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Economic Agenda for Post-Conflict Reconstruction

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Abstract

This paper focuses on the design and implementation of economic reforms, which are an integral part of the process of peace and reconstruction. The challenge for economic reforms is immense. On one hand, economic policies should aim at minimizing the risk of conflict recurrence, restoring confidence in economic institutions, generating employment and fostering investment, and enhancing the ability of the state to provide security for households and communities, enforce the rule of law and deliver essential services. On the other hand, structural economic reforms cannot be postponed in order to cope with a pre-conflict economic structure that did very little to avoid the conflict and that can be highly distorted as a result of the war effort. Therefore, reconstruction policies should be primarily geared towards changing, improving or, even in an extreme case, eliminating altogether the pre-conflict institutional fabric of the country. That is, the set of economic institutions –and their embedded structure of incentives—that helped create the conditions for failure.

Keywords: Post-conflict Reconstruction, Social Contract, Economic Agenda, Macroeconomic Reforms, Microeconomic Reforms, Power Sharing Institutions.

JEL Classifications: D73, D74, P11, P16, E61, D04.

1. Introduction

By any standard, the challenges faced by post-conflict countries are daunting. In addition to recovering from the destruction of physical, human, and social capital, societies must cope with severely weakened state capacity, distorted economic incentives, widespread poverty, population displacement, and massive unemployment.

These conditions place war-torn countries at continuing risk of relapsing into violent conflict. As discussed in Sambanis (forthcoming), civil conflicts are notoriously persistent: the same reasons that ignited the conflict, make it difficult to reach a mutually enforceable settlement that could avoid the high costs of violence in settling disputes over resources or power. Power sharing institutions, he argues, increase the political inclusion and accommodation of minority groups and former rebels after civil war, thereby reducing grievances that could fuel violent conflict.

Beyond politics, institutions also matter for the maintenance of peace after conflicts (Fearon, 2011). Besley and Persson (2011) and Elbadawi and Soto (2014), among others, provide theories and empirical evidence that political violence is the result of a game where an incumbent government and an opposition group each can make an investment in political violence and where the ruling group in each period controls the government budget, which can be used either for public goods or for redistribution between the two groups. The main determinants of conflicts include the level of resource rents, aid or other forms of income to the state, the level of wages, and the level of public-goods provision. Importantly, however, the theory predicts an influence of these determinants on violence only if political institutions are non-consensual.

Resource and power control are one of the key determinants of conflict but grievances can also play a role. Bodea and Houle (forthcoming) review the long-lasting debate on the role of grievances, inequality and natural resource rents in fueling civil conflict and violence. They investigate the ways in which horizontal wealth inequality interacts with oil resources to increase or mitigate the risk of conflict: wealth inequality among groups generates an emotional reaction to both the perceived lack of resources compared to other groups, or the need to redistribute to poorer, less deserving groups. Oil revenue can be insidious in this context, compounding such emotional reactions.

While political, institutional, and sociological considerations play a crucial role in post conflict reconstruction, an equally key determinant of success is the quality of economic policies implemented after peace is restored. This chapter focuses on the design and implementation of economic reforms, which are an integral part of the process of peace and reconstruction. The challenge for economic reforms is immense. On one hand, economic policy priorities for countries in post-conflict recovery should take into account the need for minimizing the risk of conflict recurrence and restoring confidence in social, political and economic institutions. In particular, it is important to enhance the ability of the state to provide security for households and communities, by enforcing the rule of law and delivering essential services. Economic recovery priorities must focus on employment, encourage productive investment, mitigate business risks and reduce group inequalities. On the other hand, structural economic reforms cannot be postponed in order to avoid a relapse into conflict and give the peace process some hope of being sustainable. Most likely, the pre-conflict economic structure did very little to avoid the conflict and the current economic structure may also be highly distorted as a result of the war effort. Reconstruction policies should, therefore, be primarily geared towards changing, improving or, even in an extreme case, eliminating altogether the pre-conflict institutional fabric of the country. That is, the set of economic institutions –and their embedded structure of incentives—that helped create the conditions for failure. Reconstruction has to be a nation-building exercise as well as a peace-building effort.

Undoubtedly, idiosyncratic political, economic, and sociological elements largely shape the national post-conflict reconstruction effort. Nevertheless, reconstruction must deal with common challenges, such as establishing of genuinely inclusive and democratic governance; repatriating human and financial resources, dealing with the donor community, reversing the deterioration of human development and security conditions, overcoming the destruction of infrastructure, facing the increase in the number of people needing social assistance; coping with large fiscal deficits caused by high military expenditures (usually at the expense of social expenditures); curtailing the rise of inflation; managing the increase of debts that were not serviced during wartime; or normalizing external trade disrupted by hostilities.

We submit that the reforms to be considered in the post conflict economic agenda should be based on three premises, culled from the literature on post-conflict reconstruction and the experience of a large number of countries. First, in order to gain legitimacy and be sustainable, reconstruction policies should focus on achieving wider economic inclusion and lesser inequality, in addition to achieving substantial reductions in unemployment. Second, reconstruction policies should be primarily geared towards changing, improving or, even in an extreme case, eliminating altogether the pre-conflict institutional fabric of the country. Third, proposed economic reforms and policies ought to be in line with the establishment of an implicit or explicit new form of social contract**.**

OECD (2008) defines a social contract as a process for bargaining, articulating and mediating society's expectations of the State. A social contract emerges from the interaction of five elements: (a) *expectations* that a given society has of the State; (b) *State* *capacity* to provide services, including security, and to secure revenue to provide these services; and (c) *élite will* to direct state resources and capacity to fulfil social expectations. It is crucially mediated by (d) the existence of *political processes* through which the bargain between state and society is institutionalized. Finally, (e) *legitimacy* plays a complex additional role in shaping expectations and facilitating political process. Legitimacy is also produced and replenished –or, conversely, eroded– by the interaction among the other four factors. Structural reforms in post conflict ought to provide a new framework where such interaction is fruitful, by inducing an agreement between state and society on their mutual roles and responsibilities.

As can be seen, our analysis points to the need of implementing far reaching, structural reforms. We are aware of the criticism that reconstruction often fails as a result of authorities aiming at transferring Western state institutions to post-conflict economies with disregard of local interests. Englebert and Tull (2008) identify this as one of the main reasons why some countries –particularly in Africa—have obstinately resisted attempts at transformation. The limited success of market reforms and democracy promotion indicates that the grand vision of state building, with its one-size-fits-all approach, is likely to meet resistance. To some extent, this is due to the absence of cooperation between reform supporters (especially, donors) and national leaders, itself the result of conflicting views on the causes of state failure and the goals of reconstruction. Political elites may seek to maximize the benefits accruing to them from existing institutions as well as from ongoing political instability.

We split reforms into two main areas, though some interlocking is expected to naturally occur. First, we focus on macroeconomic stabilization and structural reforms, which would provide an appropriate framework for the resumption of growth and employment, for the control of economy-wide imbalances (such as inflation, fiscal deficits, and in the balance of payments), and for dealing with the financing of those essential public services that have an immediate impact on the welfare of the population. Second, we focus on a number of crucial microeconomic reforms in areas concerning property rights, the regulation of markets left to the operation of the private sector (including privatization) and the management of markets where market fails as a result of natural monopoly power, informational asymmetries, merit and demerit goods, missing markets undiversifiable risks, and externalities. These microeconomic reforms can have a significant impact on welfare of the population in the short run as well as build defenses against corruption and abuse in the medium run.

The literature on reconstruction agendas is extremely vast, at the analytical level as well as in the reporting of actual experiences. Our main goal is not to survey it but to identify those insights, best practices, and lessons learned that best serve our purposes of illuminating the proposals for reconstruction agendas in conflict-affected MENA countries. Section 2 of the paper is devoted to reconstruction challenges. In our view reconstruction has to be a nation-building exercise as well as a peace-building effort. Crucially, reforms should steer the economy and society away from the resumption of violence while, at the same time, they should change the structure of political and economic institutions that helped create the conditions for failure. This is a very difficult challenge and needs support both at the macro and microeconomic level. In section 3 we focus on the most important macroeconomic reforms that we submit should be implemented to deal with the pressing and crucial concern of the resumption of economic growth and, in particular, the creation of employment. These include monetary, fiscal, and exchange rate reforms, as well as dealing policies to deal with infrastructure reconstruction, the role of foreign direct investment, foreign aid and commodity price shocks. Section 4 is based on the notion that reconstruction of institutions at the microeconomic level is vital for sustainable development and, more importantly, for the appropriation of the benefits of peace by the population and increasing the legitimacy of reconstruction. Microeconomic reforms are identified along three guiding principles. First, the need to restore property rights, so that security levels improve and the returns of the effort is accrued to their legitimate owners. Second, the identification of sectors where private initiative is best allocated by market forces from areas where markets fail as a result of natural monopoly power, informational asymmetries, and externalities. Third, the proper regulatory setup for each type of market. Competition in free markets would not deliver its promise of development and welfare gains if adequate regulation and supervision are not in place. Likewise, where the market fails, intervention must be designed so that efficiency is preserved and benefits accrue to the population and not to interest groups or bureaucrats.

2. Reconstruction Challenges

We start from the notion that reconstruction policies should be primarily geared towards changing, improving or, even in an extreme case, eliminating altogether the pre-conflict institutional fabric of the country. That is, the set of political and economic institutions – and their embedded structure of incentives—that helped create the conditions for failure. Reconstruction has to be a nation-building exercise as well as a peace-building effort. As noted by Devarajan and Mottaghi (2017), reconstruction should be designed to influence the conflict dynamics towards peace by changing the calculus of the belligerents.

Economic reforms must therefore be designed and implemented to change incentives for the different agents in society at all levels; microeconomic, macroeconomic, and institutional. If, as documented in Bodea and Houle (this volume) and Campante and Chor (2012), inequality in incomes and opportunities are one of the main sources of civil conflicts in the Middle East, then the challenge for authorities is to devise economic reforms that allow for an appropriate partake of peace benefits and of sustained growth. If, as claimed by Malik and Awadallah (2011) and Salih (2013) among others, the roots of the region's long-term economic and political failure is a statist model of intervention that is financed through external windfalls and rests on inefficiency and corruption, then reforms must change incentives such that a vibrant private sector emerges in areas where the government has been blatantly unsuccessful.

Political reforms also face daunting challenges. Political exclusion and repression have been repeatedly blamed for the violence of the Arab uprising of 2011 (Wimmer et al, 2009; Jofee, 2011). Devarajan and Ianchovichina (2018) claim that the underlying source of the conflict is in the fraying social contract where the government provided formal-sector jobs, education, and health care, and subsidized fuel and energy, in return for limited political freedoms. This social contract was becoming economically unsustainable and the implicit promises by the government were being eroded or not kept anymore, leading to widespread dissatisfaction and willingness to protest. They argue that a new social contract is, therefore, required that promotes private-sector jobs, accountability in service delivery, and active citizen participation in the economy and society. In particular, as discussed by Elbadawi and Makdisi (2017), Arab countries recovering from conflicts should strive to establish democratic governance if they are to embark on genuinely inclusive reconstruction that would cement their transition to a peaceful and sustainable national development.

The literature on post-conflict economic recovery shares the assumption that failed nation-states fail in their own unique way and that, accordingly, each reconstruction effort is unique (UNDP, 2008; Tzifakis, 2013). In this interpretation, every post-war situation differs in terms of the causes of conflict and the nature of its resolution; the extent of the hostilities in the territory and the magnitude of destruction; the initial economic conditions; the international support to the settlement; and the interests of donors in the country. Consequently, one would be tempted to conclude that the reconstruction agenda ought to be tailor-made to the particular needs of each country.

Undoubtedly, idiosyncratic political, economic, and sociological elements largely shape the national post-conflict reconstruction effort. Nevertheless, any reconstruction effort must deal with challenges common to all post-conflict situations, including establishing of genuinely inclusive and democratic governance; repatriating human and financial resources, dealing with the donor community, reversing the deterioration of human development and security conditions, overcoming the destruction of infrastructure, facing the increase in the number of people needing social assistance; coping with large fiscal deficits caused by high military expenditures (usually at the expense of social expenditures); curtailing the rise of inflation; managing the increase of debts that were not serviced during wartime; or normalizing external trade disrupted by hostilities.

This commonality makes cross-country analysis and country-case studies complementary approaches and important sources for the purposes of understanding the reconstruction challenges of conflict-afflicted Middle-East economies. While the Arab uprisings may have detonated the political crisis, the intensity of the demonstrations and speed at which they spread from one country to the next attest to the existence of deep-rooted, long-standing factors underlying discontent. One can group these factors in economic, political, and social categories, which we discussed in what follows.

2.1. Economic Factors

On the surface, economic factors deceivingly look as if they were not at the root of recent conflicts in the Middle East. The region had made steady progress toward eliminating extreme poverty, furthering prosperity, increasing school enrollment, and reducing hunger, child and maternal mortality (Ianchovichina et al., 2015). About half of the poor in the region in the 2000s moved out of poverty by the end of the decade. Nevertheless, chronic poverty remained high. Upward mobility was strong in Syria and Tunisia, but downward mobility was pronounced in Yemen and Egypt (Dang and Ianchovichina, 2018).

Reforms were at least partially underway and economic growth was moderate and generally in line with growth trends in other regions of the world (see Panel A in Table 1). Nabli et al. (2008) evaluate the reforms prior to the uprisings and conclude that all countries had embarked on significant structural reforms and made progress in creating environments more conducive to private sector development by allowing their economic systems to be more market driven. However, they conclude that while the reforms of the last twenty-five years helped MENA countries to open space for the private sector, its response to the reforms was weak and performance lagged significantly behind the rest of the world.

Economic growth in Arab economies outpaced the expansion of the world economy by a significant margin in the period 1990-2010 but it slowed down noticeably thereafter (as shown in Panel B of Table 1). The experience of the four case studies in this volume is notoriously heterogeneous. Economic growth in Syria and Yemen was as strong as in other Arab countries and amply surpassed growth in the world economy. Iraq managed to recover from the 1980s conflict with Iran, and only Libya lagged significantly behind other Arab countries and the world economy. Per capita GDP –a limited yet informative indicator of welfare—grew steadily in the two decades prior to 2010 in Syria and Yemen while it clearly stagnated in Libya and Iraq.

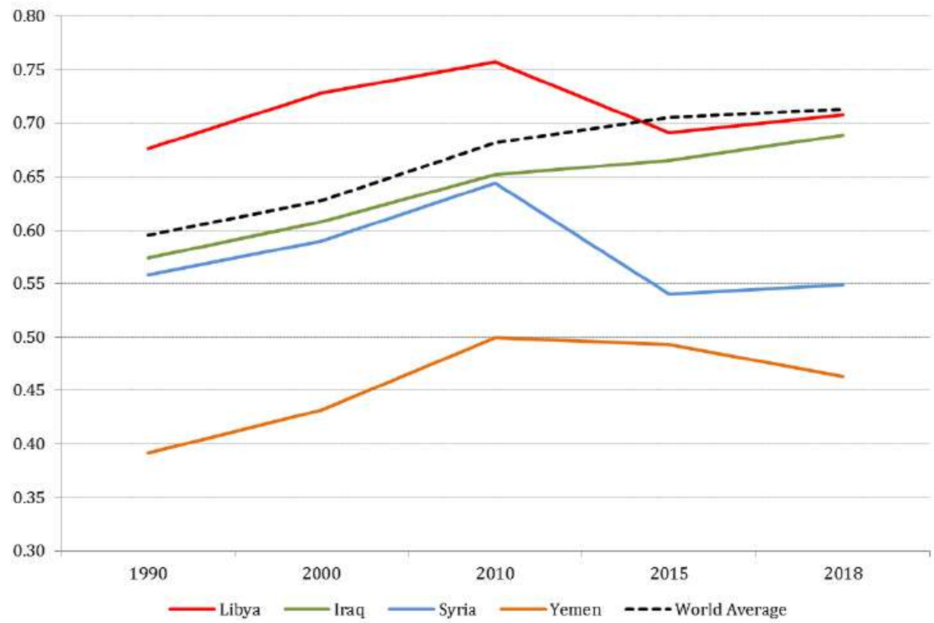
Table 1. Main Macroeconomic Indicators (%)

	World	Arab countries	Iraq	Libya	Syria	Yemen
			Panel A: Period 1990-2009			
Annual GDP Growth	3.1	4.9	3.1	2.4	4.9	4.6
Per Capita GDP growth	2.1	1.9	0.2	0.6	2.1	1.1
Investment Ratio (% GDP)	23.8	20.6	8.6	25.7	22.1	18.4
Employment Growth	1.3	4.3	3.0	3.2	2.5	3.5
TFP Growth	0.2	0.2	1.6	0.1	1.4	-0.6
			Panel B: Period 2010-2018			
Annual GDP Growth	3.4	2.3	5.7	3.7	-7.3	3.4
Per Capita GDP growth	2.1	-0.4	2.5	2.6	-6.1	2.1
Investment Ratio (% GDP)	23.5	23.5	21.8	42.0	27.0	23.5
Employment Growth	1.2	3.1	3.6	1.6	-1.7	1.2
TFP Growth	0.1	-2.1	2.3	4.2	-7.9	0.1

Source: Own elaboration based on World Development Indicators 2019, The World Bank, and Total Economy database, The Conference Board.
Note: Arab countries include Algeria, Egypt, Morocco, Sudan, Tunisia, Bahrain, Iran, Iraq, Israel, Jordan, Kuwait, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates, and Yemen.

Per-capita income is, obviously, not an all-encompassing measure of economic development or of welfare. Jones and Klenow (2006) identify leisure, mortality, morbidity, crime, and the natural environment as some of the major factors affecting living standards within a country that are incorporated imperfectly, if at all, in GDP. Nevertheless, evidence from the Human Development Index elaborated by the UNDP (2019) –a composite index measuring achievements in a long and healthy life, knowledge and a decent standard of living—indicates that all conflict-afflict Arab nations had improved significantly over the two decades priori to 2011 (see Figure 1). But, as pointed out by studies on the Arab uprisings, other economic factors have played a role in fueling social and political discontent (e.g., Ianchovichina et al. 2015; Tucker, 2012). Two classic candidates would be: the high level of inequality in expenditures, incomes or wealth of the MENA region, and the high rates of unemployment. In what follows we review the evidence.

Figure 1. Human Development Index



Source: UNDP (2019).

2.1.1. Inequality

Available data provide contrasting views on the role of inequality in conflicts in the Middle East. Data indicate that the degree of income inequality in the Arab countries is not likely to be much larger than in the rest of the world. In particular, the UNU-WIDER database reveals that the Gini coefficient of income in Syria in 2004 was 0.358 –indicating a relatively equal distribution similar to that of the UK—and that it had improved to 0.32 by 2007. A similar trend is observed for Yemen (dropping from 0.395 in 1992 to 0.377 in 2005) and for Iraq (reducing from 0.351 in 2003 to 0.301 in 2007). Data provided by WIR (2018) indicate that the share in income of the top 10% of the population in the Middle East declined steadily between 1990 and 2010, whereas in all other regions in the world it either stagnated or increased sharply. Devarajan and Ianchovichina (2018) show that during the 2000s, expenditure inequality in Arab countries was low or moderate and, in many cases, declining.

On the other hand, the demands for greater social justice associated with the Arab uprisings has led researchers to reexamine inequality in the region. Alvaredo et al. (2018) argue that previous results, based on household survey data only, highly underestimate inequality and they offer new estimates indicating that the Middle East is among the most unequal regions in the world. The most affluent of the population (top 10% income) appropriated around 60%–66% of total income, as compared to 37% in Western Europe, 47% in the USA and 55% in Brazil. The share of the bottom 50% varied between 8%–10% of total income. Hlasnya and Al Azzawi (2019) find that wealth gaps at the household level are significant across urban-rural and educated-uneducated divides in three MENA countries (Egypt, Jordan, and Tunisia). While this new evidence points towards higher degrees of inequality, it cannot be directly linked to the uprisings since income or wealth inequality had remained stable in the past 25 years. Bibi and Nabli (2010) also document the stability of income inequality measures in the MENA region between 1970 and 2010, prior to the uprisings of 2011.

While there is increasing consensus that actual degrees of income or even wealth inequality in MENA might have not been a significant determinant of the uprisings (Devarajan and Mottaghi, 2017; Joffé, 2011), it remains that the two decades of sustained growth before the outbreak of the Arab Spring did little to improve the *perception* of inequality and injustice. Indeed, perceptions seem to have played a crucial role in the social –and thereby, political—discontent. Devarajan and Ianchovichina (2017) find that measures of subjective of well-being were relatively low and falling sharply, especially for the middle class, in the countries where the uprisings were most intense. There was a growing and broadly shared dissatisfaction with the quality of life; the middle class, in particular, became frustrated by lack of job opportunities in the formal sector, poor quality of public services, and the absence of government accountability. Arampatzi et al. (2018) document the low and declining levels of subjective well-being in the run-up to the Arab Spring and find that perceptions about corruption became more important for people's life satisfaction, particularly in the countries where the uprisings were most intense. According to Verme (2014), significant differences between objective and perception data and between the perceived and actual income distribution emerged in Egypt between 2000 and 2008. While in 2000, people viewed themselves as more affluent than they actually were, by 2008 it was the reverse, despite income data showing that the Egyptians had become more affluent.

2.1.2. Unemployment

Labor markets in Arab countries share certain common characteristics, including an oversized public sector, high youth unemployment, weak private sectors, rapidly growing but highly distorted educational attainment, and low and stagnant female labor force participation. Several studies (e.g., Assad, 2014; Malik and Awadallah, 2013) identifies these features as resulting from the use of labor markets by Arab regimes as tool of political appeasement in the context of "authoritarian bargain" social contracts.

Studies in conflict-afflicted Arab countries indicate that high unemployment, in particular youth unemployment, was one of the contributing factors to the uprisings (Elbadawi and Makdisi, 2017). ILO estimates presented in Table 2 confirm that not only total unemployment has been much higher in MENA countries than the global average, but also that youth unemployment is significantly higher than elsewhere in the world. Unemployment problems are compounded by the fact that the share of those between 15 and 24 years of age in the population is considerably larger in MENA countries (the so-called "youth bulge"). Consequently, youth employment is notoriously lower in MENA countries: on average, prior to 2011, only one out of five youngsters was employed. Youth employability deteriorated in the following decade, particularly in war-ravaged Syria and Yemen.

High unemployment weakened the regimes' ability to trade-off public goods and other economic benefits for political rights and participation (authoritarian bargain). Indeed, high unemployment rates have continued to prevail in the post uprising phase even in countries where political settlements have been reached, such as Egypt and Tunisia. Unemployment poses major challenges for stability, in particular for countries that embarked on the road to democratic governance (e.g., Tunisia). Coping with unemployment is essential for their future democratic development: importantly, non-democratic parties could exploit actual and potential popular resentment associated with high unemployment to change the democratic political course underway.

Table 2-Arab Countries: Rates of Unemployment and Youth Employment

	Total Unemployment: Ages 15 and older		**Youth Unemployment: Ages 15 to 24**		**Employment to Population Ages: 15 to 24**	
	Average 2000-2009	Average 2010-2018	Average 2000-2009	Average 2010-2018	Average 2000-2009	Average 2010-2018
World	4.1	4.4	13.0	13.5	43.6	38.8
MENA	7.1	7.6	21.1	26.7	25.0	22.4
Iraq	5.7	7.4	17.2	20.7	27.6	28.8
Libya	15.1	15.9	47.5	50.2	18.6	18.9
Syria	5.9	5.4	19.3	20.8	28.4	18.4
Yemen	8.6	20.3	9.3	24.1	23.5	19.8

Source: ILO estimates.

Undoubtedly, sustained economic growth and stability are mutually reinforcing. Growth is important for achieving stability that, in turn, stimulates investment and growth (Serven, 1999). Therefore, the prospects for stable growth are vital for the reconstruction efforts in that such prospects would further spur the private sector to provide opportunities for investment, higher employment and wages. Consequently, this would provide the government with a sustainable, steady flow of resources to support reconstruction and improve the standards of living. Experience in Arab countries and elsewhere indicates that the benefits of growth should materialize not only in rising employment and wages, but also in better access and quality of public goods and services. Consequently, the prospects for improving welfare conditions (i.e., economic growth benefiting the entire society and not only those in positions of power) are also vital for the reconstruction effort. This leads to our second premise, namely that, *if they are to gain legitimacy and be sustainable,* *reconstruction policies should focus on achieving wider economic inclusion and lesser inequality, in addition to achieving substantial reductions in unemployment.*

2.2. Political Factors

High income and wealth inequality and lack of inclusion are usually the result of an economic ordering where rent-extraction dominates rent-creation: institutions are built so that a privileged few can capture the benefits of natural resources, economic growth, and overall development that would accrue to the entire population (Acemoglu and Robinson, 2012). The Arab countries are no exception. Usually, economic inequality and political inequality go hand in hand: when politicians are overly responsive to a small affluent group, policies are inevitably directed toward promoting the interests of the affluent, further enhancing the political influence of this group (Houle, 2018). On the flip side, citizens who are not members of the affluent group tend to become less engaged with politics (Rosset et al., 2013). Citizens are not politically equal in economically unequal societies, as noted by Przeworski (2015). When the political influence of individuals increases with income and decisions are made by coalitions with greater political influence, the extent of redistribution of income through taxes and transfers is always lower than the rate desired by the citizens. The end result is that representative institutions do not mitigate economic inequality, as they would in more egalitarian systems.

The unhappiness voiced during the Arab uprisings was associated with dissatisfaction with the quality of public services, the shortage of formal-sector jobs, and corruption. These sources of dissatisfaction suggest that the old social contract, where governments in Arab countries provided jobs, free education and health, and subsidized food and fuel, in return for the subdued voice of the population, could no longer be sustained (Amin et al., 2012; Cammett et al., 2015). The uprisings and their aftermath manifest that a new social contract was called for, one where the government promotes an environment that encourages the creation of private-sector jobs and accountability in service delivery, and where citizens are active participants in the economy and society. The decline in public investment has not been replaced by at least equivalent growth in private investment (see Achcar, 2017).

Growing dissatisfaction with the quality of life and income inequality is not the monopoly of Middle East economies; most countries in Africa or Latin America share similar if not deeper problems. What distinguishes our group of Arab economies from other countries in the Middle East or in other regions of the world is the recourse to untamed violence on the part of the authorities and the population as well.[2] The disproportionate response of governments to popular dissent, with widespread use of repression, is characteristic of

[2] In comparison, Latin American countries successfully transited from dictatorship to democracy without political unrest while having similar levels of inequality of conflict afflicted MENA countries –e.g., Argentina and Uruguay–or much higher levels, such as Brazil or Chile where Gini coefficients are in the range of 0.50.

societies where political participation is limited, reluctantly tolerated by authorities and/or reserved only for the elites (Besley and Persson, 2011) The onset of massive uprisings and large-scale civil wars is prima facie evidence of the breaking of the social contract between the people and the government.

This leads us to our third premise, namely, that *proposed economic reforms and policies ought to be in line with the establishment of an implicit or explicit new form of social contract*. Governments face two main challenges in trying to revive their countries' social contracts, as discussed by Dervis and Conroy (2019). They must ensure a strong and efficient safety net by adapting social and labor-market policies to the new world of work. And they must take concrete steps toward providing global public goods by securing domestic support for international cooperation.

In this regard, in post-conflict situations economic policies deemed to be optimal from a technical viewpoint ought to be weighed against their support for the proposed social contract. Otherwise, they would prove non-viable and politically damaging in the long run. In this regard, peace consolidation should take precedence over the stimulation of development. As discussed by del Castillo (2008), war-affected countries may initially be forced to adopt sub-optimal economic policies (e.g. maintain certain non-profitable production units) due to political and security considerations (e.g., preservation of jobs). The subsequent move towards better sustainable policies is one of the crucial challenges of post-conflict reconstruction.

2.3. Social Factors

Ethnic or sectarian inter-group inequality, however, may have also played an important role in the increased incidence of conflict in the MENA region (Hinnebusch, 2016). Rørbæk (2019) presents descriptive statistics showing that the Middle East is the only region in the world where religious (including sectarian) affiliation is the predominant identity marker determining group membership and, furthermore, that on average Arabs are twice as likely as people in other developing regions to belong to identity groups excluded from legitimate political representation. In his view, the comparatively high level of identity-based political inequality in the region provides a better explanation for the intensity of the conflict than does the predominance of religious identity divides.

Where societies are polarized along ethnic or sectarian lines, the combination of unemployed young men and natural resources also increases the risk of conflict (Karakaya, 2016). As discussed, prior to the Arab uprisings, double-digit unemployment was the norm in the four countries of interest and youth unemployment was above 25%. It was in this context that after the onset of the uprisings, these countries in the region seemed primed to fall into disarray. Ethnic and sectarian inequality reinforced the destructive power of income and wealth inequality. Passonen and Urdal (2016) blame the large ‘youth bulges’ in Middle Eastern economies –and the repressive response of government—for the armed conflicts to break out, with those participating in protests being the youngest and the most educated. Low economic and political opportunities for the youth in the region remain a major concern.

2.4. Post Conflict Reconstruction

In contrast with economic development in relatively normal times which takes place within a given political and economic structure, post-conflict reconstruction involves a drastic change to the pre-war economic, social and political fabric (Tzifakis and Tsardanidis, 2006). The main goal is to induce a major shift of the developmental ideology and operations of the political system. Accordingly, the economic reconstruction agenda is necessarily more broadly defined than postwar stabilization to include not only the rehabilitation or creation of basic services and infrastructure destroyed during the war, but also the modernization or creation of the basic macro and microeconomic institutional framework necessary to create a viable economy.

Reconstruction encompasses state building –the creation of the institutions of the state—as well as nation building –the forging of a sense of common nationhood, intended to overcome ethnic, sectarian, or communal differences that would counter alternate sources of identity and loyalty; and the mobilization of the population behind a parallel state building project (Ottaway, 2002; Devarajan and Mottaghi, 2017).

Because the previous social contract based on government-led development, guaranteed public employment and widespread transfers is no longer viable, economic activity, employment opportunities and welfare gains must necessarily be provided by the private sector. Private sector recovery and development is key to expand the supply of goods and services, improve on productivity levels, and provide working people with employment opportunities that would allow them to make a decent and licit living (del Castillo, 2015). A second reason to support the private sector is that a vigorous recovery is needed to encourage displaced families to return to their previous economic activities and, in particular, to move away from the war economy and illicit trades. Thus, structural reforms must include making space for vigorous but responsible private sector activity, by removing as many barriers to both formal and informal economic activity as possible and as quickly as possible. Such barriers could include from price controls to unnecessary administrative requirements.

Any reconstruction program will require prioritizing and sequencing of interventions. In principle, planned prioritization and sequencing can support better focusing and timing of state-(re)building reforms, management of competing demands, understanding of needs, development trajectories, and pathways to exit fragility. There is consensus that security and development are interdependent and that in the early stages of reconstruction, security must be achieved first (Timilsina, 2007; Ammitzboell and Blair, 2011). And there is also some consensus that transitions crucially depend on achieving satisfactory levels of governance in four areas: political, administrative, judicial, and economic. Economists argue that security is a prerequisite for economic growth, while growth in turn enhances security (Lewarne & Snelbecker, 2004; Collier et al., 2007). A key question for policymakers is whether and when to promote economic reforms, and whether these can be promoted in the absence of a stable political settlement. Decisions over which economic reforms, and which economic sectors, to prioritize are highly political, and need to consider potential impacts on different conflict actors and dynamics.

There is less consensus regarding the sequencing of structural political and economic reforms and even on their nature. Most scholars would agree that transition processes are not linear and vary widely across sectors and countries. Consequently, some call for reforms in post-conflict countries to be gradual and sequential, while others call for prioritizing political and economic goals. Some donors –e.g. USAID (2009)– support starting economic programs early on in post-conflict reconstruction, emphasizing the likelihood of a return to conflict if the economy does not grow and sustain itself. The WDR 2011 suggests prioritizing jobs, alongside basic security and justice. Mross (2019) provides a discussion along the same lines on political issues. A gradualist approach aims at fostering both peace and political and economic reforms simultaneously. Even if power-struggles pose a risk to the peace process, both are pursued in parallel. Implementing a prioritization strategy, in turn, means subordinating reforms to the goal of peace. This can entail accepting significant infringements of democratic quality and postponement of reforms as long as they do not disturb the peace. Both strategies aim to foster peace, but impinge on one of the two goals. The gradualist approach accepts potential negative consequences for peace caused by economic and political reforms. The prioritization strategy refrains from fostering democracy or economic reforms in order to avoid such detrimental effects.

Collier et al. (2007) find that economic policy reform does not have adverse direct effects on risk of reversion to conflict. Moreover, they find that sustained growth promoting reforms reduce this risk and call therefore for state-building efforts based on a mixed political and growth-promoting strategy, the latter based on promoting economic development through aid and a rapid reform program. However, while states may be essential to peace, the process of state-building can occasionally contribute to further conflict. If the central government is corrupt and predatory and/or was a party to the conflict, strengthening the state is unlikely to contribute to peace and may fuel resentment instead (Rocha 2009). In such circumstances, there is a need to reform the state. Likewise, the ability of the authorities to implement structural reforms is a crucial ingredient, in particular to account for idiosyncratic factors that are likely to characterize each post-conflict situation, including the technical and political capacities of the authorities, the endowment of natural resources, polarization levels, etc.

Post-conflict reconstruction experiences indicate that, while success is possible, problems are daunting and that design mistakes are common. We draw attention to four of them:

- First, many reconstruction efforts have been insufficiently informed by what institutions already exist, and so have tended to reinvent the wheel rather than build on the pre-existing institutional architecture (Cliffe and Manning, 2006).

- Second, efforts to support institution-building have typically been quite diffuse, spread across all sectors and all areas of the state, with central authorities usually unable to coordinate effectively such efforts.

- Third, there has been little attention to the relation between transitional oversight[3] and delivery mechanisms and long-term national institutions (Armstrong and Chura-Beaver, 2010).

- Lastly, donors' own good intentions to support rapid recovery after a conflict have all too often undermined long-term institution-building, by sapping the skills base available to national institutions and bypassing national decision-making structures. More specifically, the question of foreign aid should be examined from two broad perspectives: firstly its supplementary role in filling the finance needs of reconstruction and secondly its expected impact on growth which, in part, would depend on the institutional capacity of the recipient country to effectively utilize aid inflows for reconstruction objectives (see Hoeffler et al., 2010).

In the next sections we focus on the set of main structural reforms that, alongside with political and administrative reforms, should be at the core of any post-conflict reconstruction agenda. We first focus on institutional reforms at the macroeconomic level,

[3] The fundamental goal of transitional oversight is providing guidance, creating doctrine, and planning operations for the post-conflict transition. The latter is defined as a multi-disciplinary process when conditions for stability are achieved in security, justice and reconciliation, infrastructure and economic development, humanitarian and social well-being, and governance and reconciliation.

aimed at fostering the resumption of economic growth and, in particular, the creation of employment. Such reforms are to be complement and supported by a set of deep, structural reforms at the microeconomic level, targeted at making the fruits of development to be more equally distributed, improving State capacity, and increasing the legitimacy of the reconstruction process. We discussed these reforms in Section 4.

3. Macroeconomic Policies for Balanced Growth and Employment

The sustainable reconstruction of conflict-ravaged countries requires implementing deep structural reforms, as mentioned. But these costly efforts, in turn, necessitate a balanced macroeconomic stance to flourish, steer social discontent, and avoid renewed hostilities. A poor macroeconomic stance would otherwise constitute an important limitation to reconstruction. In what follows we review the main issues that we submit need addressing in post conflict countries in MENA.

An immediate and crucial concern is the resumption of economic growth and, in particular, employment. The political support for reconstruction efforts depend primarily on the population perceiving an improvement in their standards of living. Therefore, the creation of employment opportunities –particularly for the youth—ought to be at the center of the reconstruction agenda. As shown in Table 1, double-digit unemployment rates have been the norm in Libya, Syria and Tunisia with male unemployment among the young –those between 18 and 25 years of age surpassing 25 percent.

In most emerging economies, economic growth is accompanied by substantial employment creation. Khan (2007) estimates the income elasticity of the demand for labor in developing economies to be around 0.7. Martins (2013) estimates similar values for African economies but also that elasticities have declined over time since the early 1990s, particularly when countries invest in capital-intensive industries. Evidence for MENA indicates that before and after the uprisings of 2001 GDP growth has been on average around the same rate as that of total employment in both Arab countries and conflict economies. The implicit arch-elasticity of around 1 suggests that even if the post conflict reforms are successful and growth resumes and is sustained, it will be nevertheless unlikely to reduce the chronically high unemployment level.

The poor performance of the labor market is due to a number of factors that would require a paradigm shift to correct. Much of the Arab World is characterized by an oversized public sector, with employment in the bureaucracy and security forces being both a large fraction of total employment but also a dominant share of formal sector employment (Assaad, 2014). Public employment constitutes an important share of employment for politically significant groups, such as the educated middle class and members of key sects, tribes or ethnic groups. Malik and Awadallah (2013) conclude that an oversized public sector has produced a formal private sector anemic and small, relying mostly on government welfare and rent-seeking for its survival. The distorting role of the public sector also affects the quality of human capital. Pissarides and Véganzonès-Varoudakis (2006) argue that MENA countries failed to deploy human capital efficiently despite high levels of education because of the education system is geared to the needs of the public sector, so the acquired skills are inappropriate for growth-enhancing activities. Excessive regulation of the private sector further removes the incentives for employers to recruit and train good workers. Consequently, labor market reforms should be considered a crucial component of the reconstruction agenda.

The reconstruction agenda must be geared towards a quick and energetic resumption of economic activity. Four areas of macroeconomic management are deemed crucial for the success of reconstruction: inflation control, exchange rate policy, fiscal policies, and physical infrastructure and FDI. As shown in Table 3, the four post conflict economies suffer from internal and external imbalances. Inflation is high in three economies (and most likely it is underestimated due to price controls), fiscal imbalances are substantial in all conflict economies, public debt is high and unlikely to be serviced in non-oil economies, and current account balances are sizable. In what follows we review the received knowledge on best policies for macroeconomic management that can considered in reconstruction agenda.

Table 3: Recent Macroeconomic Indicators, 2016/2017 averages

Country	Annual Inflation	Government		Current Account Balance
		Deficit	Debt	
	%	% of GDP	% of GDP	% of GDP
Iraq	0.2	14.0	66.7	-8.7
Libya	24.4	22.0	286.0	-22.4
Syria	45.0	18.0	150.0	-15.0
Yemen	20.0	13.5	85.4	-5.1

Sources: Annual inflation and GDP growth: IMF World Economic Outlook; Government deficit and debt, and current account balance: World Bank.

3.1. Inflation Control

Immediate priority should be given to reforms aiming at the reduction of inflation, re-monetization, and the design of a proper monetary policy (Lewarne and Snelbecker, 2004). In war-torn economies, the demand for money is likely to be reduced both directly, as a result of the fall in income, and indirectly, as a result of activity and asset substitution. This exacerbates the seigniorage-inflation tradeoff facing the government (Adam et al., 2008). In the medium term, however, macroeconomic policies ought to give priority to reforms aimed at setting up the new institutions needed for a modern monetary policy framework.

3.1.1. Monetary Policy Reforms

Reforms of monetary policy frameworks in the world were the response to the patent inability of central banks to control inflation during the 1970s and 1980s. High inflation resulted from the self-interest of decision-makers subject to political pressures which tended to act in a short-sighted manner. Short-termism, in turn, creates an inflation bias, making it difficult to credibly commit to long-term price stability (Kydland and Prescott, 1977; Barro and Gordon, 1983).

To overcome this time-inconsistency problem, monetary policy needs to be delegated to an institution which is sufficiently detached from political influence. Following the example of the Fed and Bundesbank, many countries have established independent and accountable central banks since the 1980s, entrusted with the conduct of monetary policy under conditions of transparency and accountability. Independent central banks are expected to raise policy effectiveness, increase economic efficiency, and strengthen democratic and political accountability. In most cases, the conduct of monetary policy has been made more systematic by the use of policy rules, in particular by the explicit announcement of inflation targets.

Evidence indicates that central bank independence (CBI) leads to lower inflation levels and price stability which, in turn, is conducive to economic growth and high levels of employment, contributing positively to the welfare of citizens (Mishkin and Schmidt-Hebbel, 2007). However, CBI contribution to achieving a desired inflation target requires setting a limited and clearly defined mandate for the central bank, one that allows the public to be able to monitor and evaluate its performance. It is important to consider formal and properly regulated dialogue-mechanisms between the central bank and the political institutions, as well as to inform directly the public at large.

CBI in conflict–afflicted Arab economies rank comparatively low vis-à-vis the rest of the world, with the only exception of Iraq that undertook significant reforms in 2004 (see Table 4). There is, therefore, significant space for improvement in this area and post-conflict economies should seize the opportunity to instill discipline to monetary policy and achieve long-term price stability. Arab countries rank also very low in transparency. The indices, collected before the Arab uprisings, already indicated that Iraq, Libya, Syria and Yemen lagged significantly behind other Arab countries or the rest of the world in transparency and, therefore, accountability.

Table 4. Central Bank Independence and Transparency Indices

Country	Central Bank de jure Independence Index, 2012 (range 0=no independence to 1=fully independent)	Central Bank Transparency Index, 2010 (range 0=no transparency to 15=fully transparent)
Iraq	0.703	2.5
Libya	0.322	1.0
Syria	0.371	0.5
Yemen	0.520	2.0
Middle East Average	0.510	3.7
World Average	0.603	5.1

Source: Independence: Garriga (2016), Transparency: Dincer and Eichengreen (2014)

In economies where the minimal institutional requirements for CBI are not available, an alternative policy to control inflation is to dollarize. Countries such as Ecuador and El Salvador fully dollarized their economies after the economic collapses brought upon by hyperinflation and civil war, respectively. Dollarization allowed for price and currency stability and the normalization of the economic activity (Bogetic, 2000). The stabilizing benefits of dollarization, nevertheless, must be weighed against its potential costs. One such cost is the loss of seigniorage. The country may also lose the "exit option" to devalue in the face of major shocks.

If dollarization is not deemed an option or a necessity, country studies should look at the current status of the Central Bank (legal, mandate, board, and governor appointments) and propose a political and economic strategy to secure minimal degrees of independence for monetary policy in four key areas (institutional, operational, personal, and financial) (see Mersch, 2017). Institutional independence refers to the limitation of the influence of third parties on the structure, functioning, decision-making, and exercise of powers of the Central Bank. Operational independence refers to the central bank’s ability to choose its policy tools in pursuit of price stability without interference. Personal independence safeguards the capacity of the members of the CB’s decision-making bodies to make decisions without external influence. This translates into requirements for appointment and protection from dismissal, as well as setting the length of mandates longer than the political cycle. Finally, financial independence grants the CB budgetary autonomy and sufficient capital, staff and income to perform independently its tasks.

In addition to CBI, monetary policy is now conducted using inflation targeting (IT) schemes in over 65 countries in the world. In this regime, the central bank has an explicit target inflation rate for the medium term and announces this target to the public. The assumption is that an explicit target helps align the expectations of the private sector of future inflation. Corbo et al. (2002) compare the performance of 15 countries that adopted IT with a control group of ten countries that follow a variety of other monetary frameworks. They conclude that IT countries perform consistently better than the control group in terms of controlling inflation and, most importantly, without inducing additional volatility in output. Larsson and Zetterberg (2013) provide evidence of a positive impact of IT on real wages and no adverse effects on employment using a panel of 20 OECD countries from 1982-2003. Ardakani e al. (2018) find that IT reduces sacrifice ratio and interest rate volatility in the developed economies, and that it enhances fiscal discipline in both the industrial and developing countries.

The evidence of the effectiveness of conducting monetary policy using IT does not generalize to conflict-afflicted countries where the institutional conditions for targeting inflation and/or allow the currency to freely float are unlikely to be present, at least in the initial stages of reconstruction. Arguably, IT demands a relatively sophisticated institutional setup that may be beyond the possibilities of post conflict economies in the short run. Nevertheless, the institution buildup effort could be helpful in the medium term because authorities need to address their lack of credibility, re-build and/or modernize the operation of the central bank and provide signals of a change in the institutional framework of macroeconomic policies. In addition, the adoption of such framework could help the progressive abandonment of the black market for foreign currency which, in turn, provides for lower levels of corruption, particularly in foreign trade. If IT is deemed to be unviable, it remains that a number of the institutional components of modern monetary regimes (transparency, independence, and accountability) should be adopted.

3.2. Fiscal Policy

Inflation is more often than not a reflection of severe imbalances in government finances. Imbalances are usually aggravated in conflict-afflicted countries for two reasons. On one hand, the collapse in production during the conflict and the subsequent drop in tax revenues is not matched by an equal reduction of government expenditures (quite the opposite as a result of military spending) resulting in significant deficits. On the other hand, fiscal instability and imbalances have been historically the norm in most MENA economies as a result of the government's dependence on hydrocarbons, poor budgeting procedures, and short-term planning (Soto, 2019).

As shown in Table 3, government deficit exceeded 10% of GDP in all countries and government debt is extremely high in Libya and Syria, and somewhat uncomfortable in Iraq and Yemen. Fiscal stabilization is, accordingly, a second priority for post-conflict administrations. Government finances need also deep and far reaching reforms in post conflict economies if governments are to provide much needed services to the population and, thereby, legitimize the reconstruction process.

As shown in Table 4, expenditures in Iraq, Libya, Syria and Yemen are heavily tilted towards military expenditures to the detriment of social investment. Total expenditures in education and health as share of GDP are at par or below military expenditures in these economies, being twice as high as the world average and the level in MENA economies (excluding high income countries). This indicates that there is a sizable potential peace dividend that can be used to finance social protection programs, even if maintaining security requires substantial government resources (Davoodi et al, 2011). The heavy cost of the military effort is also reflected in its relative importance in the government budget, being at least twice as high in conflict-afflicted Arab countries than the world average and also significantly higher than other fragile and conflict-afflicted countries. The relocation of resources, hence, can be sizable: according to SIPRI (2017) military expenditures doubled in Iraq and almost tripled in Libya in the five years that followed the Arab uprisings vis-à-vis the previous five years.

Table 4. Structure of Government Expenditures

	Education	Health	Military	Military
	As share of GDP			As share of Gov. Expenses
Iraq (2015)	-	3.4	5.3	12.6
Libya (2014)	-	-	11.4	10.8
Syria (2009)	5.1	3.5	4.0	15.1
Yemen (2014)	-	5.6	5.0	14.3
World (avg. 2010-2015)	4.7	9.5	2.3	6.3
MENA (avg. 2010-2015)	-	5.7	3.0	10.7

Source: World Bank Indicators database.

Restructuring of government finances away from the military and towards welfare improving programs and the provision of public goods is, inevitably, a third priority for post-conflict administrations. The issue is compounded by the fact that the military not only obtain incomes directly from the government but, usually, also from their significant business interests. In several MENA economies, the armed forces control –and sometimes have a legal monopoly over— key industries, ranging from telecommunications to construction and housing projects (e.g., Egypt and Syria). While there is limited data available on the financial performance or the size of these entities, there is little doubt that they play a significant role in the economy. These companies also serve the interests of many high-ranking officials and regime figures who make money by acting as middlemen or suppliers and sub-contractors. This is, perhaps, one of the most delicate issues that fiscal reforms must deal with in the reconstruction process. As discussed in the section on microeconomic reforms, privatization and market liberalization is likely to affect military interests and, thereby, may jeopardize the peace process.

3.2.1. Fiscal Policy Reforms

Ever since the Great Depression, fiscal policy has been considered a key tool to deal with the malaises brought upon by economic downturns, natural disasters, and man-made calamities, such as wars. Politicians and the general population expect that an increase in government spending would translate into higher aggregate demand, production and employment. Fiscal multipliers in the MENA region and elsewhere are nevertheless found to be small in most studies (Ilzetski et al., 2013), possibly because private agents will undue the increase in government spending if they anticipate that such policy is to be financed by a future raise in taxes (Ricardian equivalence). This raises doubts as to the usefulness of discretionary fiscal policy for short-run stabilization purposes. Other elements –such as trade openness and the exchange rate regime—also impinge on the effectiveness of fiscal policy. In fact, fiscal stimulus may be counterproductive in moderate to highly indebted countries (above 60% of GDP) where government consumption shocks may have negative effects on output.

Changes in the composition of government expenditure appears to be, on the contrary, more significant in terms of stimulation effects. Most of the literature on the "peace dividend" shows that the majority of countries can encourage growth by decreasing military spending, which frees up resources for physical and human capital formation. Fallon et al. (2004) note that post conflict countries are faced with a complex set of challenges, including the need to demobilize and reintegrate ex-combatants, resettle displaced persons, rebuild infrastructure and institutions, and improve public service delivery to create political stability. These challenges are made all the more daunting by the scarcity of resources. Collier and Hoeffler (2002) find evidence that policies of social inclusion are particularly growth enhancing after the war and should thus become a priority.

Countries that fail to consolidate peace and relapse into violence typically do not provide sufficient public services to their citizens, particularly to the poor. Investment in health and education enables individuals to lead economically productive lives and to lift themselves out of poverty. There are many reasons for the failure of service delivery (Hoeffler, 2010). Often there is insufficient public expenditure. In other cases corruption reduces the amount spent on public services. Improving accountability is therefore a must. One mechanism of ensuring that public money provides services to poor people is through public expenditure tracking surveys, which determine how much of the centrally allocated budget reaches the local service providers (Reinikka and Svensson, 2004).

Building or re-establishing fiscal institutions in post-conflict countries should aim at strengthening fiscal solvency and sustainability (i.e., attaining sustainable levels of government deficits and debt), contributing to macroeconomic (or cyclical) stabilization (i.e., reducing fiscal policy pro-cyclicality or raising policy countercyclicality), and making fiscal policy design and execution more resilient to government corruption and private-sector lobbies. Reforms essentially entail a three-step process (IMF, 2004). These steps are: creating a legal and/or regulatory framework for fiscal management; establishing and/or strengthening the fiscal authority; and designing appropriate revenue and expenditure policies while simultaneously strengthening revenue administration and public expenditure management. The ultimate aim is to make fiscal policy and fiscal management effective and transparent. In particular, institutional reforms seek to avoiding ad-hoc decision making; promoting transparency in fiscal operations; ensuring a minimum level of revenue collection; and ensuring that spending patterns reflect government priorities. In some countries, an explicit mechanism for coordinating donor assistance is also necessary.

Modern fiscal management relies, in around 100 developed and developing countries, on fiscal rules, i.e., explicit restrictions that govern the conduct of fiscal policy. Reforms of fiscal institutions and fiscal rules are motivated by objectives that are similar to those that inspired changes in monetary institutions and policies. Fatás (2005) summarizes the literature by listing four main biases in fiscal policy: those that lead to fiscal policy volatility, to fiscal policy pro-cyclicality, to unsustainable deficits and budget plans, and to intergenerational unfairness. The imposition of rules and restrictions on fiscal authorities is called for to avoid bad equilibria arising from discretionary policymakers who decide in favor of short-term output stabilization and against long-term debt sustainability (Wyplosz, 2005); from the aim of constraining successor governments with different budgetary preferences (Alesina and Tabellini, 1990), or from asymmetric information between voters and politicians (Beetsma and Debrun, 2017).

Schmidt-Hebbel and Soto (2017) provide hard evidence of the effectiveness of fiscal rules in improving solvency and sustainability and reducing pro-cyclicality in emerging and developed economies. Imposing fiscal rules and restrictions, however, may also have costs, derived from badly or too narrowly defined rules and institutions. Excessively narrow rules without escape clauses may find fiscal policy straitjacketed when shocks of an unexpected type or magnitude materialize (Cimadomo, 2012). Compliance with the rules during unforeseen events could have large macroeconomic costs, forcing the policymaker either to incur in the latter or to suspend the enforcement of the rule. Therefore, if post conflict countries face high levels of macroeconomic and budget volatility, they ought to refrain from adopting fiscal rules and restrictions in order to preserve more flexibility under fiscal policy discretion but they could take steps towards the implementation of fiscal rules, once revenue and expenditures stability is achieved.

Many fiscal rules feature explicit monitoring by an independent domestic agency, usually dubbed the “fiscal council”. This is a permanent agency with a statutory or executive mandate to assess publicly and independently from partisan influence government’s fiscal policies, plans and performance against macroeconomic objectives related to the long-term sustainability of public finances, short-medium-term macroeconomic stability, and other official objectives (Coletta et al., 2015). Another important institution in democracies is that of independent budget offices, such as the Congressional Budget Office of the US. These strictly nonpartisan entities produce independent analyses of budgetary and economic issues to support the participation of the Legislative in the budget process, in particular, ex-ante cost estimates for proposed legislation and ex-post evaluation of the true costs of laws and reforms.

The importance of the fiscal council and budget office cannot be overlooked and should not be perfunctory dismissed in the case of post-conflict countries on the grounds that they are expensive to set up or produce information that is too sophisticated for the needs of the economy. Indeed, these are crucial institutions to achieve important political and social goals. If properly designed, these institutions provide for less arbitrary government decisions, higher social inclusion and more representative allocation of government funds. In addition, these institutions can be made to be independent of the political cycle by design and geared towards long term goals, thus providing with important intertemporal constraints to government policies.

3.2.2. Commodity price shocks

An external force affecting fiscal performance arises when taxes levied on exporting to volatile commodity markets –such as hydrocarbons—are the main source of government financing. As discussed in Soto (2019), abundant resource receipts may induce currency volatility and real exchange rate distortions in the short run, hampering the financial and exporting sectors. In the long run, resource rents may hinder economic growth by encouraging rent-seeking and corruption; by lowering savings and capital formation to levels that do not compensate for the non-renewable character of the resource exported; by impeding diversification of the economy; and by supporting oligarchical governance protected by lack of transparency and the inability of the overall populace to have a say in how resource revenues are spent. Poor governance and other unfortunate outcomes are also associated with the alleged curse of having oil deposits. Dealing with resource rents, therefore, is an important task of reconstruction agenda.

A number of fiscal reforms could improve fiscal management vis-à-vis resource dependence (such as multiyear budgeting procedures, fiscal rules, and fiscal councils) but, in general, these reforms require time to be instituted and deliver their benefits. Oil price fluctuations pose an immediate threat to post conflict authorities. Globally, countries afflicted by highly volatile terms of trade have recourse to sovereign wealth funds (SWF) as a mechanism to support their fiscal policies. SWF are state-owned investment vehicles that invest globally in various types of assets and serve various purposes: (i) enhancing fiscal stabilization, by insulating the budget and the economy against commodity price swings; (ii) promoting savings for future generations, (iii) establishing reserve investment corporations, which are established to increase the return on reserves; (iv) creating development funds, and (v) forming contingent pension reserve funds, which provide (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government's balance sheet.

The effectiveness of SWF in achieving fiscal stability has been assessed using both econometric evidence and country case studies. Elbadawi et al. (2017) provide evidence, with special emphasis on MENA economies, that countries experience significantly less fiscal procyclicality when they have a SWF in place and that this effect acts independently of another fiscal institution such as fiscal rules or fiscal councils. This indicates that both fiscal institutions are important mechanisms to dampen the procyclicality of government expenditures and their adverse effects. Furthermore, they find that countries having a SWFs in place display higher fiscal balances, i.e., that the fiscal stance is more sustainable in the long run as it leads to lower levels of public debt.

SWF are quite popular among Arab economies, particularly those located in the Arab Gulf. Among conflict economies, Iraq and Libya have already implemented oil revenue-based SWF, but only the latter has accumulated significant resources. Syria and Yemen ought to consider implementing SWF as a medium-to-long run objective for their fiscal policy. Again, some authors (Al Hassan et al., 2013) suggest that having a stabilization fund in itself does not guarantee a better management of fiscal policy, but it is rather the rules on accumulation and withdrawal and the institutional arrangement that play a major role, because they act as a signal of the commitment of the authorities to changing the conduct of fiscal policies towards the establishment of a more responsible management of society's resources. Institutional arrangements include, among other components, the legal framework governing the links between the SWF with other state bodies (including the ministry of finance, central bank), the internal governance of the SWF (comprising management practices and investment policies), and the supervisory agency (in charge of overseeing governance, accountability, and transparency).

3.3. Exchange Rate Management

Exchange rate management is of crucial importance for post conflict economies and, therefore, the choice of exchange regime (fixed, floating, or managed) is an essential consideration in the design of the reconstruction agenda. Empirical evidence suggests strong links between the choice of the regime and macroeconomic performance (Rogoff et al., 2004). Exchange rate regimes influence inflation, economic growth, investment, and productivity.

There is, as expected, conflicting views as to the superiority of the different regimes. Pegging the exchange rate can lower inflation by inducing greater policy discipline and instilling greater confidence in the currency but it might lead to currency overvaluation and Dutch disease. Floating regimes avoid overvaluation but might lead to excess currency volatility. Pegged regimes stimulate higher investment but floating regimes lead to faster productivity growth (Ghosh et al. 1997). However, pegged regimes are associated with slower growth and greater output volatility (Levy-Yeyati and Sturzenegger, 2003). In post-conflict countries, Elbadawi and Soto (2013a and 2013b) found evidence that the choice of exchange regime has no direct effect on overall GDP growth, that free floats may have a negative effect on exports, and that fixed and managed exchange regimes tend to be associated with lower levels of inflation.

The choice of the exchange regime cannot be isolated from the choice of how to conduct monetary policy. These are but two sides of the same coin. A fixed exchange regime is similar to a monetary policy with the exchange rate as nominal anchor, while a floating exchange rate regime would reflect a monetary policy with inflation as the nominal anchor. Evidence indicates that countries that have adopted IT in the context of a floating exchange regime have experienced a reduction in the pass-through from exchange rate changes to inflation, suggesting that a floating exchange rate does not present a significant threat to inflation control nor has it resulted in increased in (nominal or real) exchange rate volatility (Edwards, 2006).

The choice of the exchange regime cannot be isolated either from the issue of the credibility of the monetary authorities. In economies where for whatever reasons the Central Bank lacks credibility or does not have sufficient reserves to operate convincingly in the market, there is little chance that a fixed exchange regime will survive a speculative against the national currency. Floating the currency would be better for practical reasons as well as a tool to progressively acquire a more solid reputation. The successful provision of a stable currency and the promotion of efficient means of payment lend credibility to the state. A single, national currency can provide a unifying symbol, which can contribute to a sense of national identity (Coates, 2007).

3.3.1. Foreign Aid

One main external force affecting reconstruction agendas relates to donors. While external aid can be very effective in stimulating growth in post-war situations, financial flows need to be properly managed to avoid unintended side effects. Aid can support the effort of recipient countries to reduce inflation and foster confidence in peace (Adam et al., 2008). Moreover, it can also support the balance of payments by easing the problem of debt arrears and providing fresh resources. Post conflict governments tend to face even more pressing needs after than during war: in the absence of post-conflict aid, inflation increases sharply, frustrating a more general monetary recovery.

Nevertheless, because receiving foreign aid entails its transformation into local currency, significant flows can induce excessive fluctuations in the exchange rate when it is allowed to freely float, or currency overvaluation, when the exchange rate is fixed. The choice of exchange regime in the presence of aid, thus, becomes more complicated. While evidence suggests that aid positively affects long-run growth in any exchange regime, indirect effects of currency overvaluation could hamper economic growth in countries with fixed or managed floating regimes (Elbadawi and Soto, 2013a). Given the centrality of tradable activities for post-conflict growth, an environment in which the currency is severely misaligned (typically overvalued) is not conducive to sustained growth in exports or overall activities. Left to market forces, as is the case of floating exchange regimes, the combination of massive aid and currency overvaluation has a negative impact on growth.

Furthermore, the authorities in post conflict economies face a difficult dilemma: aid flows usually have the wrong timing because surges of aid arrive at a time when the economy is least prepared to respond –immediately after peace is achieved—and tend to fade as the economy is recovering, a period when foreign resources could be most fruitful. In view of the inability to expand domestic production immediately after peace, the real exchange rate of the national currency usually shifts from being undervalued during the civil war to being overvalued in the first few years of peace. The appreciation of the currency can potentially have a negative impact on export growth, export diversification, and economic growth, thus reducing the growth dividend of peace. As discussed by Elbadawi et al. (2008), aid commitments should spread over time and increase gradually. It has also been suggested that aid might be more effectively used if delayed until capacity was restored. This is perhaps especially the case for project aid. Staines (2004), on the other hand, find that the productivity of external assistance can be high in the initial post-conflict period when the government is committed to following a sound macroeconomic strategy, particularly if assistance is provided to the budget in support of stabilization. This indicates the need for the authorities of post-conflict countries to take an active stand vis-à-vis the donor community and manage to their best capacity, the form and timing in which these flows enter the economy. An active stand would also reduce the reluctance of donors to provide direct budgetary support, mainly due to concerns over governance. Therefore, any economic agenda for reconstruction must consider measures to channel properly foreign aid.

Conflict afflicted countries in our study are endowed with important deposits of hydrocarbons (Bowman, 2011; Salisbury, 2011), only Iraq and Libya are major oil exporters. Oil industries are important in terms of generating foreign currency and, more importantly, raising tax revenues for the government. Unfortunately, oil price volatility tends to induce high procyclicality in government finances and, thereby, in the economy. In turn, procyclicality hampers efficiency and penalizes long-term initiatives. Fluctuations in economic activity generate discontent.

3.4 Foreign Direct Investment

Reconstruction and development of physical and institutional infrastructure constitute the fourth priority of post was macro planning. Given the shortage of domestic resources, reconstructing countries would need to rely on foreign resources. One source of such funds is foreign direct investment (FDI).

FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps create a more competitive business environment, and enhances enterprise development (Alfaro, 2017). Beyond the strictly economic benefits, FDI may help improve environmental and social conditions in the host country by, for example, transferring "cleaner" technologies and leading to more socially responsible corporate policies (OECD, 2002). All of these contribute to higher economic growth, which is the most potent tool for alleviating poverty in developing countries. Although there is consensus about the economic benefits from foreign direct investment, these benefits are often viewed as being dependent on recipient countries having reached minimum levels of institutional, financial or human capital development. Estrin et al. (2017) conduct a meta-analysis of 175 studies and around 1100 estimates in Eastern Europe, Asia, Latin America and Africa from 1940 to 2008 and find that the macro-level effects are at least six times larger than the firm-level effects. They also find that benefits from FDI are substantially less dependent on development levels as previously expected.

Attracting FDI, nevertheless, requires the appropriate institutional setup that would provide investors with an environment in which they can conduct their business profitably and without incurring unnecessary risk. An adequate institutional framework would provide for the registration of firms, the protection of private property, of minority shareholders, and a modern bankruptcy law (Lewarne and Snelbecker 2004, Kusago, 2005). In general, investors highly value environments where rules and their implementation rest on the principle of nondiscrimination between foreign and domestic enterprises and where the Law is enforced in accordance with international practices, where the right of free transfers is respected and there is protection against arbitrary expropriation of investments. A stable macroeconomic environment is also conducive to FDI, in particular if it provides for easy access to engaging in international trade.

Benefits, however, are not automatic consequences of FDI and the potential spillover benefits are realized only if local firms have the ability and motivation to invest in absorbing foreign technologies and skills. It is important, furthermore, to recognize that FDI can also have negative impacts, which must be carefully considered when designing strategic policies to attract and regulate foreign investment. Not all forms of FDI are a priority for the economy. Crucially, any investment regime must recognize that foreign investment is part of economic development within a reconstruction and peacebuilding process, and not an end in itself. Therefore, the FDI's to be encouraged are those that benefit the objectives of post-conflict reconstruction such as job-creation and the spill-over of knowledge or technology that benefit the host economy.

We should keep in mind of course that attaining the above objective may be more difficult in the case of oil rich countries in that they tend to attract FDI's with limited transformative possibilities. Purely extractive industries (e.g., mining) tend to have little contact and linkages with the local firms, they usually provide limited opportunities for employment creation and linkages with the local economy and, in some cases, they may bring associated negative environmental and social impacts (Turner et al., 2008). This is a matter that these countries will have to address if they are to maximize their benefit from the inflows of FDI's.

Clearly, there is no "one-size-fits all" policy solution for post-conflict investment promotion and regulation. An additional consideration is that setting up a sound FDI regime could be supported by aid flows. Garriga and Phillips (2013) find evidence that development aid in low-information environments can act as a signal to attract investment. Before investing abroad, firms seek data on potential host countries. In post-conflict countries, reliable information is poor, in part because governments face unusual incentives to misrepresent information. In these conditions, firms look to signals. One is development aid, because donors tend to give more to countries they trust to properly handle the funds. This result suggests the need to carefully coordinate FDI and foreign aid policies so as to maximize the benefit of said signal.

4. Microeconomic Issues and Policies

Much post-conflict reconstruction focuses on quickly improving macroeconomic structures. However, by themselves such reforms are insufficient to generate sustained welfare gains to the population beyond the initial impact of the peace dividend. Furthermore, they often enhance more the welfare of those groups in position to capture such benefit than that of the general public, leading in extreme cases to crony capitalism and higher levels of corruption. Reconstruction of institutions at the microeconomic level is therefore vital for sustainable development and, more importantly, for the appropriation of the benefits of development by the population (O'Driscoll, 2018). If successful, these reforms in turn increase the legitimacy of reconstruction.

In what follows we identify a number of key issues that need addressing in the economic agenda for reconstruction. These issues are organized along three guiding principles. First, the need to restore –and sometimes expand—property rights, so that security levels improve and the returns of efforts are accrued to their legitimate owners. Second, a proper delimitation of the areas where the private initiative is best allocated by market forces, from those sectors where market fail due to "imperfections" such as natural monopoly power, informational asymmetries, and externalities. Third, the design of proper regulatory setup for each type of market. Competition in free markets would not deliver its promise of development and welfare gains if adequate regulation and supervision are not in place. Likewise, where the market fails, intervention must be designed so that efficiency is preserved and benefits accrue to the population and not to interest groups or those bureaucrats in charge of running state-controlled businesses.

4.1. Property Rights Reforms

Lack of property rights contributes to conflict that, in turn, usually jeopardizes property rights. This vicious circle is hard to break. Entrepreneurs would not invest and use their ability to produce, if they foresee that returns and property can be expropriated by the government or appropriated by others members of society. Production in a market economy rests on respect for property rights. Similarly, when property rights are protected, workers are able to retain the fruits of their effort, invest in education and housing. This security is his main incentive to work.

Leckie (2005) identifies housing, land and property (HLP) rights as one of the key challenges to all post-conflict countries and territories. Restoring HLP rights to returning refugees and displaced persons, resolving ongoing HLP disputes, re-establishing a HLP rights registration system, protecting the HLP rights of vulnerable groups and many other housing, land and property issues invariably surface in post-conflict settings (IRFC and NRC, 2016). Addressing these issues is an essential component of the peace-building process and an indispensable prerequisite for the rule of law. A simple recommendation would be to first *evaluate the status of HLP rights in the country*, particularly in those areas most afflicted by violence, and then to *provide guidelines for setting up a HLP agency* to ensure that comprehensive and consistent institutional, political and legal attention is paid to all HLP rights concerns within the country or territory concerned. Naturally, such an institution could be built from existing agencies. What is important is to design the new agency –or the to transform existing ones—so as to instill modern management techniques, accountability, and efficiency.[4] NRC (2016) identifies the pressing needs of HLP in Syria and offers recommendations for action and remedy.

HLP rights are not only an indispensable prerequisite for the peace process but also a crucial component for economic development and poverty alleviation (Calderon, 2004; Galiani and Schargrodsky, 2010). Evidence collected for Latin American and Asian economies indicates that entitled families substantially increase housing investment, reduce household size, and enhance the education of their children relative to control groups (e.g., Field, 2007). Likewise, data from around two dozen studies reviewed by Lawry et al. (2016) suggest that tenure security becomes a pre-condition to farm investments that foster productivity and increase farm incomes.

The mechanisms for welfare improvement are less clear, though. Some advocate for titling as a mechanism for improving access to credit (e.g., Binswager and Deininger, 1999). On the basis of well-defined land rights, low-cost access to reliable information on individuals' landownership reduces transaction cost and uncertainty that hinder the exchange of land in markets for rental or sale and the use of land as collateral for credit (Deininger and Feder, 2009). Others find that land titling can be an important tool for poverty reduction through the slow channel of increased physical and human capital investment, which should help to reduce poverty in future generations.

The issue of HLP rights policies become acute in post-conflict economies where internal displacement and severe housing destruction call for an active reconstruction program. With ill-defined or incomplete property rights, land holders need to spend resources to defend their rights (e.g., guards and fences), diverting resources from more productive uses (Allen and Lueck, 1992). Advocates of formal titling, nevertheless, tend to ignore the limited capacity of central land administrations for the delivery of titles or the difficulties in establishing decentralized institutions (Teyssier and Selod, 2012). Here, other institutional reforms play a decisive role and call for coordination. A land registration system can be rendered ineffective by the absence of a judiciary that is accessible and impartial for

[4] Leckie (2005) identifies seven components of such unit (policy, legal, claims, claims tribunal, housing, construction and records), each of which would be responsible for implementing specific housing, land and property rights issues.

allowing actions by the state to be challenged effectively, by ineffective government institutions with overlapping mandates that may issue conflicting documents regarding the same plot, and by unclear and contradictory policies that make enforcement unpredictable and costly (Deininger and Feder, 2009).

4.2. Market Liberalization and Regulation of Competition

A key component of restructuring post-conflict economies relates to ensuring free but properly regulated markets. When successfully implemented, market deregulation and liberalization can benefit consumers via increased access, lower prices, and better quality of goods and services. For business, reforms could also improve significantly international competitiveness (Guash and Hahn, 1999).

Studies indicate that the wave of reforms in the MENA region before the Arab uprisings helped to open space for the private sector, but its response to the reforms was weak and performance lagged significantly behind the rest of the world (Nabli et al, 2008). Indeed, structural reforms were incomplete. Keller and Nabli (2002) indicate that financial sectors remained weak, trade liberalization was only partial, with continuing high protection levels, public ownership remained overwhelmingly high, and the regulatory framework and supportive institutions for private sector investment did not materialize.

Evidence collected by economist and lawyers indicate that countries in the MENA region lag behind other economies in terms of the quality of regulations and the operation of competition laws. As noted by Youssef and Zaki (2019), while countries engaged in pro-market liberalization reforms in the 1990s, it was not until the 2000s that authorities began to pass competition laws in order to improve on the functioning of markets. Adoption of law is a necessary but not a sufficient condition: implementation and enforcement are what really matters.

Without a proper regulatory setup, competition in free markets would not deliver its promise of development and welfare gains. Regulated competition promotes the use of more efficient methods of production, benefiting consumers with access to less expensive or better quality goods and services. Unregulated competition, on the contrary, leads usually to abuse, rent extraction and all forms of corruption. Regulation and supervision reforms are, therefore, indispensable components of the reconstruction agenda. But striking an adequate balance between economic freedom and State intervention is usually difficult to achieve and expensive to implement.

These issues are more pressing in post-conflict MENA countries that in other emerging economies because for historical reasons –compounded by years of conflict—the State enjoys an overwhelming weight in terms of allocating resources and deciding what, when, and how production is to take place. A transition from an administered to a market economy is essential to sustain growth, but reforms face considerable mistrust in the region and many blame market liberalization for the rise of crony capitalism (Diwan et al., 2019). Reforms are unpopular when they entail removal of subsidies or streamlining the workforce at state-owned enterprises, which makes it difficult to get the reforms right (Arezki, 2019). Moreover, the unfair competition that results from markets dominated by state-owned enterprises and connected firms deters private investment, reducing the number of jobs and preventing countless talented youngsters from prospering.

The success of the reconstruction agenda depends crucially on engaging the private sector to provide for sustained growth, legitimate wealth accumulation, increased employment and wages, and productivity gains. But, for the private sector to fulfill its role, the playing field ought to be adequate enough. As shown in Table 2, the four conflict MENA economies rank very low in the Doing Business set of indicators. Furthermore, there has been a marked decline since the onset of conflicts following the Arab Spring. Almost all of the backwardness these MENA countries is government related: the excessive number of procedures to starting a business, the sluggish and usually corrupt mechanisms to deal with construction permits, register property and pay taxes attest to a failed bureaucracy that needs deep and far reaching reforms. These are compounded by the lack of access to production factors (such as electricity or credit) which may be partially due to private sector incapacity but often reflect obsolete and legal codes that do not provide for protection of minority investors, costless enforcement of contracts and inoperative insolvency acts.

Table 5. Doing Business Indicators

	Iraq	Libya	Syria	Yemen
Ease of Doing Business in 2010 (out of 183 countries)	144	n.a.	132	109
Ease of Doing Business in 2017 (out of 212 countries)	168	185	174	186
Getting electricity	116	130	153	187
Getting credit	186	186	173	186
Paying taxes	129	128	81	80
Trading across borders	179	118	176	189
Starting a business	154	167	133	163
Dealing with construction permits	93	186	186	186
Registering property	101	187	155	82
Protecting minority investors	124	183	89	132
Enforcing contracts	144	141	161	140
Resolving insolvency	168	168	163	156

Source: World Bank's Doing Business Database.

Reconstruction reforms must also deal with government's involvement and ownership of dominant firms or monopolies in key industries, such as infrastructure, construction, the financial sector, etc. Reform proposals should focus on identifying opportunities for the privatization of state-owned enterprises (SOEs) operating in industries where market failures are absent for two main reasons. First and foremost, for efficiency considerations. The bulk of the literature indicates that, if properly done, privatization can improve efficiency significantly and have important spillovers on the rest of the economy. Second, privatization can be an important source of revenue for resource-scarce post conflict economies. Bear in mind, however, that the real issue is not so much public vs. private—it is monopoly vs. competition.

Infrastructure is crucial for generating growth and increasing competitiveness. For much of the 20th century and in most countries, network utilities—such as electricity, natural gas, telecommunications, railroads, and water supply—were vertically and horizontally integrated state monopolies. This approach often resulted in extremely weak services, especially in developing and transition economies, and particularly for poor people. Common problems included low productivity, high costs, bad quality, insufficient revenue, and shortfalls in investment. Recognizing infrastructure's importance, many countries over the past two decades have implemented far-reaching infrastructure reforms—restructuring, privatizing, and establishing new approaches to regulation.

Resource shortages and lack of managerial abilities on the part of bureaucrats make privatization of SOEs an interesting policy option for post-conflict MENA countries. The historical record in the region is, unfortunately, not supportive: privatization programs have lacked clear strategic focus, have been implemented on a stop-go basis, and have, in many cases, resulted in the transfer of ownership without an accompanying transfer of state control (Page, 2003). Fear of labor redundancies have also slowed down privatization, particularly in the manufacturing sector. However, elsewhere privatization has been much more successful and the lessons learned would provide knowledge regarding (a) how to properly design the privatization process, reducing corruption and inefficiency, (b) how to regulate privatized firms, so that efficiency gains accrued to the general public, and (c) how to provide incentives for investment and development in privatized industries. In reviewing the Latin American experience, Chong and López de Silanes (2005) make a compelling case that privatization in Latin America has been a success and that benefits have been substantial. However, they also warn us that the manner in which privatization is carried out matters: transparency and homogeneity of procedures, speed, and moderation in pre-privatization restructuring lead to better outcomes and allow less room for corruption.

One key element in the privatization process is the control of key industries by the armed forces or their personnel. Privatization and market liberalization is likely to affect military interests and, thereby, may jeopardize the peace process and it seems highly unlikely that the officers would respond to calls for divestiture, not unless there is some form of compensation. This is a complicated issue both for peace agreements and for long run development (Brömmelhörster and Paes, 2004), for which there are no recipes for an easy solution.

4.3. Regulation and Interventions where Competition Fails

Competition is itself a form of economic cooperation when conducted under a good system of laws and a high standard of morals, thus supporting social cohesion and reconstruction efforts. When risk and uncertainty are high, as is the case of post-conflict economies, cooperation becomes a reasonable business decision which, in turn, allows for the creation of trust. However, under such certain conditions –collectively called market failures— competition does not allocate resources efficiently nor guarantees their best social uses. Adequate government regulation can rectify these problems, as long as the cost of intervention does not exceed its potential benefit. In particular, government regulation can be more efficient and less costly than recurring to litigation to solve disputes arising from market failures (Glaeser and Schleiffer, 2003).

We now turn to two areas where markets fail in allocating efficiently resources because producers and/or consumers can act strategically and benefit systematically from distorting the price mechanism: anticompetitive behavior and organized crime.

4.3.1. Anticompetitive Behavior

Anticompetitive agreements (cartels in particular), abuses by companies with dominant market position, and mergers and acquisitions are damaging for reconstruction in several dimensions. First, it damages efficiency, reduces productivity growth, and hampers economic growth, which as mentioned largely determines the success of reconstruction. Second, it benefits the owners of the firms at the expense of the general population. Because the former tend to be part of the elites, it generates popular discontent and undermines the political support of the reconstruction process. Third, because it is illegal, those involved in anticompetitive actions usually recourse to corruption in order to hide their actions or avoid paying the costs. Anticompetitive behavior is a direct threat to the creation of a viable new social contract.

From an institutional viewpoint, implementing antitrust policies in post conflict countries is of the utmost importance. Modern antitrust institutions have both important economic and political justification. On the economic front, there is abundant evidence of the pernicious effects of anticompetitive actions on economic growth; wages, incomes and welfare of the population, and on efficiency and adoption of new technologies. On the political front, abuse by firms is frequently equalized to abuse of the elites and the ruling parties. When such abuse goes undetected, is not sanctioned or is arbitrarily prosecuted, the legitimacy of the state and the political system is jeopardized. One must not forget that when it comes to these matters, the interest of consumers is typically under-represented as they are a disorganized, diffuse stakeholder.

Competition law, consumer protection regulations, and other government policies are highly developed in the EU, USA, and many emerging economies. Adopting and adapting such regulations to the case of post conflict economies ought to be a priority for the reconstruction agenda. A more complicated stage would involve suggesting changes to the legal and judiciary systems to enforce such regulations. In several countries, legal and even constitutional changes were required to give a wide range of inspection and enforcement powers to the authorities to investigate businesses, hold hearings and sanction crimes. Crane (2012) discuss the three defining elements of modern antitrust institutions: executive authority; technocratic administration; and judicial supremacy. In the end, identifying the current limitations of antitrust agencies which could serve as the basis for designing the antitrust authority.

In general terms, market regulation deals with four main areas of market failures. First, *natural monopolies,* i.e., those industries where the best social policy is to allow the presence of only one firm (e.g., water, sewerage, fixed-line telephones). Reconstruction agendas should include guidelines vis-à-vis the capacities needed to either have state-owned companies with a properly regulated equilibrium price (isolated from political pressures to set prices below marginal costs) or to allow private firms to operate a monopoly under a price-quality framework (Joskow, 2007). Second, *markets with significant externalities* for which reforms should propose a framework to ameliorate the problems. In particular, to deal with the political economy nature of the problem: because negative externalities impose a cost on third-parties, they tend to develop powerful lobbies in order to avoid paying such costs or compensating those affected (Aidt, 1989). Third, in post-conflict economies the problem of *missing markets* is pervasive: public goods are normally underprovided due to fiscal constraints but also because of the poor managerial capabilities of public servants. Reconstruction proposals should identify areas where the private sector could provide the services (e.g., using private-public partnership schemes, franchising, and BOT contracts). Fourth, *merit and de-merit goods.* This area has important implications for the political aspects of reconstruction. Merit goods are those where societies would prefer to have a supply beyond what strict cost-benefit analysis would provide. For example, education, healthcare, environmental protection. De-merit goods, on the contrary, are those where society would like to penalize its consumption beyond what private cost-benefit analysis would dictate (e.g., cigarettes, alcohol, gambling). In designing the reforms, there ought to be an assessment of the political and economic willingness to pay for merit goods and, more decisively, assess the capacity of the government to tax de-merit goods not only to discourage consumption but also to collect revenue for merit goods and other reconstruction costs (e.g., infrastructure).

Finally, there exists the danger that the regulator can be "captured" when the regulator generally implements policies that further the interests of the firm at the expense of the broader social interest (Armstrong and Sappington, 2006). Many factors increase the likelihood of regulatory capture. For example, a regulatory agency with limited expertise and resources may be forced to rely heavily on the advice and information supplied by the firm when formulating policy. Alternatively, the firm may routinely offer attractive employment opportunities to regulators who have proved to be cooperative, and the country's laws may not preclude such offers. Also, the firm may provide a sizable portion of the regulator's ongoing budget and may have some discretion over the timing and magnitude of its contributions to the regulator's budget. When factors like these lead to a high likelihood of regulatory capture, the entry of additional competitors may be the best way to impose meaningful discipline on the incumbent supplier and otherwise ensure long term gains for consumers.

National regulatory agencies (NRAs) have recently been set up in several MENA. Abrardi et al. (2016) investigate the impact in 12 MENA countries (Algeria, Djibouti, Egypt, Iran, Iraq, Jordan, Lebanon, Libya, Morocco, Syria, Tunisia, and Yemen) from 1990 to 2011 and find that inception of a regulatory agency has a positive impact on capacity growth but the setup of the NRA is influenced by the quality of the institutional environment. They conclude that independent regulatory agencies may act as a catalyst for a number of positive effects generated by the quality of political institutions.

4.3.2. Organized crime

Post-reconstruction efforts need to prevent organized (and unorganized) crime from monopolizing economic sectors and from creating a lawless environment that threatens legitimate business. This is important because the end of conflicts usually brings an end –or at least a significant decline—to the profitability of the war economy. Participants in the war economy are armed, trained for violence and display low risk aversion, therefore, if the situation is ripe they can easily turn towards organized crime. Research shows that organized crime hampers the quality of governance because, by corrupting and otherwise compromising the integrity of public officials and institutions through corruption and threat, organized crime erodes the state's long term capacity to provide for the common good (Miraglia et al., 2012). The capacity to deliver public goods is a key element in a state's levels of fragility. A state that is affected by pervasive corruption faces a loss of legitimacy that can endanger its ability to remain in power. Organized crime has thus been established as one cause for state failure.

5. Conclusions

Post-conflict peacebuilding remains a fragile undertaking with mixed results (Doyle and Sambanis, 2000). Economic reconstruction efforts do not show better outcomes. Undoubtedly, the task presents formidable challenges in political, economic, and sociological terms. In this paper we depart from the literature on post-conflict economic recovery which shares the assumption that failed nation-states fail in their own unique way and that, accordingly, each reconstruction effort is unique.

While we recognize that idiosyncratic political, economic, and sociological elements play a role in post-conflict reconstruction efforts, we think that reconstruction must deal with common challenges, such as establishing of genuinely inclusive and democratic governance; repatriating human and financial resources, dealing with the donor community, reversing the deterioration of human development and security conditions, overcoming the destruction of infrastructure, facing the increase in the number of people needing social assistance; coping with large fiscal deficits; curtailing inflation; managing external and public debts; or normalizing external trade disrupted by hostilities.

Our analysis of the reforms to be considered in an economic agenda for reconstruction is based on three premises, culled from the literature on post-conflict rebuilding and the experience of a large number of countries. First, in order to gain legitimacy and be sustainable, reconstruction policies should focus on achieving wider economic inclusion and lesser inequality, in addition to achieving substantial reductions in unemployment. Second, reconstruction policies should be primarily geared towards changing, improving or, even in an extreme case, eliminating altogether the pre-conflict institutional fabric of the country. Third, proposed economic reforms and policies ought to be in line with the establishment of an implicit or explicit new form of social contract.

A sustainable reconstruction requires implementing deep structural reforms. But these efforts, in turn, necessitate a balanced macroeconomic stance to flourish, steer social discontent, and avoid renewed hostilities. A poor macroeconomic stance would otherwise constitute an important limitation to reconstruction. An immediate and crucial concern is the resumption of economic growth and, in particular, employment. The political support for reconstruction efforts depend primarily on the population perceiving an improvement in their standards of living.

Therefore, the creation of employment opportunities –particularly for the youth—ought to be at the center of the reconstruction agenda. In most emerging economies, economic recovery from crisis is accompanied by substantial employment creation. The MENA region is an exception. The poor performance of the labor market would require a paradigm shift to correct, whereby governments must abandon the use of public employment as a key mechanism to generate political allegiance and allow the private sector to become the main source of income of the families. Labor market reforms should be considered a crucial component of the reconstruction agenda.

The reconstruction agenda must therefore be geared towards a quick and energetic resumption of economic activity. Four areas of macroeconomic management are deemed crucial for the success of reconstruction: inflation control, exchange rate policy, fiscal policies, and physical infrastructure and FDI. First, macroeconomic policies ought to setting up new institutions needed for a modern monetary policy framework, where inflation control is the sole task of an independent monetary authority, accountable only to the population via a formal political procedure. Second, restructuring of government finances away from military ends and towards welfare improving programs and the provision of public goods is, inevitably, a third priority for post-conflict administrations. Reforms must be implemented to guarantee fiscal stability and responsibility. Building or re-establishing fiscal institutions should aim at strengthening fiscal solvency and sustainability (i.e., attaining sustainable levels of government deficits and debt), contributing to macroeconomic (or cyclical) stabilization (i.e., reducing fiscal policy pro-cyclicality or raising policy countercyclicality), and making fiscal policy design and execution more resilient to government corruption and private-sector lobbies. Third, exchange rate management and the choice of the exchange regime is an essential consideration in the design of the reconstruction agenda. Exchange rate regimes influence inflation, economic growth, investment, and productivity. Furthermore, the successful provision of a stable currency lends credibility to the reconstruction process and a single, national currency can provide a unifying symbol, which can contribute to a sense of national identity. Fourth, given the shortage of domestic resources, reconstruction of physical and institutional infrastructure would have to rely mainly on foreign resources. One important source is foreign direct investment (FDI). Attracting FDI requires the appropriate institutional setup that would provide investors with an environment in which they can conduct their business profitably and without incurring unnecessary risk.

Macroeconomic structural reforms by themselves are insufficient to generate sustained welfare gains to the population beyond the initial impact of the peace dividend. Reconstruction of institutions at the microeconomic level is vital for sustainable development and, more importantly, for the appropriation of the benefits of such development by the population. In turn, these reforms would increase the legitimacy of the reconstruction process. We identify a number of key issues that need addressing in the economic agenda. These issues are organized along three guiding principles. First, the need to restore –and sometimes expand—property rights, so that security levels improve and the returns of efforts are accrued to their legitimate owners. Second, a proper delimitation of the areas where the private initiative is best allocated by market forces, from those sectors where market fail due to "imperfections" such as natural monopoly power, informational asymmetries, and externalities. Third, the design of proper regulatory setup for each type of market. Competition in free markets would not deliver its promise of development and welfare gains if adequate regulation and supervision are not in place. Likewise, where the market fails, intervention must be designed so that efficiency is preserved and benefits accrue to the population and not to interest groups or those bureaucrats in charge of running state-controlled businesses.

It can be seen that, in our view, an economic agenda for reconstruction goes far beyond selecting policies to deal with the immediate post-conflict needs but has to prepare the economy –and ultimately the society—to design and build the institutions needed for sustained development. If such reforms are able to align the expectations of the population as to economic role of the government in the post-conflict transition, convince the elites to direct state resources to build the capacity of the State to provide services and to fulfil those expectations, then there is a chance of success in the rebuilding of new social contract, by inducing an agreement between state and society on their mutual roles and responsibilities.

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