Peacebuilding Commission, Annual Session 2014

"Sustainable Support for Peacebuilding: the Domestic and International Aspects"

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Background Paper

Prepared by the Peacebuilding Support Office[1]

- **Introduction**

Effective and sustainable systems for resource mobilization are a key element of the consolidation of peace in countries emerging from conflict. The financial, institutional and human capital aspects of resource mobilization needs to be addressed in its national and international components, with due consideration for the principle of national ownership and the fundamental objective of providing sustainable support to improve the lives of affected populations. The development of capacities is particularly critical during the drawdown and closure of Security Council-mandated missions to a context with only a UN Country Team. The experience of the UN and the international community provide an opportunity for Member States to look into ways for further policy development in order to ensure timely and sustained support during the critical phase of the country's post-conflict development. Lessons learned, from Sierra Leone, but also from other countries that undertook a reconfiguration of UN presence (e.g., Timor-Leste), can be useful as the international community approaches the impending closure of UN missions in Burundi and Liberia.

- **Working Session One: Mobilization of International and Domestic Resources and Revenue Generation**

Countries transitioning from war to peace face numerous challenges that frequently require significant political, economic and social support from the international community. Early investment in critical institution building and developmental initiatives often required international donor support. Effective mechanisms for generating domestic revenues and mobilizing internal resources are crucial for promoting development and for ensuring greater national ownership and sustainability in the longer term. Domestic resource mobilization and the delivery of public services are also critical for building trust in and legitimacy of State institutions and representative structures, which is particularly important for countries emerging from conflict.

As critical as it is to ensure that sufficient resources are available during transitional periods, the hurdles for post-conflict countries are well-demonstrated by the reality that, in these countries, *domestic resource mobilization represents a very low share of Gross Domestic Product (GDP), consistently lower than in other developing countries (14% in "fragile states" vs. 17% for other developing countries; and 34% in Organization for Economic Cooperation*

[1] This background Paper was prepared by PBSO to facilitate the discussion at the PBC Annual Session.

and Development (OECD) member countries). In addition to coordination challenges on policy as well as operational levels, a key question is, therefore, how to ensure not only immediate resource mobilization when a country emerges from conflict, but also how to sustain incoming resources for a sufficient period of time that allows developmental initiatives and institution building to progress so that sustainable peace can take hold.

Domestic resource mobilization in post-conflict economies is more difficult than in economies with no recent history of conflict. Violent conflict typically reduces income and hence the tax base, disrupts economic activity, and results in financial and human capital flight. The institutional capacity for domestic resource mobilization is negatively affected by the impact of conflict. Reasons for this include destruction and lack of requisite infrastructure, flight or unavailability of expertise, data gaps and records loss, weak governance and lack of citizens' trust and oversight. The problem of institutional capacity is compounded by the inability of domestic governments to acquire the needed human and other resources that will assist it in mobilizing revenue. Furthermore, social capital and institutions tend to deteriorate, impeding resource mobilization.

How do countries mobilize resources in such situations? Public resource mobilization entails a combination of revenue generation and effective financial management practices. Both have not only domestic but also international aspects to them. With respect to revenue generation, many post-conflict countries rely heavily on bilateral or multilateral grants and/or loans, natural resources, and taxes – particularly on trade. A country's post-conflict financial management practices depend on institutional capacity, which can be supported and promoted by the international community.

International assistance

International aspects to the challenge of post-conflict resource mobilization can be approached as comprising, firstly, income provided to countries in the form of grants and loans; and secondly, technical support, including for strengthening national institutional capacities so that countries can mobilize their own domestic resources.

Half of all Overseas Development Assistance (ODA) aid – typically seen in the form of grants and loans – to fragile states is delivered multilaterally. Aid has declined to fragile states since 2005; in 2011, it fell by 2.4%. The share of grants to loans has also shifted in the past three years in favour of the latter. At the same time, aid exceeds tax revenues in 12 African countries, including those on the Peacebuilding Commission's (PBC) agenda (Burundi, Central African Republic, Guinea-Bissau, Liberia, and Sierra Leone). Indeed, four of the countries on the PBC's agenda – Liberia (4), Burundi (7), Sierra Leone (10) and Guinea-Bissau (20) – were among the world's twenty most aid-dependent in 2011.

The importance of external assistance for institutional capacity development, whether provided bilaterally or multilaterally, cannot be overemphasized. This assistance should be aimed at enhancing national ownership and inclusivity. Unfortunately, policy coordination as well as coordination at operational levels does not always adequately account for the unique political economy of a country emerging from conflict.

<u>Domestic revenue generation</u>

Taxation of income and trade is the most important source for domestic revenues. It is accordingly imperative that countries have a sufficiently wide tax base to generate the necessary revenue to fund public expenditures. Even where there is such a tax base, taxation laws and policies must be well-designed in order to maximize revenue opportunities from taxes, while institutions must also have sufficient capacity to administer those laws and policies to collect taxes due. The ability of a country to successfully generate tax revenue would thus require a sound tax base, laws and policies and ability to collect in accordance with those laws and policies.

With this in view, it is understandable that countries in post-conflict situations, particularly those in Africa, find it particularly difficult to raise tax revenue. According to the African Development Bank (AfDB), the already shallow tax-base in most African countries is eroded further by excessive granting of tax preferences, inefficient taxation of extractive activities, and inability to fight abuses of transfer pricing by multinational enterprises.

In particular, improper transfer pricing is an international problem that affects developed and developing nations alike. Transfer pricing is the general term for the pricing of cross-border, intra-firm transactions between related parties. Where the pricing does not accord with applicable norms internationally or at domestic law - called “mispricing”, “incorrect pricing”, “unjustified pricing” or similar - issues of tax avoidance and evasion may arise.

The main beneficiaries of trade mispricing are assumed to be multinational corporations, tax havens and organized crime networks. At least in Africa, it is, however, difficult to obtain a clear picture. Contracts are often subject to strong confidentiality clauses by the companies, governments, investors and banks involved. African governments also often lack capacity to negotiate contracts that allow them to generate fair share of rents from natural resource extraction. While there are no solid figures measuring the size of the problem, the AfDB has flagged that the issue deserves serious attention.

With respect to institutional capacity to develop and implement tax laws and policies, increased capacity could help countries better monitor trade mispricing and improve domestic systems. Indeed, the OECD claims that every US$1 of ODA spent on building tax administrative capacity generates about US$350 in incremental tax revenues. It would therefore appear to be a “low hanging fruit”, and thus useful for the international community to consider whether it should be investing more in supporting domestic institutional capacity in this area. As the AfDB notes, strengthening tax institutions is often viewed as an important component of state building which helps to improve accountability relationships between government and its citizens.

In addition, taxes on trade and customs duties often represent a large share of government revenues for post-conflict countries. Therefore, it is crucial to develop capacities of customs administrations to ensure that duties and taxes are properly assessed and collected on international trade.

Nowhere is it perhaps more crucial to consider political economy than with respect to the exploitation of natural resources as a source of sustainable revenue. In post-conflict contexts, government policy support for foreign direct investment in a country's natural resources can itself spark conflict, with Liberia being one example. Even where foreign investment is not involved, government policies on the use of income stemming from the country's natural resources or the unequal distribution of their benefits can pose a risk to peacebuilding gains. Technical support in the area of natural resources policymaking could help avoid risks of relapse, while increasing public coffers. Yet this is only truly useful where those providing the technical support are sensitive to the unique conflict dynamics in the concerned country. Transparency in government revenues, and in particular from natural resources, is a critical aspect of the strengthening of accountability and the fight against corruption or other illegal divergence of revenues.

Illicit financial outflows threat efforts to generate and manage resources

Illicit financial flows have wide-reaching economic, security and social consequences and pose serious challenges to governments and economies. For this reason, they are becoming ever more visible to watchdogs and policymakers who provide support to developing and conflict-affected countries alike. Extractive industries – including mining, oil and gas – are particularly prone to activities linked to illicit financial flows, creating great risk for countries with abundant natural resources. Illegal economic activities, such as the trade in drugs, are also heavily linked to illicit financial flows.

While there is no universal definition of illicit financial flows (IFFs), for the purposes of this paper and discussion that it is intended to generate, IFFs can be defined as the transfer of money into or out of a country that is earned, transferred or spent through illicit means. IFFs can include legally earned monies that is transferred illicitly or monies that are acquired through illegal means. They can include monies from crime, corruption, tax evasion, mispricing of exports or imports, illegal trade in drugs, arms and natural resources, human trafficking wildlife, or the smuggling of cut and polished diamonds, which are not subject to the Kimberley Process. Not all IFFs involving money transfers – notably, transfer pricing – necessarily violate laws. Various ongoing intergovernmental processes that focus on developing countries are working to address these types of IFFs that are not actually illegal, but that undermine a country's ability to sustainably generate revenue for domestic use.

International frameworks also exist to help curb illegal financial flows, including those that stem from otherwise legitimate economic activity. Those that are considered as models for international cooperation in helping curb illegal financial flows arising from legitimate economic activity include the Kimberley Process Certification Scheme (regarding the diamond industry) and the Extractive Industries Transparency Initiative (regarding industries that remove raw materials from the earth). International cooperation models to help curb illegal financial flows stemming from illegal activity also exist. An example is the Stolen Asset Recovery Initiative (StAR). Yet, it is also recognized that in some areas the actual effectiveness of any such cooperation, notably, on IFFs from maritime piracy activities, is limited.

There is, however, general agreement on the need for more effective mechanisms of international cooperation and coordination to make progress in curbing IFFs wherever possible, and urgently, illegal financial flows from countries emerging from conflict. There is scope for more multilateral policy to be developed around illegal financial flows, including given their potential to hold post-conflict countries back from achieving sustainable peace.

IFFs from developing countries are estimated at US$946.7 billion in 2011. As a share of GDP, Africa faced the highest estimated illicit outflows (about 6%) although the absolute levels are thought to be lower than outflows from Asia. Measuring IFFs is, however, challenging due to the lack of data, the secretive nature of cross-border activities and the lack of transparency in institutions involved in IFF transactions. Methodologies for measuring the scale and scope of the IFFs are also not uniform.

Notwithstanding the still-evolving thinking around defining and measuring IFFs, there exists a growing body of evidence of their negative impact, particularly in Africa. The UN Economic Commission for Africa (ECA) notes that IFFs out of Africa have become a matter of major concern due to the scale and negative impact of such flows on Africa's development and governance agenda. It further notes that current evidence shows that Africa lost over US$854 billion in illicit financial flows from 1970-2008, corresponding to a yearly average of about US$22 billion. Worse, the trend has been increasing over time, especially in the last decade.

Weak capacity in many post-conflict countries makes the fight against IFFs difficult. In turn, IFFs undermine existing capacities and institutions by diverting resources and eroding the social norms and rules of the game. They can contribute to corruption; provide incentives for patronage and damage public trust.

The problem of IFFs has increasingly come onto the political agenda of the African Union, the Group of 20, the Group of 8, the UN, and the OECD. The Financial Action Task Force (FATF) issued, in 2003, a set of recommendations aimed at restricting money laundering as well as terrorist financing across signatories. Their implementation, however, remains insufficient for stemming such flows. The lack of a global regulator to strengthen governance may also inhibit a global solution.

The AfDB, FATF, International Monetary Fund, UN Office on Drugs and Crime (UNODC), and the World Bank are among the multilateral institutions that provide technical assistance to developing countries to combat illicit flows. The African Union, AfDB, Group of 20, the World Bank, and the UN have called for enhanced cooperation to implement the asset recovery provisions of the UN Convention against Corruption.

The UNODC has underscored the need for increased national coordination and enhanced regional and international cooperation. Its Executive Director, in his most recent report to the General Assembly on the subject, emphasized that if left unchecked, IFFs can erode the integrity of a country's financial institutions and undermine national economies, trade markets and currencies. The UNODC has observed that due to the high integration of capital markets, IFFs enter global financial systems where they can undercut legitimate international trade, affect emerging markets and damage the global economy.

Policy considerations and identification of gaps

It appears that there are areas where policy work is still very much needed to close gaps in international action in order to ensure that the mobilization of monies domestically can be done more efficiently and effectively; and to help curb and mitigate the impact of IFFs (particularly illegal financial flows) on countries emerging from conflict.

There is need for effective mechanisms of international cooperation and coordination, and information-sharing, to ensure that assets and revenue are used towards these countries' stability and sustainable path towards development. The AfDB argues that Africa's development partners can do more to build national capacity for public resource mobilization; and, that partners can better deliver on pledges of policy coherence by putting pressure on their own corporations to combat transfer pricing and strike fair deals with African nations.

There is also a need for a better regulatory environment through enforcement of national and global standards of financial transparency and democratic accountability. Among the possible approaches is one suggested by ECA. It recommends a two-pronged approach for more transparent and accountable legal and financial governance and an integrated international asset recovery regime for curtailing IFFs from African countries.

There is some momentum towards linking anti-money laundering efforts with governance, anti-corruption and other development issues that can be built upon by Member States to prevent, detect and deter IFFs, with much room remaining for policy development targeted towards post-conflict contexts. The General Assembly found that: i) technical assistance can play an important role in enhancing the ability of States, including by strengthening capacity- and institution-building; ii) the very limited availability of information on IFFs necessitates improvement in the quality, scope and completeness of such information; and iii) there are many methods used by criminal groups for laundering proceeds of crime, including through illicit trafficking in precious metals and the associated raw materials. In this regard, in its resolution 66/177 (2012) the General Assembly provided recommendations on a series of measures to strengthen international cooperation to counter illegal financial flows.

Other actions suggested by experts and international organizations working to help countries enhance their resource mobilization include: enhanced information exchange among countries on individual and corporate taxpayers as a means of minimizing tax avoidance; action against trade mispricing as a tax avoidance strategy by multinational companies; code-of-conduct on income, costs and profit reporting by multinational corporations, country-by-country; transparency in government revenues, including from natural resources; preventing tax avoidance and promoting treaties for avoiding double taxation; promoting further ratification and implementation of the UN Convention Against Corruption; and promoting stronger political backing for UN General Assembly resolution 55/188 on the illegal transfer of assets, as well as for the World Bank's Stolen Asset Recovery (STAR) Initiative.

Key questions for discussion

- How can the international community better support post-conflict countries to mobilize their domestic resources in a sustainable way?
- In what areas is there room for the international community to make a further positive impact on sustainable financial inflows from external sources towards peacebuilding objectives?
- How can the international community act multilaterally in a more concerted way, including through the PBC as a mechanism, to develop coordinated policies that can help reduce the volume and negative impact of illicit financial flows, particularly illegal financial flows?
- What are specific policy recommendations that could contribute to a reduction in illicit financial flows in ways that will benefit countries emerging from conflict?

- **Working Session Two: Lessons learned on the development of national capacities and sustainability of resources in the context of UN missions' transitions**

The drawdown or withdrawal of Security Council-mandated missions represents a natural part of a country's transition from conflict to sustainable peace. Countries in the midst of post-conflict transitions often remain heavily dependent on external resources, while at the same time struggling to generate sufficient and sustainable domestic resources. A country's exit from the agenda of the Security Council is an important milestone requiring a review of outstanding challenges and risks to the country's peaceful and stable transition. It is long understood that national ownership and the development of critical national institutions and capacities are crucial for a successful transition process, for which the Council has repeatedly stressed the need "for more coordinated, coherent and integrated peacebuilding efforts" by the UN and the international community to support post-conflict countries to achieve sustainable peace and progress.

The Secretary-General identified ongoing international support for post-conflict countries, including with financial and technical resources, as a priority objective in his 2012 Report on Peacebuilding in the Aftermath of Conflict. Countries in the midst of post-conflict transitions often face a series of gaps in national capacity, which can threaten peaceful transitions. Sustained support for these countries is not only a long-term challenge but also one that must be tailored to the individual country context.

The PBC's Working Group on Lessons Learned (WGLL), chaired by Japan, has highlighted how the closure of Security Council-mandated missions can alter the predictability and sustainability of funding. The closure of Security Council-mandated missions entails a shift from UN assessed contributions, which flow through the UN mission, to the reliance in the UN system on voluntary and mostly bilateral funding. This shift can lead to 1) breaks in the continuity of funding for key priorities and 2) a fragmentation of UN strategy. In addition, the shift from a Security Council-mandated mission also leads to the loss of UN capacity for political analysis and facilitation. These changes, taken together, can present additional challenges for post-conflict transitions.

Case study: the transition of Sierra Leone

Since the end of the civil war, Sierra Leone has made significant progress in the consolidation of peace and the Government is increasingly focused on ensuring sustained economic development. This successful transition benefited from extensive support from regional actors, the UN and international donors. The country has held three rounds of peaceful elections. Although electoral results were often contested, these disputes were resolved through peaceful constitutional mechanisms. The Security Council decided to close UNIPSIL in recognition of the country's considerable progress towards peace and stability. Within the country and internationally, there is still an appreciation for the many remaining challenges in the country and the fragility of the progress achieved over the last decade.

Institutions remain weak, while corruption and organized crime hold the potential to undermine them further. The issue of natural resources management, a key driver of the conflict, is yet to be addressed adequately. With the increasing extraction of oil and gas resources and the revival of the iron ore industry in the country, the challenges of managing natural resources will continue to require international attention and support. In addition to weak institutions, Sierra Leone suffers from a very high rate of youth unemployment. Many in the country have yet to see how peace translates into economic opportunity.

Sierra Leone's neighbours (Guinea and Liberia) and the Mano River Union have continued efforts to stabilize the region, address cross-border issues, and explore areas for regional cooperation. The West Africa Coast Initiative (WACI), launched in 2009, which aimed to combat transnational organized crime and drug trafficking, is an important example of sub-regional security sector collaboration. More needs to be done, however, to address the areas of vulnerability associated with porous borders and its potential spillover effects.

In Sierra Leone's case, the transformation of the UN presence has been accompanied by a complementary evolution in the PBC's role. As requested by the Security Council, the PBC will scale down its engagement in the coming year by adopting a lighter and more responsive approach. At the same time, the PBC is expected to support the next crucial phase of Sierra Leone's transition by responding to requests from the Government, international partners and the UN Country Team, based on national priorities as currently outlined in the Agenda for Prosperity.

Policy considerations and identification of gaps

Over time, the international community and the UN have achieved greater coherence, efficiency and accountability in the range of support and engagement with countries emerging from conflict. Notwithstanding, there remains much room for improvement in sustaining international attention following the closure of Security Council-mandated missions and ensuring continuity of coherent support despite the shift in funding arrangements.

The PBC's WGLL discussed how countries can benefit from the support of the PBC to help sustain political accompaniment of contested political processes – in Sierra Leone's case, for constitutional review – after the countries exit from the Security Council agenda. Such accompaniment can also help sustain financial and technical support for key national priorities.

Security Council mandates often task missions to work on the extension or restoration of state authority and missions are provided with dedicated resources to commit to this area. With the closure of UN missions and the transfer of leadership to a UN Country Team, these resources are no longer guaranteed. The challenges and the urgency of post-conflict institution building however, remain. There is a need to mobilize partnerships within and outside the UN system, including International Financial Institutions, the private sector and foundations, which could in turn help in addressing eventual funding and technical gaps following the drawdown and withdrawal of United Nations missions.

A peace agreement or an end to hostilities can lead to heightened expectations and anxieties, which can carry well beyond the early post-conflict period. Clear, careful and consistent post-conflict communications that help to manage popular expectations are essential, and a government's capacity to do so should be supported. A well-devised and executed communications strategy can serve to further entrench the values of peaceful co-existence, national unity and faith in a population's ability to lead its own socio-economic progress. A significant policy consideration is, therefore, to support and prioritize sound national communication strategies to manage national public expectations, as well as those expectations of key stakeholders, during the continued progression towards a more sustained peace.

The post-conflict transition of Timor-Leste, like Sierra Leone, is seen as a major success. In recognition of the stability and progress that the country had achieved, the UN withdrew the UNSC-mandated mission at the end of 2012, ten years after the country's independence. In fact, success did not come from the international community's first attempt. In 2006, the UN began the mission drawdown, despite requests from the country's political leaders for sustained attention and assistance to address the weak capacities in the justice, police and finance sectors. The country entered a period of conflict before the UN transition was completed, resulting in a scaling back up of UN peace operations. By 2012, the international community and Timor-Leste were in agreement that, despite the challenges still faced, a UN peacekeeping mission was no longer the best option.

Key questions for discussion

- How can the international community assist in creating an enabling environment for a country's transitions and respond to critical political and socio-economic challenges, as well as capacity needs, as the UN reconfigures its presence?

- How can the international community address the drop in predictable financing for post-conflict countries, as these countries move off the agenda of the Security Council?
- How can a country in transition mobilize sustained political attention, in order to allow for post-conflict countries to sufficiently build their own capacities to self-sustain?
- How can donor countries, which have been impacted by a global economic and financial crisis, continue investing in building peace over an extended term?

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