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Chapter 4

Peace-Building and the Social Contract

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DEVELOPMENT AND THE 'CONFLICT TRAP'

The rational choice approach to conflict has put forward two competing hypotheses to explain civil war in developing countries: greed and grievance; see Murshed and Tadjoeeddin (2008) for a survey. They, however, suggest that neither of the two is sufficient for the outbreak of large-scale violence. There must be other factors at work, mechanisms in the middle related to the institutional failure to peacefully resolve conflict. Addison and Murshed (2006) describe these mechanisms as the 'social contract'. Thus, even if capturable resource rents constitute a sizeable prize, violent conflict is unlikely to take hold in states with a framework of widely-agreed rules, formal and informal, that govern the resource allocation and the peaceful settlement of grievances. Such a viable social contract can be sufficient to restrain conflict, and following its collapse on the road to large-scale conflict, reconstructing a new social contract is key to long-term conflict resolution.

Addison and Murshed (2006) indicate that a social contract contain three dimensions. The first is political (the rules that govern political representation, consultation and decision making). The second consists of moral values (the rules that govern personal conduct and society's sense of justice) and the third is economic (the rules that govern production, market exchange and government intervention). This social contract is codified partly, but not exclusively, in the country's written constitution. There are other norms of behaviour that are not in any way formalized, but which nevertheless constitute a strong element of how society functions.

Turning to the history of notions of the social contract in political philosophy, Thomas Hobbes characterized the state of nature as anarchical, akin to perpetual war, with each man taking what he can and no legal basis for right or wrong (see Sabine, 1961). Consequently, it was in the interest

of individuals to collectively surrender their personal freedom of action to a ruler (absolute monarch) in return for personal security and rule-based interactions in society. If Hobbes regarded war as the natural state of man, John Locke (Sabine, 1961) had a more felicitous view of the state of nature. Locke regarded the right to life and property (often just access to common resources) as natural rights, which existed in the state of nature. These rights could not be properly enforced in the state of nature, except through mutual self-help. In civil society, it was the duty of the sovereign to enforce these natural rights; rule ought to be based on consent; society should have the right to oust a tyrant or failing ruler. In general, political theories of the social contract base authority and the exercise of power on rational self-interest, as well as consent, and as such their aim is the avoidance of large scale violence in a well-ordered society.

Contemporary civil wars are more often related to the breakdown of explicit or implicit mechanisms to share power and resources, rather than the complete absence of an agreement to govern these. Among the various factors in question, two domestic reasons may be highlighted. The first has to do with breakdowns in the agreements to share resources in the context of economic decline, and the second refers to the malfunctioning of political institutions. Both of these factors produce what Ghani and Lockhart (2008) describe as the sovereignty gap (the wedge between the state's legal status and its ability to provide basic public goods such as security), and the accountability gap (when the government is unaccountable to the people).

The first point refers to the resource sharing agreements the state, or those in power, have with various stakeholders, and to the breakdown of these arrangements that can produce greed and/or grievance. Within nation states, the fiscal system will secure a workable social contract if the allocation of public expenditures and the distribution of taxes are judged to be fair, or at least not so unfair that some groups judge taking resources by force the better option. Disputes over the distribution of revenues from natural resources are especially common and, as in Nigeria or Indonesia, take on ethnic and regional dimensions. One reason that a contract to share revenues encounters difficulties is the imperfect credibility with which the side that controls the 'pot' honours its commitments.

Secondly, there is the political system. Hegre, *et al.* (2001) point out that the risk of conflict is lower in both well-established democracies and autocracies. They suggest that conflict risk is at its greatest during transitions to and away from democracy, when state capacity is weak, and also in fledgling and imperfect democracies (anocracies). This is when the violent expression of grievance is most likely. Autocracies are adept at suppressing dissent, and

established democracies deal with the same problem in a more peaceful fashion. Also, state capacity (its ability to both police citizens and provide public goods) is greater in established autocratic or democratic societies. The functions of the state are important in maintaining the cohesiveness of society, which in turn is central to a functioning social contract. Besides its legitimate Weberian monopoly over violence, a functioning state must be able to enforce laws, property rights and contracts, as well as have the fiscal capacity to raise revenues and provide public goods (Mill, 1848). The list grows longer with economic prosperity and progress; more affluent nations have bigger governments (as measured by the share of government consumption in national income). Economic decline in 'failing' states severely undermines the state's fiscal capacity, something which can make them aid dependent (Ghani and Lockhart, 2008). Aid dependency, in turn, further diminishes state capacity. Furthermore, a 'failing' state's ability to guarantee personal security, property rights and laws is often limited, leading to the gradual privatization of violence between predatory and defensive elements within society. All of these circumstances combine to produce a degenerating social contract, where individuals rely on kinship groups and local warlords for security and public good provision; this heightens the risk of civil war as society descends towards an anarchical, Hobbesian, state of nature.

The rest of this chapter is organized as follows: in the next section, distributional theories related to conflict resolution arising from the social choice literature are discussed; the following section is concerned with the difficulties of maintaining power sharing agreements that end civil wars in the long run which may require power dividing structures; the penultimate section deals with issues related to federalism (mainly fiscal) that are crucial for solutions to the material basis for greed and/or grievance motivations for conflict; finally, the last section provides a brief synthesis of the diverse issues discussed.

FAIR DIVISION

The post-war or post-accord economic, political and territorial pie needs to be fairly divided among erstwhile protagonists if the agreement is to be sustainable. A necessary condition for the viability of a peace treaty lies in meeting the participation constraints of those involved, and ensuring that its stipulations are enforced. But it will never fulfil incentive compatibility constraints, which are to do with the exercise of effort to ensure that the accord lasts, unless it is perceived to be just, fair and equitable. If a peace agreement, and the divisions and compromises it entails are perceived to be

unfair then the deal itself will not be robust. The social choice theoretical literature on mechanisms for sharing and division offers us several insights on how to sustain peace agreements. For example, Brams (2006) points out several allocation rules for a single divisible good, many divisible goods and several indivisible goods. All of these have implications for durable peacemaking involving compromises over issues and post-war economic stakes. Sharing in this regard must be equitable as well as efficient. That is why envy-free allocative outcomes are so important. In an envy-free outcome each participant does not regard the allocation achieved by another player to be superior to what he has achieved.

In the case of a single divisible good the analogy with cake cutting is applicable. This may, for example, concern the division of the post-war peace dividend. The application of the envy-free criterion may entail several slices or divisions that may be inefficient and in excess of the number of parties taking part to the conflict. This will be all the more true if what is being divided up is not homogenous. One can visualize situations to do with the division of the expenditure of post-war aid, and the dividing up of land that may require a great deal of parcelling.

A second situation considered by Brams (2006) entails several items to be divided, each of which is in principle divisible. Peace negotiations usually involve several issues, including regional autonomy, sharing of resource rents (such as oil revenues in the Sudan), constitutional changes, power sharing in the federal government and so on. Typically, these issues will involve a long period of extended bargaining. The procedure behind the settlement, if reached, is described as the adjusted winner mechanism. Negotiations on the issues may involve placing upper and lower bounds on the values of each issue, bearing in mind that assigning pecuniary values is more amenable in quantifiable matters such as resource rents rather than for non-monetary matters involving status such as who should be president. Each side will allocate weights on the different issues at hand, and given that each side has a similar number of bargaining chips, each party will win on some of the disputed issues. These will tend to be in areas most highly valued by the concerned protagonist. So if regional autonomy is more highly prized by a rebel group compared to resource rents, they will put a higher weight on it and secure that goal under the adjusted winner mechanism. But one side can end up with wins on many high valued issues, and the consequent allocation could be inequitable to the other side. So this mechanism requires an equitability adjustment. Basically, this means sharing on high valued issues where the two sides preferences are close, or the weights assigned to them out of their bargaining chip allocation are similar. So if the government and the rebels assign a close and high weight to resource

rents, they must share these. In other words, if the government and the rebels both value resource rents highly, one side cannot equitably be allowed to be a sole winner. There has to be a revenue sharing mechanism on this issue. Other issues, where values diverge considerably, tend to be winner take all based on which side places the higher bid. This adjusted winner mechanism gives both sides an allocation which is roughly equal, and more than 50 per cent of the assigned weights from the bargaining chip pile. The problem with applying this equitability included adjusted winner mechanism is that many issues are not easily divisible, such as which side first occupies a rotating Presidency. A further difficulty can arise if the two sides do not have similar bargaining power.

Thirdly, and most importantly, Brams (2006) considers mechanisms for allocating several indivisible issues, such as cabinet positions. The allocation of indivisible goods requires the application of the envy-free principle for any allocation to endure. And, a unique envy-free allocation may not be Pareto efficient. Pareto efficiency means that one side cannot be made better off without making another side worse off. One can make an envy-free allocation Pareto efficient by improving the utility of one side without lowering the utility of the other. But such allocations may not remain envy-free as one side could have a lower allocation of relatively more highly prized items (yielding the same utility) that are being allocated, and consequently resent the other sides allocation. Generally, allocations involving indivisible items are more difficult to achieve. The answers, in the most intractable cases, must lie in sharing: joint access, equal user rights and other 'federal' constructions, as the recent arrangements between the North and South in the Sudan, and immediate post-apartheid South African dispensation (with a rotating presidency) suggest.

POWER SHARING AND POWER DIVISION

Power sharing is an important part of framing any peace agreement that ends civil war. Peace is incentive incompatible if leaders of warring groups do not get positions of power in the settlement that follows. Power sharing can take several forms (political, territorial, military and fiscal). It is a way of re-assuring weaker parties after a conflict via a signal of inclusiveness (see Rothchild, 2008). A lot of thought and attention goes into designing post-war power sharing mechanisms, where the principles behind fair division can be applied. A successful mechanism brings about a balance of power among former belligerents. At first a transitional government and legislature is devised, with shared cabinet positions and even rotating Presidencies on occasions, as was the case in South Africa. Its success or failure rests on the individual parties commitment to the stipulations and mechanisms of

power sharing (i.e. the rules of the game), as well as the presence of external mediation and guarantees for these. A road map is usually prepared with mechanisms that devise a more lasting political and governance structure. The ultimate aims are democratization and economic reconstruction. Is it a good idea that power sharing agreements remain in place in the longer-term political dispensation, particularly in ethnically fractionalized societies, which is the case in most civil war countries?

In the longer run, power sharing by being inclusive (consociationalist as described by Lijphart, 1977, 1999), may be a preferable form of workable democracy to majoritarianism, which is a system where the winner takes all. Power sharing is not only inclusive, as minorities are part of government, but may dampen harmful and potentially conflict producing elite competition. It has been argued to be a superior mode of government (with proportional representation in elections) to the more traditional Westminster style majoritarian systems, as the majority has to accommodate the minority. This is certainly relevant to ethnically fragmented developing countries, and historically supported peace and democratic development in fragmented, yet industrialized, societies like the Netherlands.

While power sharing is necessary for the peace agreement initially, there may be a trade-off between short-term power sharing and long-term institution building which leads to a stable peaceful democracy. This has been described by Rothchild and Roeder (2005) as the *power sharing dilemma*. Rothchild (2008) cogently demonstrated that while power sharing may constitute a convenient short-term mechanism for achieving a peace accord that ends hostilities, it may become a source of long-term tensions. Power sharing arrangements crafted together with the best of intentions may go through an uneasy post-war phase, eventually descending to a stage where they are only partially inclusive (as is the case in the Sudan with the Darfur dispute unresolved at the same time as there is a North-South peace accord; or in Rwanda prior to the genocide of 1994 with Habyarimana playing a mixed strategy of simultaneously working with Hutu moderates as well as pandering to extremist elements). The ultimate denouement could be the collapse of power sharing and a return to violence (Ivory Coast in 2003, say).

The factors that contribute to the demise of power sharing formulas include firstly the problem of asymmetric information in the peace accord. Each side to the peace treaty may have private information regarding their own strengths, the presence or absence of spoiler groups within, as well as its own military capabilities; information that is unknown to other parties and external guarantors of the agreement. This includes some groups or militias attempting to retain an outside option of returning to war by only partially

disarming. Secondly, there may be an imperfect commitment to the treaty, because of the paucity of domestic and international anchors to the peace. To this list we may add the all pervading atmosphere of mutual mistrust and suspicion that characterizes many fragmented societies. Thirdly, we have the underproduction of external sanctions and guarantees of the peace accord, including inadequate external assistance to augment the peace dividend in war-torn societies where the economic pie has shrunk considerably as a consequence of war. Power sharing may also break down if external guarantors are biased, and show excessive favour to one group (the French in the Ivory Coast or erstwhile Zaire). Fourthly, the power sharing deal may be incomplete and not include all relevant groups, as in the case of the Sudan at present. In the Ugandan case, the leader of the rebel Lord's Resistance Army's (LRA) initial motivation may have been related to his non-inclusion in the arrangements following the struggle against Idi Amin. Power sharing may not, therefore, prevent the formation of splinter groups who acts as spoilers towards the peace process.

Fifthly, Roeder (2005) argues that leaders of certain ethnicities have an incentive to escalate the tensions and disputes along ethnic lines that are bound to reappear at some future juncture, thereby undermining the federal government. Various parties to a power sharing deal could try to act as veto players, thereby undermining the system. The stability of power sharing relies on a delicate balance of power. Each side must be deterred from using violence by the belief that it will bring about retaliation or through a cost-benefit calculus which informs their minds that the costs of violence exceed potential gains.

Sixthly, power sharing based on ethnicity is bad for long-term democratization because all the issues tend to 'ethnicized'. Power sharing formulas may even become obsolete if the population's ethnic compositions change over time (Jarstad, 2006). Most societies are dynamic, and the ethnic mix is subject to change. For example, in the Lebanon the allocation of seats in Parliament reflects an obsolete ethnic composition dating back to the 1920s.

Finally, power sharing formulas may give too much weight to those enamoured of violence, and place too little emphasis on moderate voices. This not only endangers the peace accord, but may also retard the future evolution of democracy.

For all these reasons, power sharing formulas need to be carefully designed. One way forward is to have temporary power sharing mechanisms that are dismantled later as democracy takes root. Secondly, mechanisms to prevent opportunistic behaviour by one party or the formation of violent splinter groups have to be considered. Thirdly, the voice accorded to moderate elements has to be increased. Cognizance also needs to be taken of the fact

that a future democratic system may have to take on a different configuration to an immediate post-war power sharing agreement.

The long-term solution, according to Roeder (2005) lies in 'power dividing' institutions, akin to the constitution of the USA. Its characteristics include first, certain limitations on the power of government. So, for example the USA has a Bill of Rights which the state cannot tamper with, and Europe has a Human Rights convention. Secondly, it is important to devise multiple majorities. This, in turn, entails the separation of decision making at various levels. This may include a federated form of governance. But power division can take place even without a politically federal structure in smaller nations. For example, even in city government, one committee decides on finance, another on education policy, another on police and yet another on street lighting. Power division occurs if the composition of each of these bodies is different leading to varying decisive majority configurations, so in one committee one group may have a majority, but not at all levels. Power division also means the separation of powers, as first discussed by Montesquieu (Sabine, 1961), and later by James Madison in his Federalist papers (1787–88). This means the separation of executive, legislative and judicial branches. Thirdly, none of the multiple majorities should have veto power. This means checks and balances (also proposed by Madison in the Federalist Papers of 1787–88) and constraints on the executive power. Constraints on the exercise of executive power are highly important.

One interpretation of the above idea is that there should be more layers of political and economic decision making than there are ethnicities. This is likely to lead to more cooperative behaviour and several overlapping coalitions between groups. Decentralization of the decision-making processes may be relevant here. A federalist construction with provinces or states, rather than a unitary system could be desirable. A bicameral rather than unicameral legislature would be superior. The electoral system whether proportional or majoritarian, should succeed in returning representatives of different ethnicities.

Crucially, Roeder (2005) argues that the very long-term survival of power sharing mechanisms in ethnically divided societies requires the construction of power dividing rules, as described above. Only then it will be stable in the long run. So, power division is essential to the sustainability of power sharing. Roeder (2005) provides empirical evidence in support of his argument.

FEDERALISM

The term federalism usually denotes a system of the government in which sovereignty is constitutionally divided between a central governing authority

and constituent political units like states or provinces. Much of the historical analysis of federalism surrounded the federalist construction of the USA in the 1780s (see the *Federalist Papers*, 1787–88).

Classical liberals argued that federalism could prevent internecine warfare within the federation; Mill (1861), for example, argued that federations created stronger states, reducing the temptation towards aggression and allowed for the maximization of the gains from trade within the federation. He, too, favoured allowing the centre sufficient power to secure the benefits of union, particularly powers to prevent internal cross-border duties that could diminish inter-regional trade. His necessary conditions for a successful federation include overlapping characteristics in race, language, religion, political institutions and rough parity among sub-units to prevent excessive domination by any. Following his logic, modern day ethnically fragmented federations in developing countries should encounter difficulties on account of their seemingly irreconcilable ethnic diversity, and the vested economic interests of some sub-units (locally generated resource rents or apprehensions of its industries being eliminated by larger competition) might make it wish not to join a federation. Tackling these problems will require judiciously designed fiscal federalism and resource sharing when forming federations. It should be pointed out that free trade and financial flows can produce highly integrated economies (globalization) without political union, however, it is difficult to imagine political federation without a degree of greater economic integration.

More recently, three processes of federalism have been identified by Stepan (1999): (i) independent states may 'come together' by ceding or pooling sovereign powers in certain domains for the sake of benefits otherwise unattainable, such as security or economic prosperity; (ii) 'holding together' federations developed from unitary states, as governments respond to alleviate threats of secession; and (iii) 'put together' federations by a strong centre like the former Soviet Union. The 'coming together' federations are typically arranged to constrain the centre and prevent majorities from overriding a sub-unit, as in the USA, Switzerland and Australia. These may be more relevant to developed countries. 'Coming together' federations are largely irrelevant in poor developing countries where the gain from shared sovereignty seem limited. 'Holding together' federations often grant particular sub-units particular domains of sovereignty over language and cultural rights in an asymmetric federation, while maintaining broad scope of action for the central government and majorities (India, Indonesia and Spain). They may be regarded as cases where the object is to appease certain minorities and prevent secession in an otherwise powerful centre, with relevance for most contemporary developing country situations. 'Put

together' federations are also of importance to post-conflict countries, where external powers interested in the peace often behave like the powerful centre, devising federal arrangements (Iraq, Afghanistan) that become unstable over time because of the absence of sufficient power dividing mechanisms and the general paucity of public goods, which intensifies the competition over scarce resources.

Federalism implies decentralization of powers and functions of the state; the degree of decentralization may be at issue (a strong centre in holding together federations or a weaker centre in coming together constructions), but its salience in ensuring lasting peace through power sharing and dividing is almost indisputable. This is not to deny that flawed federations cannot implode, as the recent examples of the disintegration of Yugoslavia and the USSR painfully demonstrate. Certain federal constructions can become very unstable, if local majorities have interests in undermining federal government, in the absence of stable dividing mechanisms.

The linking of decentralization to conflict is a fairly new area of research, with the international donor and policy community strongly in favour. From an academic viewpoint, Brancati (2006) summarizes two contrasting political arguments about the effects of decentralization in general on secessionist ethnic conflict. On the one hand, decentralization may curtail ethnic tensions and secessionism by bringing the government closer to the people, increasing opportunities to participate in government and ultimately giving groups control over their political, social and economic affairs. On the other hand, decentralization may exacerbate ethnic conflict and secessionism for the following reasons. First, decentralization reinforces ethnic identities by recognizing certain groups in countries, and giving them a sense of legitimacy. Secondly, it enables groups to enact legislation that discriminates against regional minorities. And thirdly, it provides regions with mechanisms, such as regional legislatures, local media and regional police that make engaging in ethnic conflict and secessionism easier. Brancati (2006) conducts a cross-country statistical analysis and concludes that decentralization is a useful device for reducing both ethnic conflict and secessionism, but the effect is undermined by the growth or emergence of regional parties. Roeder (2005) also points out that the risk of conflict escalation (from ethno-politics to national crises) is not diminished in territorial federations. What is missing in many of these studies is the economic dimension, specifically the fiscal devolution of powers to local authorities, which can be argued to be of greater significance than the mere creation of democratically elected sub-national legislatures where greater local competencies are meaningless without economic teeth.

Fiscal federalism means decentralized government expenditure decisions and/or revenue raising powers to sub-national entities. The revenue aspect may be important, particularly for regions with natural resources as in Indonesia or Nigeria, as it appeases local discontent about regionally generated revenues being siphoned off to central government. Other regional governments may be better able to raise local revenues, or even conduct their own borrowing. Decentralization may also increase the utility of regions that can take their own decisions about local public expenditure. It is important, therefore, to distinguish between the revenue and expenditure side of fiscal decentralization and its relation to conflict, although the two are always connected in practice. Note, one can have fiscal decentralization without elaborate political federation and vice-versa; however, a modicum of local decision making has to be in place for fiscal decentralization, be it solely administrative.

On the expenditure side, a citizen is normally indifferent to who (federal, state or city government) provides public goods, as long as provision is adequate. Citizens may care about the type of provision in some instances, say about what languages are taught in school, which might vary over different education authorities. Nevertheless, many expenditure priorities are the subject to political processes and the formation of public policy. Then, it may matter which executive authority (regional or national) or what legislature (regional or national) decides on public finance and spending priorities.

Related to this is the theory of club goods (see Cornes and Sandler, 1996 for a succinct survey). As the name suggests, club goods are excludable and voluntary. Only members can benefit from the club good, and membership is voluntary. The provision of club goods does not always require state intervention, as members incentives do not lead to under-provisioning. As with a public good, members of a club do share something, so the rule for the optimal provision for public goods based on the vertical summation of individual preferences for the common good or service applies. But here, there is an additional requirement, related to membership. This is to do with the fact that on the one hand increased membership can reduce per-unit costs (because of economies of scale or scope); but on the other hand, more people sharing leads to congestion and may crowd out benefits. So, both of these factors need to be taken into account in the pricing and provision of club goods. The important point here is that many government services are closer to the characteristics of club goods (or at least they are impure public goods) compared to pure public goods, particularly at the local level. Furthermore, an outcome closer to the club goods optimum may be achieved with greater local control over public expenditure. Since this implies volition, it may be conflict reducing.

What role does fiscal federalism have for ethnic conflict resolution? Besides outright war involving the state, ethnic violence can also take the form of peaceful protest by ethnic groups, or sectarian violence that is not targeting the state or rebellion against the state.

Tranchant (2007) points out that fiscal federalism, by decentralizing public expenditure decisions, is in principle violence reducing if different ethnicities are concentrated in different geographical entities of the federation. In other words, if each group is the majority in one of the sub-national units that make up the federation, the likelihood of peace is increased. This still leaves the problem of their conflict with remaining minorities inside the sub-national unit and violence risk is increasing in the number of minorities. Fiscal federalism, however, will not reduce conflict if minorities are thinly spread across the whole country because these minorities are not a majority anywhere. More generally, there are other problems as well, fiscal federalism can cement ethnic cleavages, it can act as a method of appeasement only for resource rich regions, and fiscal federalism can generate veto-player functions where blocking by a region does not abate conflict.

What is the empirical evidence across countries? Tranchant's (2007) empirical strategy looks at the risk of conflict onset, and also its intensity, once there is onset. Fiscal decentralization increases the intensity of protest, but not the risk of protest onset for dispersed groups. As far as rebellion is concerned, decentralization reduces the risk as well as the intensity of this phenomenon when minorities are a majority in some jurisdictions of the federation, and even reduces rebellion in some dispersed cases. Sectarian violence is also reduced by fiscal decentralization. By contrast, Alemán and Treisman (2005) in their case studies of four countries (India, Pakistan, Nigeria and Yugoslavia) find no systematic evidence to support that fiscal decentralization lowered the risk of secessionist violence, but fiscal appeasement (which allows some regions more resources or to keep more locally generated revenues) may help in conflict abatement. Fiscal appeasement may have more to do with the revenue or income side compared to decentralized expenditure decision making.

Badly conceived fiscal federalism, or the failure to adapt federalist rules to new and emerging situations (such as natural resource discoveries or debt burdens) can exacerbate latent conflictual tendencies in federations. In countries where minorities are dispersed, other forms of functional federalism or power dividing mechanisms are necessary in addition to fiscal federalism. Fiscal decentralization might work better in middle income countries with greater revenues to spend on public goods, and in countries where resource rich regions demand financial autonomy. Indeed, Tranchant (2008) empirically demonstrates that fiscal federalism is more successful at reducing conflict

risk in countries with superior institutions using the international country risk guide (ICRG) data, implying that better institutional quality means the country has superior governance, and more durable political institutions. In particular, nations with malfunctioning institutions often have weak central governments, which encourages violent challenges and fiscal decentralization may fail to mollify potential rebels.

SYNTHESIS

The preceding sections have identified three factors that contribute to long-term peace and the reconstruction of the social contract. These also correspond to the three dimensions of the social contract, identified by Addison and Murshed (2006). The first is an equity consideration, or a dimension of distributive justice. Here we draw on the social choice literature on fair division. Fair division can be across a single divisible, several divisible and several indivisible issues or items. In each case equity considerations apply, especially the principle of envy-free allocations. Without it, any post-war settlement is unlikely to endure.

Secondly, we have a more realistic vision about the balance of power which maintains peace among potential protagonists. In ethnically divided societies, power sharing may be insufficient to sustain peace if the leaders of different ethnicities have incentives to escalate conflicts, or ‘ethnicize’ future conflicts. In some cases, power sharing may become the source of future conflict. In these circumstances, power dividing formulas that devise multiple decision-making layers, with no single veto player, may be necessary. These arrangements point to a federal political system, although federalism is not essential to power division. In the end, multiple sources of power (power division) may facilitate and stabilize power sharing among different ethnicities. Many federalist constructs are imposed by outside powers or donors following a conflict. These arrangements may not hold together, unless they are domestically incentive compatible. A similar argument applies to agendas for democratic development. Unless democratization and power sharing (dividing) formulas are *sui generis* (endogenous), they will not withstand the test of time.

The third aspect concerns decentralization in the allocation of public expenditure and revenues, fiscal decentralization. Revenue sharing can be important to many settlements following civil war, particularly when there are valuable local resource rents at stake, and certain groups are disaffected by their inability to effectively control what they regard as rightfully theirs. Equally, expenditures may be important, and decentralized decision making

about public expenditure may yield greater utility to local communities. So, potentially we have two issues here concerning peace building. The first is to do with appeasing potentially disaffected groups about controlling locally generated revenues; giving these groups greater fiscal powers over revenue amounts to fiscal appeasement via increased regional public sector income, and this may be necessary to avoid conflict. Secondly, there is local control on the nature of public expenditure in ethnically divided societies. This is, broadly speaking, conflict reducing if each fiscal sub-unit has a substantial and different majority ethnic group. If ethnic minorities are thinly spread across the federation, other means of addressing potential public expenditure grievances have to be devised by the central government, leading to a broad-based and inclusive provision of public goods with the special needs of certain groups (language, say) met. Decentralized decision making about public expenditure may be more relevant for middle-income developing countries, as there the share of government consumption as a proportion of GDP is greater and more significant than in low-income developing countries.

Finally, the social contract is among citizens, individually or in groups, with the state or sovereign authority. Consequently, the failure of the state to fulfil its functions leads to the breakdown of the social contract, and in many instances to civil war. Once an uneasy peace is established, besides the restoration or reconstruction of the social contract state capacity needs to be rebuilt. Of the functions of the state, four areas may be highlighted, the first two of which constitute the primary functions of the state in classical liberalism.

First, the state must be able to enforce laws, contracts and ensure the personal security of its citizens. Otherwise violence becomes privatized, and the state loses its legitimate Weberian monopoly over violence. In many failing states, people have to rely on kinship ties to fill the sovereignty gaps left behind by a failing state. Secondly, the state must have fiscal capacity, both at the central and decentralized levels, to raise revenue and provide public goods. In states, which are at a post-conflict reconstruction phase, this hugely important task of rebuilding state capacity is often thwarted by the manner in which external assistance is provided (see Ghani and Lockhart, 2008). The state's role is often supplanted by donor provision of public goods (including particularist procurement practices), and the presence of financial aid stunts the development and need for domestic resource mobilization. Besides official aid donors, the activities of development non-governmental organizations (NGOs), both domestic and foreign, retard the development of state capacity.

Thirdly, the state has to provide the framework within which long-term economic growth is made possible. Long-term growth may depend

on institutional quality, but more immediately the right policies have to be followed. These could include addressing inadequate infrastructure, the paucity of financial capital, restrictive trade policies and so on. Sound macroeconomic management that results in sustainable fiscal deficits, inflation control and balance of payments equilibrium is also part of a growth enhancing strategy.

Finally, the state needs to be able to regulate the market. Just as the market can provide the basis for prosperity that ultimately diminishes the chances of conflict, the unregulated activities of the market can not only produce major economic downswings (the prime example of which are financial crises, which inordinately impinge on the real economy), but the workings of the free market can enhance conflict risk. Also, the government needs to ensure that growth needs to be broad-based in order for it not to ignite conflict. Despite the fact that growth ultimately reduces conflict risk, the road to prosperity along its path increased risk of conflict, unless measures are taken to address poverty and inequality, which in turn breed the greed and grievances (resource rents, polarization, horizontal inequality and relative deprivation) that produce conflict. The inevitable structural changes to the economy that emerge in the wake of growth always produce winners and losers, a some become richer and others become relatively poorer. For conflict to be avoided, the losers must not be allowed to fall too far. Thus, the current donor focus on poverty reduction is simply not enough, the presence of conflict risk enhancing inequalities also need to be addressed.

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