



# PRIVATE SECTOR DEVELOPMENT IN CONFLICT-AFFECTED ENVIRONMENTS

## KEY RESOURCES FOR PRACTITIONERS

Authors:

Lisa Curtis, Peter Davis, Canan  
Gündüz, Andrew Ockenden,  
Thomas Pedrick, Tony Vaux,  
Joost Van Der Zwan



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## **ACRONYMS AND ABBREVIATIONS**

CAEs	Conflict-Affected Environments
CAF	Competition Assessment Framework
DB	Doing Business
DCED	Donor Committee for Enterprise Development
DFID	Department for International Development
DRC	Democratic Republic of Congo
FDI	Foreign Direct Investment
GD	Growth Diagnostic
GTZ	Gesellschaft für Technische Zusammenarbeit
ICA	Investment Climate Assessment
IFC	International Finance Corporation
ILO	International Labour Organization
M4P	Making Markets Work for the Poor
NGO	Non-Governmental Organisation
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
PSD	Private Sector Development
QIP	Quick Impact Project
SCA	Strategic Conflict Assessment
WB	World Bank

# 1: Executive summary

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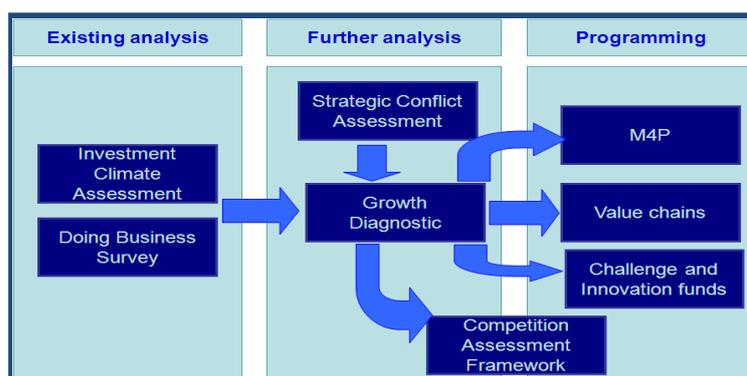
This publication is aimed at PSD practitioners and provides practical guidance on how to develop and evaluate PSD programming in conflict-affected environments (CAEs). It provides four main areas of guidance:

Section 2 provides an overview of what PSD programming should seek to achieve in CAEs. It argues that, in the past PSD programming has seen its impact as limited only to the sphere of economic development. Not only does this significantly underestimate the potential benefit of PSD in conflict, it also is a potentially dangerous oversight. This section argues that PSD programmes should seek to maximise their beneficial impact across all four aspects of peace-building: on economic development; on governance; on building security, stability and trust; and on developing infrastructure. Furthermore this section argues the importance of PSD at all stages of the peace-building process.

Section 3 sets out how to use this resource kit.

Section 4 provides greater insight into what precisely we mean by ‘conflict affected environments.’ This section argues that this definition applies to countries or regions where there is a high risk of violent conflict breaking out; that are in the midst of violent conflict; or have recently emerged from it, including countries classified as ‘post-conflict’. It offers a number of resources to help practitioners to better understand the nature of the conflict risk relevant to the countries where they operate.

Section 5 describes a range of 7 tools for PSD professionals to apply in CAEs. These tools are not new, and include many that will already be familiar to the readers of this paper, for example investment climate assessment, the growth diagnostic, and the competition assessment framework. What this section does is to explain how these tools might properly be applied in CAEs in order to maximise their effectiveness and make them as appropriate as possible for the specific circumstances of each location. Appendices A to H provide more detail on the use of each of these tools.



Finally, section 6 outlines a monitoring and evaluation framework for PSD in CAEs. Based on the DCED Standard on Results Measurement, this approach seeks to evaluate the impact of PSD programming across all four aspects of peace-building.

## **2: Introduction: What should PSD programming seek to achieve in conflict-affected environments?**

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### **2.1 Aim of this publication**

The aim of this publication is to help PSD practitioners to make better and timelier interventions in conflict affected environments (CAEs). Moreover, its aim is to ensure that PSD programming maximises the positive effect it can have on all aspects of conflict management and peace-building: on economic development; on governance; on building security, stability and trust, and on developing infrastructure.

A section 4 of this report makes clear, the ‘conflict-affected environment’ (CAE) can describe a wide range of places and contexts displaying very different challenges, some experiencing open armed violence, some not. As noted by GTZ<sup>1</sup>, “In the past it has often been assumed that development interventions can continue with “business as usual”, an attitude of working around conflict. Since the tragedy of Rwanda this is generally considered not to be a feasible option, but rather a strategy with a high risk of being harmful.” This resource kit recognises that PSD professionals need to be highly sensitive to the specific challenges of working in CAEs, and provides practical reference material for developing private sector development programmes in such countries. Section 4 helps practitioners to understand the different types of conflict environment they may face, and section 5 describes various tools that can be used. However, this resource kit is also designed to encourage PSD specialists to recognise and respond to two significant challenges:

- PSD programming needs to be an integral part of the conflict management process, not introduced as an after-thought later on. In fact, a failure to introduce PSD programming early enough can seriously undermine conflict management efforts.
- PSD has historically been seen as impacting only on the economic development aspects of peace-building. This not only underestimates the value of PSD, but also leaves open the dangerous possibility that PSD programmes could actually undermine other aspects of the conflict management process.

### **2.2 The importance of PSD in CAEs at an early stage**

Typically the early stages of post-conflict reconstruction are led by development actors in more mainstream functions such as humanitarian relief, rural development and education. The development of the private sector is not seen as a priority: this is a mistake. PSD programming needs to be a central to conflict management and peace-building at all stages. Ignoring PSD at runs the risk of undermining the effectiveness of the overall peace-building effort.

The case of Bosnia Herzegovina is a salutary demonstration of the importance of the private sector to the sustainable development of conflict-affected environments. Writing in

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<sup>1</sup> [Sustainable Economic Development in Conflict-Affected Environments: A Guidebook](#), BMZ/GTZ.

2005, one observer commented that "Bosnia is not only far from having a functional market economy: its economy still relies on foreign aid"<sup>2</sup>.|| Therefore 10 years after the Dayton Accords brought the war to an end, the international effort in Bosnia has yet to create a stable, sustainable state. Central to this failure is what Dutch economist Willem Buiter describes as "a dreadful business and investment climate."<sup>3</sup> Had PSD been integral to the development effort from 1995 would Bosnia's reconstruction trajectory have been very different, and the country's future perhaps now more secure?

The situation in Uganda presents an example of how PSD might significantly contribute to stability and development now that the conflict in the north of the country has been brought to an end. During the war, much of the population was displaced and many lived in IDP (internally-displaced persons) camps. Commercial activity thrived in these circumstances, but this has been brought to an end as people have been repatriated to their home villages. Would not PSD programming, to re-create some of the value-chains that existed in the camps, or which maximised the entrepreneurial talents that are present be a more appropriate approach to development in this area than more mainstream rural development projects?

### **2.3 PSD influences all aspects of peace-building and conflict management**

Where PSD programming exists in conflict-affected environments, it very often focuses exclusively on the domain of economic development. Although understandable, this approach means that the potential impact of PSD on conflict management is considerably under-estimated. The latest research demonstrates clearly that the private sector is be a vital tool when operating in conflict-affected countries, and that it impacts on all aspects of peace-building<sup>4</sup>.

There is much debate in both academic and practitioner circles about exactly what tasks are involved in ensuring that post-conflict states do not descend back into war, or in maximising the chance of fragile states staying at peace. Authors differ in how they define they categorise the different sets of activity that are necessary. Ho-Won Jeong for instance defines four categories: security and demilitarisation, political transition, development and reconciliation and social rehabilitation.<sup>5</sup> The Coordinator for Reconstruction and Stabilization in the United States Department of State lists a similar set of five essential tasks: security; governance and participation; humanitarian assistance and social well-being; economic stabilization and infrastructure; and justice and reconciliation<sup>6</sup>. Building on this work DCED has developed its own four-part assessment of the tasks that make up peace-building, and which should form the focus of activity for donors in conflict-affected environments. The four tasks of conflict management are as follows:

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<sup>2</sup> Solioz, C. (2005). *Turning points in post-war Bosnia*. Baden-Baden: Nomos, p.112.

<sup>3</sup> Buiter, W. (June 2008). *Designing Effective Economic and Structural Reform Policies for Bosnia Herzegovina* Presentation to development community in Sarajevo, p.14.

<sup>4</sup> Davis, P. (Forthcoming 2011). *Corporations, Global Governance and Post-Conflict Reconstruction*. London: Routledge.

<sup>5</sup> Joeng, H-W. (2005). *Peace-building in Post-Conflict Societies*. London: Lynne Rienner, p.1.

<sup>6</sup> US Department of State (2005). *Post Conflict Reconstruction Essential Tasks Matrix*. Washington: U.S. Department of State, Office of the Coordinator for Reconstruction and Stabilization.

### **2.3.1: Building security, stability and trust**

The ability to move about freely and without fear of death or injury is obviously essential to a stable state. However, a peaceful society is one where there is sustained, durable stability and trust between different elements of society. PSD can contribute to this goal, perhaps by seeking to develop businesses that cross the ethnic or other divides which fracture society and threaten conflict. As Pickering observes that “workplaces (...) [are] better suited than neighbourhoods or voluntary organisations for building bridges. [They] create opportunities for repeated, horizontal interaction between employees”<sup>7</sup>.

### **2.3.2: Fostering good governance**

Fostering good governance, to ensure that the state is run for the benefit of all its people is obviously a key focus in conflict-prone zones, where frequently poor governance fans the flames of resentment that can lead to conflict. By ensuring that the private sector governs itself well, and adopts international norms of behaviour and reporting, PSD projects are able to reinforce in their field the wider governance message that other aspects of the development community are promoting. Ensuring that firms work through government structures means that pressure is maintained for these structures to be reformed and streamlined.

### **2.3.3: Creating the infrastructure of a modern society**

Infrastructure is usually seen as meaning hard ‘stuff’ such as bridges, roads, and power supplies. Particularly in post-conflict environments, re-building the infrastructure that has been destroyed by fighting is an early priority of the development community. However, central also to a modern, peaceful society is ‘soft’ infrastructure including education, healthcare, commercial value-chains and banking. These elements of soft infrastructure can be provided by the private sector. In Rwanda for example, a collaboration between the Dutch Ministry of Foreign Affairs, the Ministry of Agriculture and Heineken is creating a strong value chain for small local producers of maize.

### **2.3.4: Economic development**

The famous Collier-Hoeffler model is stark in its assessment of the link between low rates of economic growth and levels of wealth and a propensity for violence. However, it is not simply economic growth per se that is required. Economic growth needs to be broad-based, and provide benefits across society. The private sector obviously has a pivotal role to play in this in generating jobs, wealth and prosperity. In its work with SMEs and small entrepreneurs, the PSD community is well-placed to ensure that economic development is widespread, particularly in countries where the existence of resources such as oil can mean that otherwise wealth remains with a small clique.

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<sup>7</sup> Pickering, P M. (2007). *Peace-building in the Balkans: The view from the Ground*. Ithaca and London: Cornell University Press, p.116.

### 3: Using this resource kit

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The resource kit focuses on the tools commonly used by Private Sector Development (PSD) experts to inform the design of conflict sensitive donor programmes. These are not exhaustive, but are intended to cover a broad range of donor activity, and through covering the key issues be readily applicable to tools used by a wide range of donors. Its primary intended audience is PSD advisers, growth advisers and similar, from a range of different donors, who are leading the design of PSD or other economy-related programmes in CAEs. It may also be relevant for stabilisation<sup>8</sup> experts (both civilian and military), conflict experts and other development practitioners involved in PSD programmes in CAEs. For example, stabilisation experts may be involved in decisions on “Quick Impact Projects” (QIPS) or similar, which are frequently implemented with military support but should be linked to broader PSD/economic strategies.

The resource kit also provides references and hyperlinks to a range of other resources and tools that advisers may wish to consult when designing a specific programme. Additional resources are referenced in green boxes. Guidance notes are in pink, and a range of examples in light blue boxes.

**Resources:** The Donor Committee for Enterprise Development’s work on PSD in CAE :

The DCED promotes enterprise development, in developing countries. It is the forum in which member agencies exchange information about their PSD programmes, and agree guidance on good practice. For further information and resources, see <http://www.enterprise-development.org>.

Its [workstream on PSD in CAE](#), started in 2008, includes:

- Networking and knowledge exchange between member agencies;
- A detailed review of existing knowledge and practice;
- A regularly updated online database of resources.

Much of the work done by DCED members to date is reflected in this resource kit. In addition to the tools included in this resource kit, there are a range of other highly relevant donor resources, including:

- [Minimum Standards for Economic Recovery after Crisis](#), the SEEP Network, 2009.
- [Sustainable Economic Development in Conflict Affected Environments. A guidebook](#), BMZ/GTZ, 2009.
- [Local Economic Development in Post-Crisis Situations](#), ILO, 2004.
- [Employment Creation, Income Generation and Re-integration in Post-Conflict Settings](#), UN, 2009.
- [A Guide to Economic Growth in post-conflict countries](#), USAID, 2009.
- [A Rough Guide to Investment Climate Reform in Conflict Affected Countries](#), IFC, 2009.

The structure of the resource kit is as follows:

- Section 4 introduces different types of conflict-affected environments, and sets out some key principles for PSD programming in CAEs;
- Section 5 provides guidance on the relevance and applicability of the main PSD tools in CAEs;

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<sup>8</sup> This refers to “the process of establishing peace and security in countries affected by conflict and instability”, usually involving “external joint military and civilian support.” See <http://www.stabilisationunit.gov.uk/index.php/about-us/stabilisation-concept>.

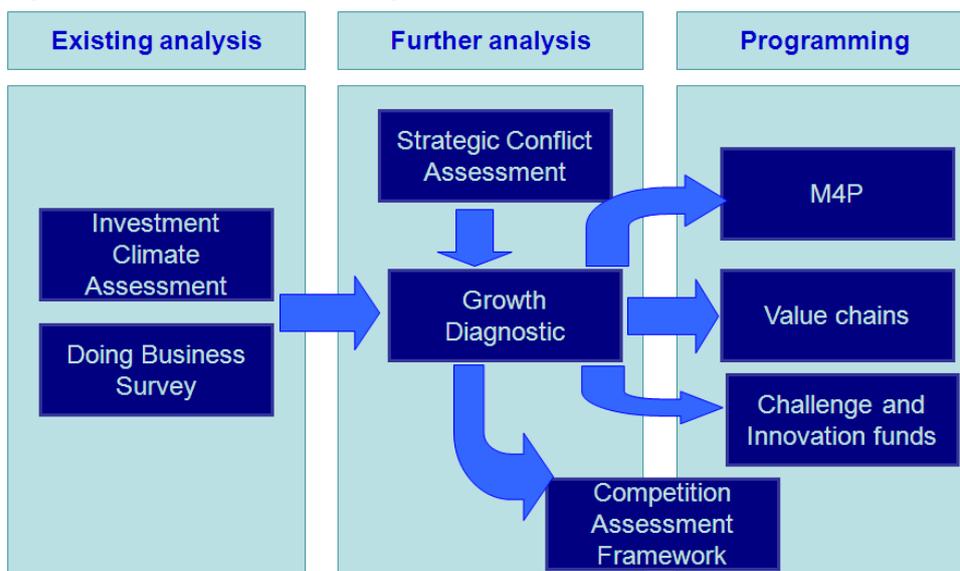
- Section 6 provides guidance on developing M&E frameworks that identify and capture the impacts of PSD on all aspects of peace-building
- The remainder of the resource kit is a series of appendices which provide detailed guidance for advisers using specific PSD tools in CAEs. Each tool has its own appendix presenting issues and considerations relevant for CAEs.

Each appendix can be used as a stand-alone guide to adapting a current PSD tool to CAEs. That said, sections 4 and 5 are recommended reading for all practitioners developing PSD programmes in CAEs.

Figure 1 sets out a schematic of the resource kit. At its core is the Growth Diagnostic, which section 2 argues should underpin PSD programming wherever possible. A range of other analyses can inform a growth diagnostic and the programming process. These can be divided into ‘existing’ analysis, and ‘further’ analysis. For the ‘existing’ analysis tools, Investment Climate Assessment and Doing Business, the resource kit recognises that a typical PSD adviser will not be able to influence their application, and focuses on how to interpret the results. For the ‘further’ analysis tools, the resource kit provides guidance on how to adapt them to take account of PSD and conflict issues respectively.

The remaining tools relate to programming - turning the analysis into action. These include the Making Markets Work for the Poor (M4P) methodology, value chains, challenge and innovation funds, and the programming elements of the competitiveness assessment framework. For these, the relevant sections of the resource kit provide specific advice for ensuring that the conflict context is recognised, and programming adapted.

**Figure 1: A schematic for using the resource kit**



## 4: Conflict-affected environments

### 4.1 Types of conflict-affected environments

**Note on definitions:** For the purposes of this resource kit we use the following definitions:

*A conflict-affected environment refers to countries or regions where there is a high risk of violent conflict breaking out; that are in the midst of violent conflict; or have recently emerged from it, including countries classified as 'post-conflict'.*

*PSD is a strategy that incorporates private industry and competitive markets into a country's overall development framework, to promote economic growth and reduce poverty.*

A 'conflict-affected environment' (CAE) can describe a wide range of places and contexts displaying very different challenges, some experiencing open armed violence, some not – currently ranging from Israel/Palestine, to Afghanistan, Iraq, Colombia and Somalia.

Conflict should not be seen as a separate issue that can be addressed in isolation from other issues such as human rights, the environment or sustainable development. Conflict is cross-cutting; it is a violent manifestation of tensions that may have arisen for a variety of reasons (e.g. human rights abuses, environmental scarcity or degradation, unjust governance, economic insecurity). It is essential that those working in conflict-affected environments ensure that their policies and practices are designed and implemented in a 'conflict-sensitive' way. This involves consideration of the spectrum of issues that may have, or may in the future, cause and trigger violence.

**'Conflict-sensitivity' involves three steps:**

1. Understanding and analysing the specific conflict context of a PSD programme;
2. Understanding the range of possible interactions between a proposed PSD programme and this context, and mutual impacts;
3. Based on this understanding, designing and adapting the PSD programme in such a way that minimises potential negative impacts, and maximises positive impacts, throughout the programme cycle.

Each tool in this resource kit helps users to collect information and guide them through these steps.

While conflicts defy neat categorisation, at the macro level it is possible to distinguish three broad scenarios that PSD advisers may face:

**1 - Latent conflict** - where there is currently no open armed violence, but where significant political, social and economic instability prevails

Characteristics can include:

- Political systems in transition, or characterised by chronic instability - e.g. frequent political deadlock, unstable government, repressive and/or exclusive politics
- Elite control over, and manipulation of, political and economic resources
- High degree of militarisation and/or availability of small arms and light weapons in society
- High degree of social unrest, including in protest against prevailing political, social and economic conditions
- Contestation or systematic violation of citizens' rights and entitlements
- Significant political, economic, developmental differences between specific regions or groups in society
- High degree of vulnerability in the economy to internal and external shocks
- Pockets or isolated incidents of violence

**2 – Open and sustained violence** – countries currently experiencing organised armed violence in parts, or all, of their territory.

Characteristics can include:

- Armed insurrections
- Civil wars
- Inter-state wars
- Foreign military occupation
- Genocide
- Wars in neighbouring countries that ‘spill over’

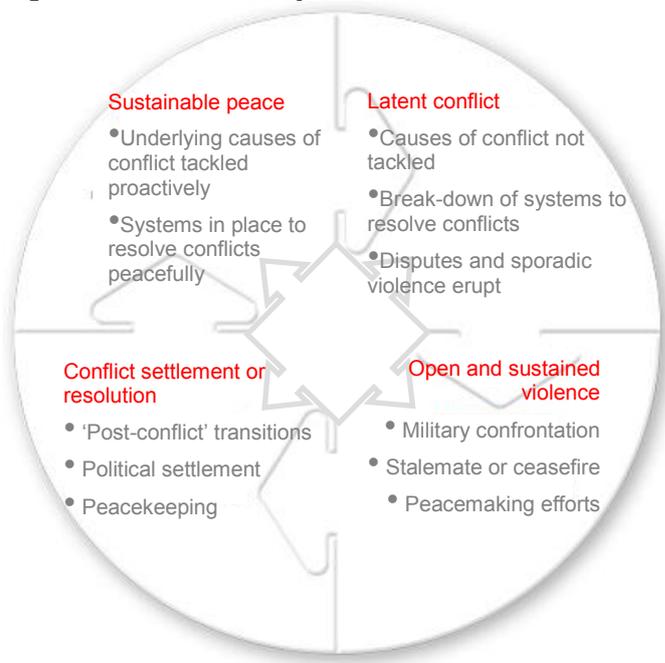
**3 - Conflict settlement or resolution** – countries that are currently transitioning out of armed conflict or have experienced armed conflict in the recent past.

These can include:

- Contexts with recent political or peace settlements and large-scale efforts at political, social and economic reforms in the aftermath of war
- Recent power-sharing agreements with new or transitional institutional set-ups
- Outright military victory of one side over another
- External military interventions to stabilise or keep the peace
- ‘No-war-no-peace’ situations where there is no open violence at present but prevailing military stalemate or ceasefire that may revert again to open warfare

The figure below sets out a typical cycle of conflict, including these three scenarios. Nevertheless, actual conflicts do not necessarily follow a predictable path from one phase to the next. Rather, conflicts evolve in different ways, alternatively experiencing progress and setbacks. The lack of linear progress helps to give the conflict a sense of intractability. Escalation may resume after temporary stalemate or negotiation. Escalation and de-escalation may alternate. Countries can become trapped in cycles of violence if underlying causes remain unresolved. They can jump between different ‘phases’. Negotiations may take place in the absence of a stalemate. However, these models are still useful, because most conflicts pass through similar stages at least once in their history.

**Figure 2: Phases and cycles of conflict**



All of these different conflict scenarios or phases, depending on their specific context, are likely to have features which impact on the environment for business or private sector development. Some (non-exhaustive) examples of possible features and impacts are listed in Table 1 below<sup>9</sup>.

**Table 1: Features of conflict-affected countries, and their impact.**

Feature	Impact
Recent violence and possible return to violence	Instability and lack of safety keep away investors and deter local start-ups
Displaced population	Large sections of the population under-employed or unemployed and consumers unsettled; both focused on survival, mostly in low-skill jobs
Destroyed infrastructure	Damaged roads, ports, power, and communication networks limit movement of people and goods and hinder production
Land ownership unclear, with successive regimes appropriating land, leading to competing claims.	Businesses unwilling to invest in long-term or high-capital projects
Short time horizon for the private sector	Businesses unwilling to invest in long-term or high capital projects
Capital flight, banks destroyed, low savings and high interest rates	Credit and insurance expensive and difficult to obtain
Fragmented markets, widespread informality, dependence on imports	Informal activity a misallocation of resources and goes untaxed
Key industries or sectors often monopolised by well-connected elite, private or public companies have limited operational skills and little desire to invest	Weak financial basis (debt and/or salary arrears), need for large initial capital investments, “cowboy” investors first to enter, predatory business practices.
Transitional government that is fragile, risk averse, and perhaps uncommitted to reforms. Missing incentives and political will for reform action	Low government capacity to deliver services, provide security, or create enabling business environment; high corruption, often through predatory behaviour by the public administration
Government harassment of businesses, low trust in government administration	Low investment, low productivity, and high prices for consumers
Government authority does not extend over entire territory, and national legislation and regulations not observed in all regions	Licence to operate needs to be secured in area of operations. Restricts development of national scale business.

## 4.2 Understanding the context of a conflict

Before attempting any programming in a conflict-affected environment, it is important to analyse and seek to understand the context of the conflict. The first OECD principle for engagement in fragile states is:

*“Take context as the starting point. It is essential for international actors to understand the specific context in each country, and develop a shared view of the strategic response that is required. It is particularly important to recognise the different constraints of capacity, political will and legitimacy, and the differences between: (i) post-conflict/crisis or political transition situations; (ii) deteriorating governance environments, (iii) gradual improvement, and; (iv) prolonged crisis or impasse.”*

There are many different ways of analysing conflict. DFID has recently published a briefing paper summarising various possible approaches. Appendix A of this resource kit

<sup>9</sup> This summary is adapted from the IFC’s [Rough Guide to Investment Climate Reform in Conflict-affected environments](#).

takes one of the most widely-used conflict analysis tools, the Strategic Conflict Assessment, and sets out some considerations about how it can be used in the context of Private Sector Development programmes. While donors use a range of specific tools for conflict analysis, these generally follow similar methodological steps. The key lesson for applying a conflict analysis tool as part of PSD programming is that it can be adapted to take account of PSD issues; however, it is important that a PSD expert is involved in the process.

A related aspect of the conflict context is its political economy. A sound analysis of a conflict context should include consideration of how economic and political power are controlled and used in a particular context, and what likely impacts this will have on development outcomes. Such an analysis should focus on the practical barriers to change and reform. A recurring theme throughout this resource kit is the need to ground programming in political economy analysis. Box 7 on page 28 sets out an example of the use of political economy analysis to complement a growth diagnostic.

There are also many different ways of defining PSD. Some practitioners view PSD as the provision of livelihoods. Some base their approach to PSD around economic growth, others see it as an incremental process in which livelihoods interventions drive growth. This resource kit takes a slightly more growth centric view – but many of the issues raised are still highly relevant to all approaches.

**Resources:**

[Political Economy Analysis How to Note](#), A DFID Practice Paper, July 2009.

[Working effectively in fragile and conflict situations: Briefing Paper A – Analysing Conflict and Fragility](#), DFID, March 2010.

[Principles for Good International Engagement in Fragile States and Situations](#), OECD, April 2007.

[How to involve the private sector in peace-building processes](#), Clingendael Conflict Research Unit, December 2009: Stresses the importance of early engagement with the private sector in parallel to humanitarian efforts, and provides practical suggestions of how to do this.

[Topic Guide on Fragile States](#), Governance and Social Development Resource Centre, February 2010 : This resource guide introduces some of the best literature on the causes, characteristics and impact of state fragility and the challenge of aid effectiveness and lessons learned from international engagement in these contexts.

### 4.3 Principles for PSD in conflict-affected environments

The broader principles for development and working in CAEs are all relevant to PSD programming in CAEs. It is important to devote effort to monitoring and evaluation from the very beginning, for example (see section 6), as with all development interventions. The ten principles outlined by the OECD for fragile states all apply, and the first OECD principle, of understanding the context and political economy of a conflict, is highlighted in the previous section. In addition, there are a number of further principles specifically relevant for effective PSD programming in CAEs:

**1. Flexibility.** CAEs and their private sectors are characterised by uncertainty and change. Rigid programming approaches, which cannot adapt to exploit opportunities or reallocate resources, are likely to be ineffective.

**2. The need for practical support** A donor focus solely on policy and technical advice will not lead to sustained change. Policy advisory work provides valuable injections of technical expertise and intellectual rigour, but can be directed at an audience that is not in a position to do anything with the advice.

**3. Recognising the trade-off between the short- and long-term:** For example, quick impact projects that provide employment to the youth can further reduce the labour supply to the private sector and increase wages. Or provision of food aid can reduce food prices, putting farmers out of business. Humanitarian and short-term responses are necessary. But where possible their effects on the long-term should be mitigated (for example setting wage rates fractionally below private sector rates), and the trade-offs should be explicitly considered when programming. There may also be trade-offs between peace-building and PSD objectives.

**4. Innovation** – Supporting local actors and businesses to lead reforms may require innovative approaches beyond the “formal” tools in this resource kit. This is particularly true in environments where there is no effective government. In these environments analysis and interventions at the “*meso*” level – i.e. a focus on a single region, administrative unit, or sector - can underpin macro-level studies, or deliver results more effectively than national business environment reform. Box 1 provides an example of working beyond the formal tools and processes in programming in Somalia. In working “beyond the formal”, donors can use business intelligence firms to provide analysis on key players in a sector, as has been done in the copper sector in the Democratic Republic of Congo. Or, in Afghanistan, the growth diagnostic has been adapted to study local processes and actors – including entrepreneurs – to underpin macro studies.

**5. Prioritisation:** Various tools can be used for identifying constraints to growth. But in CAEs many or all of these constraints may be present and binding. In these environments, analysis of issues must go further, not simply identifying constraints, but identifying which are the most pressing, and can feasibly be addressed to deliver tangible results. This is one area where political economy and conflict analysis of proposed interventions is critical at an early stage. Understanding the interests of all of the actors and stakeholders can help determine which activities are most likely to deliver the intended results, without creating distortions in other areas.

**6. Realism:** CAEs are characterized by fluidity, a rapidly changing political and security reality, and limited access to information. External assistance has a limited impact in these situations, and the risk of doing harm. Donors need to recognise the limited impact that their interventions have on the post-conflict development, and be realistic about what they want to achieve. Strict prioritisation is critical, as is avoiding the temptation of trying to do too much too quickly and overselling the ability to deliver change.

**7. Risk acceptance:** Linked closely to issues around “realism”, it is important to recognise up-front the risks associated with engagement in CAEs, and be willing to accept some of these risks as part of a decision to engage. Too often donors put in place mitigation measures that effectively crowd out any positive benefits of an intervention (accountability/fiduciary standards, procurement etc). Risk assessments are critical.

**8. Coherence and coordination of international response:** CAEs are characterised by extremely weak national capacities to manage and coordinate development assistance. To avoid a fragmented and incoherent approach, international actors need to look at the totality of their programs to ensure that everything is integrated and meet the overall strategic objectives of the post-conflict period. PSD activities need to be integrated into these plans from the outset, and the positive benefits identified and spelled out.

## 5: PSD in conflict-affected environments

### 5.1 The contents of the PSD resource kit

The table below summarises seven tools typically used by PSD advisers.

These are generally used either as a diagnostic tool – to help PSD advisers pinpoint where to focus their efforts; and/or as a programming tool, taking PSD advisers further along the process of deciding where to intervene and what activities to propose. All of the tools except the ‘Challenge and innovation funds’ involve some element of diagnosis. Typically, the tools focus on one or more of three levels of intervention in an economy:

- The policy level - usually focusing on laws and regulation;
- The sector/ market level – where the emphasis is on a particular sector such as mining or a particular market such as oil. This will often have policy implications, but through the lens of the sector/ market;
- The enterprise level – ranging from large formal companies to informal traders.

The different focuses of the different tools can therefore help advisers to decide which areas of government regulation to prioritise, which sector or sub-sector of the economy to focus on, or which part of a sub-sector’s value chain to support.

The tools are intended to apply to all contexts, which means they have not been tailored for use in CAEs. The table summarises the applicability of each tool to CAEs, and this is explored in more detail in the separate appendix devoted to each tool in turn.

Some countries in the midst of armed violence may nevertheless have conditions in place to pursue PSD programming; others may not have significant armed violence, and yet their high degree of political instability and institutional weakness makes PSD programmes difficult to implement. Therefore in each context, the specific conditions needed to design PSD programmes, and to use the tools included in this resource kit, need to be considered; these are summarised in the right-hand column of the table. It is important to note that these are not absolute – for example, some countries have precarious security environments and yet still have a flourishing private sector.

**Table 2: PSD tools**

Tool	What is it used for?	Applicability in CAEs?	Required Conditions
<b>Investment Climate Assessment</b> The World Bank’s Investment Climate Assessments (ICA) are comprehensive and data-intensive analyses of an economy’s private sector.	Diagnostic, with a broad focus on the policy level - primarily aimed at domestic investors	Attracting investment is crucial – this is particularly true in countries where conflict may have discouraged investment.	Data availability and presence of local partners to gather data  Basic security to enable data gathering  Access to private sector, and their willingness to participate in surveys.
<b>Doing Business</b> The World Bank’s Doing Business (DB) survey benchmarks 183 countries’ investment climates. Ten sets of indicators document the extent of regulation, the time and cost to firms of	Diagnostic, with a broad focus on the policy level – primarily aimed at international investors	A sound business environment is important for growth in all contexts. DB can be useful to identify areas for government reform, and to develop a pro-reform constituency.	Presence of local partners to gather data  Basic security to enable private sector activity  Functioning govt. administration at central

regulatory compliance, the extent of legal protection available to investors, the effects of employment regulation on economic flexibility, and the impact of the tax regime.			or sub-national level.
<b>Growth diagnostic</b> Provides a framework for systematically identifying the key constraints to growth in an economy.	Diagnostic, with a focus on policy and sector/market levels	The fundamental requirements for a functioning economy still apply in CAEs. Economic growth can help reduce the risk of conflict, including through tackling underlying causes such as inequitable distribution. On the other hand, economic growth can make distribution of wealth more inequitable, thus potentially exacerbating the risk of conflict.	Presence of local partners to gather data  Availability of relevant data from reliable sources.  Functioning central government and related institutions  Basic security to enable private sector activity
<b>Competition Assessment Framework</b> The CAF is a diagnostic tool based around sets of questions for identifying competition barriers caused by: the structure of the market; entry barriers, and anti-competitive conduct.	Diagnostic, with a narrow focus on the policy level  Programming, with a narrow focus on the policy level	Conflict is likely to exacerbate pre-existing barriers to competition; and create new ones. Where economic competition is perceived as unfair, or there are rent-seeking opportunities from bypassing competition, this can cause conflict.	Functioning central government  Basic security to enable private sector activity
<b>Making markets work for the Poor</b> M4P is a core tool in donors' portfolio of approaches to PSD. It is an <i>"approach aimed at effectively and sustainably improving the lives of poor people by understanding and influencing market systems"</i>	Programming, with a focus on the sector/market level,  Diagnostic to inform programming, with a focus on the sector/market level	M4P has a particular focus on poverty reduction. Poverty reduction can help reduce conflict risk where poverty coupled with inequity and discrimination has been an underlying cause.	Basic security to enable private sector activity  Sufficient security to permit long-term engagement by implementing team.  Key markets functioning, but with potential to increase accessibility for the poor and marginalised
<b>Value chain</b> Value chain tools set out approaches to identifying which value chains (ranges of activities required to bring a product/service from conception, through production, to delivery to	Programming, with a focus on the sector/market and enterprise levels,  Diagnostic to inform programming,	Conflict may break the systems, processes and relationships that link a value chain. Restoring these linkages, or making them more effective, can foster growth, and also create linkages across communities, groups and	Basic security to enable private sector activity  Viable market opportunities

final consumers and disposal after use) in an economy should be prioritised, and potential entry points within a value chain.	with a focus on the sector/ market and enterprise levels	regions in a way that can reduce the probability of conflict.	
<b>Challenge and innovation funds</b>  Challenge and innovation funds seek to leverage business activity in a way that stimulates growth and development, by encouraging private sector actors to become active in areas or countries where they previously under-invested	Programming, with a focus on the enterprise level	Attracting investment and encouraging innovation is crucial – this is particularly true in countries where conflict may have discouraged investment. In addition, the tool in appendix H recommends way of ensuring such investment is conflict-sensitive.	Few – but if no basic security then business opportunities will be limited.  Safeguards need to be in place to ensure that investment mitigates against potentially negative social, environmental, and conflict risks.

## 5.2 When should which PSD tools be used?

Private sector development in all contexts is challenging – but many challenges are even greater in CAEs. For example, in these environments government is less likely to have the capacity to play its role in regulation, enforce market rules, or more generally enforce the law. The private sector will also be affected by conflict, with direct and indirect security costs making production less competitive, a lack of access to investment financing, and depleted human capital reducing the effective labour force.

It is not possible to provide a blueprint for programming. A resource kit such as this cannot be used mechanistically to deliver a programme design, and does not provide programming answers for all scenarios. The intention is that a PSD adviser can move along a path of analysis and questioning that should result in conflict-sensitive programming.

Using the simple typology set out in Section 2, it is possible to indicate when individual tools might be most appropriate and when they might not be appropriate. The broad message is that most PSD tools are suitable for use, with some adaptation and care, in situations where conflict is at risk of emerging or re-emerging; however, in the middle scenario of ongoing violence, the range of appropriate tools is reduced.

**Table 3: Suitability of PSD tools in different conflict situations**

	<b>Which tools?</b>	<b>But...</b>
1. Latent conflict	Growth Diagnostic, Doing Business, Investment Climate Assessment, M4P, Value chain, Competition Assessment Framework, Challenge and innovation funds	All the diagnostic tools may prompt actions to change the status quo, which may then either help reduce the risk of conflict but may also run the risk of igniting it. Adopting a blanket 'Do no harm' approach may lead to a decision not to do anything, and so advisers should be careful to weigh these possible downsides against the potential upsides.
2. Open and sustained violence	Value chain approaches. The Growth Diagnostic approach may be used – in particular in parts of the country emerging from conflict.	The challenges of data gathering are particularly acute during conflict, and may require short-cuts such as workshops rather than surveys or face-to-face interviews.

		Value chain actors during open conflict are likely to suffer from restricted access to markets and heightened safety fears, and the value chain analysis may need to be split into the 'current' conflict situation and a hypothesised future settlement situation.
3. Conflict settlement or resolution	Growth Diagnostic, Doing Business, Investment Climate Assessment, Value chain, Competition Assessment Framework, Challenge and innovation funds	Judgment is needed here as to how robust the 'peace' is. If it is felt that there is a window of opportunity to implement changes that affect the balance of economic power, then the full range of tools may be appropriate. If, however, the situation is still extremely fragile, a narrower range of tools such as those under 2 above should be used.

The choice of tool will also be affected by the preferences of the donor – both in terms of which methodologies they are most comfortable and familiar with, and in terms of their ideological approach. Some donors may prefer to tackle the issue of poor infrastructure directly by financing the building of transport or power infrastructure; some donors may resist an approach focused on strengthening competition and regulation as these are not well entrenched in the donor’s domestic environment; some donors may want to confine any PSD programme to working with the Government side whereas others may want to focus only on the enterprise/entrepreneur side.

Assuming that an adviser is able to choose from all the seven tools contained in this resource kit, the following further considerations apply:

- Doing Business (DB) and Investment Climate Assessment (ICA) have some degree of overlap – it is unlikely that a donor would commission work on both of these. Both also overlap to some degree with the Growth Diagnostic, and in most cases if a decision were taken to adopt a Growth Diagnostic approach, there would be little point in commissioning separate DB or ICA work, although any existing analysis from DB and/or ICA studies would be a useful input into a Growth Diagnostic.
- The Competition Assessment Framework is a narrower, more specialist tool, and can be seen as a way of addressing one of many possible constraints to growth which may emerge from a Growth Diagnostic. It is best suited to contexts where institutions and human capital are stronger. It may also be focused on selected sectors, and hence a useful supplement to Value Chain Analysis.
- M4P and the Value chain approach also have some similarities – in fact, the value chain approach can be seen as a sub-set of the M4P approach. Again, a donor would be unlikely to adopt both at the same time. Both have the advantage of leading to support for specific business and markets whose impact can relatively easily be demonstrated.
- Challenge and innovation funds are the only tool explored in this resource kit that focus purely on the private sector. They are therefore particularly appropriate where there is little or no functioning national or regional government, or where donors want to avoid supporting a particular government.

Whether some of these PSD tools are better than others in the specific context of conflict-affected environments is hard to pin down, as each CAE is different. Overall, however:

- Between the three primarily diagnostic tools, the Growth Diagnostic appears best

suited to CAEs. It can provide more detailed analysis of the causes and effect relationships behind constraints to growth, and can easily be combined with a political economy approach. Its framework can also be used in a simplified way if data gathering is not possible in a conflict situation. The tool is perhaps the best way to organise information into a structured framework. It can both inform what types of programming are likely to be most effective, and identify issues for the design process. It appears to be the best starting point for PSD advisers in CAEs.

- Of the other tools, the value chain approach has particularly strong benefits when used in CAEs – regardless of what phase the conflict is in. Value chain analysis can inform and reinforce conflict analysis, and directly address possible causes of conflict. It is particularly helpful for leading advisers to prioritise particular sectors and to justify the decision to prioritise. The M4P tool is also well suited for CAEs, but is more comprehensive, more ambitious, and more difficult to implement in practice – which reduces its attractiveness in CAEs.
- Challenge and innovation funds offer a different approach to the traditional diagnostic one. They offer an option of not seeking to understand all the root causes of a problem (which may not ultimately be feasible), but rather to experiment with solutions that may make more of a difference on the ground in a conflict situation. Organisations proposing such solutions can still be required to demonstrate that their proposals will address root causes of a conflict, and that they will not inadvertently exacerbate a conflict.

**Box 1: Experience of PSD programming in Somalia**

The process of designing a PSD and employment generation programme in Somalia exposed some misconceptions in conventional thinking about what interventions are possible in CAEs.

The design team focused on identifying market development opportunities in Somaliland, where there is stability and a credible local administration, as well as a number of thriving (if unregulated) sectors with significant export potential. The design team's challenge was to identify sectors where donor interventions would support private sector activities to correct market failures, leading to growth in the sector and more jobs. A secondary objective was to expand the geographic presence of the sector, providing jobs and business opportunities in a wider area.

Early consultations with businesses already active in several sectors revealed an unexpected level of sophistication and understanding of international markets amongst the larger players. This was evidenced by a request for support in developing sector-level regulation, particularly standards certification and fair-trading practices, as well as the creation of public institutions able to independently certify product standards for export markets. These consultations took place in the context of preliminary value-chain diagnostic research during a World Bank project identification mission.

The lesson from this experience is that in environments where work on improving the investment climate may seem premature, there may be pockets of demand for regulatory reforms to support the growth of specific economic activities. This can be a valuable entry point for wider investment climate work.

However, an important political economy consideration is how activities that strengthen a state-level administration will be seen by central government actors, or indeed by different market players with competing political allegiances.

## 6: Monitoring and evaluation

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### 6.1 Introduction to the DCED Standard

As mentioned in the introduction, DCED has developed a Standard for Results Measurement in PSD programmes; at the time of writing, the DCED is exploring how the Standard needs to be nuanced, to be applicable in conflict-affected environments. However, the essential elements of the current Standard are broadly applicable as they stand, so they are briefly described below.

The DCED Standard for Results Measurement is built around the logic of the individual programme: why is it doing what it is doing? All programmes at least ought to have this logic, even if only in the mind of the programme managers. However, this logic is not always made explicit: the aim of the DCED Standard is to provide a process to do this – to help managers articulate the logic of their work in more detail. At the heart of the process is the idea of the ‘results chain’, which the OECD defines as follows:

*“The causal sequence for a development intervention that stipulates the necessary sequence to achieve desired objectives – beginning with inputs, moving through activities and outputs, and culminating in outcomes, impacts and feedback. In some agencies, reach is part of the results chain.”<sup>10</sup>*

Fundamentally therefore, the DCED Standard is not simply a process for measuring a programme’s impact *post facto*, but more importantly is a tool to help managers conceive and design their projects more effectively from the beginning, and to be clearer about what the outputs of those projects should be. Results chains are at the core of the Standard: everything else builds on that programme-specific logic. Each step of the chain contains assumptions about what will happen as a result of a programme’s activity. The Standard provides a framework within which these assumptions can be tested and validated.

#### 6.1.1: Impact indicators

The Standard recommends only three universal impact indicators that all programmes should use, in order to make aggregation of impacts across a portfolio of programmes possible. These reflect the aim of PSD programming to create and develop private enterprise in developing economies, and to use that as a basis for wider economic development:

- Scale: how many enterprises realise a financial benefit from the programme’s activity each year, and cumulatively.
- Net income: The net additional income gained by target enterprises as a result of the programme per year and cumulatively. Projects are also required to demonstrate how this income is likely to be sustainable over time.
- Net additional jobs created: How many jobs have been created by the programme, again per year, and in total.

Individual agencies and partner countries may of course adapt these or other standard indicators, according to their needs and interests. The key point is, however, that impact can only be aggregated if the same indicator is measured in a consistent way across the portfolio.

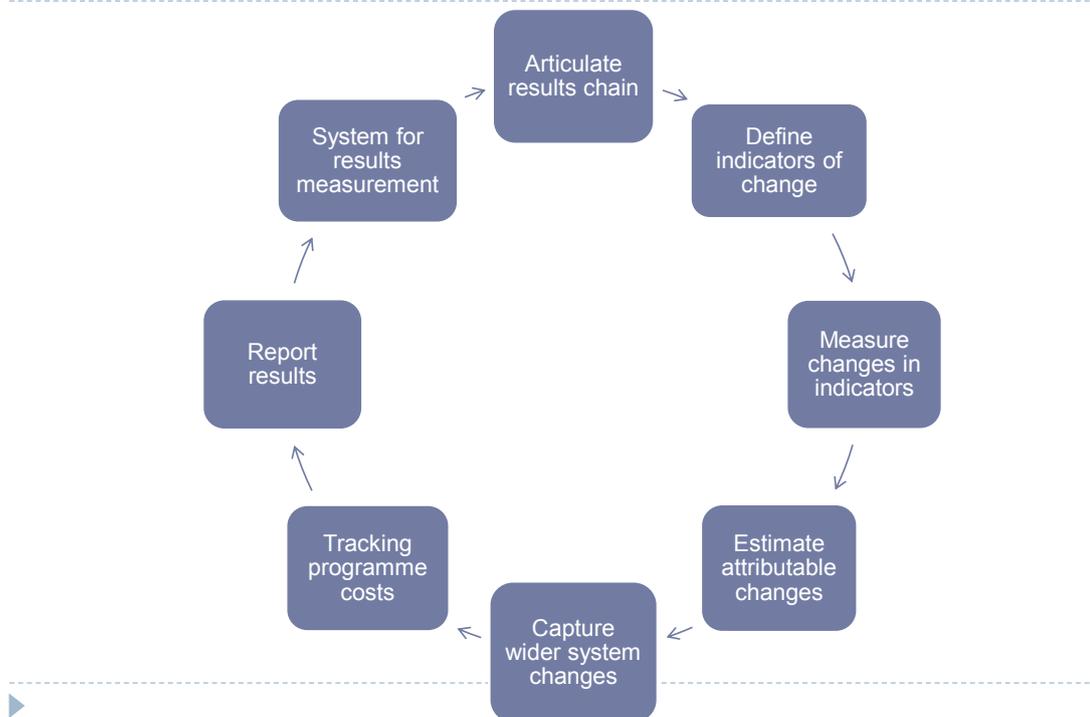
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<sup>10</sup> OECD/ DAC (2002). *Glossary of Key Terms in Evaluation and Results-Based Management*, Paris:OECD, p.2.

6.1.2: How does the Standard operate?

The stages of the process to use the Standard are as follows:

## DCED Standard



These steps are defined as follows:

- Articulate the results chain: a documented results chain is developed which needs to show, logically and realistically how the proposed interventions will lead to the achievement of the programme’s development goals.
- Define indicators of change: What indicators will demonstrate that the anticipated results have occurred, at each key step in the results chain. These indicators can be qualitative as well as quantitative.
- Measure changes in indicators: A clear plan needs to be in place to capture baseline data on the selected indicators. A robust way for assessing changes in these indicators then needs to be developed, and implemented in line with good practice.
- Estimate attributable changes: Where changes are witnessed in the key indicators of change, a project needs robustly to demonstrate the degree to which these changes were the result of the project intervention rather than other factors.
- Capture wider system changes: To what extent has the specific project led to a system change in the wider society? Again, this change can be demonstrated through both qualitative as well as quantitative means.
- Tracking programme costs: An accounting system needs to be in place to track the costs on an annual and cumulative basis.
- Reporting results: Even if a report is internal, rather than for public consumption, reporting should take place at least annually, stating changes that have occurred in

the key indicators, and the degree to which these changes can be attributed to the programme

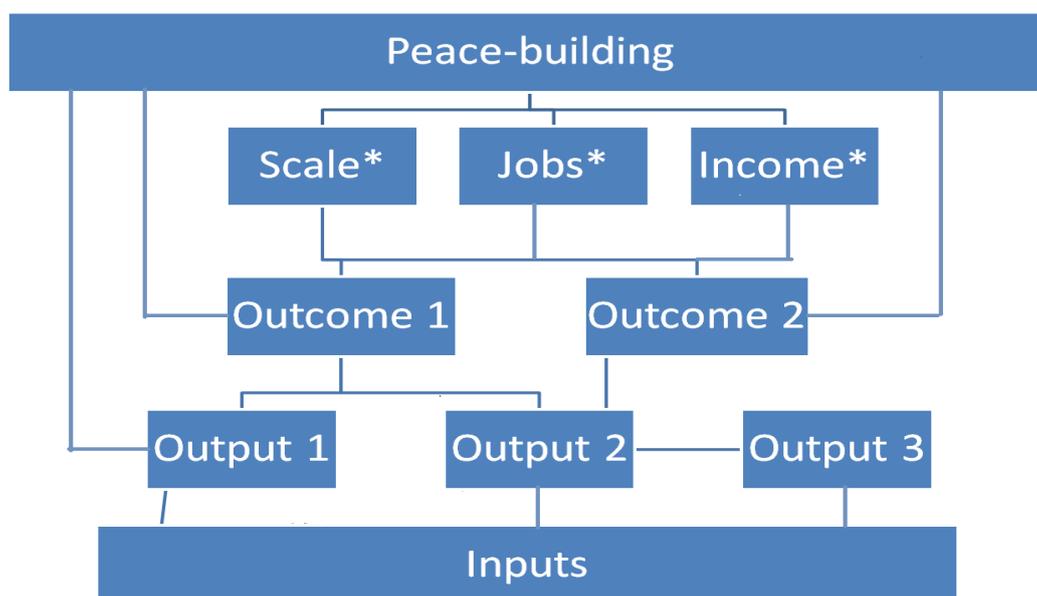
- Systems for results measurement: The programme needs to document the system for measuring changes in the key indicators.

As has happened with corporate reporting, DCED is beginning an audit process, to provide external verification of the process and its various stages. Whether or not this information is made public, it provides third party validation of how well a programme is being run, and will highlight changes that to improve a programme that the management team may have missed.

## 6.2 Applying the DCED Standard to CAEs

As made clear in the introduction, good PSD programming in conflict-affected environment will seek to optimise the impact of activities not just on economic development, but also on the other three facets of conflict management: building stability, security and trust (SST); governance and infrastructure. The essential logic of this approach is that both outputs and outcomes need to be monitored for their possible impact on other aspects of peace-building, rather than only focusing on the economic development facet. However, these indicators too need to be seen in the context of their impact on the overall peace-building effort. This logic is represented in the following diagram:

Fig 6.2: Simplified results chain for PSD programmes in CAEs



\* Scale, jobs and income could be disaggregated or targeted to ensure their optimal impact on all aspects of peace-building

Examples of how this might work are contained in Appendix I. However, the development of a robust M&E framework needs to be based on proper case study research. Work is currently in progress, under the auspices of DCED and with leadership from IFC, to provide such a basis.

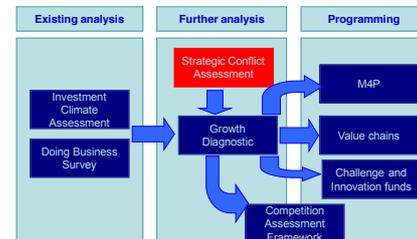
## Appendix A: Strategic Conflict Assessment

### A.1 Overview of the Strategic Conflict Assessment (SCA)

**What is the tool?** The SCA is a mapping tool enabling users to analyse a conflict, assess conflict-related risks and identify opportunities or blockages to conflict-sensitive programming.

**Why is it relevant to PSD in CAEs?** Application of the SCA can ensure that PSD programmes take account of the conflict context, and where appropriate explicitly address conflict issues.

**What are the key lessons for applying it?** The SCA tool is comprehensive, and as such can be adapted to take account of PSD issues. However, the results will reflect the issues raised, and so it is vital that a PSD expert is involved in the process if the SCA is to be used to set the context for PSD programmes.



SCA is used widely in multi-donor conflict assessments because it uses an open-ended ‘mapping’ rather than on more prescriptive ‘questions’ arising from the experience and policies of a particular donor. It is a comprehensive method, giving equal weight to security, political, economic and social factors. This allows adaptation to different purposes, or specific issues, for example PSD. The SCA rationale is that every conflict is different and guidance should be based on specific rather than generic models.

The open-ended nature of SCA means the conclusions will focus on the interests of the team applying it. Its usefulness for PSD programming will be determined by the extent to which the PSD programme designer engages in the process. While some donors use different conflict analysis tools, these generally follow the same methodological steps as the SCA, and so the guidance here is relevant.

**Resource:** For details of this method of conflict analysis see [Conducting Conflict Assessments: Guidance Notes](#), DFID, 2002.

An SCA can generate:

- Principles to guide conflict-sensitive programming and for assessing the relevance of programmes to conflict;
- Identification of new programmes addressing conflict factors.

### A.2 Sensitising SCA for private sector development

The sections below set out the SCA process, highlighting areas where PSD input may be appropriate. The section concludes with some specific issues that a PSD adviser may consider inclusion in the ToRs for an SCA.

#### Box 2: Key points for sensitising SCA for PSD

- SCA includes a focus on economic factors providing a direct opening for a PSD focus;
- Effective SCA is a participatory process, providing opportunities for staff to engage in the analysis and ensure that PSD is properly considered;
- SCA can be used to generate principles for conflict-sensitive aid, and these can be focused on economic or PSD concerns;
- SCA can be used to model PSD related conflict factors;
- The study of dynamics within the SCA process can be focused on economic interests by using the ‘Greed and Grievance’ approach (see below);

### A.3 The SCA process

The first part of the SCA process is mapping the causes of conflict (including potential causes of conflict and factors relating to conflict, such as past history). This is summarised as a table or 'conflict map'. Some typical examples have been included in Table 4 below.

**Table 4: Factors relating to conflict**

	Security	Political	Economic <sup>11</sup>	Social
International	Regional interference		Sanctions, or insecurity hampering trade; No access to international finance	
National	History of war	Unfair elections; <b>Discrimination against 'opposition' areas</b>	Growth held back by poor legal framework; poor infrastructure; poor regulatory environment; missing financial markets; <b>Unequal development</b>	Religious tensions
District	Local militias outside government control	Patron-client relations	Local rivalries disrupt linkages required for value chains, leading to a focus on low value-added activities	Religious and ethnic discrimination
Local	Lack of access to justice; <b>Availability of arms</b>	People lack experience of democratic practice	Insecurity prevents travel to markets; <b>Unemployed, alienated youth</b>	Caste rivalry

Issues directly relating to PSD are likely to appear most explicitly in the 'economic' column of the SCA analysis. But these will need to be linked to issues in other columns in order to reflect the nature of the problem. Likewise, in conflict contexts, 'non-economic' conflict causes and impacts (for example, continuing insecurity, or rises in crime levels) will inevitably affect the private sector's ability to recover from war. For example, unequal economic development in different parts of a country is often cited as a cause of tension and may be the main focus of a PSD intervention. However, this may only turn to violent conflict if other factors become involved, such as deliberate political exclusion or discrimination along ethnic or religious lines.

Creating a simple model of these interactions, will inform a better understand of the range of issues that need to be addressed, and hence programme design and planning – and linkages with other programmes. For example, the bold text in Table 4 implies that a PSD programme focused on unequal development should also take account of social discrimination (i.e. it may be necessary to target certain groups) and challenge political bias. It should try to target unemployed youths and will need to link up with other programmes such as arms control.

### A.4 Changes in the conflict context

The SCA framework provides an excellent snapshot of a current situation. But in CAEs the situation is likely to evolve. Any programme that does not seek to understand these change dynamics is likely to be ineffective.

A range of methods can be used to assess dynamic trends. One of these changes is to

<sup>11</sup> Appendix G,0 on value chains, provides more detailed examples of the value chain disruption caused by conflict. Appendix H, on M4P0 provides more examples of other market failures linked to conflict.

map dynamic trends by examining the interests of the key actors. In the economic sector, the control of valuable resources, such as oil, may be a key interest driving conflict. Economists have used the term 'Greed' to describe the pursuit of such an interest in defiance of all other interests and norms. The reaction to 'Greed' has been characterised as 'Grievance'.<sup>12</sup> Understanding and mapping greed and grievance can help a programme designer to ensure that programmes have the flexibility to deal with change, and to anticipate the risks.

**Resource:** [Beyond Greed and Grievance: Policy Lessons from Studies in the Political Economy of Armed Conflict, Program on Economic Agendas in Civil Wars \(EACW\)](#), Karen Ballentine and Heiko Nitzschke, 2003:

This paper sets out key lessons in applying the greed/ grievance framework, and provides useful issues for PSD advisers to consider in applying the methodology.

## A.5 Sensitising SCA to PSD

Although SCA has the capacity to include PSD and economic issues, there is a tendency for conflict analysis to focus on political and security issues. A PSD adviser can influence an SCA (or other conflict analysis) process in the following ways:

### Inputs to the ToRs

- Specify what the PSD team would like to get out of the process, including the strategic M4P questions “*why isn't the market system providing solutions to the problems business face?*”, and “*who does what and why in the market context?*”;
- Ensure that major PSD issues are explicit in the ToRs and that the SCA is expected to provide guidance on these;
- Identify key private sector stakeholders for the interview list;
- Indicate the scale and scope of PSD interventions, including specific locations that the SCA team should visit;
- Indicate what scope there is for new programmes and any existing parameters;
- Identify existing concerns about conflict in relation to PSD.

### Inputs to the process

- Review conflict dynamics relating to PSD (see above);
- Initiate 'Do No Harm' tests for selected programmes/projects;
- Engage in the general process of analysis (this may include a workshop, for example) in order to ensure that PSD is properly considered;
- Monitor the progress and outputs of the team to ensure that these inputs have been taken into account.

### Inputs to the analysis and strategy development

- Ensure conflict impacts on the private sector feature in the analysis
- Ensure private sector roles as 'dividers' and 'connectors' are reflected in the analysis
- Ensure potential negative impacts from peacekeeping and peace-building interventions on local markets are mitigated in the strategy;
- Ensure that PSD approaches are integrated into the strategy.

**Resource:** [Conflict and Fragility: Do no Harm International Support For State-building](#), OECD, 2010: This paper provides practical guidance on applying the do no harm approach.

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<sup>12</sup> See Berdal, M and D Malone (eds) (2000). *Greed and Grievance –economic agendas in civil wars*, London: Lynne Rienner.

## Appendix B: Investment Climate Assessments

### B.1 Introduction

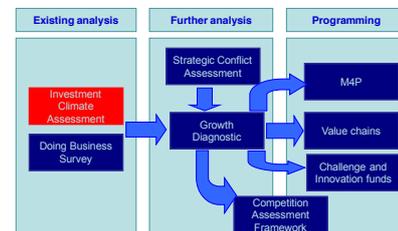
**What is the tool?** The World Bank's Investment Climate Assessments (ICA) are comprehensive and data-intensive analyses of an economy's private sector. The objectives of ICAs are to:

- Evaluate the state of the private sector;
- Identify the key constraints to increasing firm productivity;
- Evaluate how competitive firms are in a particular country relative to neighbouring countries or firms in other regions of the world;
- Identify policies that will improve firm productivity and competitiveness.

A database of ICA reports can be found [here](#).

**Why is it relevant to PSD in CAEs?** An assessment of current issues in the investment climate is an essential starting point to developing a strategic plan to address these.

**What are the key lessons for applying it?** The flexible nature of the ICA means that the questions asked of it can be adapted for a conflict-affected political context. In addition to ensuring this, practitioners in CAEs must ensure that the inputs to the assessment *represent the whole country* (not just the capital), both *formal and informal enterprise*, and that survey design encourages honest and accurate responses.



[A Rough Guide to Investment Climate Reform in Conflict-Affected Countries](#), IFC 2009.

This guide sets out the key principles for catalysing investment climate reform in conflict affected environments, as well as the programme cycle for diagnostics, planning, implementing and monitoring and evaluation for implementing reforms.

The surveys cover a broad range of business environment topics including access to finance, corruption, infrastructure, crime, competition, and performance measures. While there is no standardised methodology for ICAs, they build on the methodology for the World Bank's enterprise surveys, which are done for a wide range of countries and explore obstacles and demographics of businesses. However, an ICA will generally be adapted for the specific country context, and supplemented with additional surveys. For example in Nepal, IFC recently commissioned an Employee Survey and 5 further sector-level studies to build on the enterprise survey information in developing the ICA.

### B.2 Adapting ICAs to CAEs

The nature of ICAs - for example, that there is no standard methodology, and therefore they can be specified to be appropriate to their environment - makes them particularly well-suited to providing the basis for designing investment climate improvement programmes in CAEs. There are three general issues that must be addressed:

1. *The ICA needs to be representative of the private sector in the country, not solely the formal sector.* Standard enterprise surveys focus on formal, registered companies, with the selection of firms to be surveyed based on random sampling of a list of firms taken from government agencies (for example tax offices or business licensing authorities). ICAs have the flexibility to sample firms outside of this. For example, a sample frame can be created via block enumeration, where the World Bank "manually" constructs a list of eligible firms after 1) partitioning a country's cities of major economic activity into clusters and blocks, 2) randomly selecting a subset of blocks which will then be enumerated. In addition, other surveys, which depart from the usual enterprise survey methodology, can

be conducted. Examples include surveys of informal (unregistered) enterprises, and micro surveys, fielded to registered firms with less than five employees. This is particularly useful in CAEs where limited liability companies are rarely the dominant form of enterprise, and where central statistical databases may not have up-to-date information about activities outside the capital city.

2. *The ICA needs to be representative of the private sector across the country* In many CAEs access across a country is difficult. And given the linkages between conflict and the private sector, the economy in areas where access is difficult may be very different from that in other areas. In interpreting the results, the programme designer should look carefully at the geographical sample frame, and should also be willing to drill down into the results of surveys in specific regions – a general finding based on the overall results may mask significant regional variation.

3. *The ICA needs to address, or at least be explicit about systematic biases in the data collection* Unlike Doing Business, which relies on published information, ICAs are based on face-to-face interviews at firm level. The enterprise survey is answered by business owners and top managers. The need for sensitive survey questions addressing business-government relations and bribery-related topics means that the World Bank hires private contractors, rather than any government agency or an organisation/institution associated with government, to collect the data. Surveys are usually carried out in cooperation with business organisations, research institutes and government agencies promoting job creation and economic growth.

In order to ensure conflict sensitivity in this data-gathering exercise, particular care is needed around the selection of the private contractors who are engaged to carry out the service and of the business associations and government agencies who partner in the exercise. In interpreting the results of the ICA, programme designers should consider how this was done.

There are also two important practical issues. First, it might not always be feasible to conduct a full ICA. This could be because security considerations hamper access – or the urgency of taking action in order to take advantage of a window of opportunity means that there is insufficient time to complete a full ICA. In these cases, a mini-diagnostic should be considered as an alternative.

Second, a narrow window of opportunity and limited ability to deploy resources makes prioritisation essential. A simplified ICA can be used to consider the importance/ impact of an issue, as well as the complexity associated with addressing it.

Box 3 gives an example of both these approaches from Nepal.

**Box 3: A "mini-diagnostic" of the Investment Climate, Nepal**

In April 2007 the IFC and FIAS required an [assessment of the Nepalese investment climate](#) to inform their programming. Given the urgency of needs, they carried out a mini-diagnostic, rather than a full assessment. This quickly flagged up the key issues, supporting a quick start to programming, and a clear focus for future more detailed work.

Recognising the range of needs, the assessment also divided reforms across two axes – complexity/ importance. This allowed programmers to focus first on less complex important issues – which were more likely to yield the quick wins that are so important for relationship development.

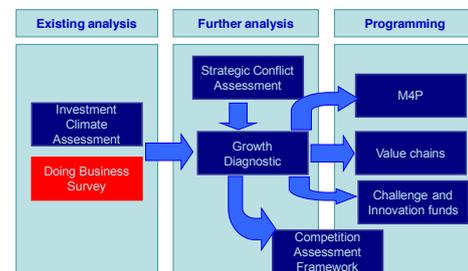
## Appendix C: Doing Business

### C.1 Introduction

**What is the tool?** The World Bank's Doing Business (DB) benchmarking of 183 countries is one of the most accessible, and widely used, measures of a country's investment climate. Ten sets of indicators document the extent of regulation, the time and cost to firms of regulatory compliance, the extent of legal protection available to investors, the effects of employment regulation on economic flexibility, and the impact of the tax regime.

**Why is it relevant to PSD in CAEs?** A sound business environment is important for growth in all contexts. DB can be useful to identify areas for government reform, and to develop a pro-reform constituency.

**What are the key lessons for applying it?** Both the way data is collected, and the types of data collected mean that the results of the DB survey must be interpreted alongside a range of other analysis – including relevant legal, regulatory and administrative issues.



### C.2 How can DB be used in CAEs?

Doing Business provides a useful benchmark for initial programme design in CAEs - but must be supplemented by other diagnostic tools. It is most useful as a tool for identifying areas of reform of government weaknesses, and for mobilising a pro-reform constituency. Appendix D, on the Growth Diagnostic, notes the self-reinforcing relationship between government failures and market failures, and the difficulty in determining which of these might be the underlying binding constraint. In such a situation an effective diagnostic approach might be to have a multi-track mapping exercise:

- DB methodology: maps out the official rules and procedures for a given area;
- Informality survey, ICA or similar: maps out actual practices and supposed rules as well as the extent of compliance (with both formal and supposed procedures);
- Market diagnostic: maps the effects on a given activity of full compliance with both formal and supposed rules;
- Political economy analysis: maps the drivers for compliance or avoidance for both formal and supposed procedures.

Implementation of regulatory reforms in CAEs can then be seen as a process of building credibility and legitimacy for government institutions. Structured public-private dialogue is essential to ensure that the migration to the new formal structure openly addresses the weaknesses of both the old rules and current practices.

Section C.3 considers how the general limitations of the DB methodology are applicable to CAEs. Section C.4 outlines specific issues, beyond those general limitations, which are of relevance to DB in CAEs.

### C.3 Limitations of Doing Business methodology

The limitations of DB methodology are well documented. An independent review carried out in 2008 summarises these. Box 4 below sets out the key limitations identified in the review, and highlights specific issues related to the application of DB in conflict-affected countries.

**Resource:** [Doing Business: An Independent Evaluation - Taking the Measure of the World Bank-IFC Doing Business Indicators](#), World Bank 2008. This independent evaluation of the Doing Business methodology provides detailed commentary on issues when using DB indicators.

**Box 4: Limitations of Doing Business methodology in conflict-affected countries**

Doing Business limitations	Specific CAE constraints
The collected data refer to businesses in the country’s largest business city, so may not represent regulation across the country.	Conflict may have created internal fragmentations so that regional or local enforcement of national regulations may be patchy.
The data often focus on a specific business form—a limited liability company (or its legal equivalent) of a specified size—and may not be representative of the regulation on other businesses, for example, sole proprietorships	Sole proprietorships and informal businesses may be the dominant business model. Limited liability structures may be more relevant to foreign investors than domestic businesses. Standard DB research may need to be supplemented to capture other business structures.
Transactions described in a standardised case scenario refer to a specific set of issues and may not represent the full set of issues a business encounters.	DB may miss some of the most important issues – for example business interruption caused by the politicisation of labour; or political interference in management decisions
The measures of time involve an element of judgement by the expert respondents	Times taken for administrative processes are difficult to estimate where administrative institutions have been damaged or are not well-staffed.
The methodology assumes that a business has full information on what is required and does not waste time when completing procedures.	Access to accurate information is frequently a significant barrier to compliance in conflict-affected countries. Both businesses and administrators can be unaware of the “real” rules”

**C.4 Specific issues applying the Doing Business methodology**

In addition to the issues above, there are specific difficulties in applying the DB methodology in conflict-affected areas:

**Data gathering:** DB relies on local professionals to gather data on the current legal and regulatory framework. In CAEs there may be limitations on the number and quality of professionals the World Bank is able to engage. In some cases, access to official records may require having the “right” connections or allegiances – an issue the selection process is not able to address.

**Data quality:** Contributors rely on published government information about extant regulations and licensing requirements. Conflict can result in the destruction of official records; changes in legislation, regulations or licensing rules may not have been fully disseminated, so that contributors are only able to access out-of date information.

**Institutional weaknesses:** Institutions weakened by conflict may have lost key staff; there may be little institutional memory of which regulations are the ones currently in force.

**Administration and enforcement:** While DB assesses formal regulatory rules, in CAEs, government institutions may have been so undermined that these have little relevance. Enforcement may be patchy, based on what has become common practice in the administrative functions of national or local government. There may be real administrative burdens on businesses that bear little relation to the documented rules and procedures.

**Box 5: An example of DB limitations**

The Doing Business Report for 2010 ranks Nepal 128<sup>th</sup> overall and 176<sup>th</sup> for Employing Workers. This compares with, for example, Sierra Leone, which ranks 148<sup>th</sup> overall, and 166<sup>th</sup> for Employing Workers.

The analysis is based on an assessment of labour laws and the regulatory framework. What these rankings overlook are the dynamics of labour relations that give a very different picture. In Nepal the propensity for workers to strike as a form of political protest has resulted in labour relations becoming one of the main constraints on doing business. Nepal's forthcoming Investment Climate Assessment conducted by the IFC aims to plug this gap.

**The audience:** Doing Business is implicitly aimed at foreign investors. However in CAEs, and particularly in the early post-conflict stage, it is likely to be returning nationals and the diaspora who are the first risk-taking investors. FDI is unlikely to flow to countries where its own nationals will not invest. DB then must be supplemented by research on the most relevant legal, regulatory and administrative issues to domestic investors and diaspora.

## Appendix D: Growth Diagnostic

### D.1 Overview of the Growth Diagnostic

**What is the tool?** The Growth Diagnostic provides a framework for systematically identifying the key constraints to growth in an economy.

**Why is it relevant to PSD in CAEs?** The fundamental requirements for a functioning formal economy are the same across all environments, as is the need for systematic analysis to identify the key constraints.

**What are the key lessons for applying it?** There are two key lessons. First, in a CAE it is likely that many of the potential constraints to growth identified in the framework are present. Prioritising the constraints is therefore key in CAEs. Second, while a growth diagnostic may identify the high-level barriers to growth, it may not identify the political constraints, and institutional blockages. Adding a political economy dimension to the analysis is required to understand the underlying constraints to growth and the political feasibility of different growth strategies.

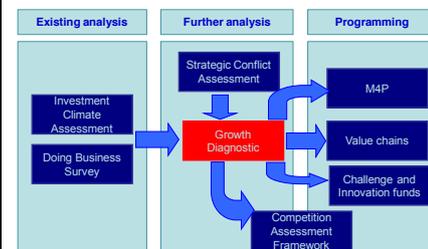


Figure 3 below illustrates the Growth Diagnostic Framework. It is an invaluable tool for advisers to identify the constraints to economic growth. Through identifying the most significant constraints to growth programming can be focused on the most important issues first – generating the largest returns.

At each stage of analysis the growth diagnostic provides two or more explanations of the key constraint, successively narrowing down until the “key issue/s” are identified. But in CAEs the application of this framework poses particular challenges. Box 6 sets out the three specific challenges.

#### Box 6: Challenges applying the Growth Diagnostic to CAEs

- With so many parts of the economy and political economy “broken” it is difficult to isolate any one critical constraint;
- Difficult working conditions and poor data undermine efforts to conduct rigorous diagnostic analysis;
- The temptation to substitute anecdotal evidence for proper analysis can perpetuate misdiagnoses, leading to wasteful or even damaging policy interventions

To gain insight into priority areas for reform in CAEs, the Growth Diagnostic analysis must be calibrated by political economy analysis.

A key political-economy consideration is the *perception* of risk – not just actual risk. Other considerations are the role of different state and private-sector actors in contributing to the perception and measurement of risk.

In the following sections we briefly outline the key issues to consider when using this framework in CAEs, examining each of the four “high level” failures –

- low potential to earn attractive returns;
- entrepreneurs cannot capture returns available;
- problems in accessing international finance;
- problems in the local financial sector.

#### Box 7: Complementing Growth Diagnostics with a political economy approach<sup>13</sup>

There is growing recognition that technically sound policy prescriptions can fail for lack of effective political support. What is needed is a political economy approach that can identify how to overcome

<sup>13</sup> Box adapted from DFID Political Economy Analysis How to note

particular economic constraints given the prevailing political reality.

For instance, a growth diagnostic may indicate that inadequate and unreliable electricity supply, caused by pricing policies and weak management within the public power companies, is currently the most binding constraint to growth. Political economy analysis might show these issues relate to systems of political patronage governing access to subsidised power and protected public employment. The analysis might go on to identify ways in which to devise new institutional arrangements and “second best” policies to mitigate the impact of patronage politics, or ways in which interest groups from the private sector or civil society could become better organised to demand reform.

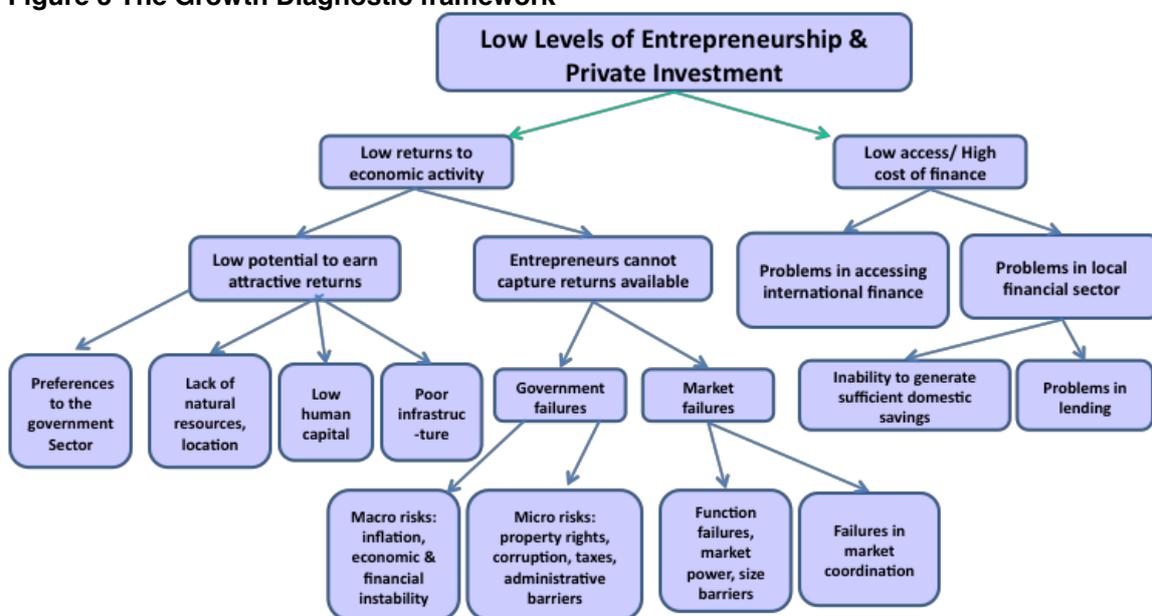
Political economy analysis can help to:

- Improve our understanding of the political obstacles and opportunities for growth.
- Enhance dialogue with government around policy options for improvement
- Inform medium-term strategies of engagement with civil society and the private sector to help overcome growth constraints.

**Resource:** [Growth Diagnostics](#), Ricardo Hausmann, Dani Rodrik, Andres Velasco, 2005: This paper examines appropriate reforms for growth in developing countries, and sets a framework for analysis. Key findings are:

- Across-the-board reform packages have often failed to get countries growing again;
- Strategies that focus on resource mobilisation pay off when domestic returns are both high and privately appropriable.
- Strategies that focus on market liberalisation work best when social returns are high and the most serious obstacle to their private appropriation is taxes and restrictions.
- Strategies that emphasise industrial policy are appropriate when private returns are depressed not by the government’s errors of commission (what it does), but its errors of omission (what it fails to do).

**Figure 3 The Growth Diagnostic framework**



## D.2 Adapting the Growth Diagnostic to CAEs:

A good growth diagnostic (GD) is based on deep analysis, using sound data. This is unlikely to be feasible in the rapidly changing context of a CAE. However, the diagnostic is still useful as a broad conceptual framework, and for pointing the analysis towards the

problem. It is possible for a small team to carry out a basic growth diagnostic in around three weeks. However, in some circumstances even this shortened timeframe may not be possible. In such circumstances it is possible that some form of GD can be carried out in a one-day workshop with informed stakeholders. This is far from ideal, and some argue that it can be counterproductive – identifying only those binding constraints that reflect prevailing wisdom. However, if this is recognised and the design of the workshop takes this into account, it can still prove useful in the absence of an alternative. Work is underway in DFID to consider adaptation of the tool for CAEs, based on experience of its application in several CAEs, including Nepal, Afghanistan and Sierra Leone.

Given the importance of the context, providing general advice on how to do a growth diagnostic will be difficult. However, there are some common features of the binding constraints that a growth diagnostic should identify. First, there should be specific evidence that agents in the economy are engaging in efforts to overcome or bypass the constraint. Second, the sectors that are thriving should be those that are least dependent upon that constraint. Third, if there has been any relaxation of the constraint, this should have resulted in significant improvements in growth.

Below we set out some specific political economy, and questions related to sequencing, that may be helpful in adapting a growth diagnostic to a CAE.

#### **Low potential to earn attractive returns:**

The key issue is to distinguish between the current state of affairs and conditions before conflict – to what extent are weaknesses attributable to conflict?

a) Lack of natural resources, location: Is the conflict making natural resources difficult to access in an economically viable way? Additionally, is the sector poorly governed: do rent seeking behaviours exist that are preventing entrepreneurs making a return on these resources?; Are the returns from natural resources being shared equitably, or in ways that are likely to fuel conflict?

b) Low human capital: Have qualified people left the labour force as a result of conflict?

c) Poor infrastructure: A key issue here is sequencing. The provision of infrastructure, and governments' willingness/ability to invest in infrastructure, is often a key factor in investors' perceptions of risk, which in turn affects the availability and pricing of commercial finance. This should make it a key priority. However, restoring infrastructure takes time, and can be a primary obstacle to growth. In considering sequencing, does the government have sufficient resources (financial and human capacity) to take a significant role in infrastructure investment? Or will shorter-term interim solutions be required?

#### **Entrepreneurs cannot capture available returns:**

a) Government failures

1. Macro risks: Who is gaining from poor public financial management (for example, from poor procurement processes?) To what extent is reform being hampered by lack of capacity, and to what extent by vested interest –for example, who gains from existing subsidy regimes?
2. Micro risks: Property rights, corruption, taxes, administrative barriers: Typically, problems in this area predate conflict, and have been exacerbated by it. Tackling these issues may make a direct contribution to stabilisation, peace-building and state-building. However, successful dialogue requires an understanding of: who benefits from the existing status quo, and who stands to lose. In addition, there are sequencing issues. For example, might one of the sets of reforms have greater

capacity for quick wins – perhaps as a result of an alignment of interests with government interests?

b) Market failures

A key consideration in addressing market failures is the extent to which these serve to protect the interests of businesses that have emerged (or already exist) and can only survive in conflict-situations.

1. Information failures: market power, size barriers: To what extent do market distortions, anti-competitive and monopolistic practices characterise the economy?
2. Failures in market coordination: Some market failures may predate the conflict; others may have resulted from the emergence of market practices that are only viable in conflict situations, such as illicit appropriation of assets; and the use of coercion in market transactions. How have vested interests changed as a result of the conflict? Which of the interest groups might prove to be a reform ally?

**Issues accessing international finance**

The key issue here is: Is the market-risk premium given by international financial institutions for a particular CAE based on perceptions of insecurity, or does it represent reality – clearly the response to the first of these is around communications, while the second is more intractable;

**Issues in the local financial sector**

Two key considerations are:

- a) Inability to generate sufficient domestic savings: Does the absence of a savings culture predate conflict; to what extent has this been compounded by loss of confidence in domestic financial institutions and capital flight during conflict? Again, what is the reason for the lack of a savings culture, and can technology be used to create financial markets without the need for large-scale investment?
- b) Control of local financial markets: Do these markets allocate investment on economic grounds? Are there groups who would benefit from improving the distribution points for financial sector activities? Can technology be used to circumvent existing market structures - for example mobile phone banking?

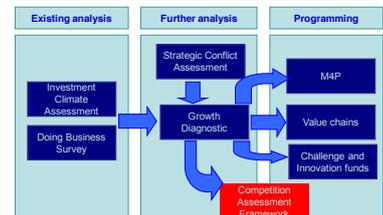
## Appendix E: Competition assessment framework

### E.1 Overview of competition assessment framework

**What is the tool?** The CAF is a diagnostic tool based around sets of questions for identifying competition barriers caused by: the structure of the market; entry barriers, and; anticompetitive conduct.

**Why is it relevant to PSD in CAEs?** Conflict is likely to exacerbate pre-existing barriers to competition; and create new ones in turn. A lack of competition is a characteristic of many CAEs. In addition, where economic competition is perceived as unfair, or there are rent-seeking opportunities from bypassing competition, this can be a key driver of conflict.

**What are the key lessons for applying it?** Conflict profoundly distorts markets and competition. A range of additional questions are required across all three themes of the CAF resource kit to ensure that competition reforms derived from it do not exacerbate conflict.



Fair competition in markets is crucial for economic and social development, and for reducing poverty. Yet, anti-competitive practices and policies are common, diminishing the opportunities for innovation and growth. DFID's [Competition Assessment Framework](#) is a guide to help policymakers in developing countries and PSD advisers identify and focus on the key barriers to competition. These barriers can take different forms – technical, financial, and legal– and may arise from public sector actions as well as private sector ones. They have a range of policy and administrative implications.

By adding a conflict lens to this tool, PSD advisers can better understand what types of barriers may be rooted in the history of conflict and related dynamics; and in turn, assess how different avenues for enhancing competition may contribute to reducing conflict tensions, or exacerbate them in turn.

Conflict has profound distorting impacts on the way different economic actors are able to compete in a country's economy and in specific sectors. Particularly lucrative or strategically important sectors may be dominated by specific political and economic elites (often linked, or overlapping); and violence, predation and coercion used to gain control over specific sectors may continue well into the post-conflict period (see Box 8).

#### Note: Conflict, market failures and competition

“Underlying many instances of market failures in conflict situations are powerful monopolies, only sometimes based on true competitive advantage. More often, they are based on ethnicity, political and family connections, military or bureaucratic control, which reaps rewards for corrupt officials. Market development programs attempt to understand, transform, work around, or confront such powerful market interests to open markets.”

Source: [Market Development in Crisis-Affected Environments: Emerging Lessons for Achieving Pro-Poor Economic Reconstruction](#), Tim Nourse, Tracy Gerstle, Alex Snelgrove, David Rinck, and Mary McVay, 2007.

#### Box 8: Violence, coercion and unfair competition in the Casamance, Senegal

Research carried out in 2000-02 in the Casamance region of Senegal, affected by low-intensity violence of an ongoing armed insurrection, shows that armed actors, both government forces and rebel groups, have taken over control of lucrative sectors such as timber and cashew nuts. Continued domination over these sectors is ensured through threats of violence; certain areas and orchards having been made inaccessible to civilians due to ‘security threats’ and landmines placed around the perimeters; or curfews in village environs that limit civilians in cultivating their lands.

Source: [Ni paix ni guerre: the political economy of low-level conflict in the Casamance](#), ODI, 2003.

In turn, unfair and discriminatory competition practices may have fuelled conflict dynamics and continue to do so – for example, systematic exclusion of parts of the population from competing in certain sectors. Without understanding the causes of conflict and without working in a conflict-sensitive way, competition reform interventions can inadvertently run the risk of reproducing the conditions that originally caused conflict in a country. At the very least, the recommended interventions and competition reforms should avoid fuelling conflict further: it is vital that competition reforms, or their anticipation, will not set off or escalate violent conflict in the country under consideration. At the same time, competition reforms informed by a strong conflict analysis can be designed to help tackle underlying causes of conflict, for example by promoting access and inclusion of conflict-affected populations in key sectors.

Competition assessments can yield important information for analysing how conflict dynamics have been and are continuing to play themselves out in the economic sphere. Political economy analysis, used in both conflict analyses and competition assessments, is a useful tool in this regard.

## E.2 Adding a conflict lens to the tool

The CAF is a diagnostic tool that presents sets of questions for identifying competition barriers, grouped by theme. This section maps a set of practical steps to add a conflict lens to the three core CAF issues:

- (i) Structure of the market (steps 1 and 2);
- (ii) Entry barriers (step 3);
- (iii) Anti-competitive conduct (steps 4-7)

Box 9 gives a broad overview of typical, conflict-related impacts on competition.

### **Box 9: Conflict impacts on competitiveness of specific sectors and industries**

*“Depending on the severity and length of the conflict, most or all pre-existing markets will have been disrupted and industry competitiveness lost. In the case of protracted conflict, it may be difficult to help firms within industries that were once regionally or globally competitive to appreciate the fact that they need to substantially upgrade in order to become competitive once more. Even harder to accept for stakeholders in once-prestigious industries is the fact that sometimes countries and regions no longer have the comparative advantage that will allow them to regain their market dominance.*

*For example, both Eritrea and Zimbabwe were once leaders in Africa’s agricultural production and marketing, and both have lost this status as a result of conflict and political instability. While many Zimbabwean farmers and entrepreneurs have coped by relocating to other more stable countries within the region, both countries have failed to create national strategies that accept and respond to their loss of market dominance, pushing away foreign investors and rendering foreign aid ineffective. For example, the Eritrean Ministry of Agriculture insisted that a recent agricultural project focus on developing the banana industry, a thriving and competitive industry in the 1960s that now, with decades of neglect, has little hope of competing against the advanced institutional and technical capacity of the Latin American industry. Competition is also created by cheap imports and the distribution of relief supplies.*

*Food aid drives down local food prices by flooding supply and by decreasing demand for locally-produced food by recipients. For example, the shift in the West African Sahel from consumption of indigenous coarse grains like millet and sorghum to wheat has been attributed to food aid deliveries of grains. Unprecedented changes in pastoralists’ diets in the Horn of Africa from animal products to maize have similarly been attributed to food aid deliveries. While donor-required analyses are meant to ensure that monetised food aid commodities will not result in substantial disincentives in domestic agriculture or marketing, these are not always thoroughly or objectively undertaken.”*

Source: [Accelerating the Transition from Conflict to Sustainable Growth](#), Saperstein and Campbell, USAID, 2008.

## E.2.1 Step 1 – Selecting sectors and markets for assessment

Many of the questions included in this first step are highly relevant from a conflict perspective – for example, a history of alleged anti-competitive conduct, and vested interests. In addition to the main two questions (including sub-questions):

- 1) Is the sector important to the economy...?
- 2) Is the important to consumers, because...?

It is worth adding a third set of questions that seek to link sector analysis and selection to wider conflict dynamics (see also the selection criteria in the value chains tool (Appendix G) in this resource kit):

- 3) Is the sector and market important to conflict dynamics, because:
  - a. It featured prominently in the conflict, for example by providing finance to political or armed actors?
  - b. It provides scope for economic recovery from conflict, especially job creation for conflict-affected populations?
  - c. Anti-competitive behaviour in the sector fuels tensions and resentment among potential competitors and consumers?
  - d. It is likely to act as a catalyst for wider economic recovery in other sector also (e.g. infrastructure, or transport)?

### Box 10: Aspects of competition

The CAF summarises the characteristics of competitive industries and sectors as:

- A wide range of product choice,
- Regular entry and exit of firms,
- Changes in the ranking of leading firms,
- Changes in the size of their market shares,
- Active product development and innovation, and
- Changes in pricing that reflect changes in market conditions (e.g. changes in input prices).

Competition in this context is reflected in:

- Competition between current competitors,
- Threat of new entrants,
- Threat of substitute products being developed,
- Bargaining power of buyers,
- Bargaining power of firms that supply inputs to the market.

## E.2.2 Step 2 – Examining market structures and conflict impacts on competition<sup>14</sup>

Conflict strongly impacts local end markets and sometimes even destroys them. Control over markets may have been one reason for fighting between conflict parties, and in many situations armed actors take control of markets, or restrict civilian access to them as part of military tactics. Similarly, violent conflict may have eliminated competition in certain markets from actors previously able to participate – this has been observed for example with the Palestinian transport sector, now no longer able to enter Israel due to access restrictions, meaning Israeli transport companies benefit from the ‘back-to-back’ system institutionalised by the closure of borders. Similarly, Sri Lankan fishermen from the war-affected North and East of the country, previously strong competitors, have been cut out of the national fish markets by decades of war restricting their access to fishing waters, and land transport, to the benefit of Southern and Western competitors.

While conflict usually does not impact regional or global end markets in similar ways, the dynamics in those markets can have a strong bearing on the conflict. As an example,

<sup>14</sup> This section is adapted from Gunduz and Klein, 2008.

fluctuations in the cost of some primary commodities (such as coffee in Colombia, and coltan in DRC) in global markets have been shown to correlate with fluctuations in conflict dynamics in producing countries.

Questions to be asked during the competitiveness analysis of markets might include the following:

- Were previously existing local or regional end markets interrupted by the conflict? How has this affected competition in the sector / market?
- How can international peace and reconstruction missions be tapped into as temporary end markets to improve competition?
- Are certain sectors connected to global markets and will fluctuations in prices severely affect them? How is this likely to impact on different competitors in the sector / market?
- Has the violent conflict made previously competitive markets uncompetitive, and have these markets been captured by other actors as a result?

### **E.2.3 Step 3 – Identifying barriers to entry**

For markets to remain competitive, new entries have to be possible – that is, commercially feasible; sufficiently likely – that is, probably enough for incumbent firms to change their market conduct (e.g., lower prices); and timely. The CAF identifies three types of barriers to entry: natural; strategic, and; regulatory.

A legacy of violent conflict can exacerbate all three types of barriers. For example, it may be easier for existing market players to create strategic barriers given a weak regulatory environment that is characteristic of many conflict-affected contexts.

In addition to these three, there may be specific, conflict-related barriers to entry. Questions to identify these can include:

- Has the conflict effectively excluded certain parts of the population, or actors from certain regions from the country, from effectively competing in the market? Who are they, and how has their competitiveness been affected?
- Is competition in the market shaped by conflict dynamics, and does it mirror ‘winners’ and ‘losers’ in the conflict?
- Do actors’ goals, positions, interests and relationships make it likely that they will act in anti-competitive ways? Who are they, and how does this manifest itself?
- Does anti-competitive behaviour include coercion, violence, or the threat of violence (Box 11 provides an example of this)?
- Has conflict reduced the institutional capacity of government to create the environment for competition?

#### **Box 11: The use of violence in competing for government construction contracts in Nepal**

In Nepal, increased donor funding channelled to local-level government for reconstruction efforts has meant that competition over these new resources has become fierce, and in some instances violent. Irregularities during local government tendering processes have for example included some district-level construction companies colluding with political party youth wings, armed groups or criminal gangs to physically prevent competitors from submitting their bidding documents. In some instances, this has led to violence between opposing groups around bidding processes. Source: *MPRF men enforce Biratnagar shutdown*, 3rd November 2008, *eKantipur*.

### **E.2.4 Step 4 – Ascertain if government policies or institutions limit competition**

Political economy and conflict analyses may reveal that government regulation and policies in some sectors are not informed by economic and sector-specific requirements, but by vested interests to ensure government control over certain sectors seen as strategic (this may be for a variety of reasons, including potential to mobilise actors in that particular sector, such as workers, for political purposes). Anti-competitive behaviour in these instances can extend across: state-owned enterprises; public procurement; sector-specific regulation; trade and industrial policies, and; unequal enforcement of laws and regulations.

**Note: Government policies and conflict**

“If inequity and discrimination were critical to a conflict, and they almost always are, they will be present in the new government’s economic decision-making; they often override considerations of economic efficiency.”

**Source:** [A Guide to Economic Growth in Post-Conflict Countries](#), USAID, 2009.

Given the wide and pervasive negative impacts on competition that distorted government policies and institutions can have, in recent years economic recovery efforts after war have included strong and early reform efforts in all these areas. However, anti-competitive behaviour in these areas has proven extremely resilient to technical reform interventions, precisely because of the complex political economy dynamics holding them in place.. There are no easy fixes to this challenge; at the very least, the competition assessment needs to include an assessment of likely conflict risks associated with different reform areas.

Questions to elicit possible conflict risks include:

- Who in the market(s) concerned is most likely to benefit and lose out from increased competition?
- Who are potential ‘spoilers’ of competitiveness efforts?
- Who benefits most from the current status quo of key state-owned enterprises? How is power and control over them likely to shift? Are certain groups and economic actors more likely than others to benefit from privatisation efforts?
- If subsidies are in place for services delivered by state owned enterprises (such as water, fuel, or electricity), how might privatisation efforts or removal of subsidies affect beneficiaries? Is it likely (based on past experience) that this type of reform can lead to public protest and political resistance?
- If procurement policies lack transparency and/or are deemed corrupt, which stakeholders benefit and how? Are rents achieved through these policies instrumental in maintaining or accessing political power?

### **E.2.5 Steps 5 and 6 – considering vested interests, and looking for signs of anti-competitive behaviour by firms**

The current guidance is relevant and useful to conflict-affected situations.

### **E.2.6 Step 7 – Drawing conclusions**

If weaknesses are found, and conflict impacts play a significant role in instigating, facilitating and perpetuating anti-competitive behaviour, the following questions (following the CAF), will help draw conclusions for potential programming:

- What effects does weak competition in the market(s) have on the economy? On specific actors? And on conflict dynamics (e.g., does it fuel tensions and resentment among or between groups)?

- Who profits from the effects of weak competition, and by how much?
- Who loses out because of weak competition, and how severely?
- Which stakeholders benefit from different types of corrective actions?
- Do differences between ‘winners’ and ‘losers’ from weak competition, and conversely, corrective actions, reflect other fault lines in society, such as gender discrimination, or horizontal inequalities?
- What is likely to be the effect of possible corrective actions on key conflict variables identified in the conflict analysis?

Different types of corrective actions identified in the CAF may have differing impacts on conflict issues and related risks; some of these may be amenable to mitigating steps, while others may indicate a ‘no-go’ from a programming perspective. In assessing different programming options, these can be mapped against different conflict issues as well as country-level conflict analyses and summarised in a matrix:

Potential corrective actions – example:	Likely impact of conflict variables on corrective action	Likely impact of corrective action on conflict variables	Proposed mitigating steps
Disseminate information to help consumers make better-informed decisions, taking care to ensure that the right information reaches the right people at the right time and in a usable form;	Difficulties in access make it hard to identify target audience  Lack of means of communication (radio, TV, internet)	Groups gaining from current market power may see this as a challenge to their position, and re-ignite conflict	Negotiation across stakeholders, either to bring vested interests on board, or where these interests are too firmly entrenched, to find ways to marginalise them.

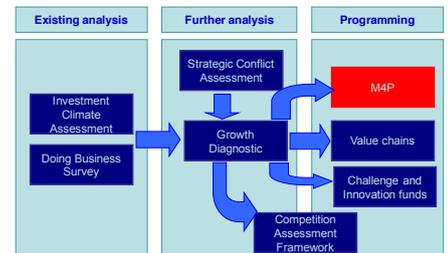
## Appendix F: Making markets work for the poor

### F.1 Introduction and key issues

**What is the tool?** Making markets work for the poor (M4P) is a core tool in donors’ portfolio of approaches to PSD. It is an “*approach aimed at effectively and sustainably improving the lives of poor people by understanding and influencing market systems*”<sup>15</sup>.

**Why is it relevant to PSD in CAEs?** M4P is a resource kit for practitioners to help them to foster economic growth and poverty reduction. Economic growth and poverty reduction are essential to moving away from conflict, and preventing its resurgence.

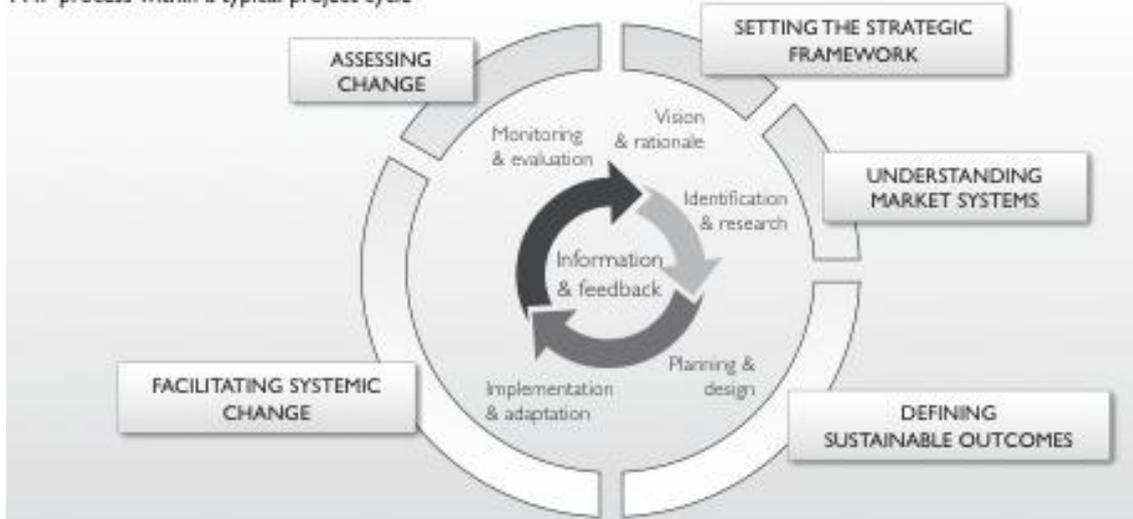
**What are the key lessons for applying it?** The M4P approach is well suited to application in CAEs, but it must be grounded in a strong political economy analysis.



The basic M4P process is set out in Figure 4 below.

**Figure 4: The M4P process**

M4P process within a typical project cycle



Several characteristics of M4P make it particularly suited for application in CAEs. It is:

- context-dependent and strongly process-oriented;
- capable of dealing with diversity and dynamism;
- opportunistic and focused on results;
- able to incorporate risk management.

**Resource:** A synthesis paper outlining the M4P approach, as well as detailing the M4P tools can be found at <http://www.mmw4p.org/>.

These characteristics are essential for working in CAEs where: the pace of change is unevenly distributed between economic sectors; political issues dominate the attention of policy-makers, and; market conditions at the national, regional and local levels reflect the

<sup>15</sup> Source: Operational Guide for Making Markets Work for the Poor Approach

shifting context of conflict. Adapting M4P for application in conflict-affected states is therefore more a question of emphasis on key features of the framework than of substantive changes.

That said, while the M4P framework may be well suited to CAEs, its **practical implementation is difficult**. These difficulties largely stem from the perceived need, especially in an immediate post-conflict situation, to “get things done”. M4P describes well this tendency among development agencies for “impulsive interventions”.

*“...the essence of the approach [impulsive intervention] is that, if the market isn’t delivering well, “we” (agencies and government) should replace it and provide finance, advice, materials, services...whatever is required directly. We should do it ourselves to get on with the job.”*

As the M4P synthesis paper notes, the results of such impulsive interventions have been limited in outreach, impact, sustainability and efficiency. If this is the case across all programmes we might reasonably expect this to be even more pronounced in CAEs, where fundamental issues are even more intractable, and political pressure to “get things done” can be overwhelming. Resisting the pressure for impulsive interventions is difficult – and on some occasions may be inappropriate. Several issues need to be considered before advocating an impulsive intervention.

First, it is vital to ground programming in an understanding of the political economy context.

Second, the SCA and growth diagnostic foundations need to be built into a consistent “theory of change” for programming. This will need to explain how a strategy of working on the relationship between the public and private sector, and a focus on the strategic isn’t “doing nothing”. The strategic framework for change (figure 6 in the M4P synthesis paper) is an excellent starting point for this.

Third, in programming the focus should be on defining clearly monitorable outcomes. This will allow programme implementers to demonstrate movement along the path to poverty reduction. Demonstrated progress will reduce the pressure for impulsive interventions.

Finally, it may be that in some circumstances the pressure for at least some “quick wins” will be overwhelming. Resisting too strongly can lead to actors being branded as unhelpful, and sidelined from political processes. Quick wins can be used where possible to build political capital and relationships with the private sector and government, and minimise inconsistencies between specific interventions and longer-term strategies. The “Do No Harm” framework, is useful here. Box 12 below provides an example of managing impulsive intervention, from the UK’s work in Afghanistan.

**Box 12: Managing the need for impulsive intervention**

**QIPS in Afghanistan**

In Afghanistan the UK government recognised a need for immediate solutions to a weak and unaccountable security sector, humanitarian issues, political solutions and basic rural infrastructure. To avoid these becoming impulsive interventions, a process has evolved for “Quick Impact Projects” (QIPs) to ensure that these are either consistent with longer-term development, or that their immediate impact is greater than their long-term dis-benefit. For example, a project to reinforce Bowlan Bridge has delayed the need for the bridge to be replaced, and so the strategic infrastructure of Lashkar Gar remains open at a critical time for reconstruction and development. Prioritisation and related trade-offs are achieved through all funding decisions going through the Helmand Executive Group. The role of this group is to ensure that there is no duplication of effort, and that short-term QIPs are consistent with the longer-term Helmand plan.

Implementing QIPS in this way has led to much better linkages to the longer-term strategic plans for Helmand. Increasingly, QIPs are not substituting for longer-term work, but rather are providing short-term foundations for the implementation of strategy. Medium-term projects - for example, capacity building at provincial level, are then providing a bridge between the immediate QIPs work, and longer-term reconstruction.

The rest of this section highlights those aspects of the M4P framework that require particular emphasis in the context of conflict and draws attention to conflict-specific considerations.

Conflict is relevant across all steps of the M4P methodology. However, the first two steps (Setting the strategic framework and Understanding market systems) are the areas that require most consideration from a conflict perspective. The three remaining steps are discussed more briefly.

## F.2 Setting the strategic framework

*“The direct objective of M4P interventions is to stimulate market systems to work better for the poor: an objective of systemic change therefore should be made explicit in a strategic framework.”*

In CAEs it is likely that entire economy requires remedial help. Market systems in general need to be made to work, and focusing exclusively on those that affect the poor may be misleading. The priority must be to get the entire economy back to work. Development of a strategy that specifically focuses on the poor may need to take place over a longer-time scale.

### F.2.1 Define poverty reduction objectives

Key questions: Which target group is being targeted and what is their economic profile? What is the anticipated final impact on the target group?	
M4P guidance	Conflict-specific
<p><i>The first step is to define specific poverty reduction objectives.</i></p> <p><i>Generally M4P interventions will have a final objective related to improving the socio-economic welfare of disadvantaged people, regions or countries.</i></p> <p><i>This needs to be defined specifically, based on context and programme type. This means defining a target group and an objective for improvement in their poverty condition – ‘more’ of something positive (e.g. income or assets) or ‘less’ of something negative (e.g. deprivation, exclusion or inequality).</i></p>	<p>The overriding objective is to make the economy in general work, creating the conditions for the legitimate government to rebuild the social contract between government, private sector and civil society. Poverty-reduction objectives therefore need to be defined in the context of improving the <b>overall</b> functioning of the economy and ensuring conditions where those who were disadvantaged before the conflict, or were marginalised by the conflict, are allowed to participate in the economy in future.</p> <p>Identifying the roles of different groups in relation to the causes of conflict is a critical first step. Priorities for intervention may not necessarily be to target the poor in the first instance; but the role of the poor and disadvantaged needs to be central to the overall programme design.</p>

### F.2.2 Define growth and access objectives

Key questions: What is the pro-poor opportunity? How might the target group’s position in the market system be improved?	
M4P guidance	Conflict-specific
<p><i>Define how the poor’s position might be improved. This entails understanding how obstacles to the poor’s access</i></p>	<p>Access to information about policy-makers’ intentions to catalyse market activity is a key step in building</p>

<p><i>to opportunities or their capacity to respond to those opportunities can be overcome, represented as objectives for either growth or access. The ‘poor’ might be producers and entrepreneurs (i.e. businesses or farmers), workers (i.e. employees) or consumers, depending on context. This entails defining pro-poor opportunities, in terms of:</i></p> <ul style="list-style-type: none"> <li>- <i>Stepping up: potential improvements in the poor’s positioning within existing market systems</i></li> <li>- <i>Stepping out: potential shifts of the poor into new market systems</i></li> <li>- <i>Hanging in: for extremely disadvantaged groups ‘opportunity’ can often mean the potential to reduce vulnerability to risk.</i></li> </ul>	<p>confidence amongst producers, entrepreneurs, etc.</p> <p>In CAEs, many market activities may have stopped or become dysfunctional in response to violence or civil disturbance; or economic actors may have been drawn into other activities (smuggling, small-scale trading, etc). While there may be a strong temptation amongst policy-makers and donors to “create” economic activities based on what used to exist before conflict, or on the supposed potential competitiveness of a given activity, a more sustainable approach is one that stimulates innovation.</p>
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### F.2.3 Define systemic change objectives

Key question: In what way does the market system need to change so that it better serves the poor?

M4P guidance	Conflict-specific
<p><i>The direct focus of interventions is to stimulate sustainable change in market systems. The next step is to identify specific dimensions of those systems that need to be changed</i></p> <p><i>Market system change might include:</i></p> <ul style="list-style-type: none"> <li>- <i>Improved delivery of the market’s core function – a better ‘deal’ for the poor (e.g. increase in access or participation rates, improved quality or levels of satisfaction).</i></li> <li>- <i>Changed attitudes, perceptions or relationships of players.</i></li> <li>- <i>Changes in capacity and practices (e.g. investment, roles or performance) of players and functions in the system.</i></li> <li>- <i>Demonstrated incentives and ownership of players</i></li> <li>- <i>Independent and continuing activity in the system</i></li> </ul>	<p>Where systemic change can be brought about by changes in attitudes and facilitating different patterns of participation, M4P need not be constrained by the legacy of conflict.</p> <p>But where changes are also required in the legal and regulatory framework, it may be difficult to persuade policy-makers to give priority to these areas. Giving visibility to the achievements of market development initiatives can help to influence policy-makers.</p> <p>To achieve this, public-private dialogue structures that deliberately locate previously excluded social and economic groups alongside the actors of the mainstream economy can help to accelerate the pace of change.</p> <p>One caution is the need to build acceptance for the concept of business failure. Some business models will be viable only as long as they fulfil a need created by market failures in other areas. These businesses need to be allowed to fail when they are replaced by better-suited business models.</p>

### F.2.4 Define broad thrusts of intervention strategy and approach

Key question: How to avoid rigidly defining operational details and inputs?

M4P guidance	Conflict-specific
<p><i>The strategic framework should establish the primary focus and overall direction of a programme in a way that is sufficiently clear to guide decision-making, monitoring and evaluation in a dynamic context.</i></p>	<p>To achieve this, it is vital to ground the framework in an analysis of the political economy. Using the SCA described in Appendix A is a starting point for this, while using the greed/ grievance framework reference Appendix A.4 can provide the dynamic element for this.</p>

## F.3 Understanding market systems

This M4P component requires substantive research, and practitioners are required to draw on a wide portfolio of analytic tools and techniques. In general M4P guidance places such emphasis on the need for analysis to be context-specific that there is little need to modify it for CAEs. The analysis must start with an understanding of situation before the conflict. This will provide a better understanding of the extent to which the poor’s situation was caused by the conflict, or indeed

was one of the causes of conflict. These considerations are critical if M4P initiatives are to avoid inadvertently exacerbating social and political tensions.

### F.3.1 Understanding the profile of the poor and their wider context

<p><b>M4P guidance</b></p> <p><i>The assessment process starts by establishing an understanding of the profile of the poor and their wider context. This may already be given by programme design, usually based on a combination of:</i></p> <ul style="list-style-type: none"> <li>- <i>Geographic focus: e.g. a neighbourhood, town, province, country.</i></li> <li>- <i>Product focus: e.g. a specific type of goods or service such as financial services or insecticide-treated mosquito nets.</i></li> <li>- <i>Target group focus: e.g. garment sector workers or female business owners.</i></li> <li>- <i>Sector focus: e.g. agro-processing or small-scale manufacturing</i></li> </ul>	<p><b>Conflict-specific</b></p> <p>The diagnostic process should be underpinned by a comprehensive political economy analysis. The foundations of this can come from the Strategic Conflict Assessment.</p> <p>The relationship of target groups to the key actors in the conflict context, the potential impact of any change in their status to the future political situation, should all be taken into account in the diagnostic process (again, the greed grievance framework referenced in Appendix A.4 provides one method of doing this). As noted in other sections, it is essential to understand whether the causes of poverty or exclusion predate the conflict, contributed to conflict, or were created by the conflict.</p>
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### F.3.2 Map out the specific market system, its dynamics and the position of the poor

<p><b>M4P guidance</b></p> <p><i>Programmes need to develop a sound understanding of the structure and performance of the specific market system(s).</i></p> <ul style="list-style-type: none"> <li>- <i>How does the market system work, what are its key functions and who are its key players (private, public, formal and informal)?</i></li> <li>- <i>What are the dynamics of the market in terms of its overall effectiveness, for example its competitiveness, productivity or level of coverage or access?</i></li> <li>- <i>How is the market failing to serve the poor (i.e. what are the symptoms of underperformance) or where are potential opportunities for the poor?</i></li> </ul> <p><i>The starting point is to map out the basic structure of the market system:</i></p> <ul style="list-style-type: none"> <li>- <i>Identify the functions played by different players ; map the relationships between players</i></li> <li>- <i>Where possible identify alternative or competing structures, channels/ relationships.</i></li> <li>- <i>Don't neglect the possibility of 'embedded' or 'hidden' transactions</i></li> </ul>	<p><b>Conflict-specific</b></p> <p>As noted above, the market map needs to incorporate political economy analysis which specifies the potential future roles of all interested actors, not only of the target group.</p> <p>Another important consideration is the function played by informality during the conflict. Informal practices may be embedded in a culture that predates the conflict; or a way of asserting social identity in opposition to a set of formal rules associated with the agents of exclusion; or simply the way that people learned to sustain economic after the breakdown of formal systems during conflict. Understanding the drivers of informality is a key step to mapping the way to new market structures.</p> <p>In applying this, it should be recognised that informal markets are not, in and of themselves "bad". Changes to them should take account of the risk of triggering conflict.</p>
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### F.3.3 Identify systemic constraints

<p><b>M4P guidance</b></p> <p><i>Assessment needs to focus on identifying the specific causes of market underperformance</i></p> <p><i>Key questions are:</i></p> <ul style="list-style-type: none"> <li>- <i>What are the underlying causes of a market system's underperformance?</i></li> <li>- <i>What are the primary obstacles and opportunities to overcoming these problems?</i></li> </ul>	<p><b>Conflict-specific</b></p> <p>As above, it is essential to support any diagnostic research with comprehensive political economy analysis; to understand the causes of any market underperformance or dysfunction in relation to the causes and consequences of conflict; and to anticipate the potential impact of any change in the market structure on the political situation.</p>
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## **F.4 Identify systemic constraints**

M4P guidance stresses sustainability as a central objective of a programme. It also notes:

*“Functioning market systems are never static; they have within them the capacity and incentives to be dynamic, to grow and to change. Determining how growth and change will take place in the future without further aid intervention is a central sustainability challenge.”*

A difficulty of achieving this objective in CAEs is that market systems and businesses may be so fragile that there may be pressures to institute some measures of protection in their early stages. Protecting livelihoods in the short term can easily overshadow the objective of longer-term sustainability and growth, particularly if this might involve business failures as markets evolve and new business models are required.

Another important consideration is the value of intermediate steps in market adjustments; that is, facilitating the creation of new structures which are not sustainable, but which may pave the way to more robust and transformative changes under a more stable, less risky economic and political climate. These may need to be explicitly built into programme design, with clear end-points so that the demise of certain functions (and the exit strategies for participants) is well-understood at the outset. For example, it may be necessary to create a temporary office within a regulator, staffed by international consultants to advise on energy prices, until local capacity is built up, and until the regulator has developed sufficient trust with the market to make it a credible partner for the private sector.

## **F.5 Facilitating systemic change**

M4P programmes are facilitative or catalytic: they aim to bring about change that alters the way in which a market system operates in the longer term. They do this by stimulating market players to perform market functions that are either absent or are being performed inappropriately.

The strategy of M4P interventions is to determine a pathway that leads to “crowding in” of market functions and players. The approach relies on facilitators to leverage a response from players within a specific market system.

A critical issue in CAEs is not the approach to facilitated systemic change, but the choice of facilitator. The effectiveness of a facilitator relies on them being viewed as an “honest broker” by all parties to the process. In environments where the causes of conflict are complex, it may be difficult for any one person to be regarded as neutral (unencumbered by assumptions of what interests they represent simply because of who they are).

In this regard, team selection requires particular care. It may even be necessary for the technical competence of team members to take second priority to their “social credentials”. Failure to get this right may mean that the implementing team may simply be denied access to all players required to effect structural changes in a market system. To some extent this additional challenge to implementation may be overcome by “doubling up” on key team members, with obvious implications for programme costs and efficiency.

## **F.5 Assessing change**

M4P programmes must rigorously assess their impact on market systems. It is critical to capture their attributable contribution to change. Attribution is important as it provides ongoing feedback to programme design, so that interventions can be modified and adapted to conditions on the ground. In this regard M4P implementers need to attribute

changes credibly and practically across the chain of causality to their intervention, based on a clear strategic framework.

In CAEs two special considerations need to be addressed:

1. The political economy surrounding a given market and the wider economic scene may be more dynamic and changeable than in stable environments. Factors may enter the equation during the implementation processes that were not anticipated at design stage.
2. Gathering and verifying data may be particularly challenging in areas where access is limited. The choice of indicators to be monitored may therefore be limited by data that can be gathered remotely. Recent innovations amongst some NGOs operating in CAEs include the development of mobile-SMS platforms for gathering data on their humanitarian and early-reconstruction programmes. Note that the M4P Operational Guide recognises the value of outsourcing some aspects of M&E, while retaining a market impact assessment capability in-house. In this regard there may be merit in partnering with other implementing agencies that may have better access or may have built effective remote monitoring systems.

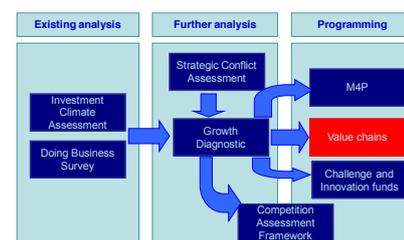
## Appendix G: Value chains<sup>16</sup>

### G.1 Overview of value chains

**What is the tool?** A value chain refers to the full range of activities that are required to bring a product (or a service) from conception, through the different phases of production, to delivery to final consumers and disposal after use. Value chain tools set out approaches to identifying which value chains in an economy should be prioritised, and potential entry points within a value chain.

**Why is it relevant to PSD in CAEs?** “Moving up” chain can be an effective growth strategy. Equally, conflict may break the systems, processes and relationships that link a value chain. Restoring these linkages, or making them more effective, can foster growth, and also create linkages across a country that can reduce the probability of conflict.

**What are the key lessons for applying it?** The use of the tool must be grounded in political economy analysis, but must also seek to understand conflicts within a value-chain. The issues addressed by improvements in value chains will differ depending on the characteristics of the sector. Selecting the chain with the highest potential income will not be sufficient to address conflict. Other issues, including the potential effects on poverty, unemployment, and inequality must be carefully considered.



Conflict dynamics inevitably affect all parts of an economy, directly and indirectly. The same is true for value chains. In fact, access obstacles in a value chain may be rooted in the conflict; and in turn, the way specific value chains are controlled and function may have given rise to grievances which fuel tensions.

Conflict and value chain analyses can therefore be mutually reinforcing. Value chain analysis can yield important information for conflict advisers about the economic dimensions of war and the financing of violence through control of specific sectors. Conversely, conflict analysis provides important insights on the root causes of different ‘bottlenecks’ in the functioning of specific chains that pure value chain analysis on its own might not detect. How specific value chains and conflict dynamics interact should therefore be a key guiding question in selecting value chains and interventions.

**Resource:** The **Overseas Development Institute’s** project on ‘**Power, Livelihoods and Conflict**’ combined political economy and conflict analyses with research on specific value chains in Senegal, Sierra Leone, DRC and Afghanistan, to highlight the links between economic systems and violent conflict.

While focused on humanitarian interventions, its lessons and recommendations are relevant for PSD audiences. In particular, the key insight is that “asking different questions gives different answers” – for example, traditional humanitarian approaches ask which groups face food insecurity – a political economy analysis asks **why** and **how** the situation evolved. The answers from this second group of questions should lead to sustainable and appropriate programme responses.

See <http://www.odi.org.uk/projects/details.asp?id=1216&title=power-livelihoods-conflict-case-studies-political-economy-analysis-humanitarian-action>

<sup>16</sup> Some elements of this approach draw on complementary work by Gündüz, C. and Klein, D. (2008) ‘Conflict-sensitive Approaches to Value Chain Development’ (Washington DC), for USAID.

### Box 13 - Combining value chain and conflict analyses

Research combining value chain and conflict analysis to assess the impacts of armed conflict on the coffee sector in the Department of Nariño in Colombia, found a number of conflict-related obstacles to improving the competitiveness of the chain:

Since the 1990s, the Nariño has experienced an escalation of armed conflict and a simultaneous increase in the cultivation of illegal crops and drug trafficking. The violent conflict, combined with a lack of state presence and public services, led to a shift to illegal activities, abandoning legal crops and, in the process, making the department one of the major coca producers in the country. This trend has been somewhat offset by the coca eradication programmes implemented by the Colombian government, which have encouraged local farmers to return to legal crops. Although there have been a number of incipient crop substitution programmes, findings indicate that the return to legal crops has been primarily reflective of farmers' own initiative.

An examination of coffee production in the region shows that the most important direct impacts of the conflict on the value chain are:

- The displacement of productive factors caused, on the one hand, by the forced displacement of workers, and, on the other, by a reduction in the opportunity cost of participating in illegal alternatives such as coca cultivation;
- Aerial spraying, which affected impacted legal crops as well as the illegal ones targeted;
- Extortion and the threat of future extortion of coffee growers and transporters by illegal armed groups seeking to control the population, valuable territory and trafficking corridors.
- Deteriorated road infrastructure and resulting transport difficulties, although not directly related with the armed conflict, represent another fundamental threat to the competitiveness of the value chain.

Source: [The challenges of supporting 'alternative' economic opportunities for peacebuilding – Perspectives from Colombia](#), Godnick and Klein, International Alert, 2009.

The [M4P 'Making Value Chains Work Better for the Poor' Toolkit](#) includes a number of tools that guide PSD practitioners through identifying and mapping chains, and designing interventions, covering a range of dimensions of pro-poor value chain analysis. Conflict dynamics fit into this already complex picture in two ways. First, *access problems in all dimensions may yield important information about conflict dynamics*: economic grievances such as exclusion from services or access to decent work opportunities are powerful drivers of conflict. In addition, conflict adds *additional dimensions* of analysis for the value chain: that is, impacts of violent conflict on the chain; and vice versa. While the questions and approaches below are adapted to the M4P value chains Toolkit, they draw on work done by other donor agencies, and are broad enough to be adaptable to other approaches also.

**Resource: USAID's Value-Chain Development in Conflict-Affected Countries** project seeks to increase understanding of how best to design and implement activities in post-conflict areas that accelerate the transition from conflict to sustainable economic growth. To date, the project has included an extensive literature review concerning value chain development and economic recovery in CAEs; 8 country case studies documenting field experience in applying the value chain approach in CAEs; and a synthesis report that brings together learning from the literature and from the field, including the identification of emerging best practices and recommendations.

See [http://www.microlinks.org/ev02.php?ID=23261\\_201&ID2=DO\\_TOPIC](http://www.microlinks.org/ev02.php?ID=23261_201&ID2=DO_TOPIC)

This section suggests ways of adding a 'conflict lens' to the four 'core tools' included in the toolkit:

- Value chain identification;
- Value chain mapping;
- Identifying costs and margins;
- Analysing technology, knowledge and upgrading.

Drawing on the approaches suggested in this section, the four 'advanced tools' in the toolkit can similarly be adapted to conflict contexts. The advanced tools may also yield important information relevant for a conflict analysis in turn, such as: horizontal inequalities

in incomes and job opportunities between groups and across different sectors; differential impacts of governance of particular chains; and levels of trust that exist between different actors in cooperating for economic benefit.

## **G.2 Tool 1 – Prioritising value chains for analysis**

### **G.2.1 Overview**

This tool helps users to decide on sub-sectors, products or commodities to prioritise for value chains analysis. The tool follows 4 steps common to processes for making allocation choices in a situation of scarce resources: determining criteria; weighting them; listing potential products/activities; ranking potential products and activities against the list of criteria selected. Sample criteria can include for example: potential for accessing export markets; or crop resistance to climate change effects. Many of the selection criteria – for example, which sectors are currently active, which sectors are likely to have the most impact in addressing poverty and employment will be common across all environments. We focus in the following sections on those issues most specific to conflict.

### **G.2.2 Adding a conflict lens to the tool**

#### **Step 1 – Determine conflict-specific selection criteria**

An evident entry point for applying a conflict lens to this tool is including conflict-specific criteria in the selection list. These can be derived from the conflict causes and drivers, identified through the market-sensitive SCA, and conflict-sensitive growth diagnostics, discussed in Appendices A and D (Box 14 lists a number of sample conflict-specific criteria, based on the literature of economic causes and drivers of conflict). Other sources of information on conflict and different sectors of the economy can also be drawn on to help identify and refine conflict-specific selection criteria. These should also be discussed and reviewed with programme partners and local stakeholders.

#### **Box 14: Sample conflict specific value chain selection criteria**

- Potential for integrating conflict-affected populations in the chain – such as IDPs, former combatants, and widows
- Potential for strengthening markets, products, services and activities that are broadly accessible and do not reinforce divisions in communities and society
- Potential for diversifying economies and diminishing dependence on primary commodities
- Potential for linking conflict-affected parts of the country with peaceful regions and encouraging integration – although clearly this needs to be carefully considered given the potential risks.
- Potential for job creation, in particular for unemployed young people

#### **Step 2 – Weighting conflict-sensitive criteria**

In conflict-affected contexts, not exacerbating the conflict and maximising opportunities to address causes of conflict trump other intervention criteria that may be important from another perspective (e.g., reducing poverty). Poverty reduction may contribute to tackling conflict; but without ensuring violence will not re-erupt, poverty reduction efforts may be in vain. The weighting of different criteria should reflect this. Equally, pro-poor and conflict criteria may well reinforce each other and overlap – but distinguishing between them means important conflict dynamics are not missed.

#### **Step 3 – Listing potential value chains**

At the point of listing potential value chains, PSD advisers and stakeholders need to agree on a list of absolute ‘no-go’ criteria from a conflict perspective – that is, risks of fuelling conflict and potentially violence through intervening in a particular value chain, which cannot be meaningfully mitigated by a programme. Such ‘no-go’ criteria will be different in different contexts, but are likely to include risks such as:

- Participants in the chain are required to take undue security risks, such as travelling

- via unsafe travel routes;
- Control of the value chain has instigated violence in the past, and may do so again in future;
- The value chain is controlled by known conflict actors, their aides, or conflict-entrepreneurs and feeds corruption as well as potentially armed mobilisation (see Box 15 for examples), and;
- Serious and systemic human rights violations have occurred as part of the chain functioning that the programme intervention is unable to address (such as forced or child labour)

Advisers and partners' assessment may conclude that an intervention should focus on precisely such 'high-risk' chains in order to tackle these challenges. This will require a high degree of realism, caution and risk assessment and mitigation.

#### **Box 15: Military domination of lucrative value chains**

In the DRC and Sierra Leone, military objectives have been aligned towards the capture of major mineral deposits; rebel dominated monopolies have controlled the purchase and export of minerals; militia forces have shifted from a role of ethnic protection to protection racketeering and the economic exploitation of populations and resources; and a systematic and intimate relationship has developed between economics and military activity. Military elements either operate their own concessions, offer protection for mining in return for a percentage of ore, or force labour in labour intensive mines.

If value chains are weighted solely to their economic return this could lead to support to value chains such as this one – entrenching current interests. Criteria for working on a value chain must take into account the effects on a broader range of stakeholders. Where a single extractive sector is a key part of the economy, but where issues cannot be directly addressed through a value chains approach without entrenching interests, other modes of intervention – for example, “higher-level” interventions in regulation or competition should be considered.

Source: [Accelerating the Transition from Conflict to Sustainable Growth](#), Saperstein and Campbell, USAID, 2008.

#### **Step 4 – Matrix ranking products/activities against the criteria**

Products are then ranked against the different criteria in one overall matrix. To promote inclusion and transparency, rankings can for example be done through discussion and consensus with a wider stakeholder group. If this is the approach taken, PSD advisers should ensure that they include not only economic development and product-specific stakeholders, but also individuals knowledgeable in politics and conflict dynamics to feed this perspective into discussions and the eventual ranking.

**Note:** After completing this tool, including the conflict lens, PSD advisers should have a thorough idea of which value chains have a high pro-poor as well as conflict-sensitivity potential.

### **G.3 Tool 2 – Mapping the value chain, and conflict dynamics**

#### **G.3.1 Overview**

In order to capture and understand the workings of a value chain, and how different components interact, maps aim to visualise actors, their functions, and relationships. This has three objectives: capturing networks, connections and processes within a chain; demonstrating inter-dependency between actors and processes; and encouraging participants in the chain to look at the 'bigger picture', beyond their own involvement in the chain. Similarly, conflict mapping helps visualise actors, relationships, dynamics and issues of contention within a conflict system. Both eventually aim to help users identify entry points for intervention, and can be effectively combined.

**Note:** Integrating conflict and value chain mapping can help users identify:

- (1) The macro impacts of conflict *on* value chain dynamics, at different levels – and vice versa
- (2) Conflicts *within* a value chain, i.e. *between* different actors within a chain.

### G.3.2 Adding a conflict lens to the tool

#### Step 1 – Mapping the value chain, and interactions with conflict

Different value chain core processes, functions, services etc. at different levels will have been impacted by the conflict, and continue to interact with it, in different ways. Conflict impacts on a value chain can be positive and negative; direct and indirect, depending also on the nature, scope and duration of the conflict. They are also likely to affect the chances for a successful intervention to strengthen a chain. At the same time, understanding negative conflict impacts assists in identifying bottlenecks and constraints in a given chain. Box 16 below sets out a range of specific impacts that can be useful in carrying out this analysis.

#### Box 16: Sample conflict impacts on a value chain

Conflict impacts on a value chain include the following:

- Destruction of critical infrastructure and disruption of access to end markets
- Weakened state institutions and policies to regulate the value chain
- Embargoes or sanctions by third parties on conflict participants that affect a particular value chain by restricting access to markets, limiting availability of inputs, or instigating consumer boycotts in end markets in response to conflict
- Security risks impacting value chain actors, structures and processes, e.g., levels of violence and crime, looting, etc.
- Direct targeting of value chain actors, structures and processes for economic, political or other reasons (harassment of producers; killing of workers; extortion of value chain-related businesses and supporting markets [e.g., transport]; kidnappings of actors at higher chain levels, etc.)
- Death or migration of value chain participants leading to loss of skills
- Illegal taxation of value chain elements/actors
- Control of certain chain levels or functions by conflict actors (armed groups, political actors, the military, and so on)
- Broken or weakened horizontal and/or vertical linkages resulting for instance from displacement of actors, destruction of assets, but also mistrust between groups resulting from conflict
- Loss of critical supporting services, such as financial, business and sector-specific services
- Lack of finance and/or the willingness to invest in upgrading a value chain
- Disruption of production and processing due to all of the above

#### Step 2 – Identifying and mapping value chain actors, relationships and conflicts involved in these processes

Value chain maps visualise relationships and directions of movement of production processes. The next step is to consider the *nature of the relationships* in a chain, and existing conflicts that stand in the way of upgrading.

#### Box 17: Sample value chain impacts on conflict dynamics

A given value chain, its actors, structures and relationships can have an impact on wider conflict dynamics, either by fuelling tensions or by mitigating them. Such impacts include the following:

- A substantial or politically significant change in access to individual or collective (material and symbolic) resources, especially ones that are non-renewable (for instance access to land or water)
- Creation or exacerbation of socio-economic tensions that can fuel violence
- A substantial change in the material basis for economic sustenance, especially of conflict-relevant groups or individuals
- Challenging the content or control of existing political, economic or social systems in a way that fuels conflict
- Failure to challenge or transform unjust or structurally violent systems or practices can inadvertently and implicitly legitimise and further support them
- Well-designed value chain interventions resulting from an initial conflict analysis can positively and directly address economic and other conflict causes and drivers (*Section 3*)
- The tangible benefits that value chain interventions bring to a community can create an important economic stake in peace

Conflicts can arise around *access* (to roles, resources, information, markets); *control* of specific parts of a chain; *distribution* of resources; and *regulation* of the chain – they can run horizontally (i.e. between actors with similar functions), as well as vertically (i.e. between actors with different functions), within the chain. They can include conflicts between:

- New actors who want to enter a value chain or end market and those who already participate in/supply those markets;
- Producers over the control of, or access to, inputs or necessary resources
- Producers and input/service suppliers over inadequate provisions;
- Producers and buyers over control of prices and access to markets;
- Producers and processors over quality and/or regularity of supply;
- Actors throughout the chain over spreading the costs and risks of upgrading or venturing into new markets, particularly if such efforts are unsuccessful;
- Different actors in the chain over transaction terms and conditions, especially where bargaining and negotiation processes are perceived to be unjust;
- Different actors within the value chain if integration of new functions by one marginalises others who previously provided those functions;
- Those introducing upgrading/innovation efforts and those whose livelihoods and roles within a chain depend on old methods and technologies.

**Note: Conflict, or competition?**

*Competition* is ideally a type of beneficial ‘conflict’ that drives creativity, innovation and upgrading, and as such is an important part of the healthy functioning of a market.

However a conflict-affected value chain may display other, dysfunctional types of conflict, such as unfair competition based on political or military contacts; or particular aspects of the chain being dominated by one group in society at the expense of others. In this way, a value chain can represent a ‘microcosm’ of the macro-level conflict.

## G.4 Tool 3 – Costs and margins in a chain

### G.4.1 Overview

Measuring costs and margins (i.e., the money different actors contribute to the chain and the money they in turn receive) helps researchers and PSD advisers determine how pro-poor a value chain is: that is, how accessible it is for poor people, and whether it presents a promising source of income for the poor.

### G.4.2 Adding a conflict lens to the tool

There is no uniform way of calculating costs of armed conflict at different levels – be that aggregate (at the level of GDP of a country for example), firm, or household levels. In fact there is little agreement over methodologies and real costs and losses incurred through armed violence. We do not set out the details for calculating these costs here. A good overview is given in the [Global Burden of Armed Violence Report](#) (see also Box 18 below).

**Resource: The Households in Conflict Network (HiCN)** brings together an interdisciplinary group of international researchers focusing on micro-level analysis of violent conflict dynamics and their impacts on household welfare. It works to quantify the impact of conflict at the household level; conversely, look at the role micro-dynamics such as poverty and inequality play in the onset and perpetuation of violence; develop adequate research methods; and derive policy recommendations.

The HiCN website includes a large number of country-specific reports; as well as surveys and household datasets. See <http://www.hicn.org/>

**Box 18: How to calculate the costs of conflict**

Different researchers use different variables and methods for counting the costs of war – and each of them offers different, and valuable, insights. A combination of them, may be useful in approaching costs to specific value chains:

- **Accounting approach:** that is, adding up different conflict-related costs that actors in the chain identify;

- **Modelling approach:** that is, identifying opportunity costs, and the difference in expected and actual margins at different levels, based on a realistic counter-factual (this is sometimes done by comparing pre-war and post-war levels of GDP, for example)
- **Contingent valuation approach:** this approach tries to capture how much different actors are willing to pay to improve their own security and avoid the costs of armed violence, such as crime (for example, through security providers).

Source: [Global Burden of Armed Violence Report, 2009](#)

Costs of conflict on different actors in the chain will vary, and some may be harder hit by conflict than others. For example, small-scale producers may be harder hit by *direct* costs (such as death and displacement), while actors further up the chain may incur more indirect costs, such as delays in delivery of goods.

## G.5 Tool 4 – Analysing technology, knowledge and upgrading

### G.5.1 Overview

This tool helps users analyse the knowledge and technology used in a particular value chain; as well as possibilities and opportunities for upgrading them. In particular, it helps PSD programmers identify whether specific types of knowledge and technology are available to the poor; affordable; and usable by them. In terms of programming, it helps analyse the efficiency and effectiveness of currently used technology and knowledge; and evaluate upgrading options.

### G.5.2 Adding a conflict lens to the tool

Armed conflict affects, positively and negatively, the way in which information and technology are available, accessible and used in value chains. Conflict may drive the introduction of new technologies and innovation (for example, new and more efficient modes of transport); conversely, previously accessible sources of information and technology may have been lost in the war (for example, if specific actors in the chain controlling specific technology were displaced, or migrated).

Equally, control over technology and information within a chain is an important source of power and may reflect wider conflict dynamics: as Box 19 shows, military and political leaders may be able to hold certain value chains and upstream actors like producers and processors 'captive' through lack of access to adequate information.

#### Box 19: Conflict impacts on learning and information exchange in value chains

Just as critical to a well-functioning value chain as the flow of products up the chain towards the consumer is the flow of information and learning from the end market down to the producer. Accurate and timely information on specifications, quality standards, volume and price is critical to producers' ability to deliver products that will be accepted by buyers at a fair price. Therefore one of the most significant results of weakened inter-firm linkages is the breakdown of key channels of information and learning. Missing actors and intermediaries, compromised relationships and lack of access to contacts contribute to the failure of information transfer. Risk-averse buyers reduce levels of downstream investment in technical and business training to help suppliers meet market standards, and publicly sponsored market information systems and investment promotion initiatives are often beyond the capacity of conflict-affected administrations. As a result, conflict-affected value chains are often characterised by truncated marketing systems, lacking forward linkages to value-adding facilities and backwards linkages to input suppliers. This eliminates opportunities for embedded services and financing as well as channels for demand-driven market information.

Source: [Accelerating the Transition from Conflict to Sustainable Growth](#), Saperstein and Campbell, USAID, 2008.

Building on research on information, knowledge and technology, PSD advisers then move to identifying different opportunities for upgrading in the chain; these include:

- **Process upgrading** - improving the efficiency of existing production processes, for

example through reducing costs or increasing speed of production or delivery.

- **Product upgrading** - the introduction of new products or improvement of existing products - for example through new technology that improves the quality of products, and product differentiation.
- **Functional upgrading** - helping actors in the chain identify which activities to focus on; whether they should outsource some activities, or acquire new functions.

In answering these questions, PSD advisers need to go back to the conflict analysis, to assess how different upgrading options may interact with existing conflict dynamics and legacies. Likewise, they need to ensure that their own upgrading plans do not generate new sources of tension in the chain, or in the wider context. The following questions provide a starting point; others may be required depending on context:

**Table 5: Questions to ask in considering upgrading technology**

Who is likely to benefit?	Who is likely to lose out?
May upgrading exacerbate unemployment among certain groups? Can this be mitigated by introducing labour-intensive technologies?	How can negative impacts be mitigated?
Will benefits and costs of different types of upgrading be incurred equally across the chain or on some actors more than others?	Can the introduction of certain types of technology help mitigate existing disputes or conflicts within a chain (Box 20 gives an example)?
Can the introduction of certain types of technology help improve the security and safety of value chain participants (e.g., safe modes of transport for female producers to and from markets)?	

A conflict-sensitive approach requires a value chain intervention to achieve its objectives (e.g. increased competitiveness of a particular chain through upgrading, strengthening support markets, etc.) in a way that also maximises peaceful outcomes and mitigates identified conflict issues or risks. PSD practitioners should not assume that a standard value chain project will have a positive, peace-building impact; this type of outcome needs to be built into a project, and human and financial resources built in accordingly.

**Box 20: Introducing new technology to overcome conflict and build trust**

Immediately following the 1999 conflict in Kosovo, the majority of dairy cattle were located in Serb villages while most of the dairy processing facilities were located in Albanian villages. This offered an ideal opportunity for cross-ethnic cooperation based on economic needs.

However, the type of cooperation that ensued fuelled resentment at best and contempt at worst. Serb family farmers waited at the edge of their villages, sometimes for hours or days, to sell raw milk at below market prices while Albanian dairy processors complained that the milk had been watered down. They also felt that their lives were in danger simply for entering Serb villages. In order to alleviate the tension and danger in the situation, Mercy Corps installed milk collection centres in a number of Serb villages where Albanian dairy processors were already purchasing raw milk. These centres provided a hygienic and secure place to store milk thereby eliminating the need for farmers to wait at the edge of their villages in order to sell their milk. They were also able to store the milk at the correct temperatures thereby enabling the dairy processor to collect the milk at his convenience. With special equipment, the milk collection centre manager was also able to measure the fat content of the milk collected in order to confirm that the raw milk was not watered down. This enabled both the processor and the farmer to confirm the quality of the milk and thus negotiate a fair price.

Source: Harvesting Learnings: Integrating Peace and Development through Dialogue in the Balkans, Mercy Corps, 2003.

## Appendix H: Challenge and innovation funds

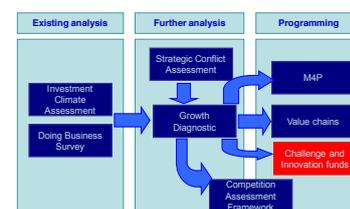
### H.1 Overview

**What is the tool?** Challenge and innovation funds seek to leverage business activity in a way that stimulates growth and development, by encouraging private sector actors to become active in areas or countries where they previously under-invested

**Why is it relevant to PSD in CAEs?** Attracting investment and encouraging innovation is crucial – this is particularly true in countries where conflict may have discouraged investment.

**What are the key lessons for applying it?** Two key changes are required in adapting challenge and innovation funds for CAEs. These are:

- **Reassessing funding criteria**, requiring, in particular, due diligence, background checks and risk assessment on project sponsors;
- **Taking a systematic approach to supporting private sector innovation** in conflict contexts. This involves promoting conflict-sensitive partnerships, and tailoring types of projects supported in conflict contexts.



Lack of productive investment and beneficial private sector activity in CAEs is a key barrier to economic recovery. There is strong evidence that countries that do not manage to achieve a strong positive trajectory in a number of areas, including economic growth, face a 40 percent likelihood of returning to war within ten years. Risks of a relapse into conflict increase to 75 percent for countries with stagnating economies; while chances of returning to war progressively decrease with increasing per-capita incomes.

Attracting beneficial investment in conflict-affected countries outside of the “enclaved” extractive industries is therefore a primary concern, and has received increasing development community attention in recent years. This includes investment from overseas (including diaspora), as well as domestic sources.

Challenge and innovation funds are intended to address this. Such funds allocate grants to organisations to implement development-oriented projects that meet certain eligibility criteria. Typically, they are used to encourage commercially-focused stakeholders to make extra efforts to reach the poor or devise market-based solutions that would significantly benefit the poor. The challenge fund therefore rewards successful firms that want to apply innovative pro-poor business models that have wider economic and social impacts; and aims to enable business projects that would not otherwise happen without the addition of public funds. In other words, the challenge fund helps firms overcome the market failures that prevent their engagement with the poor.

Challenge funds normally provide ‘matching grants’ of up to 49% of the costs of commercial proposals, selected on a competitive basis by an independent expert panel. DFID has been a leader in developing and refining the challenge fund approach, which is now implemented through a variety of funding arrangements targeting different parts of the world (for example, the recent Africa Enterprise Challenge Fund); as well as specific sectors (for example, the Food Retail Industry Challenge Fund).

Using investment promotion tools such as challenge funds in conflict contexts is in its infancy, and needs to be tested further in the coming years. As a start, using challenge funds to leverage private sector activity in conflict contexts needs to take account of the challenges present in these contexts, to minimise negative impacts on the already fragile context; and maximise positive, pro-poor and pro-peace outcomes.

This section gives an overview of guidance for PSD advisers, drawing on the range of

research and recommendations in recent years on private sector investment in conflict zones. The section on adapting funding criteria is specific to challenge and innovation funds. However, many of the lessons, particularly in terms of due diligence, apply more broadly to donors working alongside the private sector – whether in a development or client/ customer relationship - in conflict affected countries.

## H.2 Applying a conflict lens to the challenge funds

Adapting challenge and innovation funds to conflict-affected contexts can be achieved by:

- **Adapting funding criteria**, requiring, in particular, due diligence, background checks and risk assessment on project sponsors;
- **Taking a systematic approach to supporting private sector innovation** in conflict contexts. This involves promoting conflict-sensitive partnerships, and tailoring types of projects supported in conflict contexts.

Note: It is critical to remain aware that private-sector investment in a post-conflict environment, by entrepreneurs of any size, is an attempt to predict the future outcome of an uncertain process. Since a significant proportion of conflicts recur, rational businesses will often be risk averse and postpone any significant investment."

Source: [Accelerating the Transition from Conflict to Sustainable Growth](#), Saperstein and Campbell, USAID, 2008.

In this section we translate adaptations of these funds to a set of steps that PSD advisers can take to maximise the potential of challenge and innovation funds in conflict contexts:

## H.3 Adapting funding criteria

Funding decisions should be informed by a strong understanding of the impacts of conflict on specific sectors and private sector actors; and conversely, the diverse impacts and roles different sectors and businesses have played in the course of an armed conflict, including fuelling it in a number of ways:

- Vested interests in different markets and sectors;
- Conflict financing through certain markets and sectors;
- Elite capture of economic and political resources and power in a way that exacerbates grievances and conflicts;
- The way in which certain sectors may have fuelled socio-economic exclusion and discrimination that may have driven conflicts.

Risk assessment and due diligence, through background checks of project sponsors, need to include these types of conflict-related questions, to avoid the risk of challenge funds becoming associated with and thereby legitimising 'conflict entrepreneurs' that managed to do 'well out of war' by accumulating wealth and assets through rent-seeking or predatory behaviour. In their assessment, programme designers may find it useful to distinguish between different types of 'economies', activities and actors engaged during war, their likely impacts, and the likelihood of their continued presence in the aftermath of conflict (see Table 6).

In addition, different sectors may have different 'conflict footprints' that will influence their ability to promote stability. This will further depend on the type of conflict and history of conflict dynamics, of which the country-level conflict assessment and growth diagnostics should give an idea. In turn, promoting 'conflict-sensitive approaches' in challenge funds can proactively contribute to mitigating these conflict risks (see Box 21).

**Table 6: Different types of economic activities and actors during conflict<sup>17</sup>**

	Combat economy	Shadow economy	Coping economy
<b>Who?</b> Key Actors	Commanders, conflict entrepreneurs, fighters, suppliers of weapons and materiel	Profiteers, transport sector, businessmen, drug traffickers	Poor families and communities
<b>Why?</b> Motivations and incentives for war and peace	To fund war efforts or achieve military objectives. Peace may not be in their interest –as it may lead to decreased power status and wealth Fighters may have an interest in peace if there are alternative sources of income	To make profit on the margins of conflict. Peace could be in their interests if it encourages long-term investment and licit entrepreneurial activity	To cope and maintain asset bases through low risk activities or to survive through asset erosion. Peace could enable a move beyond subsistence
<b>How?</b> Key activities and commodities	Taxation of licit and illicit economic activities: money, arms, equipment, and mercenaries from external state and non-state supporters. Economic blockages of dissenting areas. Asset stripping and looting, aid manipulation	Smuggling of high-value commodities. Mass extraction of natural resources. Aid manipulation	Employment of diverse livelihoods strategies to spread risk. Subsistence agriculture; petty trade and small businesses; wage labour; labour migration and remittances; redistribution through family networks. Humanitarian assistance.

**Box 21: Potential sector and industry-specific "conflict footprints"**

Depending on the type, scale and history of conflict, different sectors' and industries' impacts on conflict can include:

- Agriculture and forestry can be a source of conflict as a result of land tenure issues, the inappropriate use of technology, distorting pricing structures and environmental damage.
- Extractive sectors (oil, gas, timber, mining) have a strong potential for creating conflict over the control of and access to resources, unfair distribution of revenues and poor management of security arrangements and community relations.
- The financial services sector has the potential to exacerbate conflict by funding "war economies," providing safe havens for looted state assets or facilitating (intentionally or unintentionally) money laundering and arms deals.

These potential conflict risks will not be present in every instance; but provide an overview of potential sector-specific conflict risks. Similar 'conflict footprint' profiles for other sectors may help fund managers think through conflict risks involved in financing projects in different sectors.

Adapted from: [Accelerating the Transition from Conflict to Sustainable Growth](#), Saperstein and Campbell, USAID, 2008.

**H.4 Taking a systematic approach to supporting innovation**

Challenge funds' eligibility criteria should reflect the below three-step approach:

**H.4.1 Step 1 – Ensure compliance**

In addition to compliance with national rules and regulations, companies are more and more held accountable – morally, reputationally, and increasingly also legally – under international laws, including human rights, humanitarian and international criminal law. Challenge and innovation fund managers and advisers can play an important role in advising companies on these obligations; and building compliance into grant agreements. Several resources to draw on in this regard are highlighted below.

<sup>17</sup> Adapted from Goodhand, J. 2004. Afghanistan, in: Pugh, M. and N. Cooper, with J. Goodhand 2004. *War Economies in a Regional Context: Challenges of Transformation*. Boulder: Lynne Rienner Publishers.

**Note: International crimes – why should companies care?**

“No one likes to think of themselves as in the same category as war criminals or dictators. But factors like global trade integration or the increasing demand for strategic minerals mean that many companies are closer than they think to very serious human rights abuse. The primary risk - although not the only one - lies in the danger of complicity, aiding and abetting those who commit international crimes. In many cases this will come down to a question of whether or not the company 'knowingly provided substantial material assistance' to the commission of a crime. But definitions of complicity vary according to jurisdiction and application to businesses remains to be defined. The bottom line is that, whether the problem lies somewhere down the supply chain or embedded in their relationship with a host government, companies will have to conduct due diligence to ensure they avoid participating in the international crimes of others.”

Source: [www.redflags.info](http://www.redflags.info)

Research and advocacy in recent years has highlighted several areas of rights violations 'typically' present in conflict contexts that companies can be held legally liable for, and therefore should have an active interest in guarding against.

**Resources:**

The UK [Foreign and Commonwealth Office's 'Business and Human Rights Resource kit'](http://www.redflags.info) helps users promote good conduct by UK companies, by:

- Giving specific guidance on the [Organisation for Economic Cooperation and Development's Guidelines \(OECD\) for Multinational Enterprises](http://www.oecd.org) and how to implement the complaints procedure via the UK National Contact Point (NCP).
- Outlining existing UK policy on business and human rights issues and suggesting actions staff can take overseas to promote human rights
- Including reference to a range of further initiatives and resources in the area of business and human rights including amongst others the [Voluntary Principles on Security and Human Rights](http://www.un.org) and the [Extractive Industries Transparency Initiative](http://www.oecd.org), as well as links to guidance that businesses have designed to address human rights and the website of the UN Special Representative on Business and Human Rights.

The 'Red Flags' initiative has identified a list of activities, drawn from a review of existing international law and court cases in more than a dozen jurisdictions, that can create legal liability risks for companies. Source: [www.redflags.info](http://www.redflags.info)

#### **H.4.2 Step 2 – Require appropriate risk assessment and mitigation**

Conflict contexts display a number of risk factors that companies' standard due diligence procedures and risk assessment methods are not designed to detect or mitigate. While political risk analysis, for example, looks at macro-level political dynamics in a country, including political instability, it does not enable companies to assess their own likely impacts in these contexts. Standard environmental and social impact assessments in turn, while assessing likely impacts in these areas at the micro-level around company operations, do not help companies gauge the risks of human rights- and conflict impacts.

**Note: Private sector's "risk-responsibility"**

Risk-responsibility refers to the combination of factors to be considered by the private sector: risk of reinforcing conflict and their responsibility for trying to mitigate conflict.

Source: [Accelerating the Transition from Conflict to Sustainable Growth](http://www.usaid.gov), Saperstein and Campbell, USAID, 2008.

In response to these gaps, several impact assessment methodologies have been developed and piloted in recent years, both by NGOs and the private sector, and through innovative multi-stakeholder partnerships. These include both human rights impact assessments; and conflict risk and impact assessment methods. While many of these have been pioneered by the extractive industries, they are increasingly also being adapted by other sectors, such as forestry, agriculture, banking, and the construction sectors.

Challenge fund requirements in CAEs should include for human rights- and conflict-impact assessments by project sponsors. There are now a range of tools with slightly different focuses and aims, which can be adapted for different purposes (see resource below).

**Resources:**

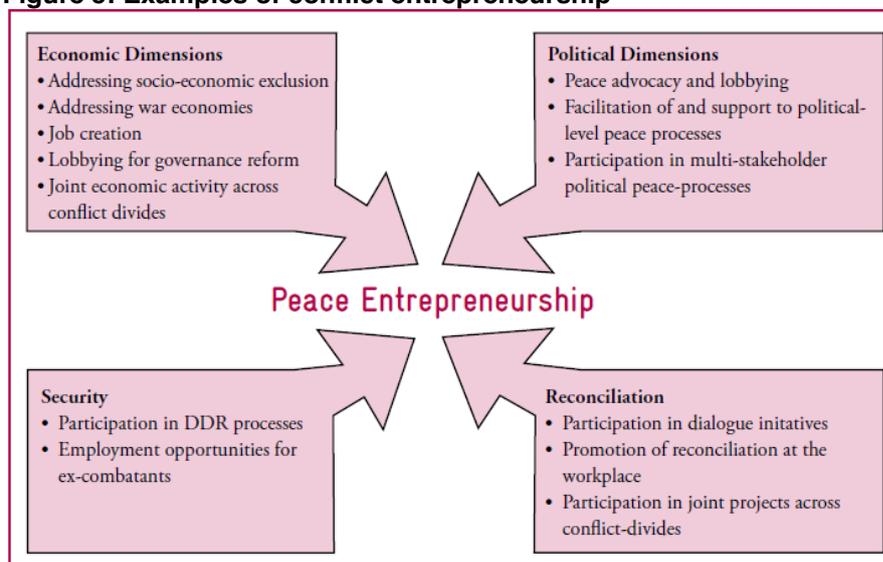
The organisation Aim for Human Rights has produced a [Guide to Corporate Human Rights Impact Assessment Tools](#), giving a comprehensive overview of a number of leading tools in this field, their approach, scope, and how to use them. It enables companies, and in turn investors, to decide which tools and approaches to risk assessment and mitigation are most appropriate.

The International Petroleum Industry Environmental Conservation Association has produced a sector-specific guide for '[Operating in Areas of Conflict](#)'. It provides basic guidance on risk assessment and risk management in conflict settings that oil and gas companies might face. These include conflicts between companies and local communities - directly related to the presence and operations of the companies themselves, as well as wider social and political conflicts in which companies are not directly involved but which are very likely to impact on companies operating in such environments.

The UN Global Compact and the Principles for Responsible Investment (PRI) initiative, in partnership with a network of international experts, companies active in conflict-affected regions, and institutional investors, has produced a cross-sectoral resource '[Guidance on Responsible Business in Conflict-Affected and High-Risk Areas: A Resource for Companies and Investors.](#)' It is designed to help companies tackle challenges in their core business operations; government relations; local stakeholder engagement; and strategic social investment.

### H.4.3 Step 3 – Encourage innovation that adds societal value and addresses conflict causes and legacies

**Figure 5: Examples of conflict entrepreneurship**



Source: GTZ 'Sustainable Economic Development in CAEs: a Guidebook

Evidence from a number of countries shows that where the private sector has a competitive advantage and an active interest in a stable operating environment, it has taken steps proactively to address conflict causes and legacies through core business operations,

social investment and policy dialogue initiatives – in other words, engaging in 'peace entrepreneurship' (see Figure 5 for examples). Challenge funds active in conflict-affected areas can seek to leverage such peace entrepreneurship, in a number of ways:

- Share examples/ case studies of successful 'peace entrepreneurship' initiatives;
- Develop specific eligibility criteria for funding lines dedicated for such purposes;
- Ensure that eligibility criteria and funded projects are in line with wider international and donor community country, peace-building and recovery strategies;
- Ensure that eligibility and funding criteria are context-specific, as template approaches to peace-building won't work.

## Appendix I: Illustrative examples of applying the DCED Standard in CAEs

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### **Agricultural supply chain intervention**

Many countries that are prone to conflict – particularly in Africa – are also reliant on agriculture to provide basic incomes. Thus PSD programming might perfectly normally focus on working in the agriculture sector as is, for example, the case in a country like Rwanda. It is realistic therefore that such programming would be an excellent example of how PSD can contribute to all aspects of peace-building, not just to economic growth. In particular, how might the process of fostering greater economic activity also be used as a way of creating cross-cutting relationships within a potentially divided society.

A value chain approach would seek to increase linkages between farmers, and between them and traders, so facilitating greater economic activity and hence more jobs and higher incomes. However, by applying the DCED Standard approach would also imply that, at the enterprise/ sector level, a valuable impact indicator to set would be the number of new business relationships created between businesses drawn from different sides of the potential conflict divide. A further qualitative indicator would be to assess the quality of the relationships between firms, farmers and traders from different factions of the conflict divide. At the goal level, the number of additional jobs and incomes created should to be disaggregated by ethnic groups to demonstrate that the programme does not favour one group over the other, hence risking to reinforce conflict dynamics.

### **Promotion of Business Registration Reforms through Public-Private Dialogue**

The sheer scale of the informal sector is often a problem in conflict-affected countries where government is weak and governance structures ineffective. In such an environment, PSD practitioners are likely to consider a programme to promote business registration. Once again this process can be undertaken in such a way as to benefit other aspects of peace-building than simply economic development.

A suitable way forward would be the establishment of a public-private forum to facilitate discussion about what might be the obstacles to more formalisation in the business sector. One measurable outcome of such an approach would be the increase in interaction and collaboration between businesses from different segments of society on common interests. In governance terms too, such an approach could be advantageous since the process aims to provide the basis for business registration reform and an infrastructure to achieve this. Such a development would be a significant step forward in strengthening the governance frameworks of the host country as part of wider efforts in this area. Hence, the enactment of business registration reforms by the Parliament as an outcome of the donor intervention can serve as a relevant indicator in this context. In measuring the impact of the reform programme on the number of business registrations, and additional jobs and incomes resulting from it, numbers would need to be disaggregated by relevant conflict-affected groups.