



The Mindanao Conflict in the Philippines:  
Roots, Costs, and Potential Peace Dividend

Salvatore Schiavo-Campo  
Mary Judd

CPR

## Summary Findings

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This paper briefly reviews the historical roots and the current status of the conflict and peace negotiations in Mindanao. By far the heaviest costs of the conflict to the Bangsamoro people and the Lumads, to Mindanao, and to the Philippines as a whole have been qualitative and dynamic. The paper provides a quantitative assessment of the direct economic costs of conflict estimated in traditional comparative statics terms as a base on which to add the more dynamic and less quantifiable costs.

The paper finds that the direct costs of the conflict have been substantial but only at the local level, with a comparatively small impact on the rest of Mindanao and the country as a whole. While bearing in mind the severe methodological limitations, the paper estimates the direct output loss from the conflict during 1970-2001 in the range of \$2-3 billion, which is low compared to estimates for other civil conflicts.

The costs are much higher, although difficult to quantify, when the authors add human and social costs (e.g., deaths and injuries, displacement, increased poverty and increases in criminality), indirect economic costs (e.g., decreased agricultural

productivity, deterioration in the investment climate), and governance and social costs (weakening in security and the rule of law, disruptions to social services).

The authors argue that the potential peace dividend is high, especially in terms of improved governance, lower spending on security, improvements in fiscal outcomes and investment climate, recovery and exploitation of Mindanao's considerable hydropower and tourism potentials, and improved access to services, especially by the poor. They suggest that whether these dividends materialize will depend critically on the adoption an inclusive approach in post-conflict reconstruction, breaking the vicious cycle of weak-capacity-low autonomy-weak capacity, and attention to environmental and social risks.

The paper also includes an Annex discussing three cross-country studies of the output effects of civil wars which were applied to available data on the Mindanao conflict to estimate the overall economic costs for the Philippines. The authors also provide a brief comparison with economic costs for the conflict in Sri Lanka.

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Salvatore Schiavo-Campo

Mary Judd

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## Acronyms

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ARMM	Autonomous Region in Muslim Mindanao
GDP	Gross Domestic Product
ICOR	Incremental Capital Output Ratio
IDPs	Internally Displaced Persons
JCCCH	Joint Ceasefire Coordinating Committee on the Cessation of Hostilities
MILF	Moro Islamic Liberation Front
MNLF	Moro National Liberation Front
SPCPD	Southern Philippine Council for Peace and Development
SZOPAD	Special Zone for Peace and Development

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Mary Judd  
Mindanao Coordinator  
Manila, January 2005

## Foreword

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This paper summarizes the roots and status of the conflict in Mindanao—the second oldest internal conflict in the world— briefly examines the social costs, estimates the direct economic costs, lists the indirect costs and the dynamic advantages from cessation of the conflicts, and suggests certain key criteria for lasting resolution of the conflict. The overriding conclusion is that such a resolution carries the potential for vast economic and social advantages not only for the conflict-affected areas, but for Mindanao as a whole. Indeed, a sustainable settlement of this persistent conflict could carry a major benefit for the development of the country—largely through the ensuing improvement of the international image of the Philippines as a predictable and peaceable place to do business.

The paper is being issued during the process of joint multi-donor assessment of post-conflict reconstruction needs in Mindanao, led by the World Bank, and aims among other things at providing useful background to assessment team members, the development partner community, and other concerned stakeholders. Accordingly, extensive footnotes and bibliography have been avoided, and only a few references to a number of key sources are included.

Joachim Von Amsberg  
Country Director, Philippines  
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# THE MINDANAO CONFLICT IN THE PHILIPPINES: ROOTS, COSTS, AND POTENTIAL PEACE DIVIDEND

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## INTRODUCTION AND BACKGROUND

### Historical Roots of the Mindanao Conflict

At the southern end of the Philippine archipelago, close to Indonesia and Malaysia, lies Mindanao—a large island about the size of Greece, with a current population of about 18 million. Contact with Mindanao by Muslim traders from today's Indonesia and Malaysia long predated the arrival of the Spaniards in the 16<sup>th</sup> century, and was responsible for the conversion to Islam of the inhabitants, and the formation of the Muslim Sultanates of Maguindanao and Sulu, among others, in the western part of the island. Spain subdued the northern island of Luzon (where Manila is located) and most of the “in-between” islands of the Visayas, converting most of the inhabitants to Catholicism, but never succeeded in controlling Mindanao. Only with the arrival of the Americans at the turn of the 20<sup>th</sup> century, and after the end of the Philippine-American War, was most of the island brought under central control, although hostility and conflict remained endemic.

Thus, persisting for some five centuries, the Mindanao conflict is the second-oldest on earth, after the conflict between North and South Sudan (which can be dated back to the 10<sup>th</sup> century, or much earlier if one includes the continual strife between Egyptians and Nubians in Pharaonic times). The Philippines was comparatively calm for a period after independence in 1946, but conflict flared up again in the late 1960s as growing numbers of Christians settled in Mindanao. Settlers arrived particularly from Central Luzon and Panay Island in the Visayas. The resettlement was fostered by deliberate policy of the central government, in Manila, and eventually resulted in Mindanao having a Christian majority overall, with Muslim-majority areas concentrated in the central and southwestern regions.<sup>1</sup>

### The Conflict in Contemporary Times

The conflict in Mindanao has been only one of five major conflicts in the Philippines since independence.<sup>2</sup> It has largely been concentrated in the Muslim-majority areas of central and southwestern Mindanao, which consists of three of today's administrative regions (Region IX—Western Mindanao; Region XII—Central Mindanao; and the Autonomous Region in Muslim Mindanao, or ARMM) and of four provinces in Region XI—Southern Mindanao (Davao del Sur; Sarangani; South Cotabato; and Sultan Kudarat).

Resistance to central control and resentment at the increasing number of Christian settlers, as well as the logging and mining activities, which had become important sources of export earnings, was at first organized under the aegis of the Moro National Liberation Front (MNLF),<sup>3</sup> formed in the late 1960s and until the 1990s largely accepted as representing the interests of Mindanao's Muslim population. Despite the formation of ARMM in 1989 and the formal acceptance of the 1996 peace accord between the Government and the MNLF, the armed

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<sup>1</sup> Among the many treatments of the Mindanao conflict, see Soliman M. Santos Jr., *The Moro Islamic Challenge: Constitutional Rethinking for the Mindanao Peace Process*, (University of the Philippines Press, Diliman, 2001); and Eliseo R. Mercado Jr., *Mindanao Peace Process: Some Historical Notes*, available: <http://www.philippineupdate.com/fjun.htm>

<sup>2</sup> The most intense conflict was the Huk Rebellion, shortly after World War II, to suppress a left-leaning movement of disenfranchised peasants and others formerly active in the resistance against the Japanese occupiers during World War II. A separate conflict against the New People's Army, a Communist-leaning group with a variable agenda, began shortly thereafter, intensified as resistance to the Marcos dictatorship, and has continued to this day, sporadically but with occasional spikes. As noted, the conflict in Mindanao is the one with the longest historical roots.

<sup>3</sup> “Moro” was the Spaniards' term for Muslim Filipinos, by analogy with the name used to refer to Muslim Arabs in southern Spain and northern Africa. The term has been adopted by the local people and is not considered derogatory.

conflict continued. The Moro Islamic Liberation Front (MILF) emerged as the Government's main opponent. The MILF, as the name suggests, is more religion-oriented than the nationalistic-oriented MNLF, but is in no way comparable in attitudes or practices to Islamic fundamentalist organizations elsewhere in East Asia. The Moros have benefited from the support of the Organization of Islamic Conferences, and have maintained close relations with Muslims in Indonesia and Malaysia. However, MILF relations with the small terrorist (and largely criminal) group Abu Sayyaf and the Indonesia-based Jemaah Islamiyah have been sporadic and loose, and in the context of the on-going peace discussions the MILF has distanced itself completely from those organizations.<sup>4</sup>

Overall, although religious differences have partly shaped the conflict, the roots of the conflict have been the clash of interests in land and other natural resources, and the identity issues emerging from the *de facto* second-class status of much of the Moro population. Complicating the picture, a number of non-Malay indigenous peoples (collectively referred to as "Lumads") have historically been pushed aside in turn by Spanish and American colonizers, Christian settlers, and the Moros themselves. They were first displaced from the lowlands to the highlands (mainly in the Cotabato-Sarangani area); then put under pressure from the outsiders' rush to exploit the timber and the gold of the highlands; and today are viewed as inferior (including by the Moros themselves), and lack a role and a voice in the peace negotiations. Yet, loosely paralleling the situation in the Amazon basin, the involvement of indigenous people in the peace process and their active cooperation with its implementation will be important not only in itself and for a lasting political solution, but also for a healthy environmental protection strategy.

As inevitable in a brief summary, the situation on the ground is more complex than indicated here. There are three major complicating factors. The first is the vast difference in economic interests among Christians themselves between the economic and commercial elite and the majority of Christians. The other two are more directly relevant to the violence. Chronic conflict among different "clans" (sometimes erroneously referred to as "tribes") within the Muslim population, generates some part of the violence and sporadic flare-ups—often drawing in military reaction. Also, ordinary but widespread banditry confuses both the origin of violent attacks, extortion and kidnapping and the often indiscriminate response of the Philippine military. To some extent, the internecine conflict among Muslim "clans" have been suppressed or hidden by the nationalist-religious organized rebellion, and the existence of a common "outside" opponent. To that extent, therefore, peace might allow them to bubble up to the surface, and a significant qualifier should be appended to the probability of realization of the dynamic benefits and potential peace dividends listed later in this paper. On the other side of the ledger, however, peace would also contribute to restoring law and order and improving overall security in central and southwestern Mindanao.

### **Current Situation and Status of Peace Negotiations**

Successive Philippine political administrations starting from then President Ferdinand Marcos have attempted to forge a negotiated peace settlement of the conflict with the Moro rebels realizing that a purely military solution to the problem was not feasible. At the height of the MNLF rebellion in the 1970s, the Marcos regime sought the intercession of Libya in the signing of the 1976 Tripoli Agreement with the MNLF. The accord provided for an immediate cessation of armed hostilities between the two parties and established the framework for an autonomous region for the Muslims in Mindanao. However, the provision on autonomy was not implemented by Marcos because it meant carving out 13 provinces from Mindanao to constitute the autonomous region. It was not until President Corazon Aquino came into power in 1986 that this provision was fulfilled, but with the crucial condition that it should follow the Constitutional process of holding a plebiscite to determine which among the provinces specified in the Tripoli Agreement would opt to become part of the autonomous region. Expectedly, only 4 of the 13 provinces, where the Muslims are a majority, decided to join the autonomous region. The MNLF

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<sup>4</sup> For a detailed analysis of the relations between the Moros and Muslims in Indonesia and Malaysia, see *Islamic Neighbors*, by Marites Dañguilan Vitug, and *Under the Crescent Moon: Rebellion in Mindanao*, by Marites Vitug and Glenda M. Gloria, pp. 162-189. For the relations between the Moros and the Arab world, see in particular *The Broker*, *ibid.*, pp. 60-73.

accused the government of violating the Tripoli Agreement and continued its armed struggle, although on a much smaller scale due to its, by then, waning influence.

President Fidel Ramos continued the policy of his predecessor and met success with his peace initiative when the MNLF leadership, under Chairman Nur Misuari, signed a peace accord with the government in September 1996. The Agreement provided for the establishment of an interim institution called the Southern Philippine Council for Peace and Development (SPCPD), to be headed by Chairman Misuari, which would be responsible for supervising and coordinating development projects in an area designated as the Special Zone for Peace and Development (SZOPAD). SZOPAD covered all the provinces specified in the Tripoli Agreement. After three years, a plebiscite would again be conducted asking the provinces in the SZOPAD whether they would like to join the “expanded” autonomous region for the Muslims. However, due in part to the disappointing performance of the SPCPD, only one additional province and one additional city joined the autonomous region—leaving the problem to fester in the other provinces.

By the time of President Joseph Estrada’s election in 1998, the threat was no longer emanating from the MNLF as most of its leading officials had the joined government or were elected local government officials with tacit support from the central administration. The new challenge was emanating from the MILF, a breakaway group from the MNLF, headed by Hashim Salamat and operating largely in Central Mindanao. With little understanding of the peace initiatives of his predecessors, and in response to alleged atrocities committed by the MILF, President Estrada declared an “all-out war policy” in April 2000 and mobilized a large military contingent to capture several MILF camps, including its main headquarters in Camp Abubakar. Although the assault was successful on the surface, it failed to crush the MILF which chose to avoid direct confrontation by splintering into smaller groups and hiding in the remote areas of the region.

In contrast, the administration of President Gloria Macapagal-Arroyo initially declared an “all-out-peace” policy toward the MILF but was forced to temporarily abandon it when the military launched another assault of MILF-controlled territories in February 2003 in pursuit of “criminal elements” operating there. By the middle of that year, peace was again restored when the new and more pragmatic leadership of the MILF under Chairman Murad Ebrahim, who succeeded the late Hashim Salamat, forged a ceasefire agreement with the government. Exploratory talks between representatives of the government and the MILF were immediately held under the auspices of the Malaysian government. The Government-MILF Joint Ceasefire Coordinating Committee on the Cessation of Hostilities (JCCCH) was tasked to monitor any violation of the ceasefire agreement. It was also agreed during the exploratory talks to welcome an International Monitoring Team, led by Malaysia, to complement the work of the JCCCH and strengthen the peace process at the ground level. The formal peace talks are expected to resume soon. At their center, as in the past, will be the strong desire of the Moros for a geographical area where they can promote their culture, religion and way of life.

## **DIRECT ECONOMIC COSTS OF CONFLICT: A COMPARATIVE STATICS APPROACH<sup>5</sup>**

By far the heaviest costs of the Mindanao conflict to the Bangsamoro<sup>6</sup> people and the Lumads, Mindanao as a whole, and the Philippines itself, have been qualitative and dynamic, and will be the bulk of the “peace dividend” from a just and sustainable agreement. These topics will be examined in the next section. It is appropriate, however, to begin with a quantitative assessment of the direct economic costs of conflict estimated in traditional

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<sup>5</sup> This section is based largely on an earlier paper by Edgardo Barandiaran, written for internal use of the Philippines Country Office of the Bank. The details of the analysis, the tables, and the paper itself are available upon request.

<sup>6</sup> Bangsamoro is the name of the area claimed by the Moro Islamic Liberation Front (MILF), and covers the islands of Mindanao, the Sulu Archipelago, and Palawan. Bangsamoro also refers to the Filipino Muslim people, in general. These included the Tausug and the Maguindanaons.

comparative statics manner, in order to provide a “floor” estimate to which can be added the indirect dynamic benefits of cessation of the conflict—much larger but less quantifiable.

## Methodology

The direct economic cost of conflict can be defined as loss of output from some initial equilibrium condition. Certain limitations and caveats should be noted at the outset. Most obviously, the approach does not take into explicit account the damages to the personal welfare of residents—human losses, destruction of their surroundings, pain and suffering, increased uncertainty, etc. Also, the valuation of lost output itself rests on imperfect data on prices (themselves an unreliable measure of scarcity value in conflict situations). Finally, the welfare losses from lost output differ widely depending on the income and personal circumstances of those who bear the cost.

The methodology to assess the direct cost of a conflict rests on the assumption that the before-conflict allocation of the area’s resources is efficient and that the conflict disrupts this equilibrium—mainly by diversion or destruction of these resources. The short-run output losses thus arise from the diversion, depletion, and destruction of the initial resource base; and the longer-run losses are determined mainly by the speed at which the pre-conflict growth path is regained, by reallocating the resources to their initial uses. Such changes in resource allocation, however, even if fully reversed at a later time, entail deadweight and unrecoverable losses. Accordingly, the state of the economy of central and southwestern Mindanao at the beginning of the conflict was assessed first, and then an attempt was made to determine the extent to which resources were diverted, depleted, and destroyed—focusing on those contemporary periods when the conflict was particularly intense (1975–82 and 1997–2001). Since the statistics available are not adequate to directly assess output losses in central and southwestern Mindanao or to construct aggregate measures of the resource base, the analysis had to rely on partial indicators of some resources and outputs.<sup>7</sup> Moreover, it is impossible to separate out the impact of other events, e.g., the negative impact of the El Niño phenomenon in 1997–98, yet another reason why the estimate of direct conflict costs presented below must be viewed with great caution.

In addition, there may be spillovers to other areas in the country; some positive (e.g., migration of skilled labor out of the conflict area), most negative—arising from adjustments in the behavior of residents and non-residents that lead to losses of output outside the conflict area. To identify negative spillovers to other regions of the country, the methodology is applied to regional GDP accounts that have been available since 1975. Such spillover effects outside central and southwestern Mindanao are shown to have been comparatively minor until recently—but have become much more important after September 11, 2001, as will be discussed later. Finally, while the cost of conflict, not surprisingly, varies with its intensity, experience shows that the dynamics of most civil conflicts are unaffected by the magnitude of their cost in terms of lost output.<sup>8</sup>

## Direct Economic Costs of the Conflict

The application of the methodology outlined above suggests that the direct cost of the conflict has been substantial but only at the local level, with a comparatively small impact on the rest of Mindanao and the Philippines—again, in narrow terms of direct output losses. As noted, the output losses have been correlated with

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<sup>7</sup> The analysis was also carried out with reference to cross-country studies and two country case studies—summarized in the Appendix.

<sup>8</sup> Following the approach of James Murdoch and Todd Sandler (*Economic Growth, Civil Wars, and Spatial Spillovers*, unpublished paper, July 2001), a cross-region analysis of the Mindanao conflict was carried out to identify the effects of the conflict on the steady-state level of per capita output, the long-run growth rate and the short-run growth rate of per capita output, based on various assumptions—of necessity arbitrary owing to lack of data. It is possible that using the partial but much more reliable data on agricultural production—which is the bulk of economic activity in southwestern Mindanao - could have produced clearer and less variable estimates.

the intensity of the conflict, and were thus substantial during the major conflict periods of 1975–82 and 1997–2002 and small during the period of low tension—1983–96. On average, the annual economic cost of the war in 1975–82 was around one percent of GDP for central and southwestern Mindanao, and one half of one percent for the Philippines—or a total of about \$200 million. The absolute cost estimate is about the same for 1997–2001. The severe limits of the methodology and of the available data allow only a broad range of cost estimates. Assuming a much lower direct economic conflict cost during the “low-intensity” conflict years 1983–96, and using a discount rate of 7.5%, the direct output loss from the Mindanao conflict during 1970–2001 can be roughly estimated at between \$2 and \$3 billion.<sup>9</sup>

In relation to other civil conflicts, the direct cost of the Mindanao conflict appears to be low. One must stress that the above estimate is a floor, and that by far the largest part of the economic damage to Mindanao and the Philippines arises from the indirect economic costs and the social costs, examined in the next section. However, there are reasons why the narrowly defined direct economic cost has been comparatively limited in Mindanao:

- Until 2002, the active conflict, and thus the direct output loss, has been largely ring-fenced within southwestern Mindanao, where per-capita output was much lower than the country’s average to begin with.
- Similarly, the damage to the capital base and infrastructure of southwestern Mindanao was limited because of the very low initial stock of those resources—an outgrowth of the centuries-long neglect of the area.
- Although the number of casualties (estimated at about 120,000 over the two decades) and the human cost have been high, the parties to the conflict have rarely mobilized large resources to fight for their positions, and the diversion and destruction of resources was not as large as the substantial human cost would suggest.

### **OVERALL COSTS OF CONFLICT: A DYNAMIC APPROACH AND THE “PEACE DIVIDEND”**

Although the indirect economic costs and the social damage from the conflict cannot be quantified with any precision, they certainly dwarf the \$2–3 billion in direct economic costs. They are listed and briefly explained as follows.

#### **Human and Social Costs**

The heavy human and social toll of the conflict includes, only since the 1970s:

- An estimated 120,000 deaths, and uncounted numbers of wounded and disabled;
- Displacement of more than two million people, of whom almost half in 2000 alone, during President Estrada’s “all-out-war”;
- The emergence of “Muslim ghettos” in various cities in Mindanao and elsewhere in the country made up of displaced persons and individuals forced out of their areas of residence owing to the disappearance of employment opportunities caused by the conflict;
- The exodus of illegal Muslim migrants to the neighboring state of Sabah, Malaysia. The recent crackdown by the Malaysian authorities as part of their anti-terrorist campaign resulted in en-masse deportation, and ensuing social and economic problems in their communities of origin;

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<sup>9</sup> An argument has been made that the Mindanao conflict is “never-ending” because both Christians and Muslims attach high independent value to political dominance. This is most probably true of certain individuals and fringe groups. The evidence on the ground, however, indicates strongly that the main organized groups attach far greater importance to autonomy than to “dominance” within a localized conflict area. The population at large, certainly, yearns for peace above all else.

- Increased incidence of poverty—already the highest in the country—from 56% in 1991 to 62.5% in 1997 and 71.3% in 2000. (Fourteen of the 20 poorest provinces in the Philippines are found in Mindanao);
- Rampant kidnap-for-ransom activities and other crimes against persons and property, as a result of the bad security situation directly related to the conflict; and, for the same reason
- Trafficking of illegal drugs and the criminal activities spawned by substance abuse have become a major law and order problem in the area – historically free of these problems.

### Indirect Economic Costs

The most important of the indirect economic costs is investment deflection—not only from the conflict-affected areas, but from Mindanao as a whole and, to some extent, the Philippines itself. There is anecdotal but persuasive evidence from the international investment banking community that the “troubles” in the island have adversely affected the image of the country as an investor-friendly venue. This is consistent with the evidence provided by Paul Collier,<sup>10</sup> to the effect that capital flight is a main result of civil conflict, with capital repatriation following a settlement of the conflict. In the case of Mindanao, however, such capital flight (limited by the low level of the initial capital) has been compounded by a failure to attract the equity investment that could be expected based on the area’s location and factor endowments—investment which was deflected to other areas in East and Southeast Asia.

Related to the above is the impact of insecurity on agricultural production and productivity. Conflict and uncertainty (i) create community-level responses that inhibit agricultural investment—from the establishment of tree farms to irrigation improvements, and (ii) disintegrate agricultural marketing, thus reducing the profitability of current crop production. Binswanger and Rosenzweig,<sup>11</sup> demonstrated how the need to cope with risk (weather risks in their case) lead poor farmers to forego otherwise profitable investments. This is an added reason why the estimate of the direct costs of conflict based on allocative input changes from a presumptive optimum equilibrium and within a constant-coefficient production function must be seen as merely a starting point. Even limiting the notion of costs to the purely economic component, consideration of the indirect impact of conflict on investment deflection and agricultural productivity could conservatively raise the overall economic cost of the Mindanao conflict to well over \$10 billion during 1975–2002. But, of course, the strictly economic costs are only a part of the overall damage from civil conflict.

### Governance, Social and Institutional Costs

Security has never been fully adequate in Mindanao, and the intensification of the civil conflict since 1975 has compounded the problem. The rule of law—an essential ingredient of good governance and development—has been especially weak in the area. Some advances had been made, particularly in the progressive recognition of customary law and its integration with formal legal and judicial systems. The resurgence of the conflict short-circuited this progress. Moreover, lack of security has created an incentive for many to join groups of *vigilantes*, producing the negative externalities typically associated with private provision of security without effective public oversight. In addition to better law enforcement, strengthening of the rule of law in central and southwestern Mindanao will also call for recognizing in practice the need for co-existence of different legal traditions—Islam-

<sup>10</sup> “On the Economic Consequences of Civil War,” *Oxford Economic Papers*, 51, 1999.

<sup>11</sup> Hans Binswanger and Mark Rozensweig, “Wealth, Weather Risk and the Composition and Profitability of Agricultural Investments.” *WPS 1055*, World Bank, 1992.

based and “western”—and enabling a judicious mix of customary judicial systems with formal courts. In turn, this can only become possible if the civil conflict stops and security is restored for everyone concerned.<sup>12</sup>

The social costs include, as in almost all other civil conflicts, disruption of the education and health systems, as well as reduced access by users, and the multitude of problems experienced by internally displaced persons (IDPs). The consequences for both short-term welfare and long-term development prospects are severe, as shown in a recent study by Ghobarah and Russett, among others.<sup>13</sup> The impact of the conflict, again as in other cases, appears to have been especially heavy on the poor. A large proportion of the population in the conflict-affected areas of Mindanao live below the poverty line (estimated at between two-fifths and two-thirds); some of the poorest provinces in the Philippines are located in these areas; and there is some evidence that the majority of the IDPs are subsistence farmers and their families.<sup>14</sup>

### **Potential Peace Dividend**

While substantial spillover effects of the Mindanao conflict were not evident from the analysis of the 1975–2001 period, they came to the fore with a vengeance after September 11, 2001—and not just Mindanao. In addition to major terrorist actions on the large Christian-majority cities of Davao and Zamboanga, a bombing of Manila’s best-known shopping mall and various other attacks made it clear to all concerned in Mindanao and the Philippines that a lasting settlement of the conflict with the Moro Islamic Liberation Front has become a prerequisite for both economic prosperity and the suppression of the fringe terrorist groups. In addition to stopping the human losses and suffering, peace would open the door to a number of measures with substantial benefits—some speculative, most impossible to quantify, but all probable to some degree.

On the institutional and governance front, lasting security and peace in the area cannot be achieved unless the fringe terrorist groups are demolished or severely degraded. On the other hand, there is a risk of military over reaction that could antagonize the civilian population. Peace would allow a clear line to be drawn between the measured and targeted use of force against these groups in central and southwestern Mindanao, and excessive or illegitimate force by either the Philippine military or loosely-regulated paramilitary groups. A well-designed program of disarmament/demobilization/reintegration, accompanied by a broader program of assistance for reconstruction and development, can play a major role in helping draw this line, while providing alternative economic opportunities for potential terrorist recruits.<sup>15</sup> In this scenario, a sustainable and comprehensive peace agreement could open the door to a gradual but massive institutional modernization in central and southwestern Mindanao and the rest of the island. And, considering that the Mindanao conflict has repeatedly been used by authoritarian elements in successive Manila governments as an alibi for malfeasance, oppression, and corruption, it is not far-fetched to speculate that lasting peace could also have a significant indirect impact on the quality of governance and public accountability in the Philippines as a whole.

On the economic front, a variety of likely benefits can accrue to Mindanao and the country from a lasting resolution of the conflict, namely:

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<sup>12</sup> In the Autonomous Region in Muslim Mindanao the role of Sharia Courts has been significantly expanded, through Act 9054 of 31 March 2001, and operationalized even to the point of defining the specific sources for interpretation of Islamic law (see section 23, Article VIII).

<sup>13</sup> “Civil Wars Kill and Maim People—Long after the Shooting Stops,” *American Political Science Review* 97 (2), 2003.

<sup>14</sup> Reliable data do not exist, and research on the possible reduction in poverty rates resulting from cessation of the conflict is yet to be carried out, perhaps using the methodology elaborated by Arsenio Balisacan. 2001. “Poverty Comparison in the Philippines: Is What we Know about the Poor Robust?” Paper delivered at the Asia Pacific Forum on Poverty: Reforming Policies and Institutions for Poverty Reduction. Manila: Asian Development Bank.

<sup>15</sup> It is very helpful in this regard that the Constitution of the Philippines prescribes a special political process to define a group as a “terrorist” organization, against which military force may be justified and appropriate.

- the positive impact on foreign equity inflows into Mindanao and elsewhere from an improvement in the image of the island and the country, and greater political and social stability;
- a beneficial influence on innovation and productivity, especially in agriculture, from the reduction of uncertainty;
- an improvement in overall fiscal prospects of the Philippines, as well as in the quality of expenditure, from the decline in military spending that a settlement of the conflict would permit;
- the positive effect of a well-coordinated reconstruction and development program on the coherence of public investment in Mindanao and the Philippines in general, and hence an increase in aggregate investment efficiency, improvement in aid effectiveness, a lower ICOR (Incremental Capital Output Ratio) and, other things being equal, either faster growth or better fiscal balance, or both;
- a likely reduction in the international interest rate spread on Philippine Government paper, both from the greater political and social stability, and from the improvement in fiscal outturn and the efficiency of public expenditure;
- realization of Mindanao's potential comparative advantage in the export of such crops as corn and poultry (arising from reduced transport costs due to improved security), particularly in light of the proximity and demonstrated complementarities between Mindanao and neighboring countries;
- exploitation of Mindanao's rich potential for hydropower<sup>16</sup>, important not only for the island, but to link inter-island grids. For example, the Agus hydropower plants have been a source of popular local resistance because they impinged on ancestral lands, and are potential targets of sabotage. A peace settlement that addressed the ancestral lands issue and facilitated suppressing fringe terrorist groups could defuse local hostility to the plants and unleash the island's potential in this area;
- the positive impact on the recovery and development of the tourism industry—so badly damaged by terrorist attacks on some island resorts;
- removal of the extra costs on the private sector of the security measures due to the existence of the conflict, along with an improvement in publicly-provided security based on non-discrimination and the rule of law; and
- greater effectiveness in the provision of basic social services, and improved access, especially for the poor—provided that the mistakes of past interventions are understood and not repeated.

Once again, there can be no assurance that:

- all of these benefits would materialize;
- each would have a large impact; and
- the impact would take place quickly.

However, each of these benefits is grounded in economic reality. There is a consensus of informed opinion that a durable settlement of the conflict would engender a veritable parameter shift for the country's economy, and produce a dynamic peace dividend for all parties that could accomplish far more than just halt the severe economic and social damage of the conflict.

## CONCLUSION

The likelihood that the potential peace dividend described above will materialize will depend in large measure on how the peace agreement is reached and implemented. The following may be suggested as guiding criteria for sustainable agreement with the MILF and other concerned parties, and for effective post-conflict assistance:

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<sup>16</sup> Hydropower plants are particularly important for stabilizing grid supplies and dealing with disturbances in the transmission systems, and are attracting keen interest from investors.



- *An inclusive approach* is needed in order to use this opportunity to address in a comprehensive fashion the unresolved issues from the 1996 Peace Agreement with the MNLF, as well as the concerns of non-Muslim and indigenous peoples in the area. Narrowly-targeted assistance might inadvertently lead to new tensions and higher level of conflict in the future. In this spirit, the concerns of the Lumads should be accorded as much respect as the concerns of the Bangsamoro people, and Lumad participation would be appropriate in the peace negotiations. Also, the post-conflict assistance program should cover all of the ARMM and not only the MILF-controlled areas inside and outside ARMM, as well as other conflict-impacted communities in central and southwestern Mindanao. Accordingly, the ARMM government and the MILF representatives should themselves evolve new modalities of cooperation, with a view to collaborative management of the post-conflict assistance;
- *Break the vicious cycle of weak capacity-low autonomy-weak capacity*, by pairing reconstruction aid with genuine capacity building both for the new institutions (e.g., the Bangsamoro Development Agency) and for the ARMM Government, while at the same time providing additional resources equally with demonstrated increases in capacity to use them efficiently and effectively; and
- *Attention to environmental and social risks* is needed in order to prevent the new economic and physical opening of the region created by restoration of security from damaging further the natural environment and the welfare of indigenous people.

Civil conflict always destroys much more than physical plants and infrastructure. The core of the damage is done to the fabric of society, to the stock of social capital. Social capital is essentially trust capital which, unlike physical capital, grows as it is used. Thus, the process of peace negotiations and cooperative implementation of an agreed framework—with the affirmative involvement of the international donor community—could gradually replace the vicious historical circle of dispossession, resistance, and mistrust in Mindanao with a positive dynamic. Experience teaches that regarding long standing civil conflicts, it is always hazardous to be optimistic about the chances of lasting peace, particularly when land and other natural resources are in contention. Realistically, however, there is at this juncture a unique confluence of internal political evolution in the Philippines, conflict fatigue on both sides, and the international political and security concerns emerging after September 11, 2001. This confluence offers a historic opportunity to finally come to terms with the reality of pluralism in the southern Philippines, and reach a final settlement to this second-oldest civil conflict on the planet. The human and economic benefits would be massive—not only for the Moro population of the island and the inhabitants of the directly-affected conflict areas, but also for the Christian majority areas of Mindanao and the Philippines as a whole. In time, the impact of a settlement of the conflict in the Philippines could even extend to other countries in Southeast Asia, through a positive demonstration effect on other civil conflicts (such as Aceh in Indonesia and others), and an improvement in the international image of the region as a whole.

## Annex 1: Selected Studies on the Economic Costs of Other Civil Conflict

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In the past 10 years several studies have attempted to measure the economic cost of civil wars. In this study, some were used to understand better the economic cost of the Mindanao conflict. Three cross-country studies of the output effects of civil wars were applied to available data on the Mindanao conflict to estimate the economic cost for the Philippines. Then a cross-country study of the economic and social costs of civil wars was considered. Finally, two country case studies were reviewed both to highlight similarities and differences with the Mindanao conflict and to see how their methodologies could be applied to the Mindanao conflict.

The three cross-country studies of reference used for the comparative analysis take a neoclassical growth model as their starting point. The applications, however, are quite different and provide insights on the results to be expected from this approach to the economic cost of conflicts. Indeed, all cross-country studies of economic growth are plagued with data problems, aggravated in the study of conflicts because of the proxies needed to measure the intensity, the duration, and the scope of conflicts. The estimates of the economic cost of the Mindanao conflict are the result of applying the estimated models of the three studies. None of the three studies included the Mindanao conflict in their samples.

The study by Murdoch and Sandler focuses on a sample of countries that suffered civil wars and their neighboring countries to identify negative spillovers. They attempt to assess the effects of a conflict on three measures of output growth: per capita output in the steady state (that is, when there is no factor accumulation and all growth can be explained by total factor productivity growth); long-term growth as determined by the transition from some initial level of output to its steady state level; and short-term growth as determined by the change in output in a given time period. In the empirical analysis of that sample for the period 1960–85, they assume that the per capita output level of 1985 is the steady state level and that according to the theoretical model this level can be explained by the accumulation of human and physical capital in 1960–85, the growth rates of technological change and population growth, and the depreciation rates of both stocks of capital. For the analysis of long-term growth, the dependent variable is the difference of the natural logs of output per capita between 1960 and 1985 with the initial level of per capita output a determinant of this rate, and for the analysis of short-term growth, the dependent variable is the difference of the natural logs of output per capita for 5-year intervals (rather than the usual assumption of just one year). In the empirical analysis, the influence of civil wars is taken into account through proxies of their existence, duration, and intensity. In particular, they use data on the starting and ending dates as well as the battle deaths of civil wars.

Collier's study is also based on a neoclassical growth model with an additional equilibrium condition for the return of capital. Collier attempts to provide evidence that capital flight is a main mechanism through which a civil war affects the economy, and therefore after a war it could be expected that capital returns to the country. He studies a sample of countries similar to that of Murdoch and Sandler but he uses the average annual growth rate of total output over ten years as the dependent variable. In addition to the variables indicated by the theoretical model of growth, he measures conflict intensity by the duration of armed conflict during the ten-year period. He also takes into account the effects of short civil wars by adjusting the duration of the conflict during the 10-year period and by constructing proxies for the potential recovery within the 10-year period and for the legacy of the war in the following periods.

The third study, by Imai and Weinstein, may be regarded as an extension of Collier's work, but with some important changes. First, in addition to the effects on investment and the stock of capital, they emphasize the effect on public finances by arguing that civil wars are a reflection of political instability and polarization, and they increase fiscal deficits. Second, in their empirical analysis, they take the average

annual growth rate of per capita output as the dependent variable and increase the number of independent variables by including proxies for country-specific economic and political conditions. Third, they introduce an important difference in the analysis of civil war influences by adding the geographical scope of the conflict measured by an indicator of the spread of conflict within the country (a scale from 1 to 5 is used with 5 meaning that the war has affected more than half of the country).

The estimates of the economic cost of the Mindanao conflict for the Philippines are the result of applying those three models to the available data for the Philippines for the period 1960–85. Leaving aside some issues posed by the poor fit of the three models to the country's GDP growth rates in 1960–85, the data show a large range for the economic cost of the conflict. The variability is due to at least three factors. First, concerning the estimates of the loss in the steady state of per-capita output, the two estimates reflect entirely the effect of using two different measures of conflict intensity. The one using the total number of casualties (120,000 in the case of Mindanao) gives a much lower loss than the one using the total number of months as a proxy for the intensity of the conflict (111 in the case of Mindanao). However, the longer the duration of the war, the more likely the intensity of the conflict will vary greatly. In the case of the Philippines, it is known that there were large variations in the intensity of the conflict over the war period of 111 months, and estimates based on the number of months as a proxy for intensity are likely to overestimate the intensity of the conflict. In addition, the estimate based on the number of casualties is much closer to the evidence reported above.

Second, estimates of the output loss due to lower long-term growth also vary greatly among the three models. The variations are due to the different approaches to the theoretical and empirical analysis. In the case of the Philippines, since it is known that the conflict area was limited to a small part of the country, it appears reasonable to rely on the estimates that follow from the model by Imai and Weinstein.

Third, the estimates of the output loss due to lower short-term growth rates are the result of applying only Murdoch and Sandler's model. The comparison between the short-term loss with the long-term loss shows that most of the long term effect would have been the result of the short-term effect, that is, during the war period and not after it was over in 1982.<sup>17</sup>

Another cross-country study was considered, that of Pottebaum and Kanbur, which looked into the impact of civil wars on social indicators based on a sample of 102 countries over the period 1960–1999.<sup>18</sup> The social indicators are infant mortality rate, life expectancy, literacy rate, and secondary school enrolment ratio, supplemented by real per capita GDP. Based on their analysis, the authors conclude that war is a significant variable in the explanation of three of the social indicators—infant survival, life expectancy, and secondary school enrolment. More important, they conclude that the impact of war on human development is greater in wealthier than in poorer countries.

Leaving aside the many problems with data, Pottebaum and Kanbur consider an economic explanation that may be relevant to the Mindanao conflict. They argue that civil wars destroy public goods, and since richer countries have more public goods, they are more vulnerable to their destruction. In the late 1960s, central and southwestern Mindanao used to have a low availability of public goods (in addition to a low stock of physical capital in the main production sectors). It was argued that in various aspects the development of central and southwestern Mindanao lagged behind the rest of the country, especially in

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<sup>17</sup> Their estimates of lower growth rates refer to multi-year periods, so annual growth rates are calculated in such a way that their compounding over the years of the period is equal to total growth rate for the period. The annual rates are to facilitate comparison with other estimates.

<sup>18</sup> The Philippines is included in the sample. According to the databank they used to describe civil wars, the civil war in the Philippines started in October 1972 and ended on December 1994, so it is counted as a 22-year war.

the provision of public goods. If this idea was correct, then it could be a reason for the finding that the cost of the war was low.

In a recent study of the ethnic conflict in Sri Lanka, the authors analyzed some specific mechanisms through which the conflict would have caused the losses.<sup>19</sup> Instead of focusing on the impact of the conflict on the aggregate levels and growth rates of national output and income, they focused on the diversion of resources caused by the behavior of the parties to the conflict and non-residents (that is, foreigners because it is a national conflict) and on the destruction of resources caused by the action of the parties to the conflict.

Ignoring data problems, the national scope of the conflict in the Sri Lankan case appeared to have been decisive for the large increase in the resources given to the military to fight the war and to maintain security. The authors present evidence that the increase in military expenditures required a diversion of public resources from investment in infrastructure.<sup>20</sup> In the Philippines military expenditures are reported to have remained within the range of one and two percent for the past 35 years, implying that there is little evidence of a diversion of resources toward military spending.

The authors also looked at the destruction of some public infrastructure and human capital and the diversion of resources as a result of foreigners' reaction to the conflict. For Sri Lanka, these costs have been substantial (in terms of dead and injured people, and displaced population, including emigration) compared to the Philippines. In addition, the Sri Lanka conflict destroyed resources in the main urban areas and the attacks often targeted public infrastructure.

In sum, the Mindanao conflict has never imposed the same high cost as estimated for Sri Lanka. The few similarities notwithstanding (in particular the long duration), there are significant differences, including the national scope and the intense violence observed in urban areas with a large resource base.

In a similar study of the economic costs of the ongoing Basque conflict, the authors conclude that the high cost of the conflict appears to be the result of a large diversion of resources by residents as well as by nonresidents.<sup>21</sup> Residents have been investing outside the Basque country and increasingly are emigrating, and tourism by non-Basque Spaniards and foreigners has fallen off substantially.

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<sup>19</sup> See Nisha Arunatilake, Sisira Jayasuriya and Sman Kelegama, "The Economic Cost of the War in Sri Lanka," *Institute of Policy Studies: Macroeconomic Policy and Planning Series* No. 13, Colombo, January 2000. All numerical results presented in the text are from Table 3 of their paper, with the annual losses compounded at the interest rate of 5 percent per year.

<sup>20</sup> The study adds the lost income due to foregone public investment to the cost of the direct government military expenditure. However, there is some double-accounting in this addition because the value of the resources used by the military should be determined by their opportunity cost that in turn is determined by the expected income from public investment.

<sup>21</sup> See Alberto Abadie and Javier Gardeazabal, "The Economic Cost of Conflict: A Case-Control Study for the Basque Country," *NBER Working Paper* 8478, September 2001.

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