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3 CCDP Issue Brief

The Centre on Conflict, Development and Peacebuilding

Guidelines for Mediators

Private Sector Investment

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A recurring challenge for mediators is to assess the usefulness of incentives as a means to strengthen the parties' commitment to a peace process. Private Sector Investment (PSI) is an incentive that can be used for these purposes. In the context of peace mediation, PSI is a financial flow that emanates from local or international private firms and is destined for conflict countries. While small in comparison to global investment flows, PSI can represent a significant economic and symbolic value for the parties to a peace process and for conflict-affected populations. Armed violence and instability are held to deter PSI, but recent Foreign Direct Investment (FDI) data and evidence from conflict zones illustrate that countries in conflict could attract PSI, and some companies continue operating despite high levels of armed violence. This Issue Brief suggests that PSI and the firms responsible for investment decisions are important assets for mediators:

- PSI can be an economic incentive for belligerents to stop fighting and increase the commitment of the parties to a peace process, especially if embedded into a broader political process. Its effectiveness as an incentive depends on the way other economic opportunities are captured by the parties, and the likelihood of PSI really materialising in the aftermath of war.
- PSI is part of a forward-looking peacemaking strategy. When mediators are forging transitional pacts for a new economic future, private sector commitment to future investments during the peace process is critical to build confidence into its viability.
- Large domestic or foreign investors have the possibility to offer credible incentives because they are able to absorb the political and commercial risks in their overall business structure. Moreover, they can have the necessary leverage to affect the parties' behaviour. Mediators should identify strategies to reach out to these investors to make sure their investments are in line with the objective of a future peace.

This Issue Brief is one of a series of guidelines for mediators. Part of a multi-year research project, it aims to introduce PSI as an economic instrument in peace processes, identify opportunities and risks for mediation practice, and propose questions for the planning and management of peace processes.

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BACKGROUND

PSI in conflict contexts

PSI refers to financial investments that are made by the private enterprise sector. It is generally divided between Foreign Direct Investment (FDI) and Private Domestic Investment (PDI). FDI is a financial transfer to a commercial entity in another country which involves a substantial control from the investing enterprise. PDI captures investments by firms into their home economy. Figures from the Organisation for Economic Cooperation and Development (OECD) highlight that FDI nearly grew fourfold between 2000 and 2006 in fragile and conflict-affected countries, from USD 5.0 billion to USD 20.9 billion.

PDI is generally low in fragile and conflict-affected countries. Its real significance may be difficult to assess given the lack of sub-national economic data and the fact that most economic activities occur in informal economies. Somalia, for example, has seen significant investment into financial services, telecommunication, and trade, despite ongoing violence and the absence of a state. When considering PSI, mediators should therefore not mistake the absence of data with the absence of an economy, and understand the ways in which local investments are related to informal markets and sub-national governance mechanisms.

Understanding PSI flows

PSI is one of three financial flows into countries in conflict together with remittances and development assistance (Table 1). While FDI is mainly related to commercial ventures, remittances occur at the individual level between family members and tend to support households and micro-businesses.

PSI flows have been explained by the fact that armed violence has a different effect on different types of investments, which in turn shapes the risk aversion of firms when making investment decisions. Attitudes towards countries in conflict depend, for example, on the magnitude of physical assets in specific conflict-affected areas, the core business of the enterprise (natural resource exploitation, services, construction, transportation), the strategy behind the investment (outputs for foreign/domestic markets, integrated production cycles), and the level of exit costs (the balance between fixed/mobile assets).

According to these criteria, extractive industries are most exposed to armed violence because their business is location-specific, long-term, and capital intensive. Instead of pulling out, they often prefer to endure the conflict, while mitigating its effect on the company though private security arrangements. Table 1 illustrates that most FDI flows concern resource-abundant countries (Nigeria, Colombia,

Table 1:
COMPARISON OF DIFFERENT FINANCIAL FLOWS TO SELECTED CONFLICT COUNTRIES, 2007

	Direct Conflict Deaths (Estimates)	FDI (USD million)	ODA (All donors, USD million)	Remittances (USD million)
Afghanistan	6,500	288	3,951	n/a
Algeria	420	1,665	389	2,906
Chad	1,044	603	352	n/a
Colombia	3,612	9,028	731	4,600
DRC	1,351	720	1,217	n/a
Ethiopia	2,418	254	2,422	172
Iraq	23,765	448	9,176	n/a
Myanmar	268	428	197	n/a
Nepal	137	6	598	1,600
Nigeria	535	12,454	1,727	3,329
Pakistan	3,599	5,333	2,212	6,100
Philippines	451	2,928	634	17,000
Sri Lanka	4,500	529	601	2,700
Thailand	452	9,575	-312	1,707
Uganda	111	368	384	856
Somalia	6,500	141	2,104	n/a
Sudan	1,734	2,436	1,947	1,157

Sources: Direct conflict deaths: Geneva Declaration Secretariat. 2008. *Global Burden of Armed Violence*. Geneva: Geneva Declaration Secretariat, pp. 18-19. ODA: OECD International Development Statistics available at http://stats.oecd.org/qwids/. FDI: United Nations Conference on Trade and Development (UNCTAD). 2009. *World Investment Report 2008*. New York: UNCTAD, pp. 249-260. Remittances: World Bank. 2008. *Migration and Remittances Fact Book*: Washington D.C.: World Bank.

Sudan), as well as countries in which conflict-affected areas do not constitute consumer markets. In contrast, smaller local companies are also exposed because they do not have the means to isolate themselves from armed violence.

PSI and peace processes

PSI has often been perceived negatively in countries prone to or in conflict. The aversion to invest in such contexts includes the possible complicity of investors in war economies, the making of exclusive deals with warring factions, and the pursuit of economic gains with scant regard for people, the environment, or international corporate norms. It is for these reasons that PSI has been perceived as 'part of the problem', or a potential spoiler of peace negotiations.

While undoubtedly important in some contexts, an overreliance on such stereotyping artificially limits recognising PSI's potential strategic benefits for peace processes. PSI can be part of incentive strategies to bind parties into a process and can also be integrated within forward-looking mediation strategies that craft new economic visions as a means to strengthen the viability of peace. Along with national and foreign governments, development agencies, and civil society, the private sector is part of the multi-stakeholder coalitions necessary for managing war-to-peace transitions.

Box 1:

OIL AS AN INCENTIVE FOR PEACE IN SUDAN

High levels of violence in Sudan's oil-producing regions have prevented the Government and rebel forces from fully valorising the commercial potential of oil, and have limited foreign companies' commitments to invest. In this context, the Swedish company Lundin Petroleum made the case to all belligerents that the best strategy to ensure a sustainable oil production and each party's future prosperity was to end fighting and embark on a peace process. One of its Board Members, Carl Bildt – also known as the former Prime Minister of Sweden (1991-1994) and the United Nations Special Envoy for the Balkans (1995-1997) – led a series of talks emphasizing that oil was an incentive for peace insofar as its commercialisation could not be pursued if the war continued. This rationale turned out to be effective in Sudan as oil fields have constituted major battlefields, and neither party was able to maximise commercialisation without FDI.

Christine Batruch. 2004. 'Oil and Conflict: Lundin Petroleum's Experience in Sudan', in Alyson J.K. Bailes and Isabel Frommelt, eds. *Business and Security: Public-Private Sector Relationships in a New Security Environment*. Oxford: Oxford University Press, pp.148-160, at pp.159-160.

Rig site at Thar Jath in 2001. Local Nuer people boarding a bus to go to Bentiu, the capital of Unity State, South Sudan, using a road built by Lundin Oil. Source: Lundin Petroleum.

PSI AS AN INCENTIVE FOR PEACE PROCESSES

What are incentives and why is PSI important for peace mediation?

- Incentives are measures that attempt to create a stimulus or encouragement for a specific action or change in behaviour of a targeted actor. These can include the delivery or promise of tariff reductions, subsidies, export or import licences, foreign aid, technology transfers, debt relief, and PSI. Incentives stand in contrast to targeted sanctions that attempt to change behaviour through threats or other coercive means.
- PSI represents an important opportunity to strengthen forward-looking mediation strategies, especially when the parties craft new economic and institutional orders. Credible private sector commitments to investments can create new visions of future livehood opportunities.
- Incentives are important because non-state armed groups are expected to denounce violence in the short-term – in many negotiations this means compromising their only bargaining chip – while the benefits of such action only accrue in the long-term. PSI commitments during mature phases of negotiations can therefore assist in making future benefits of peace more tangible.
- The incentive rationale is slightly different for governments; the case of Sudan illustrates that making future investment in the oil industry dependent on ending the conflict was one factor that changed the government's attitude to peacemaking (Box 1).

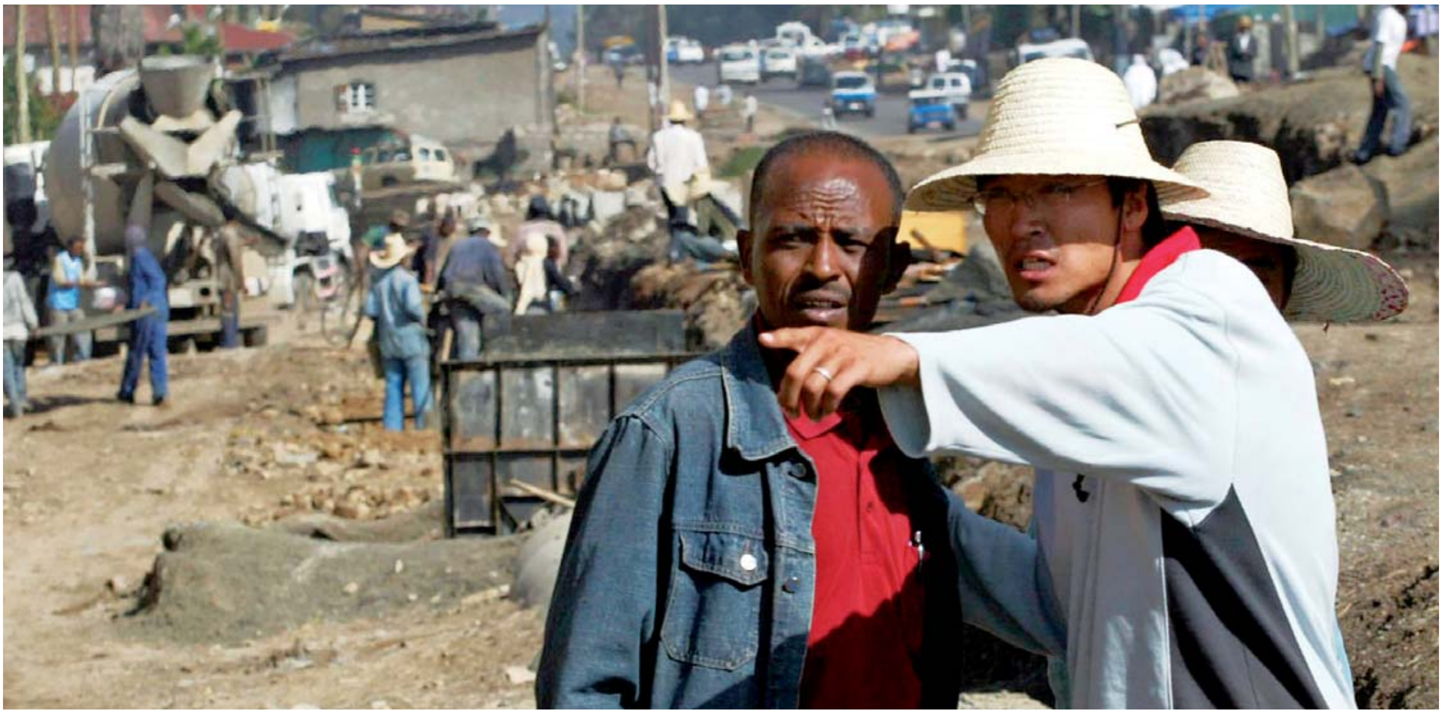
Evaluating the effectiveness of PSI incentives

- In order to be an effective incentive, PSI must be integrated into a broader political and military framework. Provided on its own, PSI is likely to remain a 'pay-off' with limited political impact.
- Investment commitments must be credible and tangible to grab the interest of the parties when the possibility of an alternative future is perceived.
- Investment commitments must also be substantial enough to be an alternative to other (illicit) economic opportunities.

Constructing credible incentives by involving large scale investors

- Investment from multinational or state-owned enterprises is a strategic opportunity for peace processes because they can provide credible incentives.
- Large enterprises are the only actors with the corporate size to accommodate security and political risks in their overall business structure.
- Large enterprises do not depend on the success of one individual venture, and have therefore a crucial advantage over small firms.

A Chinese construction worker supervises the building of a road in early 2007, in Addis Ababa, Ethiopia. Source: AFP.



Chinese investment as a new incentive for peace?

- Investors from emerging economies represent a new capital stream for areas which have so far been marginalized from global investment. In this regard, Chinese state-owned companies have invested into sectors that have long been neglected, including agriculture, infrastructure, and telecommunication. In many cases, these investments occurred through an exchange of natural resources extraction against investment in new infrastructure.
- Chinese companies have the reputation to deliver services faster than international companies or Western donors. This trend makes Chinese investments more attractive as a source of economic dividends during early recovery periods.
- The full potential of Chinese investment as an incentive may be limited by the bad quality of the end product, the predominant use of Chinese (and not domestic) labour, or negative environmental impacts.
- With growing investments, Chinese companies should become increasingly sensitive to the needs for security and the rule of law to maintain profitability of investments in the long-term. Ending conflict and ensuring stability though mediation support may therefore coincide with their commercial interests (Box 2).

Box 2:

CHINA AND THE AGREEMENT ON WEALTH SHARING IN SUDAN

The case of Sudan shows that Chinese companies have recognised their commercial interest in stability as part of the negotiations leading to the Sudan's Wealth Sharing Agreement of 7 January 2004. China accepted shifting payment for oil to financial transfers, thereby ending payment through the export of a range of Chinese consumer goods. China's resistance to shift to financial transfer to pay for oil was a major obstacle in the negotiations. Ultimately, the issue was solved through international pressure as well as the recognition by China that a general peace agreement was more valuable to China's commercial interests than insisting on the continuation of past practices.

Achim Wennmann. 2009. *Wealth Sharing Beyond 2011: Economic Issues in Sudan's North-South Peace Process*. CCDP Working Paper 1. Geneva: Graduate Institute of International and Development Studies, p. 18.

BUILDING RELATIONSHIPS WITH INVESTORS

Dilemmas for mediators to engage investors

- While mediators are usually at ease to reach out to politicians or military leaders, they are more sceptical to do so to local or international private sector representatives.
- Peace processes are so complex that adding another actor may complicate mediation rather than facilitate it.
- Individual mediators prefer to limit a peace process to actors that are part of their own network and zones of influence. Given the political or military background of most mediators, their networks are less strongly developed in the private sector.
- Political and business elites are so closely linked that it seems unreasonable to separate the 'public' and 'private' spheres in conflict countries.
- Mediators face difficulties in how to discriminate between different companies wanting to pursue their economic interest in a particular market.
- Competition between different investors may complicate a peace process as business interests frequently divide – rather than unite – the parties.
- Companies do not represent a sole legitimate actor and their commercial interests can override the reaching of a common good.
- Some companies may be seen as unsuitable interlocutors due to their perceived responsibility for participating in war economies, human rights abuses, and environmental pollution.

Identifying investors willing to support war-to-peace transitions

- Large foreign or local investors who are trapped in the midst of a conflict and want to stop attacks on their installations in order to reduce disruptions of production, risks to personnel, and protection costs (see Box 3).
- Foreign investors who withdrew from a conflict-affected country as a response to increasing conflict intensity or shareholder pressure, and want to re-enter the market.
- Small and medium-sized local businesses that have gone out of business due to the conflict. They could not afford to pay for protection from armed violence, and have an interest in conflict resolution to resume regular commercial activities.
- Diaspora investors who have a personal or emotional bond with the country in conflict and therefore a lower perception of risk than other investors.

Box 3:

DIRECT COMPANY ENGAGEMENT IN THE PEACE PROCESS IN MOZAMBIQUE

The British multinational company Lonrho became involved in the peace process after attacks on its installations in 1990. Previously, it had paid off belligerents to protect its GBP 53 million investments, but as the conflict escalated it was no longer immune to attacks. Considering its investment trapped, the company decided to engage directly in the peace process. Its Chief Executive Officer Roland 'Tiny' Rowland acted as an intermediary and made company resources and aircrafts available for use during the negotiations. Lonrho is also said to have contributed between USD 6 to 8 million to assist the transition of the *Resistência Nacional Moçambicana* (RENAMO) from a rebel group to a political party.

Source: Alex Vines. 1998. 'The Business of Peace: 'Tiny' Rowland, Financial Incentives, and the Mozambican Settlement', in Jeremy Armon, Dylan Hendrickson and Alex Vines, *The Mozambican Peace Process in Perspective*. London: Conciliation Resources.

Reservations of investors to act as 'peacemakers'

- Some companies consider that they have no stake in conflict resolution because they believe armed conflict is something inherently 'political'.
- Companies have little commercial interest to invest in public infrastructure such as property rights regimes or justice systems. Rather than committing to these investments, they often choose investment locations where this infrastructure already exists.
- Investors do not want the job of "cleaning up the mess" for which others are responsible, especially if they have to expose their shareholders to a high level of risk in the process.
- Foreign investors do not want to address sensitive political issues with host governments, as that could jeopardize valuable relationships that have taken years to build and might lead to a commercial disadvantage.

Possible solutions to dilemmas and reservations

- Keep companies away from the negotiation table, but engage with them informally on the margins of a peace process. They can be an important source of information, and act as a 'mirror' if the parties craft new economic arrangements for post-conflict economic recovery.
- Avoid competitive bidding processes and encourage local investment to be approved jointly by community councils that include representatives from all sectors of society.
- Convince companies to channel investment projects through joint ventures in order to spread their risk. Although this approach might be less profitable in the short-term, it carries a strategic value for the company in the long-term and a political value for mediators.
- Instead of working with individual investors, the mediator can identify local or international Business Associations or Chambers of Commerce.

Corporate tools for investments in high-risk contexts

- Joint ventures distribute corporate risk to various stakeholders as evidenced by most resource exploration projects being conducted by consortia.
- Project financing entails channeling capital for specific ventures financed by the private sector or development agencies.
- Companies can cover their commercial risk through insurance contracts. Involvement of the Multilateral Investment Guarantee Agency in post-conflict areas is often an important prerequisite to encourage private investment.
- Export credit protects national exporters against commercial and political risks.
- Third-country adjudication implies the agreement of the parties that the courts of a third country will manage disagreements and ensure the guarantee of contract.

QUESTIONS FOR THE MEDIATOR

Scoping investor attitudes towards peacemaking

- Who are the main local and international companies present in conflict-affected countries or areas? What amount of PSI are they responsible for? Which economic sectors do they represent?
- How, if at all, has the private sector dealt with armed violence? Has it contracted private security to isolate itself from violence? Did it temporarily cease business operations? Did it relocate commercial activities, or go out of business?
- Is the private sector willing to engage in peacemaking and support war-to-peace transitions? Have they previously acted as a pro-peace constituency? What has prevented the emergence of a business lobby for peace?

- How politicised is the local business sphere? What is the relationship between the political and business elites? Are they distinct or the same? How far is the business scene “private” and “personalised”? Does it make sense to talk about a private and public sphere?

Mobilising PSI for peacemaking

- How is the business sector constructed? Is corporate interest played out in Business Associations and lobbies?
- How is the cost of armed violence distributed among different sectors or companies? What is the cost of armed conflict or violence to those specific sectors or companies? Is there a unity of perception of these costs?
- What are the main business risks that investors associate with the conflict? Can these be mitigated through existing corporate tools such as joint ventures, project financing, or export credits?
- Does the expected amount of PSI represent a credible alternative to other economic opportunities?

Managing the private sector in peace processes

- Do investors or the companies with which they are associated have the political or economic power to influence peace negotiations in a specific context?
- Depending on the private sector’s potential impact on the peace process and local sensitivities, how can its relationship with the political scene best be reflected and utilized?
- What is the perceived legitimacy of a specific company or business leader in the eyes of the political parties or the population?
- Are there any company-specific attributes that could be useful for the peace process?

FURTHER READING

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Iraqi brokers at the manually-operated Stock Exchange in early 2006, in Baghdad, illustrating ongoing commercial activity despite violence and instability. Source: AFP.

The Centre on Conflict, Development and Peacebuilding (CCDP) is a research centre of the Graduate Institute of International and Development Studies in Geneva, Switzerland. It aims to offer policy relevant research built upon strong academic foundations on a variety of themes and issues, including: peacebuilding and reconciliation; post-conflict transitions and state-building; armed violence and development; and multi-stakeholder initiatives and the politics of monitoring and evaluation. CCDP Issue Briefs comprise one stream of the centre's publications. Their primary objective is to distil research findings amongst the relevant community of policy-makers as well as amongst practitioners and scholars.

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For more information, see
http://graduateinstitute.ch/ccdp/tools-peace-processes.html.

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