Developing countries affected by conflict, particularly those that can be characterized as weak or nonfunctioning states, have been markedly less successful than others in attracting private investment in infrastructure. These countries also face the greatest needs, because of the lack of investment during conflict and because of their low income levels—more than three-quarters of the nonfunctioning states are classified as low income. Thus while poor communities in all developing countries suffer from lack of access to infrastructure services, those in conflict-affected countries suffer disproportionately (table 1).

Despite the challenges these high-risk countries face in attracting significant, long-term private investment in infrastructure, private activity does occur. The patterns of this activity suggest policy approaches that could help expand private participation in infrastructure in postconflict countries.

The paradox of postconflict aid flows...

Aid tends to peak immediately after conflict (figure 1). As a country emerges from conflict and captures the attention of the international community, donors generally increase aid to support peace and begin reconstruction. Using aid effectively during the early postconflict years is extremely difficult, however. Within the first decade aid tends to initially spike, then to gradually decline. But during this initial period most postconflict countries face political and administrative constraints that limit their capacity to absorb this increased aid.

The constraints on absorptive capacity are especially severe for project aid. Setting up administrative, accounting, financial manage-
ment, fiduciary, and procurement systems takes time, especially in countries where conflict has weakened institutions and human capacity. Immediately after conflict, countries can better absorb aid provided as direct budgetary support. But many donors face restrictions on providing such support or have governance concerns that dissuade them from doing so. So, for a post-conflict country needing substantial investments in infrastructure, aid-funded projects offer little relief in the initial postconflict phase.

To make matters worse, paradoxically aid begins to decline precipitously at just about the time postconflict countries develop the capacity to efficiently absorb it. This is also precisely when such countries badly need infrastructure investments to sustain the initial postconflict growth spurt and help prevent a relapse into conflict. Research has shown that faster growth tends to reduce the risk of further conflict directly and cumulatively by raising income levels (Collier and others 2003).

. . . and of postconflict investment flows

The initial period of high growth and large aid inflows in postconflict countries is paralleled by a period of inactivity in private investment in infrastructure: little such investment typically occurs for the first five years after conflict abates (figure 2). Large-scale investments in infrastructure tend to materialize only after post-conflict countries have maintained stability for a sufficient period—that is, at about the time that aid slows and growth declines. Again paradoxically, it is during those initial postconflict years that investments are most needed to provide basic services, reignite the local private sector, strengthen growth prospects, and lessen the likelihood of a return to conflict.

Small-scale private providers step in

In contrast to large investors, small-scale private service providers are quick to set up shop after conflict abates—and sometimes even during conflict. In Cambodia hundreds of tiny private
power networks established themselves throughout the countryside during and after the civil strife of the 1990s, effectively filling the void left by the nonfunctioning national utility. Similar stories can be found throughout postconflict countries. Indeed, about half the countries with significant small-scale private provision of water and electricity services are conflict affected (Kariuki and Schwartz 2005).

**Diverging trends in investment levels**

Developing countries affected by conflict have attracted far less large-scale private participation in infrastructure than other developing countries (table 2). Still, the trend in private participation in conflict-affected countries is similar to that for all developing countries (figure 3). That suggests that, as a whole, conflict-affected countries are subject to the same supply-side constraints as other developing countries.

But the trend for nonfunctioning conflict-affected states, which face even greater challenges in attracting investment, diverges dramatically from the general ups and downs of the overall trend. The likely reason is that the risks associated with investing in infrastructure in nonfunctioning states are so great that they deter all but a few investors, with a profile far different from that of the general community of infrastructure investors.

**The sectoral sequencing of investment**

Private investment in infrastructure in post-conflict countries follows a clear sequence of sectors, with mobile telephony the only one likely to attract significant investment immediately after conflict (figure 4). All the post-conflict countries analyzed had at least one private mobile operator investing in the country after it emerged from war. The willingness of mobile operators to invest in high-risk environments reflects the rapid cost recovery allowed by the sector’s economics.

Beyond telecommunications, the attractiveness of infrastructure investments in postconflict countries drops precipitously (Schwartz, Hahn, and Bannon 2004). Power projects remain somewhat attractive, particularly in generation, where projects start to emerge three years after conflict and increase in frequency after five years. But retail risks make privatizing distribution difficult, particularly in the early postconflict years. In transport most private investment goes to seaports, probably because container terminals offer the potential for earning hard currency and because bulk facilities can be incorporated into vertically integrated logistics systems. Investments in rail, roads, and airports normally occur only several years after conflict. The water and sanitation sector receives the least investment and is the last to receive foreign investment—though it often has the greatest needs.
The effect of country risk

While trends in general foreign direct investment (FDI) cannot be correlated with country risk ratings for developing countries, trends in private investment in infrastructure can be—for both conflict-affected and non-conflict-affected countries (figure 5). That suggests that investors in infrastructure are more sensitive to perceptions of political and economic instability than those in other businesses, such as extractive or final assembly industries. Infrastructure investors also are more sensitive to improvements in country risk ratings in conflict-affected countries than in others; and these countries are rated riskier on average. That means that improving the underlying factors influencing political and economic risk ratings may lead to faster growth in infrastructure investment in conflict-affected countries than in other developing countries.

Notes

1. For a list of conflict-affected countries (broken down between functioning and weak or nonfunctioning states), see Schwartz, Hahn, and Bannon (2004, annex 1). Except where otherwise noted, data for conflict-affected countries in this Note refer to that set of countries.

2. For an in-depth discussion of policy options, see Schwartz and Halkyard (2006).

3. Collier and others (2003) estimate that a country emerging from a civil war typically faces a 44 percent chance of returning to conflict within five years.

References


