

Economic Approach to Conflict Issue: Investment in Post- Conflict Situation for International Business

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Abstract

The latest Global Economic Crisis and the latest Sovereign Crisis in the euro area have substantially deepened. Financial and economic conditions became a challenging matter for many investors and business organizations. The latest economic outlook is also prominent problem of researchers questioning the methods of sustaining long term interethnic peace in post- conflict countries (*PCCs*) and economies whilst the economic slowdown has effects on prosperity and development. In this study, it is aimed to develop an interdisciplinary approach to conflict issue within a theoretical framework in order to contribute to success of strategic decision making process at corporate level. Strategy makers at this level must evaluate the nature of conflict and develop conceptual skills before attempting to invest in conflict-prone economies. In this study, economic dimensions of conflict and its effect on investment climate have been evaluated to guide international business organizations. This study demonstrates that (i) there is strong tie between economic conditions and conflict risk, (ii) an increase in employment and income level in post conflicted economies is likely to decrease the probability of future conflict risk among interethnic groups (iii) inequality of income and resource distribution priorities among members of different ethnic groups escalate the risk of conflict, subsequently (iv) the success in the process of economic rehabilitation and recovery is a key contributory factor in sustaining peace and prosperity.

Keywords: Conflict, Investment, Employment, Development, Recovery

1. Introduction

The latest turmoil in global financial markets has once more illustrated the importance of strategic fit between developing long term strategy planning skills and implementing capabilities of the firms. One way to boost economic return as a strategic output is to implement risky business operations in post conflicting areas where some significant opportunities and threats are available. Attracting international businesses and enterprises to transfer both resources and capabilities into the post conflict economies is a must for sustaining long term stability, economic growth and success of recovery process required for suitable investment atmosphere. In transition economies, governmental incentives and financial opportunities are available in this purpose, become also attractive for international business operations. Subsequently, international business organizations operating in post-conflict economies became more integrated with recovery and transition process of post conflict economies (Hacıoğlu, et al. 2012:76-79).

Success of economic recovery processes in PCCs and positive investment climate for international entrepreneurs are vital factors boosting economic stability and prosperity. Prosperity and stability depends on economic factors. Two

sided opportunities are available and attached to contribution of private sector into economic development and recovery process. Maintaining economic stability in conflict prone economies is also addressed for avoiding future conflict risks contributing into interethnic peace and security.

Growth, employment and effective monetary discipline are likely to reduce risk of conflict recurrence in PCCs. However, economic recovery in the PCCs requires intensive capital flows to fuel the development and strength. Integration efforts with stable economies are also appreciated. Notwithstanding this, in post conflict economies, the lack of energy sources and of production factors continues to pose a significant risk for future conflicts. The lack of energy sources also creates vulnerabilities within a market economy, especially in the process of transformation towards an open market system (Hacioglu and Serttaş, 2011:159-164). Economic recovery requires two main accesses to energy sources and natural sources to sustain economic growth which increases level of employment, income and GDP.

The stabilization of economic recovery and peace process should be achieved with contribution of private sector contributing into efforts of fighting against poverty and creating healthy conditions for investment climate. Therefore, a new security strategy is required to fight against economic uncertainty in PCCs. The new transforming security strategy composes of economic agenda to enhance economic growth and prosperity with contribution of international business organizations. The first step is to develop the economic capability of post conflict state for joining international trade. The second step is to create suitable investment climate in which the foreign capital could be attracted.

In this study, it is aimed to illustrate the importance of evaluating conflict risk factors for international business investments. Risk of conflict and its effect on investment climate have been evaluated from a theoretical framework. Moreover, nature of conflict, its economic dimensions, its effect on investment climate, economic factors escalating risk of conflict, economic recovery and investment have also been evaluated.

2. Conflict and Its Economic Dimension in Post Conflict Countries

Conflicts are characterized by violence, poverty, food insecurity, destruction of health and other vital infrastructure, large population displacements, and the breakdown of family units. These are ideal conditions for disease and trauma to proliferate. In conflict settings, health needs typically increase while access to health services decreases making populations more vulnerable (Bustreo, et al., 2005: 1-3) According to the World Bank figures; 80% of the world's poorest 20 countries in the past 15 years have experienced major conflicts. Post conflict countries sustained significant economic development up to % 44, following the next 5 years since the end of conflicts (World Bank, 2003a). This figure illustrates linkage between stability and prosperity.

2.1 The Concept of Conflict

Mayer draws a conceptual frame of conflict within three major differences among individuals, states and organizations. These are conceptual, emotional and behavioral differences among actors in the realm of politics and economy (Mayer, 2000:1; Boulding, 1963:1). Dougherty and Pfaltzgraff defines the concept of conflict as a conscious challenge of a part of group to another with different ethnic, tribal, lingual, cultural, religious, social and economic differences (Dougherty and Pfaltzgraff, 1990: 187). Definitions made by Mayer, Dougherty & Pfaltzgraff and many other scholars combine four major dimensions of conflict. Scholarly, the first dimension is based on ethnic differences within a society where continuity of unitary state structure is a major concern. The second dimension stems from religious differences among different ethnic groups within the same state. The third one has the origins in cultural differences among various ethnic and religious groups. Finally, the fourth dimension is based on economic difference and inequality among different ethnic groups within a multiethnic society of a federal state system.

2.2 Economic Dimension of Conflict

Today in the literature, there is a strong debate among scholars on the methodology of conflict analysis. The first camp argues that strong statistical methods must be used to further a strong study on the basis of conflict risk analysis using econometric methods (Collier, 1999:13; Collier and Hoeffler, 2004; Collier, et al., 2007:2-7; Collier, et al., 2006: 3-12; Starr, 2004:1-3; Bray, 2005:4; Justino, 2004:1-15; Addison and Murshed, 2000:2-5). On the other hand, opposing camp believes statistics are prone to manipulations and misuse of data set which is not open to every scholar. The second camp insists that ethnic, religious and cultural dimensions are prior elements to understand the nature of conflict among individuals and different ethnic groups of a society, and conducts their approach with a strong critique of the methodology of the first camp (Sambanis 2001; Elbadawi and Sambanis 2002; Lujala et al. 2005; Hegre and Sambanis 2006; Korf, 2006:459-476; Suhrke, et al., 2005: 329-361; Wimmer, et al., 2009:3).

As mentioned before, conflict risk and its dimensions have negative impacts on investment climate which is

necessary for capital inflow required by stable economic conditions. Moreover, risk of conflict deteriorates political and economic conditions of post conflict states. Sustainable economic growth and political stability are the main pillars of a rational study in international political economy (Whitehead, 1991:53-57). In literature, conflict studies mostly have a theoretical base from rational school confines that economic factors are prior and central to the nature of conflict. Hence, the risk of conflict must be analyzed for stability and the success of future recovery process within a rational theory for international business operations (Starr, 2004; Collier, 1999; Collier and Hoeffler, 2004).

2.3 Major Impacts of Conflict on Economy

Conflict affects the level of GDP and monetary stability as a result of negative effects on physical and human capital, markets, investment and trust. Conflict also has two major impacts on international business operations. The first major impact stems from economic performance via precarious monetary policy and lack of budgetary discipline. The second impact is on the investment climate which is indeed a vital factor for a post conflict country to sustain economic stability in the absence of domestic resources (Figure 1). Governments with high level of expenses will not easily fuel the economy during a conflict and will have a tendency to increase interest rates to bring foreign portfolio investments (Figure 2).

In a conflict situation, increasing interest rates due to increasing budget deficits will not be so much attractive for physical investments as inflation increases dramatically during conflict and aftermath of it. Moreover, economic security of a conflicting state will be questioned by foreign and domestic entrepreneurs. During a conflict, it is going to be difficult to sustain economic stability as macro-economic performance gets meltdown. As central budget deteriorates and government's main tax income diminishes, economic stability deteriorates. On the other hand, the purchasing power of individuals within the economy will be the cause of inside riots against central authority. During such a conflict, as economy deteriorates, economic security loses power and control over the access to resources and markets. Increasing levels of interest rates and unstable currency policies have impacts on private sector financing with crowding-out effect. A government with high level of expenditures and budget deficits problems is not attractive capital and stock investors. The factors such as diminishing rate of returns in stock markets, poor performance in national reserves and capital outflows, will be major investment concerns for future investors in realm of possible conflicting economy. Hence, low currency countries are intensively prone to risk of conflict in comparison with developed countries.

3. Economic Factors Escalating the Risk of Conflict

The studies and researches illustrate a set of economic factors which may escalate the risk of conflict including economic slowdown, unemployment, inequality, low per capita income, dependency on energy sources.

3.1 Low Income

According to Collier and Hoeffler, lower levels of GDP per capita are correlated with a higher risk of armed conflicts (Collier and Hoeffler, 2002: 13-28). According to Collier and Hoeffler's risk analysis, the low income countries are significantly prone to different forms of violence. Collier and Hoeffler mention that it is easy and cheap to recruit rebel forces in a conflict condition. Moreover, rebellions and riots are more feasible as well as inequality among individuals are feasible. Low-income countries are prone to conflict demand on energy sources. The lack of energy sources and control over energy routes challenge legal authorities on sustaining economic conditions. Wealthier countries, on the other hand, not only have higher rebel recruitment costs but are also better able to protect their assets because they can raise larger amounts of state revenue that allows them to respond more effectively to a violent rebellion, either by pacifying or crushing it (Collier and Hoeffler, 2004; Fearon and Laitin, 2003). Accordingly, low-income post-conflict countries such as the Democratic Republic of the Congo, Liberia and Sierra Leone are at considerably greater risk than middle income post-conflict countries such as Bosnia and Herzegovina and Georgia (UNDP, 2008: 34-38)

3.2 The Lack of Sustainable Economic Growth

According to World Bank Reports and studies, sustainable economic performance in post conflict countries is able of reduce the risk of conflict (Collier, Hoeffler and Soderbom, 2007:3-7) The growth rate in conflict countries in the five years prior to conflict, including cases of conflict recurrence (fig.3), was on average only 0.5 percent far lower than the average of 2 percent in countries that remained peaceful (Kang and Meernik, 2005: 88-109)

3.3 The Lack of Energy Sources

For post conflict countries, availability of natural resources and security of energy supply have been key factors for productive developments and the success of economic recovery. The lack of natural resources continues to pose a

significant risk of conflict in conflict zones. The lack of energy sources also creates vulnerabilities within a market economy, especially in the process of transformation to an open market system during post conflict era. Low energy prices and the security of energy routes are the basic issue for overall economic competitiveness of an economic system. Therefore stability in energy prices is crucial for the success of economic recovery. However, volatility in energy prices is a cause for ambiguity for domestic entrepreneurs. Within a post conflict economy, efforts are combined to maintain peace and stability depending on politic and economic agenda.

Economic recovery requires accesses to energy sources and natural sources to sustain economic growth which increases level of employment. Securing energy supply for post conflict countries is also important and must be well distributed to all post-conflicting parties. Otherwise, greed and grievance will bring another inequality and ascend the risk of conflict recurring. Violent confrontations over natural resource wealth have figured in a number of contemporary armed conflicts including in Angola, Colombia, the Republic of Congo, the Democratic Republic of the Congo, Liberia, Myanmar, Sierra Leone and Sudan (UNDP, 2008:20).

According to UNDP's 2008 Crisis Prevention and Recovery Report, the presence of lucrative natural resources such as oil, diamonds, gold and tropical timber affects the incidence, and sometimes also the duration, of violent conflict. In this report, it is mentioned that oil- and gas-producing countries are the most vulnerable to the outbreak of civil war. Even though the percentage of oil- or diamond-rich countries experiencing conflict is not markedly different from non-resource rich countries, the risk of conflict is much higher for a given level of per capita income. Among both low- and middle-income states, oil producers have a higher risk of conflict than non-oil producers—nearly double in the case of low-income countries for the period 1992–2006 (Ross, 2006:265-300, 2007, and 2008)

4. Economic Recovery in Post Conflict Countries

In Post Conflict Countries, maintaining long term interethnic peace and stability is curious to prevent future interethnic conflicts. In conflicting countries, short term stability and peace can only be maintained by military measures. In post conflict countries, the general framework agreements building a state system can only contribute into the stabilization of peace at institutional level. The Stabilization of peace process must be supported by post-conflict economic recovery programs fighting with poverty and creating healthy conditions for investment climate. Moreover, the post conflict recovery programs have a combination of social, economic and politic measures.

Achieving post- conflict peace and fulfilling economic recovery agenda depends on (i) improvements in economic policies and institutional development, (ii) reconstruction of physical and economic infrastructure with food security, educational system and public health, (iii) GDP Growth and increase in employment (iv) securing energy supply to market place, (v) righteous access to energy sources for different ethnic groups, (vi) employment must be accompanied and increased by recruiting skilled workers from different ethnic groups, (vii) solving economic inequalities among ethnic groups, (viii) strong monetary discipline (ix) positive investment climate

5. Investment Climate and the Effects of Conflict Risk

In this competitive world, politic and economic opportunities may suddenly be transforming into another shape with challenging paradigm in the light of global economic integrations. The transformation process can be disastrous for the basis of national economies. Hence, the risks available in these globally integrated markets must be well defined and analyzed. On the other hand, available investment strategies must be developed and implemented. The conflict risk is one of the most important factors affecting the investment climate which is needed especially developing countries and PCCs in the process of development and recovery. The multinational companies should develop necessary investment strategies. The risk of being not investing in risky areas such as PCCs could be costly much more than investing in these countries. Therefore, the risk of future conflicts must be analyzed and investment strategies in these countries must be developed.

Investment climate could be shaped by future political and economic developments and turmoil in PCCs. Notwithstanding this; investment climate could shape economic stability and prosperity yielding in economic growth and stability, monetary discipline and employment as advocated by Starr, Collier and other colleagues (Collier, 1999:13; Collier and Hoeffler, 2004; Collier, et al., 2007:2-7; Collier, et al., 2006: 3-12; Starr, 2004:1-3).

Economic growth, employment, prosperity and effective monetary discipline are the major pillars that deescalate the risk of conflict in post conflict countries. Subsequently, investment climate is necessary for furthering economic recovery process and creates suitable circumstances for foreign investment in PCCs. With the positive effect of suitable investment climate on foreign capital, the PCCs welcome the needed resources to fuel the economy and recovery process. Simultaneously, the increase in employment, effective monetary discipline (requires institutional and governmental stability and structure) and economic development contribute stability and security in PCCs while

deescalating the risk of conflict.

5.1 The Importance of Foreign Direct Investments in PCCs

The most important effect which is required from FDIs is the ability to facilitate economic development and prosperity. According to Güven, economic development sustains exogenous benefits such as creating employment opportunities, increase in tax income, development in the volume of international trade and transactions with foreign capital, and so on (Güven, 2007:64). Moreover, FDIs provide necessary elements for economic development and for enhancing national income. These major elements are capital, information, technology and know-how.

Especially post conflict countries require the FDIs to fuel recovery process and complete transition process from closed economy to open market economy. In the process of economic development and recovery, these countries as war-torn countries need natural resources and financial resources. The effective use of natural resources requires strong entity within state structure. On the other hand, obtaining financial resources needed in financial system and credit mechanism require suitable investment climate in which foreign companies could invest at high levels in the light of certainty. According to Kula, the low currency and low income level countries exhibit the efforts to attract foreign investments (Kula, 2003:141). For the PCCs, the lack of natural and financial sources is the main element behind economic problems. Economic problems, in turn, contribute into unemployment, poor fiscal and budgetary performance, and economic turmoil with high level of debts and lack of credibility.

Economic development and recovery in PCCs require investments, financial and natural resources. Without investment, production and economic development could not be achieved. The risk of conflict escalates due to unemployment, low level of income, and economic turmoil in PCCs. Hence, FDIs are needed for economic development and recovery process for PCCs.

5.2 The Effect of the Conflict Risk on Investment Climate

According to Rob Mills and Qimiao Fan; the risk of conflict in PCCs has eight basic effects on investment climate: (i) the demise of physical security and stability, (ii) deterioration of macroeconomic stability, (iii) the demise of contract enforcement and judiciary redress(iv) the problems with access to credit and financial services, (v) increasing demand for skilled labors(vi) instable conditions for tax policies and administration, (vii) the lack of fiscal policy (viii) the lack of enabling environment (Mills ve Fan, 2006: 5-17)

According to IMF's Economic Recovery Reports, Global Economic Recession has significantly affected global investments tendencies. Especially, it has effect on emerging and developing countries. The lack of financial stability and sources affected economic development efforts in PCCs. The decrease in the volume of international trade and in the level of FDIs, especially affected investment climate and the efforts of PCCs to integrate with developed countries and emerging markets.

6. Conclusion

Sustaining long term business success depends on strategy planning and implementing skills of top managers. Moreover, organizational environment requires managers to evaluate threats and opportunities attached to investment areas. In the last two decades, the post conflict countries for international business organizations became main focus of attraction to further investment goals. However, many of multinational corporations are still in doubt either to invest into such a risky environment or to stay in secured places. Notwithstanding this Global Economic Crisis recently increased the risk of conflict in post conflict areas, the opportunities are still available in transition economies.

The conflict issue and its impacts on investment climate should be evaluated within an interdisciplinary approach for business success. There is a strong debate among scholars on the methodology of conflict analysis. The first camp argues that strong statistical methods must be used to further a strong study and analysis of conflict risk using econometric methods. On the other hand, another camp believes statistics are prone to manipulations and misuse of data set which is not open to every scholar. The second camp insists that ethnic, religious and cultural dimensions are prior elements to understand the nature of conflict among individuals and different ethnic groups of a society, and conducts their approach with a strong critique of the methodology of the first camp.

As a major threat to international business activities, conflict risk affect investment climate having negative impacts on development, financial stability, health and sustainable security. Especially, risk of conflict is capable of deteriorating political and economic conditions of post conflict states. Conflict affects the rate of growth and income of a company. Conflict deteriorates physical and human capital, markets, investment and trust. Moreover, a set of economic factors also escalates the risk of conflict, including economic slowdown, unemployment, inequality, low per capita income, dependency on energy sources. The risk of conflict in PCCs has some major effects on investment climate including the demise of physical security and stability, deterioration of macroeconomic stability, the demise

of contract enforcement and judiciary redress, increasing problems with access to credit and financial services, increasing demand for skilled labors, instable conditions for tax policies and administration, the lack of fiscal policy, the lack of enabling environment.

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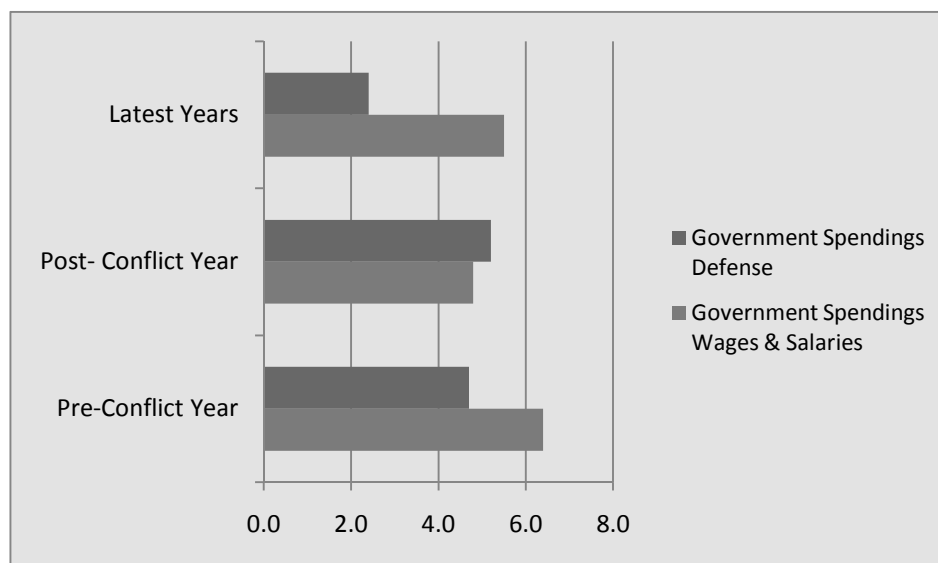


Figure 1. Government spending in post-conflict countries (In percent of GDP)

Sources: IMF, World Economic Outlook database 2004. WB Policy Research Report, 2004.

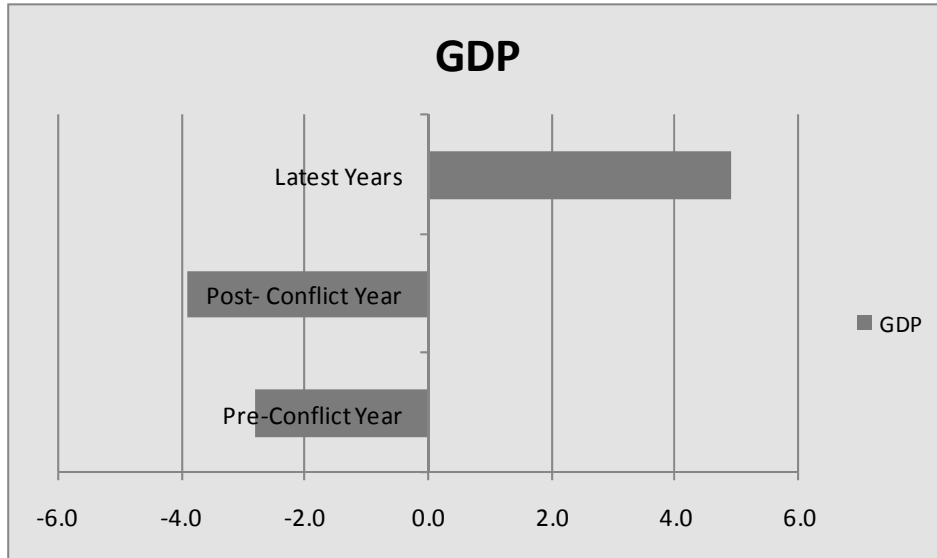


Figure 2. Real GDP growth in selected post-conflict countries (Annual percentage change)

Sources: IMF, World Economic Outlook database 2004; and World Bank, World Development Indicators database 1/ Based on a sample of 13 countries.

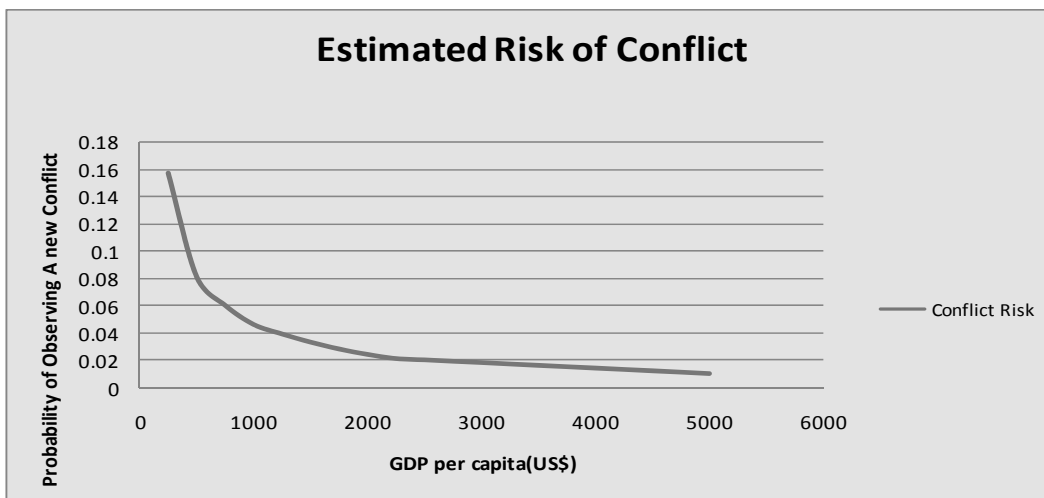


Figure 3. GDP per capita and estimated risk of conflict onset

Sources: UNDP, 2008:18, Collier and Hoeffler, 2002:13-28