

**CDP Background Paper No. 8**  
ST/ESA/2005/CDP/8

**2005**

**Reconstruction, development and sustainable peace: a unified programme  
for post-conflict countries**

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**Background**

This report was prepared by Mr. Milivoje Panić, a member of the Committee for Development Policy, as a background paper for deliberations by the Committee at its seventh session. The aim of the report is to review the role of *economic* welfare in conflict prevention, including the strategies required to ensure sustainable peace in post-conflict countries. It differs in one important respect from most of the rapidly growing literature in this field. Instead of describing *specific* conflicts or policies to prevent them, it integrates some of the key economic, social and political factors into a general analysis, with an all-embracing strategy for post-conflict countries. The integrated approach is essential because a unified strategy offers the only hope of preventing future conflicts and civil wars.

JEL classification: D74 (Conflict; Conflict Resolutions; Alliances); F5 (International Relations and International Political Economy); H (Public Economics); N (Economic History); Q34 (Natural Resources and Domestic and International Conflicts).

Keywords: economic welfare, conflict prevention, post-conflict.

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## **Reconstruction, development and sustainable peace: a unified programme for post-conflict countries**

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### **The recent history of conflicts**

There have been more than one hundred and forty civil wars since 1945. Estimates put the number of casualties at around 20 million, with 67 million people displaced.<sup>a</sup> If correct, these figures are equivalent to half of the casualties and more than double the total number of displaced persons in Europe during the Second World War - estimated at 40 and 30 million respectively.<sup>b</sup>

There was great hope during the brief euphoria in 1989/90 that the end of the Cold War would herald the beginning of a new era of widely enjoyed improvements in economic welfare, prosperity and peace achieved through greater harmony of interests and cooperation between and within countries. Regrettably, though not surprisingly, it is the sceptics who have turned out to be right. Some of them suspected that the euphoria would turn out to be no more than, as the then British Foreign Secretary put it, a “Utopian folly”.<sup>c</sup> Others feared that the removal of the East/West tensions would revive the old ethnic and cultural antagonisms and conflicts.<sup>d</sup>

Far from peace and harmony, over one hundred armed conflicts have taken place since 1989.<sup>e</sup> They have ranged in severity from minor conflicts (at least twenty-five battle-related deaths) to wars (one thousand or more battle-related deaths). In other words, “the world total of separate conflicts is still high, twice as high (in 2001) as when the Cold War began”.<sup>f</sup> Moreover, civil and international wars are not the only forms of organized aggression and brutality. A number of countries have experienced intercommunal violence, genocide, coups and high levels of organized crime.

Many factors, often specific to individual countries, are responsible for these conflicts. There are, however, certain characteristics that are shared by most countries that have experienced civil wars: poverty, unemployment and economic stagnation – with economic welfare and income security deteriorating rapidly.<sup>g</sup> The fact that rates of growth tend to be much

lower in war-affected economies than in those that have not experienced civil conflicts<sup>h</sup> makes the underlying problems even worse.

Clearly, economic conditions are of critical importance. But they cannot be considered independently of non-economic factors for the simple reason that there is a strong interaction between the two.<sup>i</sup> To achieve their objective, economic policies must therefore take into account the capacity of a society (its institutions and resources) to solve the problems created by the divisions and tensions that are responsible for recurring violence. As Lord Beveridge<sup>j</sup> pointed out, with the Great Depression in the 1930s and its aftermath in mind, “The greatest evil of unemployment is not the loss of additional material wealth which we might have with full employment: there are two greater evils. First, that unemployment makes men seem useless, not wanted, without a country; second, that unemployment makes men live in fear, and that from fear springs hate.”

Finally, the existing antagonisms, grievances and conflicts are not the only reason the world community needs to tackle the causes of armed conflicts. An international survey reflecting the views of over one billion people, published in 2004, found that there was widespread pessimism about the future. People across the globe felt “unsafe, powerless and gloomy” and feared that the next generation would live in a world even less prosperous and safe, and more internationally insecure.<sup>k</sup> These are exactly the conditions that bred civil and international conflicts in the 1920s and 1930s, culminating in the Second World War.

## **Major causes of civil unrest and conflicts**

### ***Poverty***

A recent World Bank paper on its role in conflict and development took the unusual step of admonishing publicly its economists for their professional limitations and myopia in dealing with a subject as complex as that of civil unrest and war. According to the Bank, “Bank economists were inclined to think of conflicts as an exogenous shock, akin to a natural disaster or an adverse swing in terms of trade – something bad and unfortunate that happened from time to time and which was either ‘not our problem’ or in any case ‘there was not much we could do about’ ”.<sup>l</sup> The economists’ views were in fact contradicting the findings of the Bank’s own

research which “reaffirmed the links between conflict and poverty, confirming the everyday observations of other agencies and NGOs”.<sup>m</sup>

Yet even these links, as the Bank goes on to observe, are not as simple as they might appear. Not every poor country experiences civil conflicts. For example, they have occurred since 1989 in only half of the countries included in the list of least developed countries (that is to say, the world’s poorest and economically vulnerable states) identified by the Committee for Development Policy.

Nevertheless, the fact that there is a strong link between poverty and armed conflict is indisputable and can be easily confirmed.<sup>n</sup> Half of the States experiencing such conflicts since 1989 are in the bottom quartile of the countries included in the United Nations Development Programme (UNDP) Human Development Index (HDI). With one third of the remaining countries in the next quartile, over 80 per cent of the States that have experienced civil conflicts are in the bottom half of the HDI.

The key economic characteristics that these countries share include those already mentioned: low levels of income per head and high unemployment and/or underemployment levels. Not surprisingly, in most of them, over 40, or even 50, per cent of the population is ranked as poor. As a result, their levels of literacy, education enrolment, health standards and life expectancy are well below those in high or medium income countries – making it extremely difficult for those living under these conditions to escape the poverty trap through their own efforts.

### ***Impoverishment, inequality and pessimism***

None of this need cause civil unrest and conflict if the general feeling is that the burden of low development is shared fairly, that there is a steady improvement in the country’s economic performance which is benefiting all, and that those caught in the poverty trap can expect with confidence that they will be able to escape from it in the foreseeable future. The problem is that in many low-income countries none of these conditions is satisfied. Income inequality has increased over the last thirty years worldwide.<sup>o</sup> To the extent that Governments have become either unable or unwilling to compensate for this through income transfers, this means that the *inequality* of opportunity and outcome has also gone up both within and between countries. Moreover, over the same period, annual rates of growth in the world’s poorest States

have been, on average, only a fraction of those in the countries that have achieved medium or high levels of ‘human development’.<sup>p</sup> No wonder that the feeling of economic insecurity has increased internationally, particularly among low-income countries.<sup>q</sup> People feel less prosperous – notably in Africa, South America and the Pacific Region – and generally less optimistic about the future. The pessimism about their own future and that of the world is now shared also by the majority of those living in highly industrialized, prosperous countries.<sup>r</sup> The danger is that, if nothing is done to reverse this situation, these trends will create exactly the conditions in which people, especially inhabitants of the poorest countries, can easily become caught in the vicious circle of relative and/or absolute impoverishment, despair and, as Lord Beveridge warned, hate.

The cycle is familiar. The low level of development limits the capacity of a country to produce the volume of output required to satisfy the needs and aspirations of its population. Consequently, employment opportunities are also limited so that unemployment, actual and disguised, is invariably high. Unemployment reduces income of those directly affected and, through the multiplier effect, of the country as a whole. In addition, as it does not affect all sections of the society equally, unemployment also increases the inequality.<sup>s</sup>

The immediate impact of low national income is that the Government’s taxable capacity is inadequate for the State to provide transfer payments and social services needed to minimize the social cost of unemployment and poverty. The long-term impact is that low private and State income reduces the level of private and public savings in the country and therefore – in the absence of external assistance – both private and public investment. The rate of growth declines, reducing the possibility of future improvements in the standard of living.

Starting from an already low level of economic welfare, the overall effect is greater economic insecurity and growing dissatisfaction with the existing order. Political instability and the risk of conflict increase. This encourages emigration of highly skilled and educated labour and the flight of capital – making it even more difficult to reverse the process of economic decline. The vicious circle of poverty and stagnation continues, and with it the likelihood of conflict.

The risk of civil war will be particularly high if there is a sudden, sharp fall in output, employment and income, and no clear sign that the country will be able to reverse it in the foreseeable future. The costs of economic stagnation have “a dramatic causal impact on the likelihood of civil war”.<sup>t</sup> Moreover, this is not confined to low-income countries – though they

are, of course, particularly vulnerable – because “the impact of growth shocks on conflict is *not* significantly different in richer, more democratic, or more ethnically diverse countries”.<sup>u</sup> For instance, sharp falls in income and large increases in unemployment preceded civil wars in Sierra Leone, Nigeria and Indonesia. The same happened in Yugoslavia “following the liberal reforms in 1989”.<sup>v</sup> The economy declined by 15-20 per cent and the rate of unemployment in some regions reached 40 per cent of the adult population “fuelling social unrest”.<sup>w</sup> The difference between these four States was that in Yugoslavia “income per capita was two or three times the average for civil war countries” and it had high levels of education<sup>x</sup> as well as a public health service that was unusually comprehensive for the country’s level of industrialization. Two years later the first of the Yugoslav civil wars broke out.

More generally, economic depression in Europe in the 1840s was followed by a number of revolutions across the continent<sup>y</sup>; and the Great Depression in the 1930s led to the rise of fascism in a number of States and, eventually, to the Second World War.<sup>z</sup> As an eminent social anthropologist concluded after analysing extreme nationalism and its causes, “People who are affluent and, above all, who believe themselves to be in a situation which will fairly soon improve and continue to do so are much less likely to be tempted into violent conduct... than people whose situation is deteriorating and looks like continuing to do so – let alone people whose situation is desperate”.<sup>aa</sup>

### ***Social divisions and political oppression***

The ease with which the ‘temptation’ for violent conduct within a State can be translated into action is also determined by the degree of its social cohesion and the nature of its political institutions.

When their economic welfare and personal survival are threatened, the most effective form of protection is for people to form alliances with those who face similar dangers. In that respect little has changed since Aristotle observed almost 2,500 years ago that “Men journey together with a view to particular advantage, and by way of providing some particular thing needed for the purposes of life, and similarly the political association seems to have come together originally, and to continue in existence, for the sake of the *general* advantages it brings.”<sup>bb</sup>

The optimum size of the groups formed by such alliances tends to depend on the nature of violent conflicts. In intra-State conflicts, when the Government is either unable or unwilling to act in the interest of all its citizens, it will be smaller than the State – with the exact size depending on socio-economic divisions and inequalities.

The best way to understand the origin of tensions that may lead to violent conflict or war is to start with a simple model that eliminates some of the most common causes of social divisions and frictions.

A sovereign State will normally be protected against disintegration into a multitude of warring factions if the population is homogeneous and the existing inequalities are not a divisive issue; the whole population shares the same racial characteristics, national roots, language and religion; there is no State-imposed discrimination against any section of society; everyone enjoys the same legal rights, has equal access to state institutions and influence on the way they are run; and, equally important, existing economic inequalities (functional, horizontal, personal and regional) are generally accepted as ‘fair’. Clearly, under such conditions, the scope for divisions between capital and labour, occupational or social groups and regions would not be large enough for any one sub-group within the State to advance its interests by violent action at the expense of the rest. It would face the combined hostility of the majority and, therefore, certain defeat. To succeed, attempts to improve economic and social conditions of the country as a whole, or a particular minority, have to rely on non-violent, political means.

The risk of conflict increases even if *some* of these conditions are not satisfied. For example, history shows that even a high degree of demographic and cultural homogeneity may not fully eliminate the possibility of civil unrest or war in conditions of large and widening economic and social inequalities. This may take different forms: uprisings or revolutions to change the *status quo*, military coups to protect it, or the rise of organized crime and corruption as a means of redistributing wealth. As already emphasized, poverty and economic stagnation are an ideal environment for such developments. But unequally shared benefits of progress, especially rapid progress, may produce the same outcome.

The following scenario is not unfamiliar, and the country most likely to experience it tends to be at a low level of economic development, with most of the population at or close to subsistence level. Then, a natural resource of strategic importance to the world economy is discovered on its territory. The discovery offers the prospect of a continuous stream of foreign



currency earnings and, consequently, the opportunity for the country to transform its economy and social well-being within a relatively short period to the levels enjoyed by medium- or even high-income countries. All sections of the society are gripped by high hopes for a time. Then the disillusionment in and hostility towards the existing order set in. This happens when people realize that the discovery will make little difference to their lives, as the newly created wealth is concentrated in the hands of a minority who also control, directly or through their surrogates, the levers of power. Political oppression may protect the wealth, status and power of the minority for a time. But, as history shows, it cannot do so indefinitely. Moreover, if foreign corporations are involved in the production of the resource and their Governments are seen or believed to be behind the minority who derive most of the benefits from it, it may not take long before the civil conflict spreads across the borders and assumes international dimensions.

Whatever the overall state of the economy, the likelihood of conflict will increase if economic inequalities are the result of discrimination against certain groups of society because of their nationality, race, religion, class or gender. Where this is the case, members of the dominant social group invariably ensure that the most attractive and lucrative jobs, including key political offices at all levels, are occupied by those who belong to their group. This enables them to control, in addition to the country's productive resources and the way that these are allocated, also the army, the judiciary and the police. The privileged position enjoyed by the group may be perpetuated by the fact that the best schools and universities in the country are open predominantly to their children.

Again, past experience shows that, even if the ethics of such discrimination could be justified, the longer it persists the more violent the eventual civil conflict is likely to be. This is particularly true of the countries in which the State actually institutionalizes such inequalities. The laws and the coercive power of the State are then used to instigate, promote and safeguard the discrimination in favour of a particular group because of its colour, nationality, religion or class.

Although institutionalized discrimination and political oppression are not confined to low-income countries, international comparisons of 'political freedom' show that most of these countries score well below high- and medium-income States on some or all of the following characteristics: political participation, rule of law, freedom of expression and lack of discrimination. According to an index of political freedom produced in the early 1990s for the

UNDP<sup>cc</sup>, virtually all countries that have experienced civil conflicts, and for which relevant data are available, are in the bottom half of the index. All of these countries are also ranked in the bottom 50 per cent of the UNDP Human Development Index.

### **Primary post-conflict objectives**

The most important conclusion to emerge from the preceding analysis is that economic welfare, social harmony and political stability are so closely linked that all three must form an integral part of a viable post-conflict strategy. Social harmony and political stability are particularly difficult to sustain for long in a deteriorating economic environment; and no country ridden by chronic social frictions and political instability can achieve a sustainable improvement in economic welfare (employment opportunities, job security and income security). The other characteristic that these three pillars of well-being have in common is that they may take a long time to achieve.

To have any chance of success, post-conflict strategies must, therefore, concentrate from the start on institutional changes and policies that promote reconciliation, reconstruction and reduction in absolute poverty and income insecurity. The sheer enormity and complexity of the task that confronts post-conflict States and the realization that in these circumstances economic policy on its own is not enough has led to a reconsideration of the countries' priorities. Unlike in the past, social policy is now heading the list, ahead of structural and macroeconomic policies – though, of course, all three are extremely important.<sup>dd</sup>

The reordering of the priorities is not sufficient, however, without another important change in the institutional approach to problems facing post-conflict countries. As their greatest need is to create and improve the provision of *public goods*, it is essential to recognize that “post-conflict reconstruction is inherently a top down affair”.<sup>ee</sup> The central role that the State has to play in all these countries means that the institutional framework and human resources of critical importance in the reconstruction effort have to be created and strengthened for the purpose, as happened in Western Europe after the Second World War.<sup>ff</sup> “Violent conflict is the final proof of the failure of governance.... Governance and public administration programmes must therefore be the cornerstone of peace building efforts”.<sup>gg</sup> Hence, there is a good reason why the

concept of good governance ought to be defined as unambiguously as possible in the context of post-conflict strategies.

People in the States concerned must have an operational criterion by which to judge whether those who govern them are making a genuine effort to achieve the ultimate objective: sustainable peace secured through widely shared improvements in material well-being and respect for the rights of *all* citizens irrespective of their ethnicity, creed, colour, class or gender. Stated in these terms, the criterion makes it possible to have a continuous assessment of the quality of governance in a country and the reasons behind it. Failure to make progress towards the stated objectives may be the result of one or all of the following: the Government's reluctance to pursue them, political and/or administrative shortcomings and inadequate or inappropriate external assistance.

### ***Reconciliation***

If different groups within a post-conflict country are not prepared to cooperate in solving the problems that caused the civil discontent and war, the country's future will remain as bleak as its past. The effort to achieve reconciliation of the warring factions is therefore of critical importance, and its success will depend on how the authorities deal with four major problems, each of them more serious after the conflict than before.

First, as all internal conflicts result in atrocities against civilian populations as well as the combatants, the old grievances, resentments and animosities are likely to be felt even more intensely. The war may also change the ethnic balance of the population in a region or country, as large numbers of people are forced to flee their homes. The minority will now feel even more insecure than before, a fact that the majority may exploit in order to 'cleanse' the ethnic or religious character of their region or country by making the minority's life intolerable and forcing it to emigrate. Anticipating this, a Government genuinely determined to promote reconciliation will act promptly after the conflict to outlaw discrimination and threats against any group and will use – and be *seen* to use – the law enforcing agencies to implement the new laws. This is essential to demonstrate the determination of the authorities to break with the past by giving all those living on their territory a stake in the new order. The constitutional change will be fortified further with the reforms that guarantee a genuinely democratic form of government, this being the only way to give everyone an opportunity to participate in shaping the country's

future. Where major demographic imbalances exist and people are likely to vote along ethnic, religious or racial lines, the new constitution must make sure that the minorities are adequately represented in the legislative, executive and law-enforcing branches of the State.

Second, unless internal order is reestablished quickly, the end of fighting will not stop the lawlessness created by civil war. Past malpractices and the war inevitably discredit the existing State institutions, especially the judiciary and the police. At the same time, with many people killed and forced into exile, there is likely to be a significant change in the social structure of the country<sup>hh</sup> - seriously weakening family and community control mechanisms. The provision of internal order and security becomes, therefore, a matter of high priority, as success of the whole post-conflict strategy depends on it. An essential part of this task is to ensure that people have confidence in the integrity of the relevant State organs; one way to achieve this is to enable different groups to participate fully in all the law-enforcing institutions.

Third, civil conflicts reduce the long-term capacity of a country to recover. Apart from damage to property, casualties will include a substantial number of highly qualified and skilled people. Some of them are often specially targeted in such conflicts.<sup>ii</sup> Many of those who survive, especially the younger and more dynamic among them, will flee the country during the war or emigrate afterwards. Attracted by the prospect of higher living standards and better working conditions in the world's most advanced economies, they normally form a high proportion of emigrants from low-income States in any case<sup>jj</sup>. The war and uncertain future in post-conflict countries will make the prospect of emigration even more attractive for them. The human capital will be further depleted by a large number of people who come out of the war with physical and mental disabilities. The problem is particularly serious in Africa where military and paramilitary personnel have been largely responsible for the transmission of life-threatening diseases like human immunodeficiency virus/acquired immunodeficiency virus (AIDS/HIV). No post-conflict country can, therefore, afford discrimination of any kind that prevents the most productive employment of all those who are able to contribute to the reconstruction and development process.

Finally, to achieve the primary post-conflict objectives it is important to rebuild and, where necessary, create new State institutions. That can be done on a lasting basis only with strong popular support; to give such support people need to be convinced that the new institutional framework offers them the best chance to escape poverty, social divisions,

oppression and war. It is just such a fundamental change in the attitudes and institutions, and the extraordinary economic and social progress that followed, that has transformed Western Europe over the last sixty years and that made possible the creation of the European Union (EU).<sup>kk</sup> Instead of frequent wars that have plagued the continent for centuries, it is inconceivable now that any two EU member states would go to war to settle a dispute.

### ***Reconstruction***

“The reconstruction of physical infrastructure and the provision of social services are critical for the revival of economic activity and giving people a stake in the peace process”.<sup>ll</sup> Although the scale of destruction inflicted by civil wars will vary from country to country, the effect can be devastating even in conflicts of relatively short duration. In addition to the costs (human, social and economic) mentioned earlier, shortage of food is a common problem. As a result, nutritional standards, which are inadequate in low-income countries even at the best of times, can fall to dangerously low levels. With many residential buildings badly damaged or destroyed, serious shortage of housing is another common problem. Much of the infrastructure and productive assets in agriculture and industry will also be destroyed, damaged or made obsolete during the conflict.

The combined human and economic cost of the devastation can be staggering. For example, as a result of the genocide in 1994, GDP per capita in Rwanda is 25-30 per cent lower than it would have been without the conflict.<sup>mmm</sup> During the conflict, 10 per cent of the population died and almost four times as many people fled to neighbouring countries. As a result of such heavy casualties, children have been left with the responsibility of looking after 85,000 of the country’s households. The level of poverty has also increased significantly, with 60 per cent of the population regarded in 2001 as poor and 42 per cent unable to meet basic food needs.<sup>nn</sup>

Food, shelter, clothing and medical services must, therefore, be given priority in post-conflict countries in order to provide people with the basic needs necessary for survival. What makes the task of these countries even more difficult is that none of the problems created by civil conflicts can be solved in isolation. For instance, although it is of critical importance, it may not be easy to increase food production rapidly for a number of reasons: insecure property rights, mines left in the countryside, destroyed or obsolete production assets, damaged infrastructure,

inefficient marketing and lack of access to credit. Industrial capacity and income-support programmes may be needed to increase the supply of goods essential for agricultural production<sup>oo</sup>, but few, if any, post-conflict countries are in the position to do much about either for years.

The process of reconstruction is bound, therefore, to take time. The danger is that people may not be prepared to wait long for the ‘peace dividend’ to materialize. According to World Bank estimates, even if external assistance is available, it may take a low-income country four to five years to develop the capacity to use foreign aid effectively. The pressure to achieve a rapid improvement in economic welfare will be particularly great if public expectations of the benefits from peace are unrealistically high.

At the same time, although these problems are widely shared, it is difficult to generalize about the capacity of a country to use foreign assistance. The nature of civil wars and the size of their cost vary from country to country, as does the capacity of individual countries for rapid and successful reconstruction. Consequently, the international community must pay special “attention to local knowledge and perceptions and listen to the needs that are articulated by conflict affected countries and their ideas about what can be done to address them”.<sup>pp</sup> Equally important in assisting post-conflict countries is the need to “build on the capacities that exist” instead of trying to duplicate “or displace locally developed initiatives”.<sup>qq</sup> The reconstruction that involves all sections of the community working in tandem towards common ends, and seeing the benefits that such cooperation brings, can also play an important role in demonstrating practical advantages of achieving the reconciliation.

### ***Economic development and poverty reduction***

The importance of sustained development in reducing the risk of armed conflict and war was recognized early in the Industrial Revolution.<sup>rr</sup> In the static pre-industrial economies, with rigid social structures that make any change and progress difficult, redistribution of wealth through war and plunder will come to be regarded as the quickest way to riches and power.<sup>ss</sup> In dynamic industrial societies, on the other hand, “affluence and the expectation of growth...mitigate against extremism. People who may or may not harbour personal ethnic prejudices will not sacrifice their security and comfort for the sake of provoking violent conflict”.<sup>tt</sup>

There are two important reasons for such a fundamental change in public attitude to war. First, as John Stuart Mill observed, the continuous specialization, economic interdependence and, consequently, ‘commerce’ that these developments make essential lead people to realize that their wealth and prosperity depend on the wealth and prosperity of others.<sup>uu</sup> As a result, it is the improvement in economic welfare “which is rapidly rendering war obsolete, by strengthening and multiplying the personal interests which are in natural opposition to it.” Second, in highly industrialized societies, war inflicts such heavy human and material costs on all the combatants that it is “futile – useless even when completely victorious”.<sup>vv</sup>

The problem is that the conditions of affluence and confidence about the future, in which “the personal interests” opposed to war outnumber greatly those that benefit from it, still do not exist in many countries. The task in post-conflict countries in particular is to ensure through economic development and poverty reduction that they do.

The success in achieving major improvements in economic conditions depends on numerous decisions that have to be taken early in the process of reconstruction. Two of these are of critical importance for economic development and poverty reduction in post-conflict countries: the countries have to adopt the goals that are consistent with the objective of improving economic welfare in general; and, equally important, they need to employ a system of ownership and allocation of resources that are the most likely to achieve their main objective, based on the country’s problems and the social preferences of the population.

The principal goals of economic policy adopted more than fifty years ago by many countries are familiar enough. They are also highly relevant to post-conflict States because they were intended specifically to help prevent armed conflicts within and between countries. The continuing relevance of these goals emerges clearly from numerous international surveys that indicate that the attitudes, needs and concerns of the world population have not changed significantly since the 1940s.<sup>ww</sup>

The reasons behind the five goals of macroeconomic policy make it clear why this is still the case.

The first goal is to achieve high levels of employment and job security in order to give everyone a stake in their country’s future so that people do not feel useless, not wanted or live in fear of the future. This was judged in the 1940s to be so important that it was enshrined in the United Nations Charter. The second goal aims at sustaining the rate of growth required to

maintain high levels of employment and job security in the long run. The third goal is to keep prices stable so that the rate of inflation does not make it impossible to achieve the other objectives. The fourth goal is to ensure that the gains from economic progress are distributed in a way that is widely regarded as fair and, also, makes sure that nobody is allowed to exist below a socially acceptable standard of living. The fifth goal is a sustainable external balance (on the current and long-term capital accounts) to enable the country to preserve its economic sovereignty, thus allowing it to pursue the other four goals.<sup>xx</sup>

The second decision of critical importance concerns the ownership of productive resources, control over their allocation and which of the two alternatives, private or public, is most likely to achieve the five goals of economic policy. Unlike the welfare-enhancing decision, this one is much less clear-cut. The fact that the issue has provoked heated debate, even revolutions, since the eighteenth century indicates that it is virtually impossible to reach an unambiguous, definitive answer that is equally valid at all times and places.<sup>yy</sup> The reason is that productive resources, economic and social problems, preferences and priorities tend to differ significantly even among countries which appear to be very similar.

For instance, one problem that all post-conflict countries have in common is inadequate provision of *public goods*. That also happens to be the area of economic activity where the State has traditionally had to play an active role. The reason is that the private sector is either unable to provide such 'goods' (law enforcement, defence) or will do so only for those who are able and willing to pay for them (healthcare, education, housing).<sup>zz</sup> However, as the provision, nature and quality of public goods vary from country to country, the extent to which public and private sectors need to be involved will also vary.

The same is true, in fact, of those activities that are normally carried out entirely or predominantly by private corporations. Insecurity and general lack of confidence make it difficult to attract private investment, both domestic and foreign. Although the problem is common to all least developed economies, it will be particularly serious in post-conflict countries.<sup>aaa</sup> Hence, Government has to become involved in some of these activities either directly or by providing subsidies to encourage private investment. The subsidies may have to be substantial to attract foreign private investment. Even Europe was unable to avoid this problem after the Second World War. Private investors returned to Western Europe only *after* it had completed its post-war reconstruction and recovery. The experience of many developing



countries has led one writer to conclude that “foreign capital typically lags rather than leads industrial development”<sup>bbb</sup>.

Yet, this experience is not equally true of all sectors, regions or countries, including those emerging from a civil war. Despite the risks and uncertainties, private international investment will flow into a region or country devastated by internal conflict if it has resources that promise a high return on the capital invested.<sup>ccc</sup>

As a result, the method and the means used to achieve post-conflict economic objectives will have to be flexible and pragmatic. This was the approach adopted in the two most successful post-war recoveries on record, those in Western Europe and Japan.<sup>ddd</sup> All the countries involved pursued very similar welfare-enhancing economic goals. But the success that they achieved was the result of different priorities and policies – determined by each country’s needs and public preferences.

### ***External economic assistance***

Few questions of international economic policy have attracted as much attention since the 1940s as external assistance, its size, the form in which it is provided, conditions attached to it and its management and monitoring. Moreover, although it is almost sixty years since it was offered and implemented for a short time only (four years), the Marshall Plan remains for many people the ‘ideal’ form of external assistance. There are still regular calls for ‘New Marshall Aid’ to be given to this or that region of the world. What those who advocate this usually have in mind is the financial aspect of the assistance that the United States gave to Western Europe between 1948 and 1951. It was on an unusually large scale (around \$150 billion at today’s prices) and most of it (over three quarters) consisted of grants. The loans accounted for slightly less than 10 per cent of the total and the repayment terms were, especially by present day standards, exceptionally generous. They were to start in 1952 and to be spread over a period of thirty-five years at a fixed rate of interest (2.5 per cent).<sup>eee</sup>

However, though the financial side of Marshall Aid deserves the attention that it has received, it is important not to overlook a number of equally relevant aspects associated with the Aid.<sup>fff</sup>

First, other things being equal, external assistance is most likely to succeed when the recipient’s needs and donors’ interests coincide, as was the case with United States assistance to

Western Europe and Japan after the Second World War. Otherwise, the danger is that it will be given for the benefit of donors and, therefore, do little to solve the recipient's problems. Second, one of the preconditions for successful foreign assistance is that those who provide it must resist the temptation to impose on the recipient *their* preferred solutions and course of action. It is essential for the receiving country to determine its objectives and priorities and to be able to pursue the policies most likely to realize them. A successful strategy can be developed and implemented, therefore, only through the active cooperation between the donors and the recipient. This may not be easy to achieve in the absence of a genuine coincidence of interests. Third, a single donor, preferably an international organization coordinating the activities of various donors, is needed to avoid waste and the risk of failure caused by inconsistencies between the objectives and policies, duplication of effort and uncoordinated completion of projects.<sup>ggg</sup> When there are several donors the danger is that each may pursue its own goals, which may be very different from those of the country that they are supposed to be assisting. For instance, they may discriminate in their assistance in favour of a particular group that will promote their interests – thereby acting contrary to one of the most important preconditions for avoiding future conflicts. Another problem with many donors, all acting independently, is that it is not unusual to find in post-conflict countries that even the country's Government is unaware of how much external assistance has been given to the country, by whom and for what purpose. As a result, waste on a large scale is unavoidable, not least because of the unnecessarily large bureaucracy that the administration of uncoordinated foreign aid requires.

Fourth, donors must not insist on the reciprocity in policies such as trade liberalization that may impose serious long-term costs on the recipient, preventing it from achieving its reconstruction and development aims. Contrary to the practice that became increasingly common towards the end of the last century, the United States unilaterally liberalized its trade in the second half of the 1940s<sup>hhh</sup> to give other countries easier access to its market, thus making it possible for them to boost their inadequate dollar reserves.

Fifth, as already mentioned, it is imperative that foreign donors do not impose on the receiving countries the nature, timing and sequencing of economic policies – each of which can result in unacceptable social costs and the risk of conflict. It is for this reason that Western European countries were not prepared to risk either internal deregulation or external liberalization until their economies were ready for such fundamental changes.<sup>iii</sup> For example, all

of them had achieved full employment by the early to mid 1950s and completed their postwar recovery by the end of the decade. Yet, although the exact timing differed from country to country, they removed import quotas in the early 1950s, abolished domestic price controls in the second half of the decade and made their currencies convertible into the US dollar at the end of 1958. Tariff reductions came in the 1960s and early 1970s, more than a decade after most of the countries had become structural surplus economies, earning large balance-of-payments surpluses at full employment. It took even longer for exchange controls to be abolished: from the end of the 1970s through the early 1990s. By that time Western Europe had also, thanks to the countries' economic success achieved by these countries through cooperation, managed to realise the centuries old dream of many Europeans: lasting peace and the creation of the European Union.

Finally, external donors have the responsibility to ensure through careful monitoring that the essential post-conflict strategy originally agreed upon is implemented, and to discontinue development assistance when the recipient is failing to implement it because of widespread corruption. Equally important, they have the responsibility to prevent their own commercial interests from encouraging international corruption and failure, especially in post-conflict countries.

### **Domestic economic policy**

As emphasized in the preceding sections, it is difficult to generalize about specific policies in post-conflict countries as their conditions, problems, needs and priorities will differ, often significantly. The same is true of each country's capacity for successful reconstruction and development. Nevertheless, there are certain general principles of economic policy that apply to all of them.

Consistency of policy objectives is among the most important of these principles. If poverty is at the root of civil conflicts, therefore making its reduction through economic development the key objective of economic policy, a macroeconomic policy whose main goal is a low and stable rate of inflation – irrespective of what happens to employment and growth - is clearly inconsistent with the overall objective. As inflation is for various reasons (widespread shortages, pent-up demand) a common problem in these countries, the pursuit of low and stable

prices requires a highly restrictive macroeconomic policy. The result is deflation, economic stagnation, unemployment, low job security and income, greater poverty and inequality – exactly the conditions that give rise to conflict.<sup>jjj</sup>

The economic and social costs of deflation will be even greater if the objective of price stability is contradicted by policies that are, by their very nature, inflationary. Premature price deregulation, a sharp increase in indirect taxes and massive devaluation of the currency, especially when they are implemented at the same time, may give rise to runaway inflation. Yet these policies were forced on many transition economies in the 1990s, usually as a precondition for external assistance. The result has been unnecessarily heavy economic and social costs.<sup>kkk</sup> Similar policy inconsistencies in a country that has just experienced civil war are certain to result in a revival of old hostilities and conflict, a totalitarian form of government, or emigration of the young and those with vocational and professional qualifications and skills.

To avoid similar inconsistencies and outcomes, it is also essential that no *structural* policy that can be effective in achieving the post-conflict objective of improving economic welfare should be ignored for the sake of some economic dogma. All industrial countries have used a wide range of policies to achieve and maintain their present levels of affluence: industrial, regional, and others that involved active collaboration between the State and the private sector.<sup>lll</sup>

Countries that are heavily dependent on exports of one or two primary commodities may need to use a combination of such policies to diversify their output. The capacity for product diversification is much greater in large than in small countries. However, whatever the size, countries need to diversify their economies to reduce vulnerability to external shocks and the risk of a debilitating deterioration in the terms of trade. The risks are especially serious in the case of countries dependent on exports of a single primary commodity. Again, it is important not to be dogmatic about the nature of economic diversification, as branching out into other primary commodities, manufactures or services may be equally beneficial.<sup>mmm</sup>

The consistency between the objectives and policies is also of critical importance in the pursuit of external economic policy. With the exception of a few small, mainly oil-rich States, all developing countries are essentially in fundamental disequilibrium (that is to say, unable to reconcile their internal and external economic objectives).<sup>nnn</sup> The problem is particularly serious in post-conflict countries. Premature liberalization of trade and capital flows by these countries

may easily exacerbate their economic problems and thus jeopardise the whole strategy of reconstruction, development and conflict prevention.

There are several reasons for this.<sup>ooo</sup> First, their totally inadequate foreign currency reserves will be drained quickly for purposes other than reconstruction and development. Second, trade liberalization will reduce Government income. Import taxes are a major source of income in many developing countries<sup>ppp</sup>, as they were for a long time, for instance, in the United States.<sup>qqq</sup> Third, premature liberalization of trade makes it difficult to phase economic diversification and modernization carefully in order to avoid major losses in economic welfare. As Samuelson concluded over sixty years ago,<sup>rrr</sup> it cannot be demonstrated “rigorously that *free* trade is better (in some sense) for a country than *all* other kinds of trade”.<sup>sss</sup>

In conclusion, a pragmatic approach to macroeconomic policy is required if it is to play effectively the role for which it was developed: to help post-conflict countries secure sustainable peace through economic prosperity. To achieve this, it is essential to re-consider, bearing in mind international experience since the 1940s, priorities attached to the main objectives of macroeconomic policy, including consistency of the specific policy instruments employed. Macroeconomic policy should create the conditions that help conflict prevention, not conflict creation.

## **Conclusion**

The close link between economic prosperity, optimism about the future and peace is not a recent discovery. It was the realization of the importance of this link that made the German Government under Bismarck lay down the foundations of the modern welfare state in the 1880s.<sup>ttt</sup> And it was the appalling brutality and cost of the Second World War that paved the way for a completely different approach to macroeconomic management and collective social responsibility in the 1940s. The United States Secretary of State Morgenthau spoke for all of those attending the Bretton Woods Conference in 1944 when he told them, “All of us have seen the great economic tragedy of our time. We saw the worldwide depression of the 1930s. We saw... unemployment and wretchedness – idle tools, wasted wealth. We saw their victims fall prey, in places, to demagogues and dictators. We saw bewilderment and bitterness become the breeders of fascism, and finally of war”.<sup>uuu</sup>

Unfortunately, not everyone has benefited from the new order. Many countries are still as poor and vulnerable to civil unrest and conflicts as they have been for centuries, which often make it impossible for them to escape – without assistance from the international community - from the poverty-conflict trap, no matter how much they might wish to do so. That much is generally recognized and accepted. What we still need is a consensus on how to achieve this objective.

This paper suggests an integrated approach to the problem and why the task is beyond the capabilities of a single country or profession. In a globalized world, lasting prosperity and peace are possible only through *collective* commitment and effort.

Note

<sup>a</sup> N. Sambanis, loc. cit., p. 1.

<sup>b</sup> D. H. Aldcroft, *The European Economy 1914 – 1980* (London, Croom Helm, 1978), pp. 133 and 135.

<sup>c</sup> D. Hurd, “The New Order”, speech to the Institute of International Affairs in London, 27 January 1993.

<sup>d</sup> J. J. Mearsheimer, “Back to the Future: Instability in Europe after the Cold War”, *International Security*, vol. 15 (Summer 1990), p.5-56; S. P. Huntington, *The Clash of Civilizations and the Remaking of the World Order* (New York, Simon and Schuster, 1996).

<sup>e</sup> N. P. Gleditsch and others, “Armed Conflict 1946-2001: A New Dataset”, *Journal of Peace Research*, vol. 35 (2002), p. 616.

<sup>f</sup> *Ibid.*, p. 623.

<sup>g</sup> I. de Soysa and N. P. Gleditsch, “The Liberal Globalist Case” in B. Hettne and B. Oden (eds.) *Global Governance in the 21st Century: Alternative Perspectives in World Order* (Stockholm, Almkvist and Wiksell International, 2002); and ILO, loc. cit.

<sup>h</sup> N. Sambanis, loc. cit.

<sup>i</sup> J. Galtung, *Peace by Peaceful Means – Peace and Conflict, Development and Civilisation* (London, Sage Publications, 1996), and M. Renner, *Fighting for Survival – Environmental Decline, Social Conflict, and the New Age of Insecurity* (London, Earthscan Publications, 1997).

<sup>j</sup> W.H. Beveridge, *Full Employment in a Free Society* (London, Allen and Unwin, [1944] 1967), p. 248.

<sup>k</sup> World Economic Forum, “Survey on Security and Prosperity”, Geneva, 2004.

<sup>l</sup> World Bank, “The Role of the World Bank in Conflict and Development: An Evolving Agenda” ..., p. 5.

<sup>m</sup> *Ibid.*, p. 6.

<sup>n</sup> See Gleditsch and others, loc cit.; and *Human Development Report 2003: Millennium Development Goals: A compact among nations to end human poverty*, United Nations Development Programme.

<sup>o</sup> A. B. Atkinson, “Is Rising Inequality Inevitable? A Critique of the Transatlantic Consensus”, WIDER Annual Lecture No. 3, UNU/WIDER, Helsinki, 1999; United Nations, *Report on the World Social Situation 2001* (New York, United Nations publication, Sales No. E.01.IV.5); and B. Milanović, “True World Income Distribution, 1988 and 1993: First Calculations Based on Household Surveys Alone”, *Economic Journal*, vol. 112 (2002).

<sup>p</sup> *Human Development Report 2003*....

<sup>q</sup> ILO, loc. cit.

<sup>r</sup> World Economic Forum, loc. cit.

<sup>s</sup> J. K. Galbraith and M. Berner (eds.), *Inequality and Industrial Change: A Global View* (Cambridge, Cambridge University Press, 2001).

<sup>t</sup> E. Miguel, S. Satyanath and E. Sergentis, “Economic Shocks and Civil Conflict: An Instrumental Variable Approach”, *Journal of Political Economy*, vol.112 (2004), p. 746.

<sup>u</sup> *Ibid.*, p. 725.

<sup>v</sup> N. Sambanis, loc. cit., p. 20.

<sup>w</sup> *Ibid.*

<sup>x</sup> *Ibid.*

<sup>y</sup> E. J. Hobsbawm, *The Age of Revolution* (London, Weidenfield and Nicholson, 1962).

<sup>z</sup> A. S. Milward, *The European Rescue of the Nation-State* (London, Routledge, 1992); and M.Panić, “Managing Reforms in the East European Countries: Lessons from the Post-war Experience of Western Europe”, Economic Commission for Europe Discussion Paper, vol. 1, no. 3, New York and Geneva, 1992.

<sup>aa</sup> E. Gellner, *Nationalism* (London, Phoenix, 1998), p. 106.

<sup>bb</sup> M. Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge, Mass., Harvard University Press, 1971), p. 6.

<sup>cc</sup> M. Desai, “Measuring Political Freedom”, Discussion Paper 10, London School of Economics, 1992.

<sup>dd</sup> P. Collier, “Aid Policy and Growth in Post-Conflict Countries”, CPR Discussion Notes, No. 2, World Bank, Washington D.C., April 2002; P. Collier and others, *Breaking the Conflict Trap: Civil War and Development Policy* (Washington, D. C., World Bank and Oxford University Press, 2003); and S. Sardesi and P. Wam, “The Conflict Analysis Framework (CAF): Identifying Conflict-Related Obstacles to Development”, CPR Dissemination Notes, No.5, World Bank, Washington D.C., October 2002.

<sup>ee</sup> S. Schiavo-Campo, “Financing and Aid Management Arrangements in Post-Conflict Settings”, CPR Social Development Notes, No. 12, World Bank, Washington, D.C., June 2003, p. 4.

<sup>ff</sup> A. S. Milward, op. cit.



- <sup>eg</sup> United Nations Expert Group Meeting on Conflict Prevention, Peacebuilding and Development, held at United Nations Headquarters in New York on 15 November 2004.
- <sup>hh</sup> H. Lopez, Q. Wodon and I. Bannon “Rwanda: the Impact of Conflict on Growth and Poverty”, CPR Social Development Notes, No. 18, World Bank, Washington, D.C., June 2004.
- <sup>ii</sup> World Bank, “The Role of the World Bank in Conflict and Development: An Evolving Agenda”....., p. 22.
- <sup>jj</sup> J. C. Dumont and G. Lemaitre, “Counting Immigrants and Expatriates in OECD Countries: A New Perspective”, OECD Social, Employment and Migration Papers, 2004.
- <sup>kk</sup> M. Panić, “The Euro and the Welfare State” in M. Dougan and E. Spaventa (eds.), *Social Welfare and EU Law* (Oxford, Hart Publishing, 2005).
- <sup>ll</sup> United Nations Expert Group Meeting on Conflict Prevention, Peacebuilding and Development ....
- <sup>mmm</sup> Lopez and others, loc. cit.
- <sup>nn</sup> *Ibid.*
- <sup>oo</sup> E. Fitzgerald, “Paying for the War: Macroeconomic Stabilisation in Poor Countries under Conflict Conditions”, *Oxford Development Studies*, Special Issue, vol. 25 (1997).
- <sup>pp</sup> United Nations Expert Group Meeting on Conflict Prevention, Peacebuilding and Development ....
- <sup>qq</sup> *Ibid.*
- <sup>rr</sup> See M. Panić, “The Euro and the Welfare State” ....
- <sup>ss</sup> See Gellner, loc. cit.
- <sup>tt</sup> *Ibid.*
- <sup>uu</sup> J. S. Mill, *Principles of Political Economy* (London, Routledge, [1848] 1965), p. 594.
- <sup>vv</sup> N. Angell, *The Great Illusion* (London, Heinemann, 1912), pp. v-vi.
- <sup>ww</sup> See, for instance, M. Panić, *Globalization and National Economic Welfare* (London and New York, Palgrave/Macmillan, 2003. Paperback edition: January 2005); and ILO, loc.cit.
- <sup>xx</sup> See M. Panić, *National Management of the International Economy* (London and New York, Macmillan and St. Martin’s Press, 1988), in particular Part II.
- <sup>yy</sup> See C. P. Kindleberger, *Comparative Political Economy: A Retrospective* (Cambridge, Mass., MIT Press, 2000); and M. Panić, *Globalization and National Economic Welfare* ...., in particular chapters. 1 and 4.
- <sup>zz</sup> See A. B. Atkinson, and J. E. Stiglitz, *Lectures on Public Economics* (Singapore, McGraw-Hill, 1980); and I. Kaul, I. Grunberg and M. A. Stern (eds.), *Global Public Goods: International Cooperation in the 21st Century* (New York and Oxford, Oxford University Press, 1999).
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- <sup>ddd</sup> M. Panić, “Managing Reforms in the East European Countries: Lessons from the Post-war Experience of Western Europe” ...; S. Tsuru, *Japan’s Capitalism: Creative Defeat and Beyond* (Cambridge, Cambridge University Press, 1994).
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<sup>iii</sup> See for instance, H. J. Chang, *Kicking Away the Ladder: Policies and Institutions for Economic Development in Historical Perspective* (London, Anthem Press, 2002); and R. E. Goodin and others, *The Real Worlds of Welfare Capitalism* (Cambridge, Cambridge University Press, 1999).

<sup>iiii</sup> C. P. Kindleberger, *Foreign Trade and the National Economy* (New Haven and London, Yale University Press, 1962).

<sup>nnn</sup> See M. M. Panić, *National Management of the International Economy* ....

<sup>ooo</sup> See M. Panić, *National Management of the International Economy*..., chap. 7; and M. Panić, *Globalization and National Economic Welfare* ..., chaps. 1 and 5.

<sup>ppp</sup> See *Human Development Report 1999: Globalization with a Human Face*, United Nations Development Programme

<sup>qqq</sup> L. Davis and J. Legler, "The Government in the American Economy 1815-1902: A Quantitative Analysis", *Journal of Economic History*, December 1966.

<sup>rrr</sup> P. A. Samuelson, "The Gains from International Trade", *Canadian Journal of Economics and Politics*, May 1939, p. 195.

<sup>sss</sup> See also P. A. Samuelson, "Where Ricardo and Mill Rebut and Confirm Arguments of Mainstream Economists Supporting Globalization", *Journal of Economic Perspectives*, Summer 2004.

<sup>ttt</sup> See M. Panić, "The Euro and the Welfare State" ....

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