



Private Enterprise Development in Low-Income Countries

Conflict and Private Enterprise Activity in Low-Income Countries

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Violent conflict has numerous negative effects on private entrepreneurial activity and, as a consequence, on economic development. We show that even when we observe resilience of entrepreneurial activities in countries experiencing conflict (entrepreneurship increases with conflict), this is a sign of regressive structural change: a country moves towards low capital intensive and subsistence activities. However, entrepreneurial resilience may work as a foundation for post conflict reconstruction and economic development.

The Complex Interactions between Conflict and Entrepreneurial Activity

The relationship between conflict, economic development, and private economic activity (PEA) is still puzzling, despite the recent increase in studies investigating the microeconomic impacts of conflict. Violent conflict has a negative effect on the economic growth of low-income countries; entrepreneurship is a key determinant of economic development; there is evidence that in fragile and conflict affected states (FCS) employment is higher in areas with more conflict; and there is growing evidence that PEA is resilient, or even increases, during conflict.

How do we reconcile the positive effects of business development with the negative relation between growth and conflict, and the evidence of resilience and increased PEA under conflict? One possible explanation is that the negative effect of conflict on growth is transmitted through micro mechanisms which are not related to entrepreneurship. Another possible explanation is that the observed PEA in places experiencing conflict is non-productive, or even harmful for economic growth.

This project was a first attempt to disentangle the complexity of the relation between conflict and PEA, identifying the effect of distinct conflict measures on distinct types of entrepreneurial activities, in distinct settings. First, we wrote a systematic literature review, capturing the main consensus on the micro relation between conflict and entrepreneurial activity across all studies to date. Second, we built a rich dataset with an unprecedented level of data granularity, combining a number of household surveys run in Afghanistan (2003-2008) and Iraq (2006), and detailed data mapping through space and time the conflict related events in both countries. Third, we ran several analyses linking different types of conflicts and PEA, as well as comparing Afghanistan and Iraq.

The Available Evidence

The limited number and the differences among the papers did not allow a proper meta-analysis of the literature. Using all available papers investigating conflict and entrepreneurship, we developed a taxonomy to investigate whether the findings are conditioned to aspects of the study design – such as the object of analysis and the method adopted, and to identify regularities¹.

We found that the evidence is quite evenly distributed between studies that suggest a negative relation and those that suggest a positive relation. Extrapolating from the substantial heterogeneity we found that: (i) the subject of the analysis is crucial: individuals and the self-employed react differently from households and formal enterprises; (ii) using subjective or objective indicators of violence seems to influence the results; (iii) the

¹ Paper available as Ciarli, Tommaso, Michele Di Maio, and Sarah Langlotz (2015). *Difficult Relationships: Conflict, Entrepreneurship and Economic Development*.



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effect of civil conflict differs only mildly with respect to civil war and armed conflict; and (iv) sectors also seem to influence the findings, but the evidence is scant. Surprisingly, we found little evidence that the method of analysis, data sources, and the context influence the results.

Identifying Different Effects

The chief contribution of the project is the testing for some of these heterogeneous effects, identifying the relation between different aspects of conflict and different types of entrepreneurial activities, within a setting (Afghanistan), and across different settings (Afghanistan and Iraq).

First, we collected, cleaned, and harmonized a number of household and conflict databases to study the relation between conflict and PEA in Afghanistan (primarily) and Iraq (for comparison). We matched unique sources of information with a level of detail and precision along many different dimensions not available in the literature so far: disaggregated types of economic activity, geography, household background, and types of conflict events².

Second, we significantly improved the precision of the estimation and the identification of the effects by constructing a spatial grid (area) in Afghanistan.

Third, exploiting spatial and time variation of conflict and PEA (Fig. 1) we tested the probability that an Afghan household in a given area is engaged in one type of PEA (formal business, low or high capital non-agriculture self-employment, sale of agricultural products, and subsistence agriculture) for different indicators of conflict (intensity, impact on population, subjective experience, and frequency) in the same area. We also tested the effect of conflict on the likelihood of a household investing in agricultural assets (cattle, capital, and land). We used a robust identification strategy which minimizes the role of factors that we cannot measure or observe in influencing the results³.

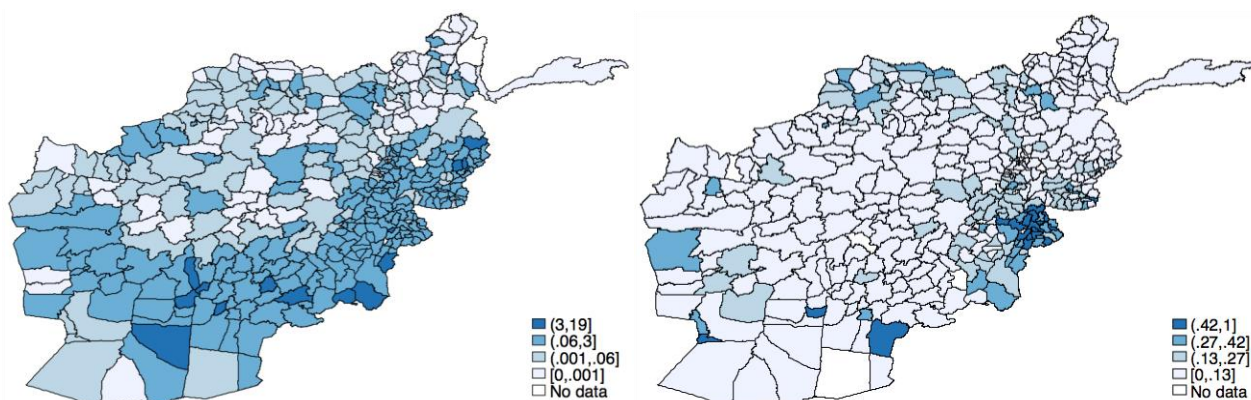


Figure 1: Number of relevant conflict per population (left) and % of households with a non-agriculture self-employment activity in Afghanistan (right) (per district, 2008)

Fourth, we controlled for reverse causality (PEA's influence on conflict) by combining a geographical area's relative share of the 1979-1989 Soviet conflict and the current national conflict intensity. This method is similar to assuming that the level of conflict in an area depends only on external physical and geographical factors (such as ruggedness, accessibility, position, etc).

Fifth, using a simpler estimation strategy (due to data limitation), we analysed how the effects of conflict on PEA varies between Afghanistan and Iraq, which differ significantly in terms of economic, social, and political factors, as well as for conflict intensity.

² Details on the harmonization of Afghan data can be found [here](#).

³ Paper available as Ciarli, Tommaso, Chiara Kofol, and Carlo Menon (2015). *Business as Unusual. An Explanation of the Increase of Private Economic Activity in High-Conflict Areas in Afghanistan*. SERC Working Paper.



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The results show that the probability that an Afghan household engages in PEA is, in general, positively affected by the level of conflict, its impact, and to a lesser extent by its frequency. However, the results vary with respect to the type of activity and the conflict indicator used, and vary for different types of conflict and settings (e.g. Afghanistan and Iraq)⁴. Less capital-intensive self-employment activities drive the positive relationship. Self-employment activities requiring higher capital investments are instead negatively affected by the intensity of the conflict. Small businesses thrive in the presence of foreign troops (but not of conflict). All results hold when we focus on agricultural assets, and for different identification strategies and robustness checks. However, they differ when we contrast Afghanistan with Iraq, where the conflict was more intense, and PEA more diffused. Here we found that low intensity conflicts have either no effect or a positive effect, but high intensity conflicts have a negative effect on all types of PEA.

Policy Relevance

The evidence available to date on the relation between conflict and entrepreneurial activity is too scattered and varied to allow for the design of general policies with significant impact. In Afghanistan and Iraq, different aspects of conflict exert different effects on different types of entrepreneurial activities. International organizations and aid agencies can improve the resilience of economic activities by stimulating self-employment in activities that are less affected by conflict, especially in areas where civilians are less involved. Some of these entrepreneurial activities may become leverage for economic development after the conflict (but there is no clear evidence for that). Finally, “collateral” damages represent a huge toll for countries that are under fire, not only on human lives, but also in terms of future economic development. Violent conflict, including when driven by a foreign coalition, rewinds the slow process of structural change of a low-income country. If the conflict lasts for an extended period, such regression may require a long time before the country can change direction again. If a conflict is underway, our results show that it is the “collateral” damages destroying the lives of civilians that have the strongest effect on household’s decision to invest in a private economic activity of a given type.

Moving Forward...

The private sector is set to provide 90% of the jobs in FCS, where the highest number of poor have been concentrated since 2015. Moreover, improvements in economic opportunities tend to be associated with lower incentives to engage in conflict associated activities. A more systematic and insightful understanding of how conflict affects entrepreneurial activities under varying conditions is crucial if we are to make progress in the fight against global poverty through private economic development. This requires investigating the questions addressed in this project at a larger scale – such as the effect of different types of conflict on distinct entrepreneurial activities, controlling for characteristics of FCS such as institutions, political control, sector and trade specialization, and geography. The growing availability of cross country harmonised data on conflict (e.g. ACLED and GDELT) provides an opportunity to harmonise household and firm data across several in- and post- conflict countries. This would generate findings useful to design effective policy interventions in different FCS.

⁴ See the paper for full details.