to begin such reforms as soon as possible (Bray 2004). This lesson has wider application. Policy-makers should not wait until the physical infrastructure has been repaired before beginning the reform process. Among other ingredients, this should include a particular emphasis on anti-corruption initiatives.

In assessing the prospects for investment, it is important to have a sense of realism. Peace, security and regulatory reform facilitate commercial opportunities but do not create them. Regardless of the sector, there is an obvious difference in the scale of the opportunities that are in due course likely to present themselves in Iraq compared with those in Afghanistan, Timor-Leste or Liberia. In the latter countries, the majority of investments are likely to come from regional, diaspora and niche companies. If policy-makers wish to encourage foreign investment in post-conflict economies, they need to take special consideration of the needs of smaller companies rather than pinning their hopes exclusively on the larger, better known international firms.

Among other things, smaller companies typically need better access to finance. MIGA, the World Bank’s political risk insurance agency, recognizes this point in that it aims to increase the number of its SME clients, and to promote investment in post-conflict countries. MIGA uses similar environmental and social safeguard guidelines to the IFC, and conducts its own assessments for war and civil disturbance risk before deciding whether to issue guarantees for particular projects, although the details are normally confidential. In July 2004, it set up a special Afghanistan Investment Guarantee facility in association with the Asian Development Bank (ADB), and this will provide political risk insurance with coverage capacity of up to $60 million. Much of this cover may be used to support SMEs.

All companies—large or small—need access to information. Even in the best cases, countries typically suffer from a ‘reputation’ lag for several years after the end of a conflict. Residual fighting will continue to damage the host country’s international reputation, even if it takes place in remote areas. It is important to publicize commercial success, for example the advances of the mobile phone companies in Sierra Leone, as a means of encouraging other investors. Small companies in particular may need help in identifying local partners.

**Doing No Harm**

Like aid projects, commercial enterprises are subject to the law of unintended consequences. Both business development and aid can and should promote economic recovery. However, individual projects may, if badly designed, exacerbate social and political tensions rather than alleviating them.
Some of the most important analysis on this theme, focusing on the impact of aid, comes from within the development community. Mary Anderson’s study *Do No Harm* (1999) discusses how ‘aid can support peace or war.’ Aid may support war if—however unintentionally—it frees up economic resources that can be used for the pursuit of conflict, or if it appears to give preferential treatment to one social group/warring party at the expense of another.

In presenting a framework of analysis to help aid agencies assess their potential impacts on conflict, she places particular importance on ‘connectors’ and ‘dividers’. ‘Connectors’ include projects that bring people together through a shared interest in a common objective. An example would be the construction of a road that is in the common interest of all communities. ‘Dividers’ reinforce social fragmentation. Applying some of the same principles to business, Anderson argues that ‘the-day-to-day activities of companies have effects in the societies where they operate and… these can be either positive or negative, but never neutral’ (Anderson 2002).

**Conflict Impact Assessment**

Greater awareness of the risk of ‘doing harm’ has led to increased interest in the concept of conflict impact assessment as a sub-category of social impact assessment. The UN Global Compact, which was formally launched by UN Secretary-General Kofi Annan in 2000, took up this theme in one of its first dialogues between the UN and representatives of the private sector. In 2002 the Compact published its *Business Guide to Conflict Impact Assessment and Risk Management in Zones of Conflict*.

Meanwhile, researchers and NGOs have been taking this idea forward by developing new conflict impact assessment tools. For example, International Alert will publish both a Macro-level and Project-level Conflict Risk and Impact Assessment tool as part of its forthcoming *Conflict-Sensitive Business Practice Toolbox for Extractive Industries*.

One of the most important requirements of any conflict risk assessment is to understand the impact of the foreign company’s local connections. Connections start with the host government. The Danish Institute of Human Rights (DIHR) has produced a guide on *Deciding Whether to Do Business in States with Bad Governments*. It takes a nuanced view: companies should take care that their operations do not legitimize ‘egregious violators of human rights’.

International petroleum and mining companies will find it all the harder to distance themselves from host governments because they often form joint ventures with local state-owned companies. Furthermore, the host governments often deploy state security forces to protect what they regard as strategic industries, and this is likely to reinforce public perceptions of the companies’ close links with government. And, as discussed, there is particular concern that large revenue payments may serve to reinforce the power of predatory regimes.

Similarly, in Afghanistan and Iraq, aid agencies and commercially-managed reconstruction projects aspire to bring benefits to the population as a whole. However, while they might like to think of themselves as ‘non-political’, they are often seen as agents of the interim administrations in those countries—and their foreign backers. In such circumstances the details of project design, and the degree of local consultation, will be particularly important. If the projects are seen to benefit only a favored minority, they will increase tensions rather than alleviate them. In Kosovo and Bosnia-Herzegovina companies will need to be alert to the risk of inadvertent links with organized crime. Making background integrity checks on potential business partners is good practice everywhere, and all the more necessary in current or former conflict zones.
The recruitment of local employees is another sensitive issue. Here companies often find themselves having to strike a delicate balance. Although it is important to hire local people so that they feel that they have a stake in the project, people with the right skills may not be available. From the perspective of the local population, recruits from one particular group, or of people from other parts of the country, may serve to reinforce tensions.

Finally, it is important to be sensitive to the interests of local communities: who benefits and who loses as a result of the company’s operations? Who should companies consult, and which leaders are truly representative? Corporate sensitivity to the interests of local communities can make the difference between life and death in conflict-affected countries.

**Corporate Responsibility and Peace-Building**

Like development projects, international companies may contribute to either peace or war, but on their own will serve neither as the sole source of conflict nor the sole remedy. The most important questions are how to minimize the risk of causing harm, and how to maximize the social benefits of their activities.

Most of the larger international companies now emphasize the importance of corporate social responsibility and this often includes charitable endeavors such as corporate sponsorships of educational or health programs. Such initiatives are important in their own right, but companies’ most significant social impact will come from the way that they conduct their core activities, and in particular from their local relationships. A key test will be the relationship between international companies and local businesses. In its recent report, the UNDP Commission on the Private Sector and Development (2004:30) refers to business ‘ecosystems’ and networks. International companies may be larger or smaller players in local ecosystems. They may act as predators, or they may provide a catalyst to other companies and entrepreneurs. If all goes well, their participation in local economic networks will contribute to sustainable, equitable development—without which, in any case, there will be little prospect of lasting peace.

One of the characteristics of conflict economics is that rival protagonists tend to see development as a ‘zero sum game’. In a divided society—for example post-war Bosnia-Herzegovina—one community’s commercial gain is often seen as a loss to its rivals. Business planners tend to see things differently. Bosnia-Herzegovina is in any case a small market, and social divisions risk making it even smaller—they need as many customers as possible, and look for the best employees, regardless of their ethnic origin. The logic of ethnic politics and the war economy is divisive—the logic of a more open economy is inclusive.

By presenting a vision of a different kind of future, where personal success comes from entrepreneurial initiative rather than military expertise, international companies and their local partners can help find a way out of cycles of deprivation and conflict. In the worst cases, companies can inadvertently fuel the structural causes of the conflict, undermining prospects of recovery. In the best case, their most important contributions may be not money, nor even expertise, but hope.
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