

THE STATE-OWNED ENTERPRISE AS A VEHICLE FOR STABILITY

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Neil Efird

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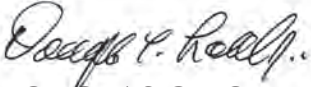
## FOREWORD

Dr. Efird has made a case that state-owned enterprises (SOEs) affect stability in conflict-prone environments, and decisive control of them creates positive or negative conditions. He describes the importance of SOEs and their treatment in five post-conflict environments. Dr. Efird acknowledges that in areas of the world in which security forces stepped in and took control, their actions helped stabilize the government. In contrast, when security forces failed to act decisively, the fragile government remained or was further destabilized.

But as often happens in complex environments, it is a challenge to know how and when to use SOEs, and Dr. Efird rightly points out that a good set of metrics is necessary to measure their effectiveness. He provides an overview of the analytical tool known as "Measuring Progress in Conflict Environments" (MPICE) that is used to determine progress in stability operations. He proposes that associated with this tool are objectives that directly relate to production, or the output of economic resources. Other objectives relate to policy frameworks that directly affect production. Thus using MPICE to measure progress is essential to successful stability operations.

Dr. Efird's experiences as a Foreign Service Officer and U.S. Army officer in conflict-prone societies as well as his service as an economic development advisor to the Peacekeeping and Stability Operations Institute

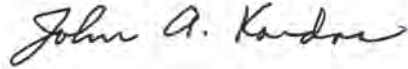
(PKSOI) have enabled him to apply economic theory in a practical way in areas of instability. Those of us working in the stability operations arena are fortunate enough to be the beneficiaries.



DOUGLAS C. LOVELACE, JR.

Director

Strategic Studies Institute



JOHN A. KARDOS

Colonel, U.S. Army

Director

Peacekeeping and Stability  
Operations Institute

## ABOUT THE AUTHOR

NEIL EFIRD served as an economic development advisor in the U.S. Army's Peacekeeping and Stability Operations Institute (PKSOI) at the U.S. Army War College in 2009. He has broad experience in economic development in conflict-prone societies with both the U.S. Department of State and the U.S. Army. As a Foreign Service Officer, he served in diplomatic assignments in Russia during its transition toward a free-market economy; in Kosovo during its reconstruction; in Mozambique during its civil war; and in the U.S. Mission to the United Nations Industrial Development Organization. Dr. Efird's managerial assignments included Asian trade relations, global investment affairs, African refugee assistance, and assistance to the former Soviet Union and East European democracies, with emphasis on Bulgaria, Macedonia, and Croatia. Dr. Efird's military assignments included overseas tours with the 30th Artillery Brigade (Okinawa) and the 9th Infantry Division (Vietnam), as well as stateside tours with the 82nd Airborne Division, the 171st Support Group, and other active and reserve units. His duties spanned the spectrum of operations, logistics, and intelligence management, including staff assignments with the Defense Intelligence Agency and the Office of the Deputy Chief of Staff for Intelligence, Department of the Army. Dr. Efird's experiences influenced his academic studies, which focused on development in conflict-prone societies. His dissertation research on reform of centrally-managed economies focused on the former German Democratic Republic (East Germany), in the context of Eastern Europe and the Soviet Union. While a lecturer at the Catholic University in Angola, Dr. Efird organized a distance-learning

program between the state university of Angola and East Carolina University, while publishing the article, "Development in Globalization: Perspectives for Angola." He taught international economics at Dickinson College and a variety of international business management subjects at George Washington, Trinity, and Shippensburg Universities, and at the University of Maryland, European Division. Dr. Efirid holds a B.S. in Engineering Science from the U.S. Military Academy at West Point, an M.A. in English and Master's in Business Administration in Management from Duke University, and a Ph.D. in International Business from George Washington University.

## SUMMARY

As providers of essential public or commercial services, state-owned enterprises (SOEs) are important in modern economies. Since SOEs are ubiquitous in the global economy, they are likely to be present in conflict-prone societies. In such environments, the defining political and economic systems within which the SOEs exist are likely to embody the interests both of participants in the conflict and of those hoping for an end to the conflict. In stability operations, the imperative for SOEs is to become productive in a way that helps create stability.

Achieving this result is apt to be difficult. SOEs are often tainted with the very elements that created the original conflict. They can be microcosms of the societal and economic problems that led to conflict, and the struggle for control over them among actual or former combatants can serve to sustain the original conflict. To avoid that outcome, campaign and development plans must address SOE issues decisively, comprehensively, and pragmatically.

Although revitalizing SOEs can be complex and ambiguous, the task can be a useful, intermediate objective on the road to the end state of a *sustainable economy*. One multinational force commander with experience in Kosovo and Afghanistan described those particular conflict environments as “mosaic wars” offering many perspectives, which therefore made them difficult to visualize.<sup>1</sup> In similar contexts, SOEs offer focal points for visualizing the intended end state of the operational environment, precisely because they often are a microcosm of a country’s pre-conflict power structure. Consequently, if handled correctly, SOEs can be stepping stones toward stability.



Recent experience in stability operations demonstrates the value of gaining early control of and effectively restructuring SOEs. In one Liberian example, United Nations (UN) security forces took steps to enable the state-owned electric power company and state-managed rubber plantations to serve as the basis for political stability. This action yielded three immediate benefits that enhanced stabilization: (1) economic production, (2) employment, and (3) symbolization of governmental control.

In contrast, the hands-off approach of the occupying UN authority in Kosovo allowed ex-combatants to assume control of the all-important electric power company, which resulted in a politicized workforce and continued instability. In Iraq, Coalition forces lost opportunities for stabilization when they initially failed to reactivate potentially viable state enterprises, which might have absorbed into the legitimate workforce the potential recruits for the insurgency. In Mozambique, UN authorities failed to integrate the SOEs in a comprehensive short- and long-term development plan, owing to the UN agencies' own competing visions.

The experience of countries at peace confirms the potential for SOEs to contribute to mid- and long-term economic development even in conflict-prone environments. In former centrally-managed economies, as well as in free market, efforts to make SOEs more productive have centered on privatization, the process of transferring ownership to private interests. Generally, post-conflict privatization is the end state of a lengthy process, the preliminary phase of which involves repair and refurbishing of plant and equipment, restructuring of management, and revision of policies and procedures, all of which aim to make

SOEs competitive in the market place. In this setting, SOEs can be focal points of development.

While the post-conflict long-term restructuring imperative of SOEs is to attract private investment, both foreign and domestic, the short-term objective of SOEs during stability operations must be to absorb or at least befriend that part of the labor force that might otherwise be recruited by insurgents. Reconstruction and revitalization of SOEs during stability operations thus require a flexible, pragmatic, and non-ideological orientation. The process must begin with a political-economic analysis of the conflict-prone country to answer the following basic questions:

- What SOEs have been critical to the pre-conflict economy?
- What domestic and international market conditions will support these SOEs in a competitive environment?
- What costs are associated with the potential reconstruction of the SOEs?
- What should be the reconstruction priority order of these SOEs?

SOEs tend to be providers of essential public services—such as electric power companies, water utilities, ports, and transportation networks—but SOEs also engage in an array of commercial activities involving airlines, banks, basic commodity plantations, textile manufacturing, and vehicle assembly plants. Given this array of SOE activity, during the first 6 months following conflict, entities like the Provincial Reconstruction Teams (PRTs) that operate at the subnational level should screen, prioritize, select, and help in the restructure of SOEs. During the restructuring process, they should closely monitor

SOE management to prevent conflict between former combatants.

Due to their scope and scale of resource use, SOE management and operations can significantly affect national-level economic development. Therefore, agents engaged in stability operations should work with development planners to ensure mid- to long-term institutional capacity building that enhances the conflict-prone country's broader capacity for sustained growth. The intended end state of SOEs in stability operations should be functioning entities that can attract new investment, perhaps by privatization when and where appropriate. Although the priority for particular SOEs in a conflict-prone environment must be restoration of those that can provide essential public services, agents engaged in stability operations should be prepared to support the revitalization of commercially-oriented SOEs as well, especially when they account for a significant proportion of regional economic output, income, and employment.

Measuring progress in these efforts is essential for evaluating the pace at which SOEs are transitioning from conflict damage repair to steady production and, ultimately, a sustainable economy. SOE-specific metrics are generally based on broader indices of stability because SOEs are often at the core of the economic and political dynamics of conflict-prone societies. In fact, experience has shown that "the main barrier to measuring progress is political, not conceptual," meaning that the first step is to "depoliticize metrics."<sup>2</sup> Among the more useful sets of metrics established for stability operations are MPICE and its predecessor, the *Framework for Success: Societies Emerging from Conflict*, which list essential requirements for stability as discussed below. For operational purposes, it is useful

to separate these stability requirements into those related to *production* and those related to *policy*.

It can be safely assumed that agents engaged in the economic aspect of stability operations will focus first on the physical production objectives; therefore, the proposed set of SOE-specific metrics addresses only those. Establishing such objectives must induce neither an exclusive focus on production objectives nor encouragement of policy reporting through stovepiped organizational channels. To avoid these potential outcomes, personnel of all agencies that play a role in stability operations must widen their peripheral vision to sense how the synergy from the coordinated effort relates to individual agency objectives. Based on the physical production objectives as complemented by policy objectives as shown in Figure 1, Section IV subsection titled “Measuring Progress” sets forth a guide for using the SOE as a vehicle for stabilization.

Production (Physical)	Development Climate (Policy)
<p>Reconstruct public infrastructure (e.g., electric power, communications, and transportation) and the infrastructure of commercial entities, if appropriate</p> <p>Create viable workforce (employment)</p>	<p>Promote sound fiscal policy</p> <p>Build effective and predictable regulatory and legal environment</p> <p>Build effective financial and economic institutions (e.g., banks)</p> <p>Promote business development and sustainable employment</p> <p>Increase access to capital</p> <p>Limit corruption and illicit economy</p> <p>Protect, manage, and equitably distribute natural resources</p>

**Figure 1. Production (Physical) and Development Climate (Policy) Objectives.**

This paper will describe the importance of SOEs and their treatment in five post-conflict environments and suggest lessons and metrics for measuring progress.

## **ENDNOTES - SUMMARY**

1. Major General A. J. H. Van Loon (The Netherlands), "Coalition Operations," presentation to the U.S. Army War College, Class of 2009, January 27, 2009.

2. Craig Cohen, "Measuring Progress in Stabilization and Reconstruction," Stabilization and Reconstruction Series No. 1, Washington, DC: United States Institute of Peace, March 2006, pp. 3, 11.

# THE STATE-OWNED ENTERPRISE AS A VEHICLE FOR STABILITY

## I. THE IMPORTANCE OF STATE-OWNED ENTERPRISES

As hybrid creations of economics and politics, state-owned enterprises (SOEs) have always played important roles in the political economies of nation-states. SOEs have often become inefficient burdens on national budgets, however, and policymakers have tried to improve their productivity and to privatize them to become parts of growing free market economies. The prediction by many economists in the early 1990s that SOEs would become “a relic of the 20th century” has thus far proved incorrect—instead, SOEs “are far from extinction, are thriving, and in many cases seek to expand beyond their own borders, particularly in the commodities and energy sectors.”<sup>1</sup> For purposes of stability operations planning, it can safely be assumed that national economies will long feature SOEs that can usefully be incorporated in the effort. From this standpoint, a purely ideological rejection of SOEs is counterproductive to stability and is impractical, given their ubiquitous presence in the global economy.

There are four main categories of SOEs: (a) public utilities such as electric power, water, communications, and transport; (b) basic goods industries such as coal, oil and nuclear resources, and steel; (c) financial services such as banks, insurance companies, and social security administrations; and (d) social services such as education and health services.<sup>2</sup> In addition to the often-designated natural monopolies of the public utilities, the range of commercial activities that might qualify for SOE status is rather wide. To analyze the

SOEs in the context of stability operations, it is useful to subsume these four categories in two: basic utilities and commercial enterprises.

The impact of SOEs on the global economy is significant. In the early 1980s, SOEs produced 10-25 percent of the manufacturing output of the developed world and more than 25 percent in the developing countries. Textiles, food, beverages, tobacco, cement, automotive vehicles, ships, and aircraft comprised the principal categories.<sup>3</sup> The proportion of national economic production from SOEs has varied historically according to the shifting tides of political and ideological forces. From the completely centrally managed economies of the former Soviet Union and its satellites and imitators in the developing world at one extreme, to the open market economies of the Western industrialized nations at the other, there has been movement in both directions along this spectrum, in part because, as noted by economic theorists, “the development of a positive approach has shown that government failure is as frequent as market failure.”<sup>4</sup> In addition to the political and ideological motivations for establishing SOEs, there generally are three other reasons for doing so: (1) market failures; (2) promotion of economic growth on the basis of long-term planning; and (3) industrial and financial bailouts resulting from irreversible crises.<sup>5</sup>

As national economies adapted to historical events in the 20th century, the ideological pendulum swung back and forth from one extreme to the other—on one swing from unregulated markets to growing state involvement (1933-80), in accordance with the economic philosophy of Keynesianism following the market failure of the Great Depression; and on the return swing from state regulation to minimal

government and market freedom by a process of deregulation (1980-present) following the stagflation of the early 1970s and early 1980s, all in accordance with the philosophy of Friedrich Hayek, as interpreted by Milton Friedman and others, and as implemented by the government of Margaret Thatcher in the United Kingdom (UK) and by the Reagan administration in the United States. The policies at work within these two national economies strongly influenced other national economies directly as major trading partners and indirectly through the international financial institutions, which required economic reforms as conditions for loans.

The place of the SOEs in the national economies changed with these swings of the ideological pendulum. During the Keynesian era, “profound criticism of the capitalist system opened the way to doubt about the market economy, and liberal forces believed that stronger state control of crucial sectors of the economy could resolve the problems of market failures, with the result that an impressive first wave of nationalization began, particularly in those Western countries most affected by the Depression.”<sup>6</sup> State involvement in the economy seemed to be the correct path, with public enterprises being developed in the Western economies through deliberate nationalization of the enterprises. “In most Western countries, the great age of nationalization and successful public enterprise was the 3 decades following World War II,” with its peak in the mid-1970s when the output of SOEs averaged 10 percent of gross national product and 16.5 percent of gross capital formation.<sup>7</sup>

In the United States in 1980, the economic policies associated with Reaganomics sought to reverse Keynesianism through deregulation, minimal taxes,



and high interest rates to control inflation, swinging the influence and acceptance of SOEs in the opposite direction. The Reagan administration noticed the formula that banks discovered to correct the deficits of New York City's budgetary management of the 1970s: call in loans and cut payrolls through layoffs of hospital staff and school workers. The formula worked so well in restoring fiscal balance that U.S. bankers, working through the U.S. Department of the Treasury, recommended it as the standard prescription for the international financial institutions' economic reforms for developing countries. The recommendations reflected market fundamentalism which eventually became part of what is sometimes called the Washington Consensus.<sup>8</sup> As social theorist David Harvey pointed out, while the banks had not articulated a complete theory of what they were doing in New York City, they recognized successful financial results when they saw them, and therefore decided that their method could be applied to indebted countries around the world.<sup>9</sup>

Critics of the Washington Consensus assert that it too often prescribed "shock therapy," that is, economic reforms of developing countries that featured immediate price liberalization and rapid privatization of SOEs, the effect being massive layoffs in the absence of social safety nets. Such economic reform measures were predicated, these critics say, on the perceived need to transition the public management of enterprises toward free markets, often postulating wholesale reduction in the number of SOEs by means of privatization. In the financial sector, the formula meant elimination of controls and opening of markets to the free flow of capital, a situation which likely led to the Latin American debt crisis of the early 1980s and the disastrous Asian crisis of 1998 in which numerous governments defaulted on their debts.<sup>10</sup>

In Mozambique in 1988, for example, International Monetary Fund (IMF) loan conditions included a 50 percent reduction in the government payroll despite an absence of private sector jobs.<sup>11</sup> In Iraq in 2003, this approach was the basis for the Coalition Provisional Authority's (CPA) illusive vision of a transformed and vibrant market economy following shock therapy, as will be explained in Section II.

Today's economic crisis is a comprehensive global market failure. It includes both finance and manufacturing, reaches all national economies, and has caused ideological confusion and reexamination of basic economic tenets. Under the Obama administration, the ideological pendulum appears to be returning to state-managed enterprises. As the traditional lead locomotive in the global economy, the U.S. Government now essentially owns a significant share of the capital of banks, insurance companies, and automotive vehicle manufacturers, after bailing out major banks and manufacturers with loans.<sup>12</sup> This salient fact has not escaped the attention of the international community. As of this writing, the U.S. Government owns 72 percent of the equity of the largest U.S. automobile manufacturer, General Motors, the result being that some commentators are referring to it as *Government Motors*. U.S. policymakers are also working hard to re-regulate the financial sector to prevent future crises, but in ways that reflect concerns and conditions of earlier eras rather than recent decades.

Despite this trend, the number of SOEs in the developed world will probably remain far fewer than in developing countries. In emerging markets of the developing states, the importance of SOEs increases faster than in the more industrialized economies, where, until not too long ago, private financial

engineering (such as derivatives and credit swaps) was associated with the public sector's decline in relative importance.<sup>13</sup> However, since the financial crisis has shown the unprecedented levels of financial leverage and risk associated with these financial instruments to be unsustainable, corrective international regulation and presumably an increase in the numbers of SOEs in the developed world, will likely lessen the difference between the number of SOEs in the rapidly emerging economic powers and the number in long established dominant industrial and market states.<sup>14</sup>

Much of the policy discussion regarding SOE reform has centered on the need to privatize them in order to generate the investment needed to make SOEs self-sustainable. Privatization is a complex undertaking and should be attempted only within a proper regulatory framework, however. Without proper regulation, a rush to privatization would likely lead to the kind of abuses that characterized Russia's economic reforms of the 1990s. Of equal importance, broader distribution of wealth within a country might help preclude potentially corrupt deals stage-managed by oligarchs. In 2003 in Iraq, the CPA's ill-considered rush to privatize the SOEs in the absence of the proper conditions wasted at least 2 years and much effort and money. In 2006, experts cautioned that a similar attempt at privatization in Afghanistan, in the absence of basic resources and a regulatory framework, would be "putting the cart before the horse."<sup>15</sup>

There is no question that privatization can improve the financial balance sheets of national governments by removing from them the burden of unprofitable SOEs, but scholars differ on whether privatized enterprises always perform more efficiently than comparable SOEs. The analysis of the experience over the last

25 years shows mixed results. In the UK, a philosophical partner of the United States in the ideological swing to minimal government economic interference and a deregulated market, the Thatcher government's privatization of British Rail did not correct the underinvestment in infrastructure that had preceded privatization, ostensibly because of shareholder interest in dividends rather than capital improvements. The neglect of aging infrastructure resulted in 59 deaths in five fatal crashes and continuing poor service, which led analysts to conclude that it was a fatal mistake to hold railway infrastructure hostage to the "need to generate profits for shareholders."<sup>16</sup> Some critics have also noted that the options for privatization of health care, education, and transportation in the UK were "spurious, unwanted, too difficult or impossible for most people to exercise, or self-defeating in their broader effects."<sup>17</sup> In the United States, some critics have noted that "many [of the] privatizations of public utilities neither improve services nor lower costs for consumers, but instead guarantee revenues to the new owners while leading to a collapse in infrastructure investment."<sup>18</sup>

Studies of the effects of privatization in developing countries are, thus far, inconclusive. A study by the Organization for Economic Development and Cooperation of 10 developing countries during the period 1985-92 found significant implementation of privatization in only three countries. The study concluded that "reductions in the central budget deficit can only be marginal," because the impact (in profitable SOEs) was not evaluated over several years to consider the effect of the revenues foregone from the SOEs.<sup>19</sup> Several later econometric studies measured the budgetary effects and did report significant

increases in profitability and productivity as a result of privatization, but the methodological flaws related to the difficulty of isolating the performance of the SOEs from other elements rendered the findings ambiguous.<sup>20</sup> While the evidence on the performance of SOEs “shows that state ownership is often correlated with politicization, inefficiency, and waste of resources,” the assumption that ownership per se creates an environment influencing the quality of performance is not proven, with the empirical research on this point having yielded conflicting results.<sup>21</sup> Given the inconclusive evidence, many scholars did not concur in a World Bank statement in 1995 that SOEs “remain an important obstacle to better economic performance.”<sup>22</sup>

Reflecting a belief that the market is the best allocator of resources, development experts have often recommended “unleashing” the private sector by removing regulations and privatizing SOEs. In 1995, to preclude hasty and simplistic privatization efforts, the World Bank recommended that SOEs be corporatized under commercial law<sup>23</sup> and issued guidance on “[p]re-privatization interim measures and institutional arrangements for ‘permanent SOEs’.” The bank also listed five preconditions for successful privatization:

- Hard budget constraints;
- Capital and labor market discipline;
- Competition;
- Corporate governance free of political interference; and
- Commitment to privatization.<sup>24</sup>

In view of the pervasive presence of SOEs in the global economy and their embodiment of political and economic considerations, SOEs are an entity to be considered and managed in the pursuit of stability. In

many countries in which stability operations may be necessary, it should be expected that SOEs have major roles, both pre- and post-conflict. As noted above, and as will be seen in greater detail in Section II, the strategy for use of SOEs in stability operations should have two components: (1) reactivation of critical SOEs, and (2) identification of investment capital, both public and private, for the possible recapitalization and subsequent privatization of the SOEs.

## II. RECENT EXPERIENCES IN STABILITY OPERATIONS

### **Liberia.**

When Liberia's 14-year civil war ended in 2003, the UN Mission in Liberia (UNMIL) found the country's infrastructure devastated, control of the abandoned rubber plantations (major contributors to its gross domestic product) actively disputed, and the state-owned electric power company nonfunctional. Each of these situations posed a formidable obstacle to stability. Overcoming each obstacle required a unique effort by the UNMIL members, but all the efforts were similar in that they called for comprehensive and simultaneous control of the political and economic forces in the country.

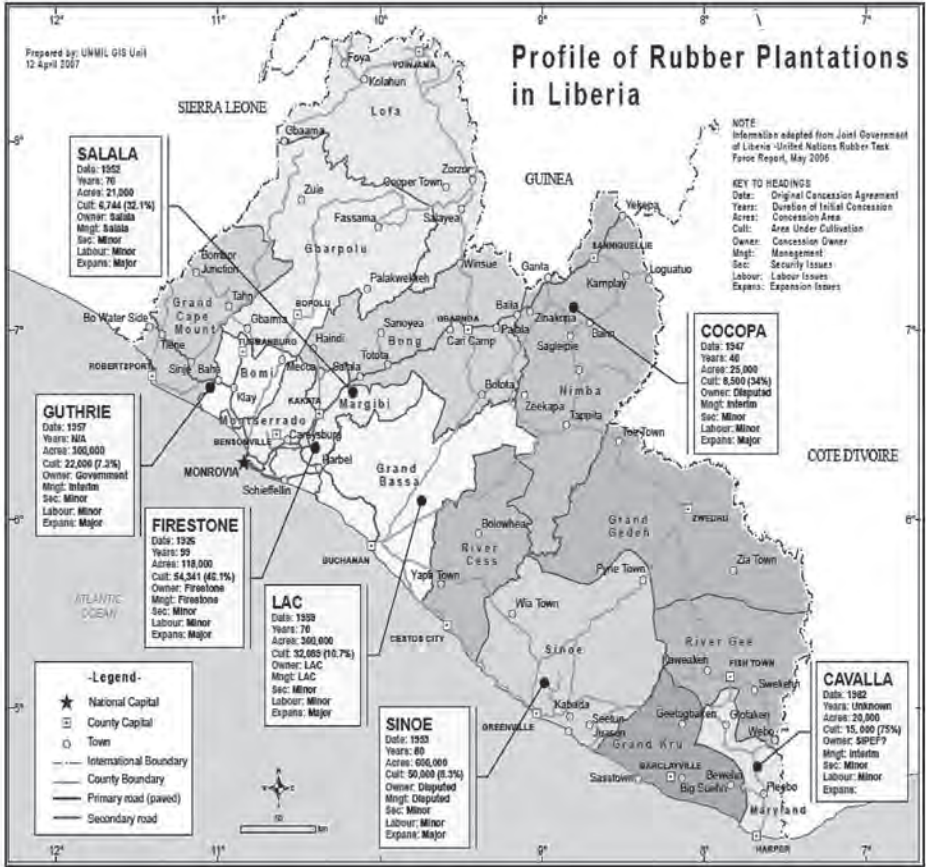
John Blaney, who was then the U.S. ambassador to Liberia, described the situation at that time as a chaotic transition from war to peace in which there were no timelines. The persons who aimed to restore order "needed all the friends they could get," and there was a "golden hour" when opportunities to create order had to be seized—or were lost.<sup>25</sup> Ambassador Blaney noted that waves of security forces were needed to prevent the emergence of a power vacuum. Elements

of the military forces of the Economic Community of West African States (ECOWAS), along with UN peacekeeping forces ("*Blue Helmets*"), were deployed to Liberia in such waves.<sup>26</sup>

Recognizing that the absence of electrical power was apt to be a cause of political and economic instability and a potentially fatal threat to the nascent government, Liberia's new president, Ellen Johnson-Sirleaf, made reelectrification a cornerstone of Liberia's stabilization and reconstruction program. In July 2008, in the crowded marketplace of the capital city, Monrovia, where no street lights had functioned for at least 4 years, she threw the switch on and restored light, thereby holding up a potent symbol of hope before her fellow citizens, who were destitute and demoralized by the conflict. Street lights enhanced security; security enhanced economic recovery. With electricity—and street lights—it was possible for street vendors to sell their wares much less harassed by the thieves, ex-combatants, and roving bands of hungry young men who had ruled the city in darkness. The restoration of electric power in Monrovia demonstrated that the new government could deliver basic services.<sup>27</sup>

This result was made possible by UNMIL, which had placed high priority on restoration of the state-owned electric power company, Liberia Electric Corporation. The UN command then provided security to the technical assistance teams under contract to the U.S. Agency for International Development (USAID) who completed the project. Since most of the neighborhoods in Monrovia had been contested by parties to the conflict or ruled by street gangs and thieves, the participation by military representatives of the UNMIL in the donor reconstruction committee proved crucial to success.<sup>28</sup>

Even more dramatic than this success was UNMIL's restoration of the Liberia Rubber Development Authority, which included six plantations under diverse ownership and management<sup>29</sup> (see Map 1<sup>30</sup>).



Map 1. Liberian Rubber Plantations.

By April 2006, President Johnson-Sirleaf had formed a 22-person task force comprising representatives from the ministries of agriculture, justice, and commerce, plus UNMIL, which recommended that the plantations



be freed from ex-combatants and illegal management.<sup>31</sup> In the plantations themselves, the basic conflict had not been settled: militias loyal to former strongman Charles Taylor ruled, and back pay demands, human rights violations, riots, and rising tensions were the order of the day.

In Liberia, the rubber plantations were not intended to be state-owned permanently. They were temporarily taken over as part of the comprehensive stabilization effort under *force majeure* provisions of the concession agreements to preserve them for their rightful owners, to provide employment to Liberians, and to provide income to the state in the absence of taxes from the owners. Without the UN and the Liberian Government's intervention, it is highly likely that there would have been continued competition among ex-combatants, severe lawlessness, and exploitation of the population.<sup>32</sup>

The situation at each plantation, along with the particular process of intervention, together form a large case study for comprehensive application of all elements of state power, in differing contexts. In Cavalla (southeast Liberia), for example, after UNMIL intervened, the Ministry of Agriculture took control of the plantation from rioters, partially paid back wages, established interim management, and began researching the ownership of the concession.

More effort was required in Guthrie, 2 hours from the capital. The plantation had become overgrown with jungle vegetation during the preceding 20 years. By 2006, the high price of rubber on the world market made the plantation an object of intense conflict and competition. From the outset, UNMIL realized that the military-age population was just looking to make a living. Accordingly, UNMIL prepared itself

to engage this group in dialogue through the British nongovernmental organization (NGO) Manaction, which specializes in job creation.

During the 2 months of negotiations with the Guthrie plantation's chiefs regarding the right to retain ex-combatants, UNMIL assembled a force consisting of one battalion of UNMIL members, an element of the UN Police, and the Liberian National Police, just outside the plantation. In a persuasive application of pressure, UNMIL then started operating inside the plantation, informing its population that, although they did not have to leave, they had to relinquish control and apply for jobs. By the end of 2006, the Government of Liberia had complete control of the plantation and all rubber produced, within the compromise with Guthrie's prior rebel management that included a mentoring commission and check points at the plantation.

Different circumstances prevailed at the Cocopa plantation near Liberia's borders with Guinea and the Cote d'Ivoire (Ivory Coast). Although the plantation was already in the hands of its rightful owner, UNMIL intervention was necessary to avoid open warfare, as Cocopa's abusive management had inflamed feelings among inhabitants of the surrounding countryside. Four months of low-profile occupation of the plantation by UNMIL members, Ministry of Agriculture administrators, and police patrols stabilized the situation and established a more democratic style of management, which reduced the internal tensions. A similar situation existed in Sinoe, where its ownership was in dispute and bad relations between the operating family and the surrounding communities had created conflict. However, by the second half of 2007, government-sponsored job creation programs made

these communities more stable and receptive to the new status.

Decisive individual focus on the SOEs in Liberia thus created the economic platform for a successful new government. The enabling resource of electricity and the dominant production of rubber were both revitalized and made functional. By using the security forces of UNMIL, together with the economic development expertise of the UN and the USAID, President Johnson-Sirleaf laid the basis for stability.

### **Kosovo.**

In the spring of 1999, as the political conflict between Slobodan Milosevic's Federal Republic of Yugoslavia (FRY) and the North Atlantic Treaty Organization (NATO) ripened into military confrontation, two acute uncertainties dominated NATO planning: (1) would Milosevic back down as he had in earlier confrontations, so that no military action would be necessary; and if it became clear that he would not do so, (2) would an air campaign alone set things right without a ground invasion?<sup>33</sup>

Reliance on an air campaign to accomplish NATO's political-military objective put a premium on thoroughness and speed in executing the campaign. In the perspective of the Joint Force Commander: "The most precise and lowest collateral damage air campaign . . . in history achieved all objectives at the strategic, operational, and tactical levels of war, [was] highly effective and superbly executed, but [was] politically constrained, and [became] the victim of a 'Short War Syndrome'."<sup>34</sup> Among the many successes of nodal analysis (to reduce effort, risk, and cost by attacking targets at the vulnerable nodes of a network) were the

targeting of electric power plants, petroleum, oil, and lubricants (POL) depots, and lines of communication (LOCs).<sup>35</sup> Targets also included drainage culverts and single lane bridges.<sup>36</sup>

During the air campaign, the preservation of economic assets for post-conflict stability operations was hardly considered. Although constrained by the need to minimize collateral damage, the planners were permitted to target Kosovo's economic assets. They were guided solely by the need to be thorough, with a view to making the air campaign independently effective or facilitative of the entry of ground forces if necessary.<sup>37</sup> The result was that almost all of Kosovo's economic infrastructural assets were destroyed, either by retreating Serb forces or by NATO bombers before NATO forces entered Kosovo.<sup>38</sup> One senior coalition commander ruefully reported at the time that "[w]e needed all the bridges to get in, but the air campaign had destroyed them, along with even telephone poles!"<sup>39</sup>

Even before the air campaign, the economy of Kosovo—which had been part of the former Yugoslavia—was in shambles. The Federal Republic of Yugoslavia (FRY) had been economically ruined by Marshal Josip Tito's socialist management schemes. By 1979, the end of its foreign borrowing period, the country was bankrupt.<sup>40</sup> By 1999, Milosevic had created criminal power structures in which embezzlement by the newly introduced Serbian elite steadily drained the country of capital.<sup>41</sup> In the centrally managed economy of the then-communist FRY, any economic activity of a significant scale had to be owned by the state, such as it was, which meant ownership of state assets by these corrupt elites.

In Kosovo, this situation was complicated by Serbian efforts to put economic power solidly in the

hands of Serbs. Fifty-five state-owned enterprises then accounted for more than \$1.0 billion in assets, and these SOEs were the dominant source of legitimate revenue in the economy.<sup>42</sup> This conglomeration of economic resources, in the context of an economy described authoritatively as “neuralgic,”<sup>43</sup> became the only base upon which the post-Milosevic provisional authority, the UN Mission in Kosovo (UNMIK), could restore political-economic stability in the country.

In the summer and fall of 1999, UNMIK adopted a problematic approach to the task at hand and delegated economic reconstruction and development to the European Union, under *Pillar IV*, as mandated by UN Security Council Resolution 1244. That resolution authorized UNMIK to begin the long process of building peace, democracy, stability, and self-government in the shattered province. UNMIK did not begin with a political-economic strategy, but allowed a strategy for economic development to evolve in response to events. While not rigidly *laissez-faire*, this approach placed considerable faith in market forces.<sup>44</sup>

The strategy assumed – almost as a matter of fact – that an appropriate policy framework would be created for the private sector without impediment:

UNMIK was betting that “[i]f you build it, they will come.” The question was, [w]ould they come quickly enough to demonstrate to Kosovo’s massive unemployed population that peace would pay, an essential condition for advancing the peace process?<sup>45</sup>

This emphasis on building the private sector had significant implications for political stability, due to the corruption it entailed: “The economic plans first

pursued by UNMIK focused on liberating the private sector and dealt perfunctorily with POE's" (publicly owned enterprises). It left them to "operate with minimal oversight . . . , inadvertently creating an environment in which corruption flourished, illicit power structures took over management, the workforce became politicized and incompetent, and the inability of the international community to manage and deliver regular electricity became a symbol of the failure of international forces and fomented instability."<sup>46</sup>

After a 2002 auditing established that relatively few of the roughly 350 SOEs were worth salvaging (although many unprofitable SOEs sat on valuable land), UNMIK created the Kosovo Trust Agency to manage the privatization effort and took control of the enterprises in late 2003.<sup>47</sup> According to USAID, the privatized SOEs accounted for 90 percent of total SOE output in Kosovo as of 2007. Perhaps even more significant, privatization increased employment by 15 percent by then, raised average revenues by a factor of seven, and attracted capital investment an average of more than \$0.5 million per company.<sup>48</sup> Meanwhile, donors provided assistance to several sectors of the economy; for example, USAID worked with agricultural cooperatives to develop commercial and entrepreneurial skills.<sup>49</sup>

During the several years just prior to the beginning of UNMIK's mission in 1999, the lack of basic services and the low level of economic activity had contributed to a palpable sense of stagnation and paralysis that had exacerbated political tensions between the Albanian and Serb communities. Distribution of electric power remained undependable, and trash was then only rarely removed from the streets of the capital, Pristina.

Although Kosovo's first-ever democratic elections in the fall of 2000 constituted political progress, economic progress was not keeping pace. UNMIK's relative inattention to economic activity was justified by the coalition authorities on the grounds that "UNMIK could not do everything at once, and peace was the top priority."<sup>50</sup> This questionable justification reflects the dubious wisdom of separating political and economic activities from each other in a stability operation when they should be mutually supportive. Operation of the informal or "shadow" economy, heavily tainted by drug and human trafficking along the traditional highways from the Middle East to Europe, along with remittances from the Diaspora, apparently were all that kept many Kosovars from starvation during this time.<sup>51</sup> With the formal economy in disarray, both Albanians who had fled the war and those already living outside Kosovo were able to send significant funds back to their relatives and associates.

One important lesson drawn from the Kosovo experience, in the opinion of a former UNMIK official closely involved in its policy management, was its illustration of the successful use of the SOE as an instrument of stability:

SOEs offer opportunities for advancing the political strategy behind post-conflict stabilization and reconstruction, opportunities poorly understood by political strategists and tacticians. Getting SOEs to work right offers immediate, tangible benefits to local populations whose support is essential for earning trust and credibility . . . because in post-conflict situations, local populations are traumatized . . . so providing concrete improvements to daily life that they can see . . . gives arms and legs to go along with hearts and minds.<sup>52</sup>

An even more basic lesson from the Kosovo reconstruction effort is that rebuilding was retarded by the effects of the air campaign and by UNMIK's *laissez-faire* approach to reconstruction and economic development. The military imperative to minimize coalition casualties and the pressure to avoid a ground campaign had led to targeting of electric power plants, petroleum product depots, and transport infrastructure like bridges, which were both military and economic in nature. Similarly, UNMIK's deemphasis of economic development in favor of political efforts to restore peace allowed corruption to flourish, thus jeopardizing both governance and stability.

## **Iraq.**

The U.S. Government's experience in Iraq shows both the central importance of SOEs while revealing their dual political-economic nature. Paradoxically, even before the conflict, Iraqi economists were nearly unanimous in calling for privatization of the bloated public sector, which had come to a virtual halt as a result of economic sanctions, while the private sector prospered.<sup>53</sup> Thus, it was not surprising that in 2003, the CPA deemed privatization an imperative for creating economic stability: "Rebuilding the Iraqi economy based on free market principles is central to our efforts."<sup>54</sup> Thomas Foley, the CPA's manager of private sector development, put into motion privatization measures initially for fewer than 10 SOEs based on an assessment of 153 of Iraq's 193 SOEs. He identified cement, sulfur-mining, fertilizer, textile, and automobile assembly and tire plants as SOE candidates for privatization, estimating that the process would take 3 to 5 years.<sup>55</sup>



However, by 2004, privatization efforts had not progressed beyond the initial assessment, apparently because insecurity had discouraged potential investors. The World Bank, nevertheless, noted that Iraq's SOEs then comprised 90 percent of industrial capacity and employed 500,000 of the four million-person labor force. The Bank also noted, however, that the SOEs were "seriously de-capitalized, asset-starved, obsolescent, inefficient, saddled with high production costs, over-staffed, and—as a result of looting—in a state of physical degradation."<sup>56</sup> Although the need for new investment was urgent, the World Bank concluded that privatization was "not an option for the short term," mainly because "antipathy to private and particularly foreign investment" was strong, and an extensive safety net would be necessary "to avoid a social crisis."<sup>57</sup>

Dealing with the prevailing crisis in SOEs was a high priority for USAID, however. It noted that "[r]estarting industry is critical to involving the labor force in productive activity and to preserving the existing industrial base for later economic reform" from which "new job creation in the private sector" can flow.<sup>58</sup> During this period, Iraq's Ministry of Industry and Minerals (MIM), which was responsible for most of the country's SOEs, developed a strategy to keep its "staff working and off the streets, cover their payroll disbursements contribute to critical supplies, help kick-start the economy, and buy time for medium term restructuring, the cost of which was estimated at \$300 million for electric power, \$350 million for necessary repairs, and \$100 million for start-up costs."<sup>59</sup>

In March 2005, Paul Brinkley was named U.S. Deputy Under Secretary of Defense for Business Transformation. Fifteen months later, he established

the Task Force for Business and Stability Operations (TFBSO) in Iraq. TFBSO's comprehensive vision of a modern industrial economy in Iraq led it to focus on a fiber-optics communications backbone, the banking sector, industrial operations, small business and private entrepreneurial activity, and private sector investment processes.<sup>60</sup> For the TFBSO, the key to revitalization continued to be the eventual privatization of the SOEs, extrapolating from the efforts begun by the CPA in 2003.

As late as the first months of 2007, however, other economic experts continued to argue that revitalizing Iraq's SOEs was not feasible. They believed that such action would not prove decisive in stabilizing the politically-driven conflict. This seemed to be the view of most of the participants at a working group meeting of the United States Institute of Peace (USIP) on February 1, 2007, that critiqued Brinkley's January announcement that 10 factories would be opened within 3 months.<sup>61</sup> The working group chair cautioned that:

. . . plans to revitalize SOEs must include a conflict assessment; implementers of the program must have a solid understanding of which actors become empowered as a result of revitalization; the drivers of conflict are so complex that it is simplistic to think that violence will be reduced simply because individuals are offered jobs; and long-term sustainability will require a clear commitment from the Iraqi government to protect the investment initially made to restart the facilities.<sup>62</sup>

One of the participants at the working group meeting, Keith Crane, a senior economist at the RAND Corporation and former adviser to the CPA, believed that revitalizing SOEs

would offer little by way of new employment opportunities and doubted whether SOEs are the right investment, in view of the facts that “[a] third of the state-owned enterprises are damaged beyond repair, another third are hopelessly unprofitable, and the rest are a mismanaged assortment of plants, a few of which could potentially produce something of value, but only with proper management and incentives.”<sup>63</sup>

Crane saw the conflict in Iraq as fundamentally a struggle for political power that would not be affected by improvements in the economic quality of life, such as that promised by revitalization, but might perversely empower insurgents and militias and thus prolong the conflict.<sup>64</sup>

Despite these negative prognostications, economic progress appeared in late 2007. During the 10-month period ending in September 2007, with a team of experts and U.S. and Iraqi government contracts in hand for goods and services, TFBSO assessed 73 major industrial sites and restarted 17 factories across various industrial sectors. During the following 8 months, TFBSO restarted or materially increased production at 12 additional factories and relinked those that had previous commercial ties, creating more than 10,000 sustainable jobs in the process.<sup>65</sup>

Steps were also taken to secure the investment that might be needed for the subsequent privatization of SOEs. TFBSO looked to models followed in other former command economies which avoided large-scale displacement of workers and thus reduced their vulnerability to recruitment by insurgents. In February 2007, Iraq’s MIM solicited proposals for investment in 13 large SOEs, and by January 2008, three joint ventures in cement manufacturing involving more than

\$100 million each were established with European firms.<sup>66</sup>

In view of the foregoing developments, two hypothetical questions come to mind. First, what would have been the likely results of the CPA's intervention in Iraq if one of the CPA's goals in June of 2003 had been the revitalization of SOEs as a prerequisite for their privatization? Second, what would have been the impact if the CPA had been prepared to restart facilities with the local authorities based on the realities on the ground?

One experience of the First Marine Expeditionary Force (IMEF) in Iraq's Al Anbar province in January 2004 may point to answers to both questions.<sup>67</sup> At that time, two cement plants sat idle despite the availability of nearly 5,000 local workers, a moderate Sunni businessman, and a Jordanian government representative willing to lease and operate the plants for 10 years. When the Sunni businessman presented the proposal to the Interim Government of Iraq, he was told it could not make such a commitment. During the USIP workshop described above, however, a UN participant pointed out that the UN could have placed the facility in a trust and later turned it over to a new permanent government. Had the CPA arranged for this to be done, the SOEs could have been restarted to the benefit of the inhabitants of the local area, and of the IMEF, since the recruiting pool for the insurgents might well have been reduced by the resulting employment.

The SOEs in Iraq were potentially useful for stability, but efforts to use them began late due to the simplistic vision of the CPA, which prematurely pursued privatization. In the February 2004 final push, Iraq's Ministry of Industry attempted to lease 35

state-owned factories rather than sell them outright. However, by the time that CPA Administrator Paul Bremer left Baghdad on June 28, 2004, not a single factory had been leased.<sup>68</sup> The most likely reason is that he had attempted privatization prematurely based on a strong philosophical commitment to private enterprise and the belief that other transitional economies had demonstrated the necessity for rapid privatization.<sup>69</sup>

TBSFO's competing model of pragmatically revitalizing SOEs, as made possible by a shift in earlier U.S. interagency policies from opposition in principle to one of support for SOEs, began late and coincided with the onset of greater stability. In contrast with the inability described above to restart the SOEs in Anbar Province in 2004, the establishment of a legitimate Iraqi government a year later and the TFBSO's more pragmatic approach led to assisting SOEs to prepare for privatization.<sup>70</sup> Sector analysis and prioritization were combined to facilitate Iraqi investment.<sup>71</sup> Two examples of TFBSO's efforts to put large plants back into operation are a now-functioning glass factory and a fertilizer plant in Anbar Province, and a ceramics factory in Ramadi.<sup>72</sup> In Salah Al-Din, which is an important agricultural market center, the Balad Canning Factory was privatized. The Bayji Refinery Complex, a fertilizer plant, and a vegetable oil plant—all constrained by uncertainty in electric power deliveries from the power plant—are targeted for further assistance.<sup>73</sup> While it is not possible to ascribe the general improvement in stability directly to revitalization of these SOEs, it would be implausible to infer that the increase in economic activity and jobs played no role in the public acceptance of the new Iraqi regime.

The experience in Iraq clearly underscores the fallacy of separating political and economic activities, as that fallacy had been visible in Kosovo, during the preceding 3 years (2000-03). Implementation of the CPA's vision of a free market economy had the fatal flaw of assuming that economic strength would naturally result from market forces, even if detached from their political context. In this sense, the approach of policymakers was ideological instead of pragmatic, and the cost was delay, if not derailment, of stabilization.

### **Mozambique.**

SOEs, including all the large companies specializing in cashews, tea, cotton, and other agricultural products, have been a critical element of the Mozambican economy ever since the government took over from the Portuguese colonialists. After 16 years of bitter civil war accompanied by post-colonial economic collapse, the combatants were exhausted and the economy lay in ruin by the time peace was restored in 1992. Virtually all the factories, the sugar and cotton plantations, and the critical agricultural processing industry had been destroyed.<sup>74</sup> About 5.5 percent of Mozambique's population (1.0 million out of 18 million people) had been killed during the conflict; another 12.8 percent (2.3 million) of the population had become refugees in Malawi, Zimbabwe, Swaziland, and South Africa; and several million more had become internally displaced and homeless.

Using tactics during 1977-92 that would later be seen in Liberia and Sierra Leone, the anti-post-colonial government force, Resistência Nacional Moçambicana (National Mozambican Resistance, [RENAMO]), had

perpetrated numerous atrocities against civilians; leaving corpses with arms or ears hacked off, forcing child soldiers to burn huts with families inside, and using machetes to kill hospital patients in their beds.<sup>75</sup> Following these horrific events, the hard task of restoring peace at the village level, which involved the agonizing need for forgiveness (village reconciliation), became central to political and economic reconstruction.<sup>76</sup>

When peace was achieved in 1992, the international community faced four essential tasks: (1) demobilize the anti-government force, RENAMO; (2) integrate RENAMO personnel into Mozambican society; (3) repatriate 2.3 million refugees; and (4) restore economic growth to sustain peace. The international donor community then applied the standard formula for restoring peace—establishment of a multiparty democracy, with multifunctional assistance from UN peacekeeping forces and bilateral donors. Scholars have remarked that while Mozambique was “one of the least likely success stories of its type” (in view of its poverty, undemocratic history, and the essentially apolitical character of the anti-government ex-combatants), it is now “the United Nations’ only post-conflict success story in Africa, [with] no return to armed conflict, no significant political violence, and no questioning of the essential terms of the political settlement.”<sup>77</sup>

The explanations for this remarkable result are both political and economic. Politically, democratization was consolidated by the two former belligerents’ acceptance of the international community as the third member of a triad, as a result of which the international community became a *de facto* constituency for the other two parties. Economically, Mozambique’s “high

dependence on aid and its successful application of Western prescriptions for economic recovery have created sustained donor interest," the result being that "neither Mozambique nor its major donors could afford to let the democratization process there fall by the wayside."<sup>78</sup> That the West provided massive assistance is evident from the fact that total donor financial support varied between \$800 million and \$1.0 billion per year in the late 1990s, while Mozambique's gross national product was only about \$1.5 billion.<sup>79</sup> Other economic explanations pointed to Mozambique's paradoxical advantage in being resource-disadvantaged: Mozambique lacked crude oil or the diamonds that supported anti-government forces elsewhere, such as in Angola, where the União Nacional para a Independência Total de Angola (National Union for the Total Independence of Angola [UNITA]) funded itself by control of diamond mining.

These successful actions were neither simplistic nor naïve. The international community created a framework in which the two parties competed to be seen by the international community as the main champion of democracy. Being democratic was necessary to obtain aid funds—"a positive force for the transition so far, [but] a highly contingent one."<sup>80</sup> Observers of the process noted "widespread uses of financial incentives to elicit cooperation" from both RENAMO and the government, including the use of substantial cash payments to the RENAMO movement's leader, Afonso Dhlakama, from the trust fund overseen and audited by the UN, "in exchange for his ongoing participation in the peace process."<sup>81</sup> These powerful inducements were ultimately decisive in a country economically and emotionally exhausted by war.



Humanitarian and economic development assistance was crucial for stability following the peace agreement of October 4, 1992. The delivery of food, following the disastrous drought of 1991 that had left four million people at risk of starvation, was a principal lever for achieving and implementing the peace agreement. During this time, the World Food Program (WFP) and its NGO partners delivered nearly half a million tons of food at a cost of \$192 million, at the rate of 19,000 tons per month.<sup>82</sup> WFP and its partners were almost always the first to be allowed into RENAMO areas and were able to speak to Dhlakama when other donors could not, thus obtaining a critical channel and a decisively powerful inducement to all parties to cooperate, which resulted among other things in Dhlakama's agreeing to stop attacking food convoys in government areas.<sup>83</sup>

Short-term economic assistance was also necessary for demobilization, the first step toward creating an environment stable enough for elections. When troops in assembly areas waiting to be demobilized began to riot and military control was lost, it was the "generous redundancy package supplied by the donor community that led them to choose to be demobilized."<sup>84</sup> The value of the package (Reintegration Support Scheme, or RSS) was estimated to be \$32 million of the \$85 million for demobilization. It consisted of subsidy payments, basic food rations, transportation vouchers, a tool and seed kit (each including a bucket, a machete, a hoe, vegetable seeds, and an instruction manual), and two meters of cloth.<sup>85</sup>

Some UN officials nevertheless remained concerned that long-term economic development was being short-changed by the donors' focus on short-term needs. Unfortunately, their preoccupation with long-term

development may have threatened the demobilization program and thus stability. The unwieldy UN structure featured the UN Office for Humanitarian Assistance Coordination (UNOHAC) and the UN Development Program (UNDP), with both competing against each other to manage demobilization.<sup>86</sup> Seeking long-term reintegration, UNOHAC proposed a 3-year program of training, job creation, and credit that emphasized community projects and skills development, with a late 1994 start date when soldiers were due to return home.<sup>87</sup> "UNOHAC insisted on pushing a long-term developmental approach designed to empower the local government," despite the counsel of others who maintained that immediate economic improvements were crucial for stability.<sup>88</sup>

Sensing that demobilization was an urgent race against time, a like-minded donor group bypassed UNOHAC and reallocated aid to the short-term RSS. Among other things, it provided for 18 months of subsidies to beneficiaries, following the government's own subsidies of 6 months, and used USAID's low-budget information and referral service at the provincial level to spread the word.<sup>89</sup> The donors separately considered short- and long-term assistance initiatives, choosing to postpone the latter.<sup>90</sup> However, UNOHAC director Felix Downes-Thomas continued to argue that UNOHAC be given management authority, saying that cash payments alone did not guarantee successful reintegration. The UNDP also continued to concern itself with long-term development as the focal point of its efforts.<sup>91</sup> Downes-Thomas's boss, Special Representative of the Secretary General (SRSG) Aldo Ajello, characterized the disputes as "the result of tensions in the culture of development versus peacekeeping."<sup>92</sup>

In the continuing debate about short-term versus long-term development, most observers agreed that the RSS succeeded in buying time and providing breathing space to help the ex-combatants while they identified or generated employment opportunities for themselves. Other observers, however, felt that the most critical problems confronting the demobilized former combatants had merely been postponed.<sup>93</sup> A similar concern was expressed by observers of the returning refugees, potentially 2.3 million strong, a significant fraction of Mozambique's 18 million citizens. By the end of 1995, it was widely felt that the programs of the UN High Commissioner for Refugees (UNHCR) were not sufficiently robust to sustain the resettled refugees after the UNHCR's departure, with the U.S. Committee for Refugees predicting that it would be a full generation before most Mozambicans could regain the "meager standard of living [that] they had in 1980."<sup>94</sup> Observers noted that "the sustainability of many rehabilitation projects was limited as the United Nations Development Program did not follow-up on many of these."<sup>95</sup>

Faced with the pressure to help demobilize former rebel combatants before elections were held, most donors promoted quick-impact projects, but the choice between short- and long-term projects need not have been either-or. The UN's coordination problems obscured the fact that a comprehensive program that integrated the short-term assistance of the RSS with longer-term development initiatives could well have been within the UN's capabilities to design and implement. In any event, the UN office in Mozambique and its parent agencies in New York had no clear vision of the economic basis of stability and so created unnecessary conflict within itself (UNOHAC and

UNDP), compelling bilateral aid donors to go around it to get the job done. SRSG Ajello is rightly credited with brilliant diplomacy in making the peacekeeping operation work, but economic coordination of the effort is one aspect of the UN's responsibility in Mozambique that he did not manage well.

Prioritizing and properly sequencing the short- and long-term activities that comprise a comprehensive development strategy are the classic trade-offs faced by providers of assistance. The absence of blueprints of a comprehensive strategy does not mean that either its short- or long-term aspect must be forgotten.<sup>96</sup> In fact, many effective donor programs address long-term projects while providing short-term relief.

Even if donors had created a comprehensive program in Mozambique that linked short- and long-term activities, it nonetheless is unlikely that they could have incorporated Mozambique's SOEs in the program, for two reasons. First, at the time of the cease-fire in October 1992, very few SOEs remained largely intact, and none had benefited from regular maintenance. For example, in the critical agricultural marketing sector, the facilities of the Cereals Marketing Institute were completely destroyed, and donors did not press the government for an investment program.<sup>97</sup>

The second reason that the donors gave short shrift to Mozambique's SOEs in their comprehensive program was that they wanted to privatize its SOEs quickly. Revitalizing the SOEs would very likely have been off limits. The goal was privatization, a goal incompatible with the SOEs' taking on new publically funded employees. The pressure for privatization was so great that even in the face of known corruption in the privatization process, donors pushed the government to privatize.<sup>98</sup> This pressure had been of

long-standing: When Mozambique joined the IMF and the World Bank in 1984, the IMF's policy prescription for the country included a large reduction in the public payroll despite the lack of a significant private sector to absorb laid-off employees.<sup>99</sup>

The proposed privatization of the SOEs, as pushed for by the donor community, encountered no significant resistance from the post-conflict government, in whose pragmatic view the SOEs were mostly small, devastated, and neglected properties, with few ready to be profitable without new investment. This explains why after the withdrawal of the Portuguese colonialists in 1975, there had been no large-scale nationalization of property. Shortly thereafter, the government took over "only what had been abandoned by the Portuguese" and left about 20 percent of the enterprises private; it also decreed an intervention law by which anything nationalized could be subsequently reclaimed.<sup>100</sup>

Contrary to the interpretation above, other observers contend that the government did nationalize virtually all of the economy during that period, taking all the housing in the capital city, Maputo, a policy that had both symbolic (ideological) and practical effects.<sup>101</sup> In 1979-80, however, President Samora Machel began privatizing oil and insurance companies and some banks. Estimates are that between 1,200 and 1,700 enterprises were privatized, mostly the smaller ones, leaving the ports, railways, and utilities state owned. About this time, Machel also began to privatize the coal and sugar terminals at the port of Maputo, which were then operating at about 10 percent capacity.<sup>102</sup>

Restoring stability in post-conflict Mozambique did not require immediate revitalization of the SOEs, however. There was no competition between the ex-

combatants for control of them, and no danger that the conflict might continue within their management. Enlarging the role of the SOEs as employers of demobilized combatants, returning refugees, and internally displaced persons would have required a comprehensive program combining short- and long-term measures. It was thus not pursued as part of the demobilization program described above. Unfortunately, pressure by donors to privatize the SOEs encouraged corruption (most visibly in the case of the national bank), which remains one of Mozambique's weaknesses, retarding its development of a politically balanced, sustainable economy.<sup>103</sup>

All the foregoing notwithstanding, some analysts point to the continuing influence of the state as a positive force. They note that the government was not stampeded into hasty privatizations. Its controlled privatizations showed careful treatment of SOEs.

It was the state that confronted the problems of salaries in arrears, untrained personnel, and worker layoffs. And it was the state that monitored the new private operations. The demands of the international financial institutions, Western donors, and a new constituency of private investors influenced the activity of government officials, but they did not determine it. . . . [C]laims about the success of privatization have been quite superficial .<sup>104</sup>

This observation suggests that the donor-led privatization effort in Mozambique may have been of secondary importance, and that SOEs may continue to be an important part of Mozambique's economic landscape. It is clear that the role of the state in Mozambique's transformation from central management to a market economy was complicated. The addition of capitalism to the ideological mix

of Marxist socialism, nationalism, and modernism contributed notes of uncertainty.<sup>105</sup> Whether a broadly based economy, with many centers of power and income, can be created remains to be seen.

Is the stability currently achieved in Mozambique sustainable? In 2002, a decade after the peace agreement, Mozambique was still seen as a worthwhile ongoing gamble; its people's "repetitive interaction will eventually produce a formal system to which all political players have a strong commitment . . . a stable political system."<sup>106</sup> Three years later, by 2005, both the dependence of peace on foreign aid in Mozambique and the failure of its ex-combatant RENAMO movement to become an effective opposition had led scholars to express growing concerns about the country's stability. Economic growth remained sharply unequal and "narrow donor obsessions" had played into the hands of an increasingly corrupt elite.<sup>107</sup> The ruling party, Frente de Libertação de Moçambique (Mozambique Liberation Front, or FRELIMO) continues to show a remarkably sturdy character and has "obsessively maintained unity at all costs—no high-level splits, resignations, or expulsions—but the price has been a failure to make decisions when consensus cannot be reached, and, more recently, tolerance of growing high-level corruption."<sup>108</sup> Mozambique's control of privatization has not been characterized, however, by hasty sales to insiders or the empowerment of oligarchies, as has occurred in other countries.

Today, Mozambique is stable. It is experiencing consistent economic growth as well as the problems that usually bedevil developing countries in Africa; e.g., high prevalence of HIV/AIDS and poverty.<sup>109</sup> It is now difficult to imagine that a sudden withdrawal of donor support, a severe economic downturn, and

heightened political instability could transform RENAMO from a failed political opposition to an armed threat since the external supports that created it have disappeared. Mozambique's success story continues, based as it is on pragmatic and careful privatizations of SOEs and a political balance underwritten by foreign donors—but its future is by no means assured.

### **Afghanistan.**

Lessons learned from the foregoing cases suggest a potential role for the SOEs in Afghanistan. Restoring stability there requires creation of a sustainable economic alternative to cultivation of the poppy plant for the international illegal drug industry,<sup>110</sup> the estimated export value of which was \$3.4 billion (of the \$23.03 billion economy) in 2008.<sup>111</sup> Because this requirement is critical to the success of the U.S. stabilization effort in Afghanistan and because our supporting economic strategy is in its early stage of formation,<sup>112</sup> an important opportunity exists to use its SOEs as an integrating mechanism to achieve required broad-based economic growth. Any such strategy must feature demonstrable metrics to show progress within a 2-year period.<sup>113</sup>

The SOEs can be a focal point for such a strategy because a successful effort has already been made to rehabilitate some of them. One SOE project, the Kajaki Dam, built with USAID assistance, is a centerpiece of reconstruction in that it took account of electric power projects, road building, and water control throughout Afghanistan's south-central region.<sup>114</sup> One Afghan Army official affirmed that this project created more than 1,000 jobs, provided powerful symbolic value by



demonstrating that the government could protect such projects, and had a critical impact in the “information-psychological war by enabling the government to counter terrorist propaganda by powering 14 television channels.”<sup>115</sup> The numerous attacks on the dam reflected the strategic importance that the Taliban believed it had for the government.<sup>116</sup> One expert with extensive on-the-ground experience and broad Middle Eastern experience believes that large-scale fish hatcheries on many of the rivers and commercial forestry operations on state-owned land are feasible for SOEs and might realistically employ thousands of the country’s “illiterate but hard-working population.”<sup>117</sup>

This potential for the SOEs in Afghanistan to serve as a focal point for development exists in the context of a sobering reality: the condition of the SOEs is extremely poor, and their exact number is not clear. Afghanistan’s political experience has left it a complicated situation, a key feature of which is the lack of an effective legal and regulatory framework. In part, this is the result of its many abrupt changes in government: Mohammed Zahir Shah’s attempted modernization efforts (1929-33), ill-advised state planning (1953-63 and 1973-79), the Soviet intervention (1979-92), and the Taliban period (1996-2001). As a result of these disjunctions, SOEs generally lack title documentation, which is more than just a privatization issue. Reliable secondary sources and acceptable court procedures are necessary in any privatization effort.<sup>118</sup> Despite these obstacles, “most major donors have had a privatization-related project at one stage or another since 2003.”<sup>119</sup> The pervasive destruction of SOEs in Afghanistan severely limits the resources available for the reconstruction effort.<sup>120</sup> Three important SOEs that employed thousands of

people but were totally destroyed included the clothing factory at Nasaji Bagrami, the steel and machine plants at Jangalak, and another clothing factory in the Golbahar district of Parwan province.<sup>121</sup> Some smaller state-owned construction companies have been privatized, however, and three large publically-owned hotels have also been leased to private parties.<sup>122</sup> USAID reported in June 2009 that 15 SOEs are being liquidated.<sup>123</sup>

Any comprehensive program designed to create broad-based economic growth as an alternative to the cultivation of poppies in Afghanistan calls for the strategic integration of the SOEs in the country's development activities. In the agri-business sector, donor assistance could target relevant SOEs in such a way as to enhance the viability of the public and private firms in the sector. Enhancing the operational capabilities of the SOEs would facilitate their finding suppliers, distributors, and customers and thus would lessen the need for the SOEs to rely on government contracts or other forms of government support.<sup>124</sup>

World Vision International, a humanitarian relief organization, successfully pursued a similar integrating strategy in Angola and Mozambique by vertically integrating agricultural projects in guaranteed markets in regional centers.<sup>125</sup> In Afghanistan, linking development zones and associated SOEs could facilitate the integration of multisectoral assistance in a coherent and broad-based economic growth strategy. The inclusion of the SOEs in this effort need not raise the specter of a move toward a centrally managed economy, as preparations for the eventual privatization of the SOEs need not be interrupted, and management contracts as used by USAID in Liberia might be appropriate for Afghanistan.<sup>126</sup>

Centered on appropriate SOEs, the establishment of poles of development in Afghanistan encompassing agricultural, industrial, and commercial plants in specific regions would likely attract investment from public and private sources. By this means—which would involve the concomitant pursuit of short- and long-term aid activities—donors could cope with classic short- and long-term development assistance dilemmas. Through high-level coordination, donors could focus geographically on the development zones and functionally on the SOEs, all the while avoiding fragmentation and stovepiping among the specialized donor organizations. Overarching capacity-building, such as literacy programs, could be simultaneously pursued across all zones.

Donors may find that revitalizing the SOEs in Afghanistan is too daunting a task. Pressure may rise to privatize them in their actual state, notwithstanding the inadequacy of current regulations. According to experts with experience in Afghanistan and elsewhere, however, failure to use SOEs in the pursuit of political stability and economic development would almost certainly lower the chances for their subsequent privatization. Early revitalization of SOEs would create jobs, goods, and services. Were this to be done, the SOEs could be prepared for eventual privatization, if appropriate. A recent recommendation by U.S. Presidential Envoy for Afghanistan and Pakistan, Ambassador Richard Holbrooke, calling for “revamping the entire U.S. reconstruction effort,” opens the door for the pragmatic inclusion of Afghanistan’s SOEs in the effort.

Thus, the very complexity and ambiguity of Afghanistan presents an opportunity for a fresh approach—an approach without limiting assumptions

that would exclude SOEs. There are areas in the agricultural economy where SOEs can play a role in development. If pragmatism can be the order of the day, the lessons from earlier experiences can be applied. In the next section of this paper, those lessons are emphasized.

### III. LESSONS FROM EXPERIENCE

State-owned enterprises can be powerful vehicles for stability in conflict-prone environments when managed as described in Liberia. Conversely, when not managed well, or worse, ignored, their presence, or lack thereof, can have significant negative effects on state-stability, as shown in the Kosovo, Iraq, and Mozambique studies. It remains to be seen whether SOEs are used adequately to fulfill their potential promise in Afghanistan. Decisive control of SOEs makes a difference in both how quickly stability can be achieved, and how durably it can be maintained. In Liberia, the positive benefits of UN intervention in the control of the electric power utility and the commercial rubber plantations were both palpable and visible. UNMIL soldiers provided security for the rehabilitation of both enterprises, although in the case of the plantations, they did so by gradual physical occupation. The SOEs of the critical public service infrastructure were rendered functional and contributed substantially to restoration of stability in that country.

The potentially powerful role of the SOEs was reflected negatively by their absence in Kosovo, Iraq, and Mozambique. The cost of delayed stability resulted in large part from a failure to use the SOEs in a timely fashion. In both Mozambique and Kosovo, this failure

derived in large measure from the lack of rehabilitated infrastructure in the post-conflict environment. While in Mozambique, the inefficient and severely damaged infrastructure was the result of a long and exhausting conflict, the frustration of the Kosovo experience is that much of the infrastructure damage was recent and may have been avoided had military and political leaders applied any reconstruction and stabilization planning in the air campaign. The full-throttle air campaign which extensively damaged the country's infrastructure, as compounded by the UN's *laissez-faire* approach to economic reconstruction in favor of political peacemaking, precluded attention to the SOEs. Moreover, such inattention reflected a belief in market fundamentalism. As a result, during 2000-02, the tension between ex-combatants remained unnecessarily high, and peace remained fragile. The failure to use the SOEs was expensive.

Congruent with the Kosovo experience, the damage caused by the shock-and-awe air campaign in Iraq and the transcendent vision of a free market combined to exclude the SOEs from CPA deliberations. It was a widely held consensus that the opportunity to establish order had a 6-month window, but the free market economy envisioned in June 2003 was barely visible in January 2007. The focus had been on rapid privatization for essentially ideological reasons, but private investors did not materialize. The cost of underestimating the utility of Iraq's SOEs during this period of instability cannot be estimated in human terms, but the purely economic cost may someday be estimated in the hundreds of billions of dollars.

By not using the SOEs in the stabilization of Mozambique, the donors forfeited an opportunity to generate synergy by combining their long-term assistance with short-term means. Although the donors

had the managerial capacity to integrate the SOEs in their stability effort, the lack of a coherent plan allowed two debilitating conflicts to develop: (1) between the UNOHAC and the UNDP for leadership of the economic development and humanitarian assistance effort, and (2) between the UNOHAC and the like-minded donors group that worked heroically, successfully coordinating the successful reintegration of ex-combatants in society in spite of UNOHAC. The donors consequently often found themselves having to decide whether to pursue short- or long-term activities exclusively, a distracting choice that should be obviated whenever possible. A comprehensive blend of short- and long-term activities might well have accelerated development in Mozambique to the extent that today it would not be in the borderline category on the "Failed State Index."<sup>127</sup>

Afghanistan now offers the opportunity to use the SOEs in an integrated framework that provides meaningful alternatives to the cultivation of the poppy crop. The demonstrated benefits of the Kajaki Dam are evidence of the power of the SOEs to promote economic development and political stability. Equal benefits could be had by rehabilitating select SOEs connected primarily to agricultural production (which accounts for about one-third of the country's economic output).<sup>128</sup>

## IV. USING THE SOE AS A VEHICLE FOR STABILITY

### General Guidelines.

A major challenge in stability operations is how to harness SOEs in the short term in the immediate wake of conflict. These enterprises usually appear unviable and infected with the political forces that created the conflict in the first place. However, revitalizing SOEs reassures a conflict-prone country's populace that its legitimate government is committed to immediate improvement of their well-being. The government's task of revitalizing SOEs is not inconsistent with attempts to create a sound market-based economy. Instead, it is a way to secure the population's support for rational privatization in the longer term and to attract domestic and foreign investment for sustained economic progress. Thus, revitalization of SOEs is a useful objective on the road to stability.

The use of SOEs in stability operations should begin with proper answers to the following basic questions:

- What SOEs were critical to the pre-conflict economy?
- What domestic and foreign markets will support these SOEs post-conflict if they become viable?
- What will be the costs associated with reconstruction of the SOEs?
- What should be the reconstruction order of these SOEs, keeping in mind functionality and market support?
- What short-term assistance (such as demobilization subsidies for soldiers) might be integrated in the reconstruction of SOEs?

SOEs generally function as part of the public service infrastructure, such as electric power and water utilities, ports and transportation facilities, but they sometimes function commercially, as with banks, airlines, and commodity plantations. During the immediate post-conflict period—when organizations such as provincial reconstruction teams can be used for the initial screening and selection of SOE revitalization candidates—planners should not neglect the need for institution-building, which typically requires medium- and long-term expertise typically found in economic development agencies. The need is pertinent given that SOEs can be national in scope of operation and scale of resources. During this period, the management of the SOEs should be aimed at avoiding conflict among ex-combatants. The goals should be the reestablishment of physical security and the installation of politically neutral management in the important SOEs. Use of expatriate managers, hired by transparent international tender, as was done in Liberia, may be necessary to achieve neutrality. The critical SOEs should be prepared for refurbishing and recapitalization by means of privatization when appropriate.

### **Measuring Progress.**

In the immediate post-conflict period (the transition from active combat to tenuous peace), metrics are essential for gauging the pace at which the state-owned enterprises are transitioning from the repair of conflict damage to sustained production. Such metrics are dependent on broader metrics of stability, because SOEs are often at the core of both the economic and the political dynamics of conflict-prone societies.



The broader metrics often measure the state of the infrastructure (the condition of entities that provide essential public services), but the term SOE embraces both infrastructure and commercial organizations like plantations, airlines, shipping and mining companies, and similar activities. It is also important to remember that infrastructure includes not only physical hardware but also organizations, the labor force, and managerial systems. Although the priority task in the post-conflict environment is virtually always restoration of essential public services, the authorities responsible for putting the economy on a sound footing must be prepared as well to address the commercial SOEs, especially when the output and the income they generate are important to the populace.

An appropriate overall metrics framework for determining the progress of stability operations, with an economic component that encompasses SOEs, is the analytical tool known as MPICE. It establishes among its desired end states a Sustainable Economy, our main concern in this paper, along with two prime goals: diminish the drivers of conflict and strengthen institutional performance.<sup>129</sup> The first of the eight objectives in strengthening institutional performance is strengthening infrastructure, progress toward which is measured by the level of the availability of electric power and essential services (water, sewage, telecommunications, trash removal, and public transportation) (see Figure 1). Another one of the eight objectives is strengthening of employment. These two objectives are directly related to production, or the output of economic resources.

PRODUCTION	POLICY
Infrastructure	Fiscal Integrity
Employment	Regulatory/Corporate Governance
	Financial Institutions
	Private Sector
	Management of Natural Resources
	Economic Performance and Self-Reliance

**Figure 2. Measuring Progress in Conflict Environments:  
The Economic Component.**

The remaining six objectives (which relate to fiscal integrity, regulatory and corporate governance, financial institutions, the private sector, management of natural resources, and economic performance and self-reliance) relate to policy frameworks that only indirectly affect production. This dichotomy between production objectives and policy objectives, which together strengthen institutional performance, is shown graphically in Figure 2. We now turn to a more detailed treatment of the use of sound metrics in measuring SOEs' contribution to the economic aspect of progress in conducting stability operations.

**Strengthen Institutional Performance.**

The dichotomy shown in Figure 2 is especially helpful in the immediate post-conflict environment. Although all eight objectives are essential to the

end state, Sustainable Economy, there are clear interactions among them. When hostilities substantially cease, proper sequencing and application of resources require that restoration of production and employment be the priorities. They are the foundation of a sustainable economy and contribute directly to the coequally important end state, Stable and Secure Environment, through the creation of jobs that deplete the population of potential insurgents.

The dichotomy portrayed in Figure 2 is even more clearly visible in another set of metrics, the Framework for Success: Societies Emerging from Conflict, which was designed 2 years before the MPICE (see Figure 3).<sup>130</sup> It specifies desired end states, critical leadership responsibilities, and key objectives for success. Its end state, Sustainable Economy, has nine objectives related to SOEs, as appear in Figure 3.

PRODUCTION (PHYSICAL)	DEVELOPMENT CLIMATE (POLICY)
<p>Reconstruct public infrastructure (e.g., electric power, communications, and transportation) and the infrastructure of commercial entities, if appropriate</p> <p>Create viable workforce</p>	<p>Promote sound fiscal policy</p> <p>Build effective and predictable regulatory and legal environment</p> <p>Build effective financial and economic institutions (e.g., banks)</p> <p>Promote business development and sustainable employment</p> <p>Increase access to capital</p> <p>Limit corruption and the illicit economy</p> <p>Protect, manage, and equitably distribute natural resources</p>

**Figure 3. Framework for Success: Societies Emerging from Conflict – Physical and Policy Objectives.**

It may be safely assumed that the military commander of a stability operation will first address the objectives related to physical production; therefore, the set of metrics used to evaluate SOEs includes only those relevant objectives. The break-out of objectives in Figure 3 must not induce the commander to focus exclusively on production objectives, or induce the commander's superiors to encourage reporting only through stovepiped organizational channels. To avoid these potential pitfalls, all agencies must take a broad perspective, viewing their individual objectives in relation to the operational mission, thereby promoting the synergy of team effort.

Establishing a widely approved set of metrics to measure progress is essential to the success of stability operations. Momentum is both the key characteristic of successful operations and the reason for the central importance of metrics: "If a mission is not moving toward stabilization, then it is not moving toward a viable outcome, and it will continue to require international engagement."<sup>131</sup> Experience has shown that "the main barrier to measuring progress is political, not conceptual" and that the first step toward success is to "depoliticize metrics."<sup>132</sup> All those engaged in stability must therefore resist political pressures to show success undocumented by facts on the ground. Despite the understandable stakes of the interested political actors, yielding to such pressures would jeopardize the credibility of the operation and its prospective end state. A good set of metrics can be the basis for specific, practical actions and measurable results, as shown in Figure 4.

The imperative nature of using the SOE as a vehicle for stability is clear. Viable SOEs that exist in the post-conflict environment not only *can* be used,

they *must* be used. They are a key component of the platform for stability. To neglect the SOE is to delay progress toward the end state, a Sustainable Economy, and its companion end state, a Stable and Secure Environment. The fact that dealing with the SOE does not fall neatly into the purview of one agency and thus requires interagency coordination does not mean it can be avoided. Assuming we can accurately measure the contribution of the SOE, its use will accelerate progress toward stability and mission accomplishment.

PREPARATION	RESULTS
<p><b>SOEs in Infrastructure Assessment:</b>            Confirm and adjust Estimate of Economic Resources (EER) by physical reconnaissance, population assessment, and public attitude surveys.</p> <p><b>Determine levels of essential services, both pre- and post-conflict:</b></p> <p>Percentage of population covered.</p> <p>Dependability of delivery.</p> <p>Determine which facilities are physically and commercially viable.</p> <p><b>Planning and Evaluation:</b>            Determine resource requirements for physical and personnel security and allocate resources to inspect operations and survey public at frequent intervals.</p>	<p>Level of essential services “restored” (= pre-conflict level at a minimum)</p> <p>Electricity</p> <p>Water</p> <p>Sewage</p> <p>Trash collection</p> <p>Telephone</p> <p>Transport</p> <p>Rising public satisfaction with services restored.</p>
<p><b>SOEs in Commerce Assessment:</b> Review studies and follow advice of USG and international agencies to determine pre- and post-conflict levels of production and delivery.</p> <p><b>Planning and Evaluation:</b>            Use same advice to determine technical and resource requirement for operation and evaluation.</p>	<p>Production and delivery restored.</p> <p>Stakeholders and public attitude supportive.</p>

**Figure 4. Metrics for Gauging the Contribution of SOEs to the Economic Component.**

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