

The Traps of Economic Reconstruction

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Abstract

We analyze the incentives and constraints facing reconstruction authorities involved in economic reconstruction efforts and, in doing so, identify four ‘reconstruction traps,’ which often hamper efforts to rebuild post-conflict economies. These traps include: (1) the credible commitment trap, (2) the fatal conceit trap, (3) the political economy trap, and (4) the bureaucracy trap. We illuminate the dynamics of each trap by drawing on a variety of reconstruction experiences. Avoiding these traps is critical for success in economic reconstruction and we therefore discuss potential strategies for avoiding them.

JEL Codes: D03, D73, D74, P41

Keywords: bureaucracy, credible commitment, economic reconstruction, fatal conceit

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1. Introduction

Post-conflict economic reconstruction involves building and rebuilding physical infrastructure, restoring and investing in human capital and services, as well as fundamental reforms to institutions and policies related to economic activity in the wake of conflict. Economic reconstruction is typically carried out simultaneously with broader reconstruction efforts across the legal, security, social, and political sectors because all of these areas are interrelated. For example, it is difficult to encourage economic activity if citizens cannot be confident that public officials are constrained from expropriation or that police and courts will operate effectively. Likewise, economic reconstruction is an important aspect of maintaining peace because the consolidation of peace following conflict will be greatly eased if there are economic opportunities for the parties involved.

This paper contributes to our understanding of the large variance in economic reconstruction outcomes. How is it that some countries can successfully emerge from conflict while others remain in poverty and civil strife? Despite the importance of economic reconstruction, the topic has received scant attention from the academic and policy community. As Del Castillo (2008: 19-20) notes, “Post-conflict economic reconstruction has been a much-neglected aspect of the extensive and fast-growing literature on war-to-peace transitions.” That said, there is a small existing literature in economics which explores different aspects of economic reconstruction.

The contributors to the volume edited by Boyce (1996) explore the economic policies conducive to peace based on reconstruction experiences in El Salvador. Boyce (2002) highlights the role of conditional aid in encouraging domestic investment in peace. If aid is structured correctly, he argues, it can play an important role in establishing sustainable peace. The

collection edited by Montgomery and Rondinelli (2004) provides historical context for reconstruction efforts in Afghanistan and critically assesses international donors' plans for development in post-conflict societies. Collier (2007) identifies several development traps and considers how they contribute to the continued poverty of the 'bottom billion.' In doing so, he analyzes and discusses the types of aid and policies which are most likely to encourage development and prevent the reoccurrence of conflict. Del Castillo (2008) emphasizes that post-conflict economic reconstruction is a multi-pronged challenge which involves standard issues of socio-economic development, as well as the need to consolidate peace and provide basic services to citizens. Adam et al. (2008) analyze the role played by aid in monetary reconstruction. They address the tendency for post-war governments to engage in monetary inflation and highlight the importance of aid for transforming the path of monetary variables. The volume edited by Addison and Bruck (2009) reviews the main challenges in social and economic reconstruction and discusses potential solutions. Collier (forthcoming) analyzes whether post-conflict economic policies should be distinctive from those adopted in equally poor, but peaceful, countries. He concludes that policies should be distinctive because of the likelihood of subsequent conflict in conflict-torn countries.

Missing from the existing literature on economic reconstruction is an analysis of the incentives and constraints facing domestic and foreign policymakers, aid workers and development experts, military officials, diplomats, academics, and others engaged in economic reconstruction efforts (henceforth referred to as 'reconstruction authorities') involved in post-conflict economic reconstruction. As noted, the existing literature is mainly focused on identifying the challenges involved in economic reconstruction, as well as the ideal policies necessary to address these challenges. While identifying challenges and solutions is clearly

important, it is only part of the story. Also important is the ability of reconstruction authorities to actually design and implement policies in a way that effectively address the challenges of reconstruction. It cannot simply be assumed that reconstruction authorities will be able to design and implement policies in the desired manner to address the challenges of post-conflict economic reconstruction.

Our central argument is that reconstruction authorities in post-conflict situations face a unique set of incentives and constraints which influence their ability to effectively carry out economic reconstruction. To date, this aspect of economic reconstruction has not received the attention it deserves, hence this paper. In focusing on the incentives and constraints facing reconstruction authorities in economic reconstruction, we identify four main ‘reconstruction traps’ which often hamper efforts to rebuild post-conflict economies. These traps include: (1) the credible commitment trap, (2) the fatal conceit trap, (3) the political economy trap, and (4) the behavioral trap. Avoiding these traps is critical for success in economic reconstruction so we discuss potential strategies for avoiding them. Many failures in past economic reconstruction efforts can be attributed to a lack of appreciation for some, or all, of these traps.

In what follows, we dedicate a section to each of the four economic reconstruction traps. In addition to discussing the dynamics of each trap in the context of economic reconstruction, we also consider strategies to avoid the pitfalls created by these traps. The final section concludes with the implications of our analysis.

2. The Credible Commitment Trap

In order for reforms to be effective, reconstruction authorities must have the incentive to follow through with the course of action to which they have previously committed. As we discuss

below, the *credible commitment trap* may emerge because the operational environment is inherently dynamic and reconstruction authorities may perceive that they must change their strategies given new developments. However, if reconstruction authorities capriciously change the policy environment, citizens will doubt their commitment to a particular policy framework. This doubt will diminish the prospect of effective reconstruction because the legitimacy of reconstruction authorities will be in doubt and citizens and indigenous leaders will not buy in to subsequent reconstruction policies. Reconstruction authorities must therefore credibly signal their commitment to fulfilling their promised policies, reforms, and actions *and* establish binding constraints on future behavior.

The importance of reconstruction authorities establishing a credible commitment to a specific set of reforms and actions cannot be understated. The problem of credible commitment has been recognized as one of the most significant impediments to effective economic reconstruction (Coyne and Boettke, 2009; Flores and Nooruddin, 2009). The establishment of legitimacy is indeed seen as the *main* objective of counterinsurgency (COIN) and reconstruction operations by the U.S. military (U.S. Army/Marine Corps, 2007: 1-21; U.S. Department of the Army, 2008: 1-7.) given that this issue so heavily influences post-conflict outcomes. Given this, avoiding the credible commitment traps is crucial to the success of economic reconstruction.

2.1 The Problem of Credible Commitment

The credible commitment problem can be understood as follows. Without a binding and credible commitment to engaging in a specific course of action, those involved in economic reconstruction efforts may have an incentive to renege on the announced course of action in future periods. As Acemoglu and Robinson (2006: 193) explain, credibility becomes an issue

when there is a disjoint between those holding power (reconstruction authorities) and the beneficiaries of announced reforms (citizens) because those holding power may renege on their vocalized intent in later periods and citizens have limited recourse when they do so.¹

If citizens expect that reconstruction authorities will capriciously change their policies, then they will have great difficulty accepting the commitment of reconstruction authorities to a specific policy framework in the future. This necessarily results in ‘regime uncertainty,’ which is the instability of rules and institutions over time. When regime uncertainty is present, both citizens living in war-torn regions *and* reconstruction authorities cannot be confident in the stability of social and economic orders over time and their actions will be suboptimal. It is important to note that the relationship between regime uncertainty and the problem of credible commitment runs in both directions. A lack of credible commitment on the part of reconstruction authorities contributes to regime uncertainty, and ongoing regime uncertainty makes it increasingly difficult for reconstruction authorities to send a credible signal in future periods. This is because citizens in post-conflict countries, to varying degrees, will base their decisions in the current period on past actions of reconstruction authorities (see Kydland and Prescott, 1977).

To illustrate the importance of the credible commitment trap, consider that regime uncertainty and credible commitment problems have hindered economic reconstruction efforts in Iraq and Afghanistan from reaching the outcomes desired by reconstruction authorities. For instance, in Iraq, the Coalition Provisional Authority (CPA) changed their policy regarding the privatization of state owned enterprises (SOEs) after seeing how initial privatization

¹ Note that there is no assumption here of malevolent intent on the part of reconstruction authorities. Given that it takes time to understand ‘what works in development,’ reconstruction authorities may seek to experiment with the policy regime. It is important to note, however, that this may have deleterious effects for subsequent development efforts because of citizens’ behavioral responses,, hence the importance of understanding how the credible commitment trap can hamper development efforts.

subsequently affected the economy, which led to uncertainty regarding the perceived legitimacy of future economic reforms announced by the CPA. In the case of Afghanistan, constant changes to policy by reconstruction authorities have led to fundamental and widespread uncertainty on the part of Afghani leaders and citizens. As Stewart (2010) explains,

We [the U.S. and its allies] armed militias in 2001, disarmed them through a demobilization program in 2003, and rearmed them again in 2006 as community defense forces. We allowed local autonomy in 2001, pushed for a strong central government in 2003, and returned to decentralization in 2006. First we tolerated opium crops; then we proposed to eradicate them through aerial spraying; now we expect to live with opium production for decades.

This lack of commitment to a particular policy framework, while necessary for a dynamic and flexible approach to economic reconstruction, can inadvertently hinder the credibility of future policies of foreign governments and international organizations and necessarily contribute to regime uncertainty. As Stewart (2010) explains, “Frustrated by a lack of progress, the U.S. and its allies have oscillated giddily between contradictory policies [in Afghanistan]. The British government that once championed more generous budgetary support for the Kabul government now portrays it as corrupt, semi-criminal, ineffective, and illegitimate.” Such drastic changes in policy imply that both the Kabul government and reconstruction authorities will be seen as lacking commitment to a particular policy regime. In the absence of a credible commitment on the part of reconstruction authorities, citizens will have difficulty in coalescing around reforms.

The problems of credible commitment and regime uncertainty can best be understood as emerging from an endogenous process. For instance, rapidly changing economic, social, and political conditions at time t may lead reconstruction authorities to perceive that they must alter their course of action at time $t+1$. However, institutions must consolidate over time and capricious policy changes will negatively affect the emergence of consolidated order. If citizens coalesce around the time t policy regime and see that it is changed at time $t+1$, it is likely that

citizens will see the time $t+1$ policy regime as ephemeral. This has drastic implications for subsequent economic, political, and social outcomes since the consolidation of these orders necessitates citizens' coalescence. Behavioral and cognitive biases in the decision-making of reconstruction authorities may also explain the emergence of regime uncertainty in reconstruction efforts. For instance, present-biased preferences (O'Donoghue and Rabin, 1999) may influence reconstruction authorities' decision making processes such that they weight the immediate outcomes from reconstruction efforts relatively greater vis-à-vis the outcomes or processes in subsequent periods. Inadequate planning for exit strategies or a delayed turnover of reconstruction efforts to indigenous authorities may be a result of present-biased preferences for reconstruction planning and results. As Knowlton (2009: A11) reports on Afghanistan, "The [State Department] has not clarified an end state for counternarcotics efforts, engaged in long-term planning, or established performance measures." The time-inconsistency of policies, as a result of present-biased preferences, may be manifested in the above example, where reconstruction reforms must be altered in subsequent periods because reconstruction authorities did not attach sufficient weighting to long-term outcomes.

There are many barriers that prevent the emergence of credible courses of action in post-conflict countries. For example, where tensions between indigenous religious and ethnic groups exist, compromise and consensus around reforms has proven difficult because many citizens do not view other members of other groups as being credible. In Iraq, successful reforms needed to satisfy members of Iraq's major ethnic groups—the Arabs and the Kurds—and religious groups—Shi'a and Sunni Muslims (Coyne and Boettke, 2009). In reality, the situation is even more complex given that there are various intra-group factions in the broader Sunni and Shi'a groups in Iraq at both the national and local levels (Fearon, 2007). In Afghanistan, the *mélange*

of ethnic and religious groups expands further, with Pashtuns, Hazaras, Uzbeks, Tajiks, and Turkmen, and many other ethnic groups all comprising power in Afghan governance (national and local). Finding a policy consensus to which reconstruction authorities can commit is especially daunting in these situations, as the commitment to a specific policy may isolate a particular religious or ethnic group or renege on a promise to these individuals.

2.2 Strategies for Avoiding the Credible Commitment Trap

Establishing the legitimacy of reconstruction authorities is a crucial element of successful economic reconstruction. Yet finding solutions to the credible commitment trap is not simply a matter of establishing constraints on those directing economic reconstruction activities. Those engaged in economic reconstruction efforts must simultaneously establish binding constraints on their courses of action *and* send a strong signal to citizens that they are sincere to committing to their announced reforms and policies. By doing so, repeated interactions can shift the emergent equilibrium from a 'one shot' situation, where reconstruction authorities may have the incentive to renege on their vocalized course of action, to an equilibrium of cooperation between citizens and those involved in leading reconstruction efforts.

Filkins (2009) describes a discussion between General Stanley McChrystal and Abdullah Jan, a governor in Garmsir in Afghanistan which captures the essence of the credible commitment problem in reconstruction. Abdullah Jan told Gen. McChrystal the following:

Everyone in Garmsir sees that you are living in tents, and they know that you are going to be leaving soon. You need to build something permanent---a building. Because your job here is going to take years. Only then will people be persuaded that you are going to stay.

What Jan is expressing is the importance of reconstruction authorities signaling a credible commitment to a future course of action. Absent such a signal, citizens living in post-conflict

countries will not see the future course of actions espoused by reconstruction authorities as legitimate. Yet given different perceptions based on historical experiences and cultural differences, this can be a difficult endeavor. For instance, many Iraqis did not view U.S. reforms as credible given the history of colonization in the country. This is a difficult perception to overcome.

One strategy for overcoming credible commitment problems is for reconstruction authorities to go overboard with reforms to signal the strength of their commitment to a stable policy regime. As Rodrik (1989: 770) explains, "...policy overshooting may have the consequence of distinguishing a genuinely reform-minded government from its more equivocal counterparts." As an example of policy overshooting in the context of post-conflict reconstruction, consider the case of Iraq, where private entrepreneurship is stifled by excessive regulations and corruption which raise the cost of opening a business (see Gunter, 2009). In order to signal a credible commitment to reform and support for private enterprise, reforms could simultaneously remove regulations on opening and closing a business while permanently closing the agencies that had previously enforced those regulations. This would send a credible signal to that current reforms are breaking from the past given that the previous means of enforcing those regulations are no longer available.

In sum, reforms that are not credible or are logistically, epistemically, or politically infeasible should be discarded or reformulated since it is likely that they will be ineffective and will disrupt the social and economic orders that emerge in post-conflict countries. Although often underappreciated in reality, this principle is recognized as essential in the counterinsurgency field manual, where it is advised that "U.S. agencies trying to fan enthusiasm for their efforts should avoid making unrealistic promises. In some cultures, failure to deliver

promised results is automatically interpreted as deliberate deception, rather than good intentions gone awry” (U.S. Army/Marine Corps, 2007: 1-25). Indeed, when occupiers fail to understand the underlying belief systems of indigenous citizens, including how those citizens perceive, interpret, and respond to the policies and actions of reconstruction authorities, reconstruction efforts are more likely to be unsuccessful since reconstruction authorities will necessarily have to alter the policy course. Hence absent the requisite incentives for commitment to a policy regime, the appropriate credible signal, and knowledge about how individuals will respond to such actions, economic reconstruction efforts are more likely to fail. The next section is focused on better understanding the knowledge problems in economic reconstruction efforts.

3. The Fatal Conceit Trap

The role of knowledge is pivotal in economic reconstruction efforts. As practitioners are well-aware, understanding the conditions at the ‘grass-roots’ level is essential for effective implementation of policies and reforms. But possessing, processing, and understanding this informal and indigenous knowledge is quite difficult, if not impossible. In the context of reconstruction, the *fatal conceit trap* is the assumption that reconstruction authorities have the requisite knowledge to design and implement first-best economic institutions in order to develop a market economy. Hayek (1988: 27) described the fatal conceit as the presumption that “man is able to shape the world around him according to his wishes.” However, absent the requisite knowledge of initial conditions, citizens’ subjective valuations of goods and services, and various social and cultural systems, the capacity for shaping economic, political, and social outcomes is severely diminished. To understand the importance of this trap, consider that a key part of most economic reconstruction efforts is the implementation of a market economy based

on a multi-pronged plan. This inherently assumes that (1) planners can possess the knowledge necessary to effectively design a market economy and (2) that the consequences (negative or positive) of implementing this multi-pronged plan can be forecasted *ex ante*. As Coyne and Mathers (2010) argue, this is an infeasible endeavor because attempts to plan and implement markets ignore the complex chain of experiments, choices, errors, and informal institutions which must emerge over time for functioning markets to operate. Most markets are not planned, but instead are largely the result of emergent norms and institutions which lead to increased interaction and exchange. The irony of the fatal conceit trap is the belief that planners have the knowledge to design and implement markets, which are desirable precisely because they are best able to deal with the fact that knowledge is dispersed and context specific.

3.1 The Knowledge Problem in Economic Reconstruction

While positing strategies and prioritizing goals for economic reconstruction is necessary for developing the ‘blueprint’ for donor-led planning, the implementation of these plans is a disparate subject of inquiry. The knowledge problem has significant implications for those who seek to exogenously plan markets in post-conflict countries, since certain knowledge critical to interaction and exchange is dispersed and context specific (Hayek, 1945) and is therefore impossible to obtain. Consider the case of Afghanistan where the level of dispersion is especially daunting; the country has a population of 30 million people, “80 percent of whom are scattered among 20,000 remote, often mountainous villages” (Stewart, 2010). To be able to acquire and process all of the information and knowledge requisite for country-wide economic reconstruction is impossible.

The knowledge problem presents a significant hurdle for reconstruction authorities. Development project administrators in general have been prone to underappreciating the role of indigenous knowledge in developing countries. Pritchett and Woolcock (2004: 197), for instance, note that “valuable local ‘practices’---idiosyncratic knowledge of variables crucial to the welfare of the poor (e.g. soil conditions, weather patterns, water flows)---get squeezed out, even lost completely, in large centralized development programs.” A study by Stephens and Ottaway (2005) provides evidence for this claim in the context of reconstruction efforts in Afghanistan, finding that the roof designs for schools and health clinics were not sufficient to support snowfall during the winter season, resulting in the collapse of many. Mohammed and Leland (2009) describe, anecdotally, the failures of recent reconstruction projects with regard to planners not being able to understand the flow of water in the streets of Iraq. These experiences are not unexpected; Pritchett and Woolcock (2004: 198) find that under reliance on local knowledge and engagement can lead to technological mistakes, which is what is evinced above.

Easterly (2006) dichotomizes development efforts as led by two different groups of individuals: ‘planners,’ who engage in top-down administration and must systematically disregard dispersed and context-specific knowledge, and ‘searchers,’ who operate at the grass-roots level and utilize such knowledge to engage in effective economic and social development. In the context of economic reconstruction, one could refer to the above failures as an inevitable consequence of planners-led efforts whereas one could look at the successes of Greg Mortenson’s construction of schools in Pakistan and Afghanistan, for instance, as a result of effectively utilizing the knowledge, connections, and historical experiences specific to particular villages and tribal elders (Mortenson and Relin, 2006).

To illustrate the overemphasis on planning that pervades economic reconstruction efforts, consider the U.S. military's counterinsurgency and stability operations field manuals, which inform military doctrine regarding economic reconstruction and provide a of overarching institutional and macroeconomic goals. Among the military's goals and objectives along 'logical lines of operations' for economic development are (1) mobilization/development of local economic activity (manufacturing, services, agriculture); (2) initiate contracts with local businesses to stimulate trade; (3) rebuild commercial infrastructure (banks, transportation, markets, currency); (4) support broad-based economic opportunity (micro to macro development); (5) support of a free market economy (5-5). In the counterinsurgency field manual planning schematic, these five goals will prospectively result in a reestablished functional economy, with restoration of the "freedom to conduct lawful commerce" (U.S. Army/Marine Corps, 2007: 5-5).²

These 'blueprints' for reconstruction and counterinsurgency efforts, while laudable in the abstract, capture the essence of the fatal conceit trap because they fundamentally assume that planners can design and implement a logical and cohesive plan to rebuild an entire economy. U.S. military planners are evidently self-aware of the shortcomings of this strategy. Indeed, in the counterinsurgency field manual, it is claimed that "many commanders are unfamiliar with the tools and resources required for promoting economic pluralism" (8-16). What is overlooked is whether military commanders, and reconstruction authorities more broadly, can ever possess the

² Among the U.S. military's short-term goals for post-conflict recovery include the "(1) Security [of citizens] from insurgent intimidation and coercion, as well as from nonpolitical violence and crime; (2) Provision for basic economic needs; (3) Provision of essential services, such as water, electricity, sanitation, and medical care; (4) Sustainment of key social and cultural institutions; and (5) Other aspects that contribute to a society's basic quality of life" (U.S. Army/Marine Corps, 2007: 2-2). The military also seeks to engage in economic and infrastructure development (U.S. Army/Marine Corps, 2007: 1-19). These goals are relatively more tractable vis-à-vis the set of goals listed for overarching economic development. This is because (1) the knowledge required for such endeavors is not *as* context-specific, (2) they are immediate in time frame and are more readily implementable through standard military chains of logistics, and (3) do not involve the level of knowledge or logistics complexity required for overarching economic transformation.

relevant knowledge to achieve the goals dictated by the counterinsurgency and stability operations field manuals.

3.2 Decision Making Within Knowledge Constraints

Given the inherent inability to possess the relevant context-specific knowledge, how do reconstruction authorities make decisions regarding reconstruction efforts? One way to inform contemporary reconstruction policies is to fall back on data and evidence from other reconstruction experiences and then extrapolate comparable procedures or policies to contemporary reconstruction efforts with the assumption that this will generate the same outcome. Yet given contextual heterogeneity, it is fallacious to assume that what works in one setting will work in another. The ability to transfer one set of policies or reconstruction efforts from one region to another depends critically on the homogeneity—culturally, politically, legally, etc.—of countries. Further, “Initial conditions in the respective countries and access to external financing will determine the appropriate reconstruction strategy and policy mix required for the reestablishment of production trade,” (Del Castillo, 2001: 1980) hence context truly matters and each reconstruction experience will be very different. In support of this claim, Muggah, Berdal, and Torjesen (2009: 274) argue that the “failure to adequately account for regional and local dynamics can undermine the effectiveness of institutions.” This is also one of the self-proclaimed paradoxes of counterinsurgency strategies as indicated in the counterinsurgency field manual, which notes that “if a tactic works this week, it might not work next week; if it works in this province, it might not work in the next” (U.S. Army/Marine Corps, 2007: 1-28). Indeed, those involved in stability operations are cautioned that “no two situations are exactly the same and the development of strategy must be adapted to the specific conditions

of the operational environment” (U.S. Department of the Army, 2008: 1-18). Despite this realization, the extrapolation of past reconstruction experiences—both within and across countries—continues to be seen as an important input into current and future reconstruction efforts as evidenced by Dobbins et al. (2003) and Dobbins et al. (2005).

The extrapolation of past evidence to current reconstruction efforts can be differentiated into two types—‘vertical extrapolation’ and ‘horizontal extrapolation.’ Vertical extrapolation involves the use of evidence from *prior* experiences in the quest for economic reconstruction and extrapolating these experiences to the set of current policies to be implemented. As Montgomery and Rondinelli (2004: 4) argue, “the most obvious risk in translating lessons from history to the present is that no two sets of experiences are interchangeable parts of a static paradigm.” Horizontal extrapolation, in contrast, involves the assessment of current cultural or environmental settings that planners deem as comparable to the current country of analysis and extrapolating these cultural elements from other countries. Montgomery (2004: 37) elucidates how this fallacy is often employed when he argues that “the use of Morocco and Turkey as exemplars for planners may satisfy some cultural expectations, but their critical characteristics are significantly different.” Horizontal extrapolation may also take the form of using Western institutions and assuming that the results they produce in Western, developed countries will be comparable to the results in other countries.

In the context of economic reconstruction, it is often assumed that if planners can figure out what the problems are, finding solutions is simply a matter of logic. However, given limitations on knowledge, and the resulting reliance on extrapolation and decision-making heuristics, this assumption should be met with skepticism.

3.2 Strategies for Avoiding the Fatal Conceit Trap

The fatal conceit trap has significant implications for economic reconstruction efforts. Stewart (2010) argues that the plans for reconstruction in Afghanistan tap into “an Enlightenment faith that there is nothing intrinsically intractable about Afghan culture and society and that all men can be perfected (to a Western ideal) through the application of reason and the laws of social science.” As we have argued, the idea that a country’s economy can be designed based on logic alone is fallacious given limits on what human reason can comprehend and rationally design, as well as the fundamental incapacity of acquiring dispersed knowledge. In order to carry out large-scale, top-down, and overarching macroeconomic reforms, planners must necessarily abstract from complex context-specific intricacies such as local belief systems, informal institutions, and historical experiences, because there is no feasible approach to accumulating this information in its entirety. Therefore, the only true solution to the fatal conceit trap is to recognize the binding knowledge constraints on human planning and take these lessons into account when contemplating or formulating future economic reconstruction efforts.

Smaller scale reforms and actions, which make these knowledge constraints less binding (but not completely absent), are more likely to succeed (see Schilderman, 2004; Coyne and Mathers, 2010). This stands in stark contrast to the standard approach taken in economic reconstruction efforts, however, which has been the overarching and top-down reform of post-conflict economies based on a master blueprint of how a country’s economy should look and function. Smaller scale movements do indeed appear to be more effective. In the case of Iraq, for instance, Berman, Felter and Shapiro (2009) find that the violence-reducing effect of the \$2.9 billion in American reconstruction funds allocated through the Commander's Emergency Response Program (CERP) was found to be particularly effective after the troop surge. These

funds were essentially allocated for small-scale projects and were at the discretion of military commanders. Because the surge led to an operational change in the way troops were deployed—for instance, greater forward operating base deployment and communication with indigenous actors—this led to a greater understanding of communities’ needs and therefore a greater reduction in violence was seen after the change in tactics. Of course, smaller-scale reforms and actions are less likely to influence the overarching framing of reconstruction efforts (Lyons, 2009) yet a greater reliance on indigenous action will likely produce quicker and more effective reconstruction results.

Another strategy is to incorporate indigenous citizens into the reconstruction design and process. By allowing those individuals with robust knowledge sets specific to the contextual environment to lead reconstruction efforts, this can bypass the incapacity of planners to implement reforms. In many cases, these individuals possess local knowledge of the language, culture, and history of the region and typically are seen as legitimate in the eyes of the citizens in these regions. Further, they understand the channels of logistics and have connections with fellow citizens. This can also mitigate aid ‘blowback’ where negative and violent unintended consequences may emerge after the initiation of reconstruction reforms. The U.S. military has recognized the importance of local integration by the launching of Provincial Reconstruction Teams (PRTs) in Afghanistan. Allowing citizens, elders, and local government officials operating at the grass-roots to engage with individuals from NGOs, IGOs, and multinational corporations can lead to increased sharing of knowledge, ideas, beliefs, values, and feasible approaches to economic reconstruction.

Knowledge truly matters in economic reconstruction and the importance of context cannot be understated. Perhaps ironically, given the overemphasis on planning in the passages

discussed above, the counterinsurgency field manual shows an appreciation for the nuances of the knowledge problem by instructing those engaged in economic reconstruction efforts to “Learn about the people, topography, economy, history, religion and culture of the area of operations. Know every village, road, field, population group, tribal leader, and ancient grievance. Become the expert on these topics” (U.S. Army/Marine Corps, 2007: A-1). A key part of becoming an “expert on these topics” is realizing and appreciating the limits of human reason to design the economies of post-conflict societies.

4. The Political Economy Trap

Economic and political reconstruction efforts are inextricably linked. Indeed, institutions, economic outcomes, and political outcomes are all simultaneously and mutually determined. For instance, if political institutions are characterized by corruption and unchecked power, this will stifle economic activity because property rights may be denigrated or the regulatory hurdles to exchange, investment, and innovation may be too significant for local citizens or firms to overcome. Conversely, success (or failure) in different economic sectors may generate different political impulses by local citizens (e.g. support for less or more free trade, levels of redistribution, etc.). The implementation of economic reforms within the context of political agreements is especially difficult (Del Castillo, 2001). The *political economy trap* refers to the idealized view of politics and democracy which pervades reconstruction efforts. This view assumes that political and economic goals are compatible and that there is no tradeoff between democratic and economic outcomes. This romanticized view overemphasizes the benefits of democratic political systems while understating the potential costs on economic reconstruction efforts.

4.1 The Democracy-Economic Tradeoff

Circumventing the political economy trap is essential for successful implementation of reforms and the failure to escape this trap can adversely effect economic reconstruction in several key ways. First, the idealized view of democracy overlooks the fact that unchecked democracy can produce a variety of negative outcomes. While reconstruction authorities typically develop a comprehensive list of targets and goals to attain related to the establishment of democratic political systems in conflict-torn countries, implementation must be carefully performed, else negative unintended consequences may emerge. For instance, Flores and Nooruddin (2009: 5) find that “countries that undergo extensive democratization in the immediate postconflict period recover more slowly than countries that do not.” This may be because “typically early elections in a highly polarized society empower elites, senior military leaders, and organized criminal elements” (U.S. Department of the Army, 2008: 1-18). This highlights how important the proper consolidation of democracy and institutions is for effective post-conflict economic reconstruction. Absent effective constraints, democracy can produce illiberal outcomes—political, economic, and legal—that can do significant harm to post-conflict economies. When analyzing donor-led reconstruction goals, Montgomery (2004: 36) illustrates the democracy-economic tradeoff as such:

- (1) the rule of law can degenerate into the rule of lawyers--litigious, costly, and dilatory;
- (2) economic efficiency can turn into profligacy--piratical and predatory;
- (3) free speech can reward superficiality and extremism;
- (4) the demand for unfulfilled rights can invite invidious reverse discrimination;
- (5) checked-and-balanced governmental institutions can yield policy stasis.

The above five factors shed light on the necessity for establishing effective constraints to ensure that reconstruction efforts result in stable political and economic orders. Yet creating these

checks and balances is by no means a simple task, and social scientists and practitioners typically lack the knowledge of how to design effective comprehensive constitutional rules that will stick over the long run. This is because formal institutions, such as constitutions, must be grounded in informal customs and belief systems, which are largely beyond the reach of policy (Boettke, Coyne and Leeson, 2008).

Second, the idealized view of democracy often leads reconstruction authorities to overlook the tensions that may exist between the dual goals of establishing democratic political institutions and constructing the foundations of a market economy. These tensions may preclude the emergence of large-scale and first-best reforms; for instance, the privatization of state-owned enterprises or the removal of all tariffs and non-tariff barriers to trade may not occur because majority interests drive policy efforts in the other direction. Allowing for self-determination through democracy can lead to demands by citizens that run counter to the free market economic plans often envisioned by reconstruction authorities. When this happens, it presents a conundrum because implementing reconstruction plans requires either preventing democratic participation or ignoring the results. Denying political participation, or ignoring the outcomes of participation, is tantamount to denying political liberties and self-determination, which are typically considered important aspects of reconstruction efforts. For instance, when the highest ranking Shi'a Muslim scholar in Iraq, Grand Ayatollah al-Sistani, issued a *fatwa* calling for general elections in June 2003, this led the CPA to ultimately abandon plans to appoint a body to construct a national constitution (Wong, 2004). This had real effects on economic outcomes since the CPA was unable to have oversight over the writing of a constitution that could have provided a foundation for a permanent government, which would have led to stability and the encouragement of economic activity.

Third, the romantic view of democracy can cause reconstruction authorities to neglect the realities of the status quo. This happens because in assuming the ideal reconstruction authorities lose focus of the realities of the situation they face. Buchanan (1975) emphasizes that all reforms must start from the 'here and now' by recognizing the status quo and the associated constraints. The status quo refers to the array of existing formal and informal institutions, economic and political actors, and other particularities of post-conflict settings. Focus on the ideal, and the resulting failure to appreciate the status quo, has contributed to the failure of various reconstruction efforts. One well-known example can be found in Iraq where, instead of rebuilding governmental institutions from scratch, the CPA implemented a process of de-Ba'athification through the existing government apparatus. The intent of this policy was to minimize disruptions to the government's provision of services following the 2003, U.S.-led invasion. Yet as Allawi (2007: 161-2) explains, this proved problematic as the CPA did not have enough competent staff to operate the government. Further, the centralized nature of the pre-invasion government implied that "the removal of ministers did not simply allow subordinates to take over and carry on" (Rathmell, 2005: 1024). Hence, the lack of appreciation for the status quo—i.e. the recognition and understanding of pre-invasion governance structures and the associated binding constraints—led to significant hurdles for economic reconstruction efforts in Iraq.

As another example, consider that a lack of appreciation for the status quo led reconstruction authorities to underestimate the magnitude of corruption in Iraq and Afghanistan. In Iraq, when the police, military, and intelligence services were dissolved, the constraint on small-scale corruption was removed and a "real, endemic, and pernicious" (De Young and Pincus, 2007) corruption emerged in the country, which significantly diminished political and

economic reconstruction. Similarly, the well-documented levels of corruption throughout Afghanistan have served as a hard constraint on reconstruction efforts in that country (Transparency International, 2009; UN News Centre, 2009; NPR, 2009).

4.2 Strategies for Avoiding the Political Economy Trap

Reconstruction authorities must be cognizant of the tradeoff between democratic goals and economic outcomes in the early stages of reconstruction. The focus must be shifted away from the idealized view of democracy and towards finding ways to implement effective constraints on political decision makers to ensure that economic reconstruction efforts are not in conflict with political endeavors. Recognizing the endogeneity of political outcomes, economic outcomes, and institutions is crucial for those engaging in reconstruction efforts in order to understand how reforms in one sector may influence another. Additionally, recognizing, understanding, and appreciating the status quo and the associated constraints in post-conflict regions will provide a sounder foundation from which to implement policies. While attempting to map out the possible outcomes from engaging in a particular political or economic reform provides a conceptual understanding of the possible unintended consequences of reconstruction policies, it is wise to acknowledge the limits of human abilities as per the fatal conceit trap discussed above (Section 3).

It is important for reconstruction authorities to recognize that some policy priorities are fundamentally incompatible. For instance, Okun (1975) has described the classic tradeoff between economic efficiency and equity, which in the context of reconstruction implies that if donors slightly weigh one priority over another, this may significantly shift this tradeoff in a

particular direction, for better or worse. Appreciating the compatibility, or lack thereof, of political and economic priorities will lead to better informed policies.

Given the democracy-economic tradeoff, one possible strategy for overcoming the political economy trap is to prioritize political reconstruction over economic reconstruction or vice versa. For instance, del Castillo (2008: 41) argues that “should a conflict arise between peace (political) and development (economic) objectives, the first one should be paramount at all times. Because peace is a precondition for sustainable development, all actors should recognize and accept that political priorities will often constrain economic policymaking.” It should be realized that this approach places limits on the scale and scope of economic reconstruction efforts and implies that large-scale, first-best economic reforms are unlikely since they are more likely to conflict with political objectives. Alternatively, reconstruction authorities could take into account the policy recommendations of Hausman, Rodrik, and Velasco (2005) regarding optimal reform priorities. According to their analysis, reformers should implement policy reforms to those social and economic distortions that have the largest direct effects on individual welfare (i.e. the most binding constraints on economic growth). Of course, carrying out such diagnostics must appreciate the knowledge constraints discussed earlier.

5. The Bureaucracy Trap

There are appreciable limits to the capacity for reconstruction goals implemented through bureaucratic channels to result in complete economic reconstruction in post-conflict countries. Indeed, there have been scathing critiques of bureaucracies over their lack of effective planning and cross-coordination in economic reconstruction efforts, as well as reports of rampant corruption, waste, nepotism, and inefficiency. For example, Stephens and Ottaway (2005) have

documented the progress of a program to construct Afghan schools and health clinics, finding that the program suffered from a lack of coordination and poor planning due in part to the desire to have something completed before the 2004 Afghan presidential elections. These inherent inefficiencies have led to continued calls for “improved coordination” and “better planning” on the part of government bureaus. For instance, the U.S. Army’s stability operations field manual (2008: 1-3) calls for ‘unity of effort’ among the array of actors involved in a stability operation, including the “synchronization, coordination, and/or integration of the activities of governmental and nongovernmental entities with military operations to achieve unity of effort.” However, this focus on ‘streamlining’ bureaucracies places disproportionate emphasis on the role of bureaucracy in reconstruction efforts while neglecting the key role played by ordinary citizens acting in an entrepreneurial manner to solve the problems facing post-conflict societies. The *bureaucracy trap* emerges when there is an overreliance on bureaucracies in economic reconstruction efforts. Avoiding this trap therefore involves an understanding of the industrial organization of bureaucracies, including the incentives and constraints faced by bureaucrats who hold non-elected positions in government, as well as an appreciation for the capacity for ‘searchers’ to coordinate scarce resources and find solutions to problems in war-torn societies.³

5.1 The Industrial Organization of Bureaucracy

Government agencies engaged in economic reconstruction efforts receive their budgets from an array of government actors. Budgets are allocated based on relationships with these actors, as well as on the logistical and compensatory needs of each bureau. Yet financial resources are

³ There are an array of bureaucracies involved in post-conflict economic reconstruction including government agencies, IGOs and NGOs. Although our analysis could be applied to any of these organizations, we limit our focus to government agencies since they are typically the largest bureaucracies involved in post-conflict reconstruction and usually play the largest role in terms of planning, implementation and oversight of reconstruction plans.

scarce and each bureau is therefore competing with other agencies over a limited budget. The incentives created by this process result in predictable behaviors among those working in these bureaucracies and these behaviors influence the process of economic reconstruction in a number of ways.

First, bureaus involved in reconstruction efforts will attempt to receive the largest possible share of financial resources and the associated influence over reconstruction efforts. This typically involves investing resources in signaling the relative importance of one bureau over others. Second, this intrinsically creates an important tension in reconstruction efforts: agencies should be united in the common goals of reconstruction (e.g. security, amelioration of poverty, infrastructural development, etc.) yet they are instead competing with one another for funds and power. This often leads to efforts to develop a specialization that differentiates one agency from the others in order to receive a larger part of the fixed budget. Each bureau has its own agenda, which may clash with the agendas of other agencies as well as with the overarching goal of successful economic reconstruction. Third, bureaus will tend to exhaust their entire budgets while continually seeking financial appropriations in order to increase the size and scope of the agency. The failure of a bureau to spend its allocated budget typically leads to budget reductions in subsequent years. This creates the incentive to ensure that budgets are exhausted even if wasteful expenditures are necessary to achieve this outcome. This inherently runs counter to ensuring that reconstruction costs are minimized while the benefits to the citizens of post-conflict countries are maximized. This waste is magnified by the lack of adequate feedback mechanisms in bureaucratic settings making it difficult for bureaucrats to accurately gauge the effective allocation, and reallocation, of resources to high-return uses (Mises, 1983). Lastly, bureaucracies are typically judged on the basis of readily observable outputs which do not

necessarily coincide with the goals of long-run economic reconstruction and development (Easterly, 2003). For example, focusing on hospitals and schools constructed or GDP growth as indicators of success means little if this infrastructure cannot be used by citizens because of a lack of security or lack of qualified staff.

These four factors have had substantial impacts on reconstruction efforts in Iraq and Afghanistan. For instance, infighting for control over Iraq reconstruction policy between the U.S. Department of Defense and the U.S. State Department became quite acrimonious (Phillips, 2005: 7). Diamond (2005: 28-9) claims that “a number of U.S. government agencies had a variety of visions of how political authority would be reestablished in Iraq. In the bitter, relentless infighting among U.S. government agencies in advance of the war, none of these preferences clearly prevailed.”

Yet another factor affecting the capacity for bureaucracies to effectively engage in economic reconstruction is decision making and the flow of information within these organizational structures. Bureaucratic rules tend to be rigid in nature which often prevents flexibility to rapidly changing conditions. This poses a problem for economic reconstruction which typically takes place in the context of uncertainty and constant change. As Rondinelli (2004: 12) explains, “Many of the decisions about how to promote the development of Afghanistan are likely to be made rapidly, reactively, and in response to uncertain and ever-changing political forces. Careful deliberation is likely to be in short supply in the face of rapidly changing political trends and complex social and cultural conditions in Afghanistan.”

In addition to rigid rules, bureaucratic hierarchies face the challenge of long information chains from lower levels to higher levels. The longer the information chain, the more likely that ‘noise’ will be introduced into the process of information transmission decreasing the likelihood

that bureaucrats at higher levels will receive the necessary information. This implies that higher-level bureaucrats will often necessarily make decisions with partial and abstract information. In the absence of appropriate feedback mechanisms, bureaucratic decisions based on partial information can generate perverse outcomes with a slow process of resource reallocation.

To provide a concrete example of this logic, consider the reconstruction of Iraq where bureaucratic waste and inefficiency have been magnified as a result of the absence of effective feedback and accountability mechanisms (Glanz, 2006). Specifically, consider the \$644 million “Community Stabilization Program” (CSP) in Iraq, which was suspended due to significant fraud and waste. An audit by the USAID’s Inspector General found that some of the funds allocated specifically for weakening the insurgency actually went to insurgents, as well as to corrupt community leaders and CSP representatives (USAID Office of the Inspector General, 2008: 8). Disturbingly, the U.S. appears to have been providing funding to the very insurgents it intended to fight.

5.2 Strategies for Avoiding the Bureaucracy Trap

Myopic focus on improving coordination and planning within and between bureaus ignores the constraints on what bureaucracies can actually achieve in post-conflict situations. Coordination is a necessary but insufficient condition for successful economic reconstruction because real constraints exist on bureaucratic activity no matter what the level of coordination. Perhaps more importantly, this focus puts unrealistic faith in increased bureaucratic central planning, which is the very antithesis of the free markets that reconstruction authorities seek to engender through economic reconstruction.

As long as economic reconstruction takes place, the involvement of an array of bureaus is unavoidable. However, the logic of the bureaucracy trap indicates that overreliance on these bureaus can stifle reconstruction efforts. The main concern is that the central planning associated with bureaucracy results in the systematic disregard for the capacity of ordinary citizens and ‘searchers’ to act entrepreneurially to find solutions for the problems of economic reconstruction.

For instance, Lyons (2009) finds that owner-driven solutions for post-disaster housing in Sri Lanka outperform donor-led programs on a number of performance measures. Further, the owner-driven approach “fostered the (re)development of a cooperative local social fabric that institutions achieved only exceptionally in the [Donor Assisted Program (DAP)] and, as a process, met a range of human rights needs generally neglected by DAP” (Lyons, 2009: 395; Kalin, 2005). Another example of the power of private initiative is the mobile phone industry in Iraq (*The Economist*, 2009). With 20 million subscribers in a country of 27 million citizens, mobile phones have become a tool of commerce and have allowed for greater interpersonal communication. The U.S. Army (2008: 1-18) also finds that following conflict or major disaster, “Commerce—both legitimate and illicit—previously inhibited by circumstances emerges quickly to fill market voids and entrepreneurial opportunities.”⁴ While many reconstruction activities must inherently be dealt with through bureaucratic channels, it is critical to realize the limits of bureaucratic activity and the importance of private initiative for sustainable economic recovery.

⁴ Yet the U.S. Army (2008: 3-15) still maintains a planner mentality even at the local level. For instance, it is posited that the local economy requires stimulus to “sustain economic generation and enterprise creation.” Local economic development efforts include “efforts to execute contracting duties; identify, prioritize, and manage local projects; and implement employment programs...this assessment of the economic sector must include developing knowledge and understanding of local pay scales; this is essential to establishing jobs programs with appropriately wages. Inflated pay scales may divert critical professionals from their chosen field in pursuit of short-term financial gains from new jobs created by the force.” Hence the setting of market wages in the context of security may be necessary for competing with insurgents in the labor market, but as far as economic reconstruction is concerned, reconstruction authorities have no way of weighing the relative values of different labor usages without a reliance on emergent labor market prices (i.e. wages).

6. Concluding Remarks

The existing literature on economic reconstruction has focused on identifying the challenges of reconstruction as well as the design of first-best policies to address these issues. The missing gap in this literature is a focus on the ability of reconstruction authorities to effectively design and implement policies to address reconstruction challenges. To fill this gap, we have identified four reconstruction traps that result from the incentives and constraints facing reconstruction authorities. The failure to appreciate these traps has significant implications for economic reconstruction efforts.

The overarching implication of our analysis is that there are significant constraints on what reconstruction authorities can accomplish in economic reconstruction. The economic reconstruction traps indicate that the first-best, and often the second- and third-best policies, will not be realistic given the incentives and knowledge limitations facing reconstruction authorities. This implication may appear obvious, but as the numerous examples discussed throughout this paper indicate, actual efforts to engage in economic reconstruction tend to neglect these traps and the resulting constraints. The failure to appreciate the traps of economic reconstruction explains many of the failures in the history of reconstruction efforts and implies that a deeper appreciation of the incentives and constraints facing reconstruction authorities is still necessary.

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