

# 2 An assessment of post-conflict economies

## 2.1 Defining the informal sector

All economic systems contain formal and informal components, with the relative size of the components varying from country to country. In under-developed regions, such as many parts of Africa, the informal sector often overshadows the formal sector, with similar dynamics existing in conflict and post-conflict economies. Hence, the focus of this section will be on the informal sector.

*In Sub-Saharan Africa, the ILO estimates that informal income generation represents 72% of non agricultural employment.*

In general, the informal sector is not typically regulated, taxed, documented and protected by governments. It is also referred to as the hidden, shadow, grey, underground, clandestine, subterranean or parallel economy, and it entails “extra-state exchange systems”.<sup>35</sup> The informal economy includes the unreported activities related to the manufacture and trade in both legal and illegal goods and services, and such economic transactions are typically in cash or by barter. This sector of the economy tends to be prominent in countries where there are high levels of income and asset inequality.<sup>36</sup> The informal economy is linked to the formal economy at both the national and global levels.<sup>37</sup>

It has been estimated that the average size of the global informal economy (as a percentage of GDP) in 2002/03 in 96 developing countries was 38.7%, in 25 transition countries 40.1%, and in 21 Organisation for Economic Co-operation and Development (OECD) countries 16.3%.<sup>38</sup> The ILO has estimated that informal

income generation comprises 48% of non-agricultural employment in North Africa, 51% in Latin America, 65% in Asia, and 72% in sub-Saharan Africa. Estimates of the informal economic sector for developed countries are around 15%.<sup>39</sup> According to an OECD publication (2009), the informal sector is estimated to be 43% of the total official GDP in Africa.<sup>40</sup> However, these estimates should be treated with caution. Indeed it is exceedingly difficult to define and delineate this component of the economy, as it is dynamic in nature, comprises a diverse range of activities and often defies national boundaries. In addition, the quality of data collection varies between countries.

A vast amount of economic transactions in the informal sector are unrecorded. Hence, some scholars have suggested that “unrecorded economy”, is more accurate and less derogatory than the more popular terms mentioned above “as a verifiable distinction” can be made between this economy and the recorded economy.<sup>41</sup> The OECD uses the term “non-observed” economy and has compiled a handbook for measuring this component of the economy.<sup>42</sup>

## 2.2 Rationale and role of the informal economy

There essentially four key reasons that the informal economy is so prominent in underdeveloped countries. First, the agriculture sector and the formal economy do not have the capacity to absorb surplus labour, which is compounded by high rates of population growth or urbanisation. Second, there have been significant obstacles to entry into the formal economy, including cumbersome regulations, high business registration fees and corruption. A predatory state, for

example, tends to erode the formal economy, which in turn can stimulate growth in the informal sector. Third, formal institutions have lacked the capacity to provide training and establish infrastructure to facilitate growth in the formal sector. Fourth, in the context of high levels of poverty, there has been a sustained demand for low-cost goods and services, which is provided more efficiently by the informal sector.<sup>43</sup> The informal sector is usually pronounced during periods of war and political transition due to weakened state controls.<sup>44</sup>

There are two opposing schools of thought regarding the informal economy. According to the first school of thought, this sector of the economy provides the potential for income generation in regions with restricted formal employment opportunities, and/or large pool of unskilled labour. In most economies, particularly in developing countries, the unrecorded economy is key to providing a safety net for the poor.<sup>45</sup> The other school of thought regards the unrecorded sector as being a pervasive feature of the economy that can undermine competitiveness, growth, and the rule of law, as informal sector proceeds do not contribute directly to government revenue. In essence, it is argued that the informal sector crowds out the formal sector economic activities, and has the potential to undermine the social contract between individuals and the state.<sup>46</sup>

In general, the informal sector tends to thrive in circumstances where onerous barriers to formal sector entrepreneurship exist or emerge, such as: deficient infrastructure; cumbersome regulations and compliance requirements; inadequate access to credit; high and unpredictable taxation; burdensome trade barriers and duties; and a risky investment and legal climate. However, as competition increases, informal sector businesses tend to become less profitable.

### 2.3 Informal economies in countries experiencing armed conflict

There is considerable literature on the subject of economies in times of war or sustained armed conflict. Such an economy is often referred to as a war economy, which is a system of profit, power and protection that directly contributes to, emerges from, and has the potential to perpetuate, armed conflicts. The literature (in relation to civil wars) describes war economies as being “parasitic”, “illicit” and “predatory”, which do

not make constructive contributions to building state capacity and human development. Militarised elites, fronted by strongmen or warlords, tend to dominate such economic systems. These elites retain power by intentionally undermining state institutions, enshrining patronage relationships and using violence or the threat of violence to reinforce their authority.<sup>47</sup>

War economies are usually characterised by looting, exploitation and rent-seeking behaviour, which are utilized by elites through rebel groups, government forces and militias to acquire control over assets, natural resources, trade and infrastructure networks, cash, produce and labour. This form of economy tends to be fragmented and privatised, with the informal and criminal sectors being stimulated. War economies consequently destabilize the formal economy, and in extreme cases override it entirely.<sup>48</sup> War economies are particularly difficult to dismantle due to the vested interests of elites, and that a war scenario legitimises these arrangements, which may be deemed criminal offences in a non-war context.<sup>49</sup> In war-oriented contexts, informal economic activities are more pronounced than during times of peace, and are considered to be a key component of a war economy.<sup>50</sup>

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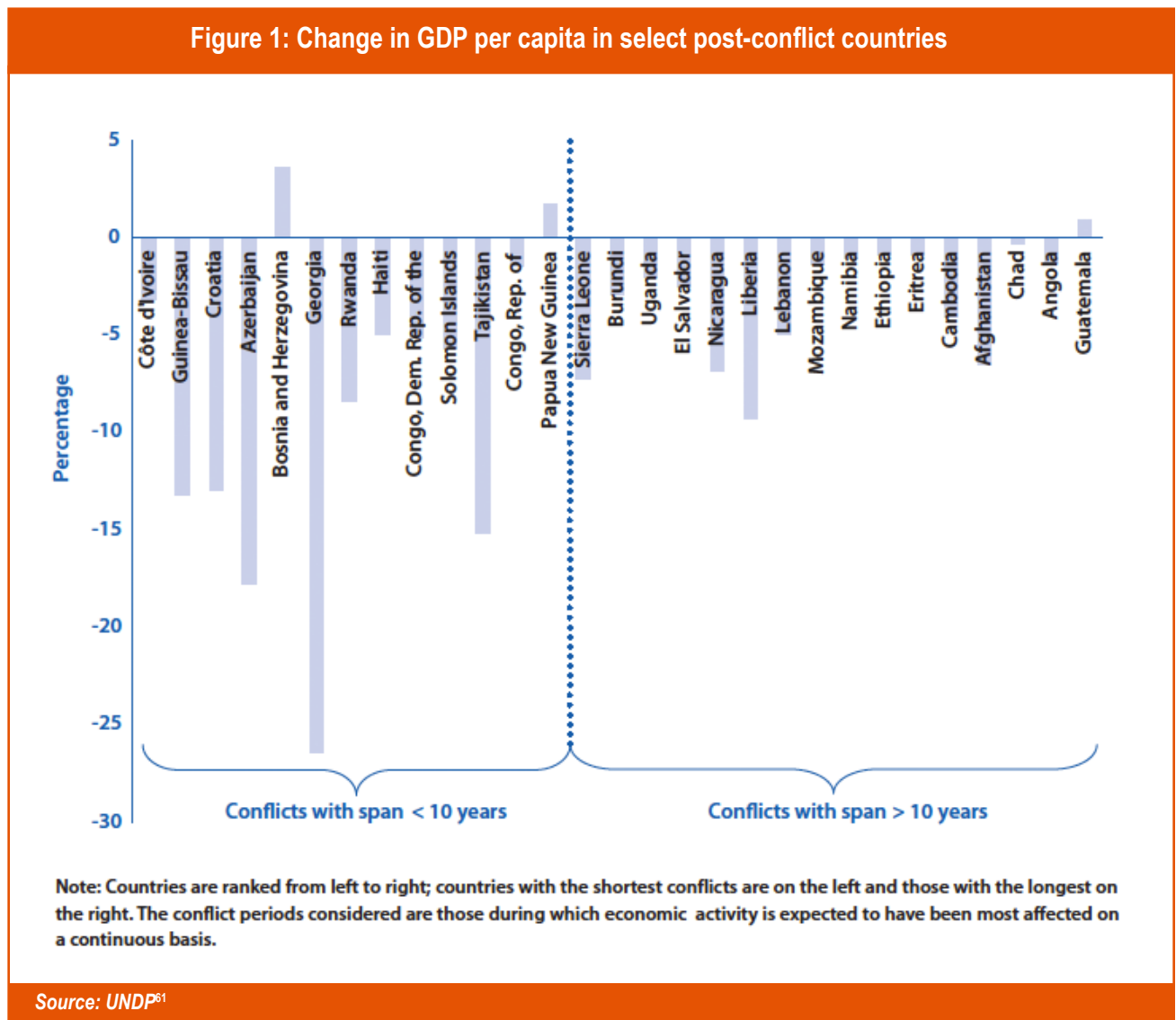
A central, but controversial theoretical contribution within this literature is the ‘greed and grievance’ thesis popularised by Paul Collier and Anke Hoeffler, who used panel data of armed conflicts for the period 1960-99 to examine the risk of civil war using regression analysis. The authors employed a set of rational choice models of rebellion that revolve around two contrasting motivations for rebellion, namely “greed” and “grievance”. The simple greed-rebellion model holds that rebellion will occur if it is financially profitable, provided rebel forces are able to evade, endure or repel assaults by government armed forces. The simple grievance model states that war will occur as a consequence of one or more grievances, such as inter-group hatred, political exclusion, and vengeance. Through an intensive statistical analysis, of the global pattern of large-scale conflict from 1965, Collier and Hoeffler found that the grievance models had low explanatory power, while greed models perform well.<sup>51</sup>

There has been much debate about, critique and support for this thesis, and consequently there have been numerous publications.<sup>52</sup> This model has three shortcomings. First, it seeks to compare two contrasting motivations for rebellion, namely greed and grievance. However, while the grievance model considers motivations for armed conflict, such as inter-ethnic hatreds, the greed model appears to rather focus on opportunities for rebellion (e.g. size of the rebel movement, relative military advantage and cost of recruitment). Second, the grievance model does not reflect the myriad of sophisticated theories of the causes of armed conflict. Third, as the models are concerned with major trends, and hence indigenous/unique features are not taken into consideration. For example, a number of rebellions have been initiated and/or sponsored by foreign governments.<sup>53</sup>

In advanced war economies, military goods and services are prioritised in the government budget, which is typically financed through increases in public debt. Given the security and investment risks, the private sector tends to redirect the bulk of its capital to safer, offshore destinations (capital flight). The increased insecurity and exploitive behaviour of security forces and insurgent groups in a wartime environment usually results in ordinary people gearing their economic activities towards low-level subsistence in the informal economy.<sup>54</sup> In addition, major job losses in the public and private sectors force civilians to resort to informal means of livelihood support.<sup>55</sup>

## 2.4 Post-conflict economies

Many of the dynamics of war economies often persist



in post-conflict environments, especially in the context peace agreements and conflict stalemates, as there have been insufficient countervailing forces to reconfigure and transform the power dynamics within the economy. However, overt violence in the conduct of economic transactions is less evident, with militarised elites often swapping combat fatigues for business attire. Nonetheless, most-conflict environments are often characterized by insecurity and uncertainty, with insurgent groups and spoilers posing a threat to the government and the peace agreement. Consequently, high levels of military spending are typically maintained.<sup>56</sup>

The viability of such economies is often dependent on a small basket of primary commodity exports, such as minerals, oil and cash crops. Therefore, such countries are vulnerable to large fluctuations in global commodity prices.<sup>57</sup> They are frequently constrained by damaged or destroyed infrastructure; weak state institutions; and incapacitated human and social capital. Links between areas of production and trade, as well as between rural communities and urban areas have been disrupted. States do not have the requisite expertise, resources and political will to adequately facilitate economic recovery; and there is usually a severe skills shortage.

Excessive regulation and cumbersome trade barriers are also the order of the day, with private sector entrepreneurship and large-scale employment creation being stymied. Public expenditure is poorly structured and executed; commercial law is erratic, and property rights are opaque.<sup>58</sup> A further ‘hangover’ of the conflict-era, which is directly associated with the insecurity of the post-conflict environment, is that the

general population tend to remain risk-averse in pursuing a livelihood, and continue to rely on subsistence activities. Added to this formal sector employment opportunities in post-conflict countries tend to be infinitesimal.<sup>59</sup> Most countries emerging from a period of violent conflict experience a significant decrease in GDP per capita compared to the period before the conflict took place (see figure 1).

In such situations, there is a noticeable increase in the number of small, informal businesses. This is due to the stabilisation of the economy, the demand for basic goods and services, and labour flexibility in this sector. Uncertainty, excessive and unpredictable economic regulations (including taxation), as well as the potential for renewed violence remain, however, informal business have higher tolerance for such risks and constraints, and are less dependent on public institutions and infrastructure (such as electricity and fixed business locations), than formal sector businesses. Such informal sector businesses typically involve retail services such as small trade, repair, and construction.<sup>60</sup>

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Most post-conflict settings, however, see the sizeable intervention of international organisations, aid agencies and foreign non-governmental organisations (NGOs), which stimulate both the formal and informal sectors of the economy. There is evidence to suggest that international aid can directly contribute to growth in such settings.<sup>62</sup>