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THE TRANSATLANTIC DONOR COMMUNITY NEEDS TO REDESIGN AID FOR FRAGILE STATES

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No Development without Security

The transatlantic donor community needs to redesign aid for fragile states

Brussels Forum Paper Series

March 2009

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1 Introduction

The economic crisis continues to wreak havoc globally, and it is becoming increasingly clear that the poor will suffer disproportionally. According to the World Bank, 100 million people were driven into poverty last year. Social tensions and geopolitical risks will be particularly acute in fragile states, impacting security and livelihoods in the Western world just as well. At the same time, development efforts will likely lose momentum due to growing protectionism or budgetary constraints. As global leaders are seeking to steer their countries toward recovery, they are reexamining the underlying institutions and policies behind the global economy. The United States and Europe were central actors in establishing the Bretton Woods institutions in the aftermath of World War II. The U.S. Marshall Plan, which helped rebuild war-torn Europe, continues to offer lessons on how development cooperation can generate peace and prosperity.

The United States and Europe remain vital partners in global development, accounting for more than 85 percent of total official development assistance (ODA) among Organisation for Economic Co-operation and Development (OECD) member countries. The United States and Europe generate the bulk of foreign direct investment (FDI) and philanthropic flows to the developing world. They continue to heavily influence the global aid architecture through multilateral institutions such as the World Bank, the International Monetary Fund, and the World Trade Organization. Transatlantic partners have supported economic growth in the world's poorest countries, promoted stability and prosperity in Eastern Europe through EU enlargement, and rolled out major education and health programs such as the U.S. President's Emergency Plan for Aids Relief (PEPFAR) that has reached nearly 60 million people.[1] These efforts have increased living standards, reduced the propensity for conflict, and increased security.

However, in the absence of the strategic rationale for aid which prevailed during the Cold War, questions have emerged over the effectiveness of foreign assistance. Throughout the 1990s, despite aid, diplomatic initiatives, and even military intervention, these efforts have largely been unable to reverse the cycle of political instability, poor governance, low growth, severe poverty, and conflict in certain states. The number of donors, foundations, and instruments supporting development has increased and there is a severe lack of coordination. While China, India, and Brazil, among others, have begun to breakout from poverty and benefited from globalization, fragile states are falling further behind.

Throughout the 1990s, despite aid, diplomatic initiatives, and even military intervention, these efforts have largely been unable to reverse the cycle of political instability, poor governance, low growth, severe poverty, and conflict in certain states.

In the aftermath of 9/11, policymakers on both sides of the Atlantic sought to elevate the role of development in foreign policy and recognized the links between fragile states and national security. Fragile states represent the biggest constraint in achieving the United Nations Millennium Development Goals (MDGs) and are the source of numerous foreign policy challenges facing the United States, Europe, and the world. Policymakers see the need for improving coordination, for a better understanding of the drivers of conflict, and for a recalibration of aid instruments. More recently, at the High Level Forum on Aid Effectiveness in Accra, donors, NGOs, and developing countries agreed to a step change regarding fragile states. Fresh commitments were made. However, given the depth of the necessary changes in policy, practices, and institutions: Will it be enough to fix fragile states?

The United States and Europe face a conundrum. Policymakers recognize that fragile states—which account for about one billion people—must find

[1] http://www.pepfar.gov

Limited policy focus on and investments in fragile states have compounded the problem by narrowing the scope of practice and instruments available to help them.

a path out of poverty and insecurity. Paul Collier estimates that over the course of its lifetime the cost of a fragile state to itself and its neighbors is about $100 billion.[2] Yet, fragile states are not only under-funded, they suffer from volatile aid flows. In the absence of predictable aid flows, "aid shocks" can produce the equivalent of a World War or the Great Depression. Some donors have limited their engagement to humanitarian efforts or have avoided these "difficult partners." The aid effectiveness debate has brought greater focus on "good performers." Some experts contend that this has taken attention away from fragile states. Limited policy focus on and investments in fragile states have compounded the problem by narrowing the scope of practice and instruments available to help them. Fragile states have fragile societies. Development can help mitigate social tensions and the risk of conflict, but it can exacerbate them too. These countries have been unable to globalize their economies and they risk falling further behind. As a result, fragile states remain unstable, insecure, and prone to conflict—putting both the poor and the rich at risk.

This paper will examine three major failures in development policy that put global security at risk: the failure to fund fragile states, help them to globalize, and prevent conflict in and around them. It will illustrate how development policy heavily impacts security—either strengthening or weakening it—and how development policy is not often seen through the lens of security. It will also explore how although some donors have demonstrated leadership by formulating fragile state strategies, development policies remain severely misaligned, risk averse, and unable to address this global security challenge. Not lifting millions of people out of poverty, not raising incomes, and not strengthening global security represents a massive opportunity cost. This enormous cost has implications on foreign policy. It impacts other government agencies, those responsible for foreign affairs, defense, trade, agriculture, and legislatures. These failures are not solely the responsibility of aid agencies and require government-wide, transatlantic solutions. Aid to fragile states must be redesigned.

[2] Paul Collier, *The Bottom Billion: Why the Poorest Countries Are Failing and What Can be Done About It,* (Oxford: Oxford University Press, 2007).

2 Failing to Fund Fragile States

While there is no universal definition for fragile states, most authorities characterize them in terms of capacity or willingness to provide public services. They measure them according to a number of institutional policy and conflict risk indicators. According to the OECD, fragile states are defined as countries that "lack political will and/or capacity to provide the basic functions needed for poverty reduction, development, and to safeguard the security and human rights of their populations."[3]

No two fragile states are alike. But, they are most often marked by the fundamental breakdown of the relationship between the state and society. Poor governance results in ineffective and inequitable distribution of public goods, such as education, health care, water and sanitation, and physical security. Public resources are drained by corruption and rent-seeking. These problems are magnified in the presence of natural resources like oil and diamonds. These conditions erode growth and undermine the tax base necessary to provide public goods. A weak business climate deters the creation of private business. Low skills stifle entrepreneurship. National wealth is often controlled by clientalistic relationships or certain ethnic groups that reinforce social inequities and tensions. Unable to control their borders or provide for their citizens, fragile states are breeding grounds for transnational threats, such as global pandemics, criminal networks, wars, and terrorism, all of which have regional and global implications. Yet, when examining foreign assistance it becomes apparent that there has been a failure to fund and help fragile states.

The United States and Europe continue to be among the largest contributors of foreign assistance (Chart 1). In 2007, total ODA declined to $103.5 billion, down from the exceptionally high level of $107.1 billion in 2005 and $104.4 billion in 2006. The 2005 record level of aid was largely driven by Paris Club debt relief programs, notably in Iraq and Nigeria. This one-off spike in debt forgiveness has allowed poor countries to channel resources into education, health, and other development activities. After substracting debt relief, total aid rose slightly by 2 percent from 2006 to 2007, well below the growth rates required to achieve the 2010 targets committed to at the Gleneagles Summit in 2005. In terms of net ODA as a percentage of Gross National Income (GNI), European countries account for the 14 top providers. The highest percentages were reported by Norway (0.95 percent), Sweden (0.93 percent), Luxembourg (0.91 percent), the Netherlands and Denmark (0.81 percent), all of which surpassed the United Nations target of 0.7 percent of GNI.[4]

In 2007, the leading recipient of net bilateral ODA was Iraq ($9 billion), followed by Afghanistan ($3 billion). Aid flows to Least Developed Countries (LDCs) have been on the rise, amounting to $32.5 billion in 2007 and have doubled in the past ten years. LDCs represent roughly one-third of total ODA. Net ODA to Africa was $38.7 billion and declined by 18 percent in real terms. However, this was due to the exceptional debt relief the previous year and once debt relief is taken out, ODA to Africa rose by 12 percent. The 38 countries that are categorized by the OECD as fragile states have in part benefited from the rise in aid flows to these countries.[5] Fragile states also experienced debt relief to some degree, but the numbers have declined sharply. Other sources of ODA have gradually

Only five countries accounted for more than half of total ODA to fragile states between 2000 and 2007.

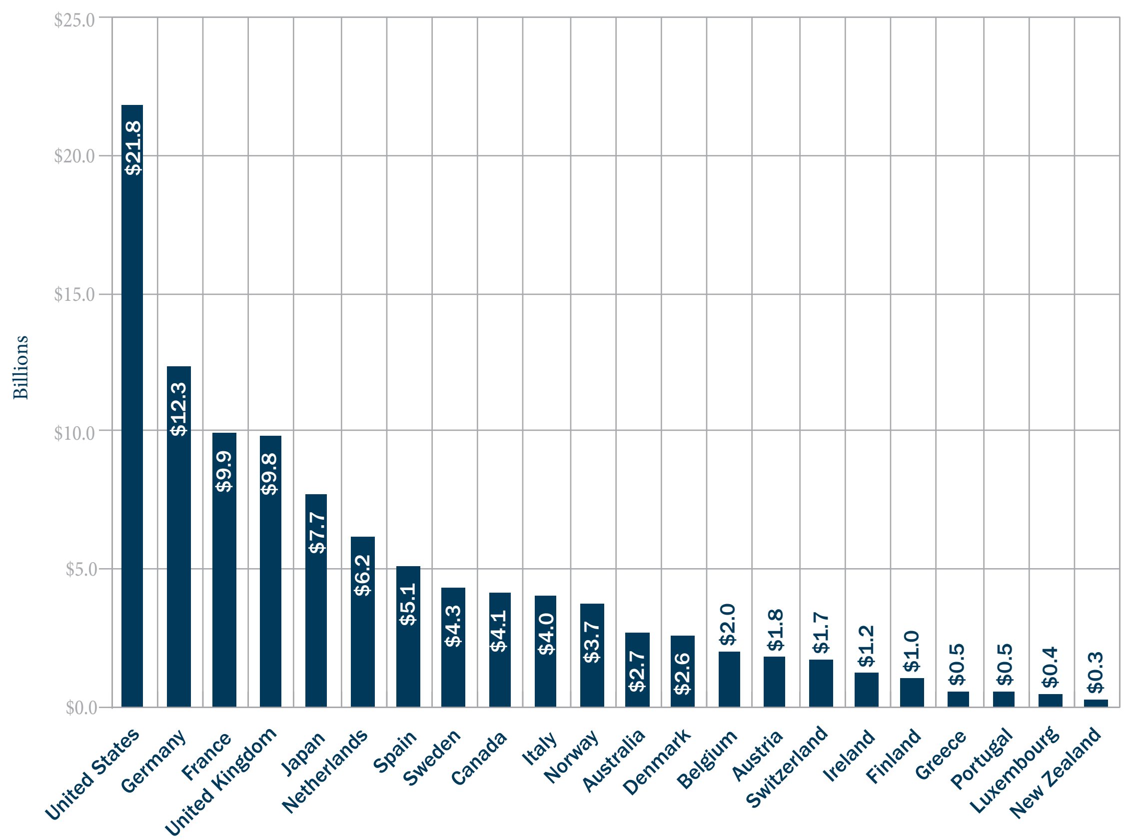
[3] OECD, *Concepts and Dilemmas of State Building in Fragile Situations: From Fragility to Resilience*, OECD 2008.

[4] OECD, *Aid Targets Slipping Out of Reach?,* OECD 2008.

[5] The 38 fragile states are: Afghanistan, Angola, Burundi, Cambodia, Cameroon, Central African Rep., Chad, Comoros, Congo, Dem. Rep., Congo, Rep., Cote d'Ivoire, Djibouti, Eritrea, Gambia, Guinea, Guinea-Bissau, Haiti, Kiribati, Laos, Liberia, Mauritania, Myanmar, Niger, Nigeria, Papua New Guinea, Sao Tome & Principe, Sierra Leone, Solomon Islands, Somalia, Sudan, Tajikistan, Timor-Leste, Togo, Tonga, Uzbekistan, Vanuatu, Yemen, and Zimbabwe.

Although there is a high probability of an eruption of violence, thus imposing costs on the country itself, the region and the world, these countries gain little attention.

Chart 1: DAC Members' Net Official Development Assistance in 2007



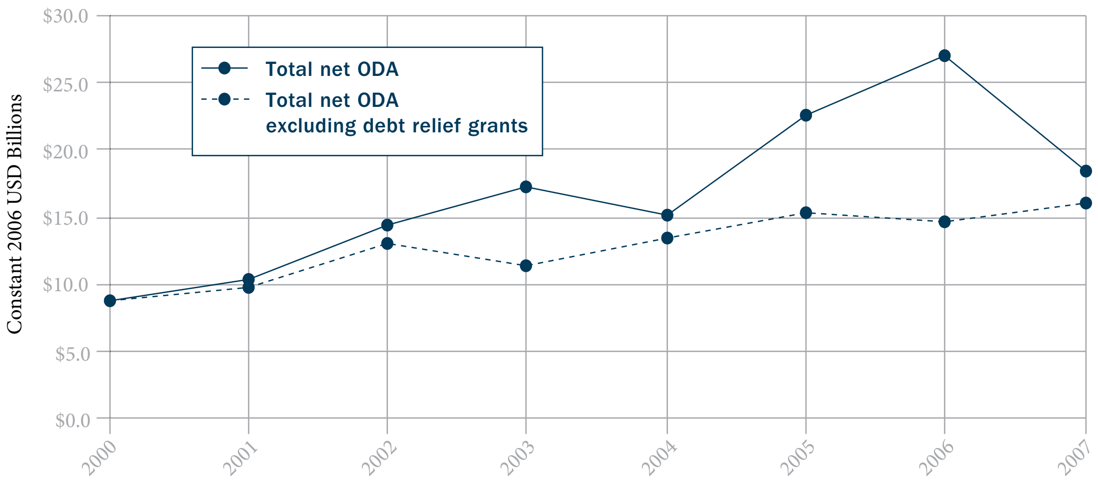
Source: Organisation for Economic Co-operation and Development

risen in fragile states since 2000 (Chart 2).

However, only five countries—Nigeria, Afghanistan, the Democratic Republic of Congo, Sudan, and Cameroon—accounted for more than half of total ODA to fragile states between 2000 and 2007 (Chart 3). A high portion of the aid to these countries was in the form of debt relief and humanitarian assistance. As a result, there has been less programmable aid that is considered vital to supporting long-term institution building and development. The bulk of foreign assistance is channeled to moderately well-off countries, those recently emerging from a conflict or those possessing special geopolitical significance. The rest are "aid orphans." Although there is a high probability of an eruption of violence, thus imposing costs on the country itself, the region and the world, these countries gain little attention. Conflict prevention does not appear to be the focus of overall global development policy.

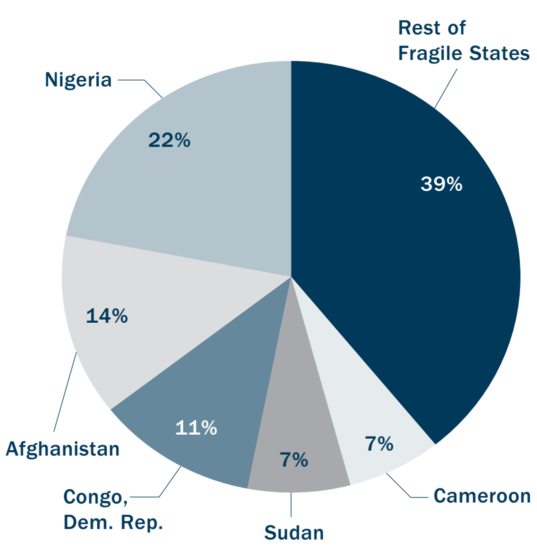
In recent years there has been greater focus on "good performers," largely an extension of the

Chart 2: Net ODA Disbursement from all donors to Fragile States



Source: Organisation for Economic Co-operation and Development

Chart 3: Shares of Net ODA to Fragile States 2000–2007 (percentage)



Source: Organisation for Economic Co-operation and Development

growing aid effectiveness debate that began in the late 1990s. Donors have increasingly used a variety of criteria to measure country performance and help determine aid allocations (known as selectivity). Two researchers, Craig Burnside and David Dollar, showed that aid has a positive impact on countries with good fiscal, monetary, and trade policies and little impact where policies are bad.[6] Accordingly, by channeling aid to countries with better policies, foreign assistance would lead to higher levels of income and help accelerate progress toward the MDGs. This highly influential work has led to more selective approaches and disbursements with a greater concentration on countries that get higher performance scores. Some contend that the aid effectiveness agenda and the emphasis on performance-based aid have left fragile states behind: "A focus on 'good performers' and an indefinite wait-and-see approach to the

[6] Craig Burnside and David Dollar, "Aid, Policies, and Growth," *American Economic Review* 90 (2000): 847-68.

Fragile states are largely underserved and this represents a massive opportunity cost from failing to lift millions of people out of poverty, raise incomes, and strengthen global security.

poor performers leaves the root causes of state 'fragility' unaddressed," writes one analyst.[7]

Policymakers face a dilemma. In an ideal world, foreign assistance seeks to lift the greatest number of people out of poverty. However, in those countries that are most in need, aid is typically less effective. How can the imperative to help the poorest of the poor be reconciled with the necessity to ensure effective aid results? One study addressed this problem with a model that incorporated both of these factors—need and efficiency—based on the concept of "poverty efficiency."[8] It requires more aid to be allocated to countries with higher levels of poverty (need), but also to countries where a dollar of aid results in higher levels of income and poverty reduction (efficiency).[9] This model considers the diminishing returns on aid, where at a certain level aid becomes less efficient. It results in less income and poverty alleviation. This is important because it addresses the question of "absorption capacity" for aid in fragile states.

The most significant deviation revealed by the model is between middle-income countries and fragile states; middle income countries received far more aid than fragile states did. In other words, fragile states do not receive aid consistent with what they need and what aid could potentially achieve in terms of growth and poverty alleviation. Political and commercial interests, which are more often tied to middle-income countries, could be a driver of this allocation structure. The deviation between middle income countries and fragile states was most pronounced among bilateral aid agencies. It was less pronounced in the case of multilateral agencies that are less susceptible to such influences. Based on these findings, there is an inefficient allocation of aid. Fragile states are largely underserved. This represents a massive opportunity cost from failing to lift millions of people out of poverty, raise incomes, and strengthen global security.

According to another study, when considering aid flows from 1992-2002, fragile states were underfunded relative to what they should have received based on their poverty, populations, and World Bank Country Policy and Institutional Assessment (CPIA) scores.[10] Aid flows to fragile states collectively were 43 percent below what their scores would imply. Multilateral aid showed a 34 percent shortfall compared to bilateral aid that showed a 58 percent shortfall in aid levels for fragile states. By a wide variation, some countries received more aid than what their scores justified, while others received less than they should have. Nevertheless, consistent with the above analysis showing a concentration of aid in a few fragile states, there were fewer overfunded "aid darlings" compared to the large number of underfunded "aid orphans."[11]

This does not necessarily prove that performance-based aid is biased against fragile states. But it does show that aid to fragile states is on average lower than what their performance, their needs, and potential effective poverty reduction merit.

[7] Jonathan Goodhand, *Conditioning Peace? The scope and limitations of Peace Conditionalities in Afghanistan and Sri Lanka,* The Netherlands Institute of International Relations Clingendael, Conflict Research Unit 2006; also see Peter Uvin 2002 and Sakiko Fukuda-Parr 2007.

[8] Paul Collier and David Dollar, *Aid Allocation and Poverty Reduction,* The World Bank, 1999.

[9] According to some, if strictly applied, this model may neglect those countries that suffer from extreme aid inefficiency, such as fragile states. However, this is an unwarranted concern given that Collier himself argues that the model shows how the "bottom billion" gets less aid than their need and efficiency would imply.

[10] Victoria Levin and David Dollar, "The Forgotten States: Aid Volumes and Volatility in Difficult Partnership Countries" *(1992-2002),* OECD, 2005. Summary paper for DAC Learning and Advisory Process on Difficult Partnership.

[11] Mark McGillivray, "Aid Allocations and Fragile States," Background paper for the Senior Level Forum on Development Effectiveness in Fragile States, January 13-14, 2005.

The movement toward more effective aid and the use of performance criteria have improved metrics and provided for evidence-based decision-making. The Millennium Challenge Corporation (MCC) has been focusing on "good performers," but also has created Threshold Programs specifically aimed at helping fragile states climb-up the performance ladder. Aid has become more selective since the mid 1990s, but aid has also become more poverty-focused during this time. It has been found that donors that are more likely to employ selectivity in aid allocation decisions also tend to be poverty-focused in their approaches.[12]

A number of other factors discourage fragile state engagement. Legislators, oversight agencies, and donors alike have concerns over corruption and weak accountability. There are internal and external pressures to disburse aid quickly in places where projects are more readily available with lower administrative costs. The G8 Gleneagles commitments and the MDGs are putting a premium on aid volume. Donor staff performance is often linked to expenditures and the size of projects. Fragile state operations by definition are more risky and tougher, requiring "the skilled and delicate application of expertise and leverage to unblock political obstacles and tackle long-established systems of power and hierarchy."[13] Higher levels of corruption require higher levels of supervision. But, there are pressures to keep administrative costs low. Program effectiveness is sometimes measured in terms of administrative costs; this generates incentives to allocate aid away from the more problematic and complex projects in fragile states. There are few incentives for the most experienced staff to pursue posts in fragile state countries. They often have high turnover rates, limiting local, deep knowledge. Risk-aversion, budget pressures, and a reluctance to make the labor-intensive investments commensurate with challenge posed by fragile states, all discourage engagement with them.

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[12] Mark McGillivray, "Aid Allocations and Fragile States," Background paper for the Senior Level Forum on Development Effectiveness in Fragile States, January 13-14, 2005. Lancaster House, London.

[13] Edward Bell, *The World Bank in Fragile State and Conflict-Affected Countries: How, Not How Much,* (London: International Alert, 2008).

3 Failing to Globalize Fragile States

While countries like China, India, and most other developing countries are converging with developed economies, fragile states have slipped off the radar.

The global economy has helped to lift millions of people out of poverty, despair, and insecurity. Since the end of the Cold War, many countries have harnessed the opportunities offered by access to technology, trade, FDI, and financial markets by lowering barriers that previously isolated them from global commerce. Countries that previously belonged to the Soviet bloc have joined the European Union and have harmonized regulations, lowered tariffs, and attracted investment within a common market. Many of these countries have or are seeking to adopt the euro to mitigate financial disruptions and provide for a more stable business climate. As American and European firms have extended their supply chains across Eastern Europe, investment, incomes, and standards of living have risen. China, India, and the so called "Asian tigers" pursued export-led development policies, often reinvesting earnings back into their education systems and infrastructure to accelerate industrial development. Much of the developing world has been seemingly on a path of economic growth and poverty reduction, converging and competing with the West.

There have been notable advances in fragile states too. About 70 percent of the people living in fragile states reside in Africa. Many African countries have suffered persistent wars, coups, and economic instability. High inflation, budget as well as trade deficits, and overvalued currencies that weaken export competitiveness have all plagued these markets. But, democracy has been on the rise and the macroeconomic picture has turned for the better in Africa. The divergence between black market and official exchange rates has narrowed and excluding extreme cases like Zimbabwe inflation has declined. FDI inflows on the continent have grown from $4.7 billion in 1989 to $53 billion in 2007.[14] More recently, tariff barriers in Africa have fallen from 22 percent in 1995 to 13 percent in 2006.[15] The Heavily Indebted Poor Countries (HIPC) and other debt relief initiatives have freed up resources to invest in education, health, infrastructure, and civil servant wages. They aim to help these countries stabilize their finances.

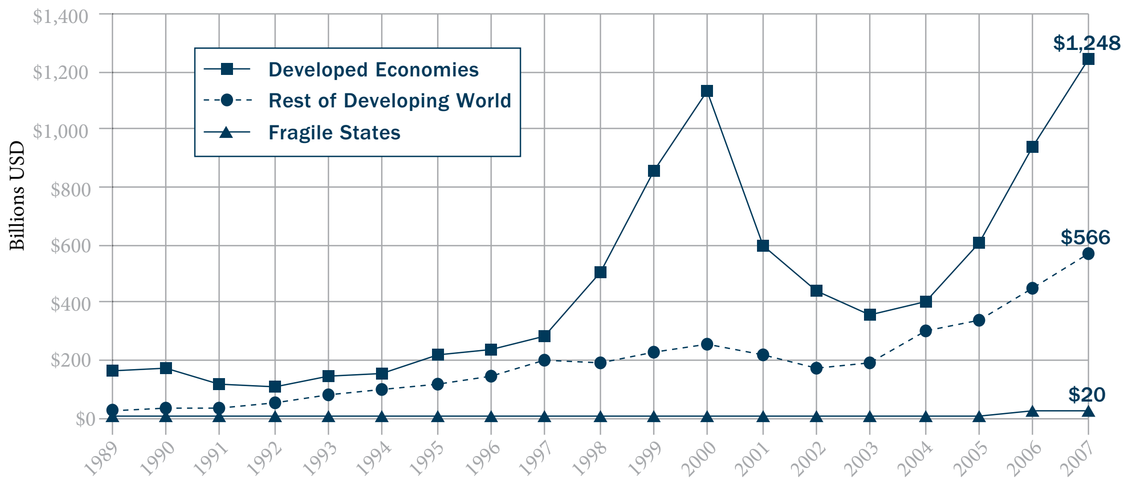
However, these gains have not been widely shared. Only six African countries—Angola, Algeria, Libya, Mozambique, Nigeria and South Africa—account for three-quarters of the region's commodity exports. More than three-quarters of the region's FDI inflows are limited to these six countries and mostly focused on natural resources. While natural resource wealth can be helpful, major commodity dependency can be debilitating. High external commodity demand can appreciate the currency, undermining the competitiveness of other potential growth industries from agriculture to textiles. With easy money, the country does not have to rely on a wide public tax base or a citizenry that demands accountability for sound public services. Commodity dependent countries remain vulnerable to price shocks and income volatility. As a result, the recent food and fuel crises have had severe detrimental affects on the poor. Africa's moderate improvements in export growth have been overshadowed by the even bigger gains by other countries, such as China. Africa has not kept pace as its share of global exports fell from 6 percent in 1980 to 3 percent in 2007.

Looking at the OECD's group of 38 fragile states—24 of which are in Africa—this pattern is even more pronounced in terms of FDI and trade (Charts 4 and 5). Fragile states have missed the latest wave of globalization. While countries like China, India, and most other developing countries are converging with developed economies, these countries have slipped off the radar. Post-1989, the global economy accelerated at an

[14] United Nations Conference on Trade and Development.

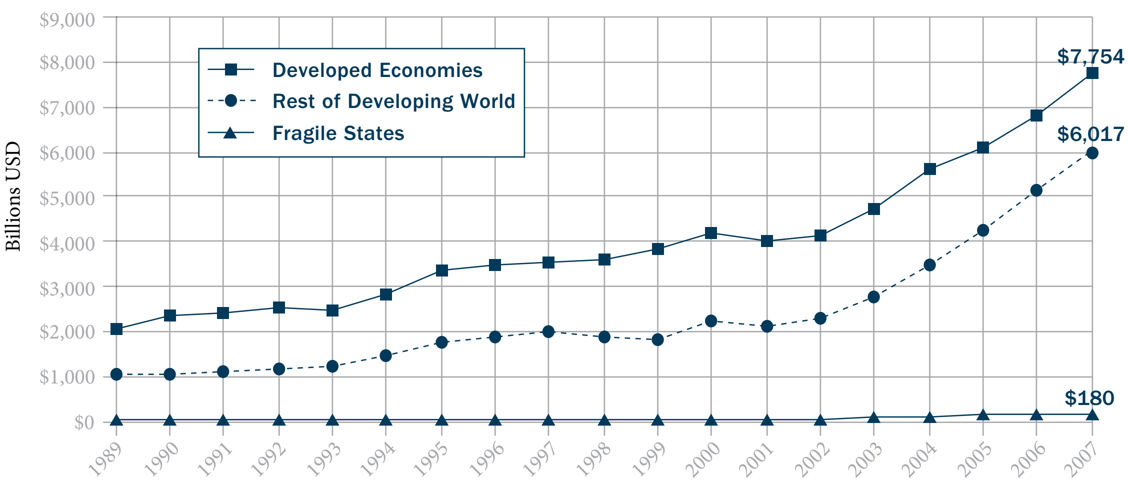
[15] UNCTAD, *Economic Development in Africa 2008*, UNCTAD, 2008.

Chart 4: Foreign Direct Investment Inflows



Source: United Nations Conference on Trade and Development

Chart 5: Total Merchandise Trade Exports



Source: World Trade Organization (excludes Somalia and Timor-Leste)

The new global divide will not be between the West and the rest, but between the extreme poor and everyone else.

Fragile states will not be able to mimic the development strategies that South Korea, Singapore, China, and India chose.

unprecedented pace and much of the developing world began finding its way out of poverty while fragile states experienced an absolute decline of 0.5 percent annually. Rather than benefiting from economic convergence, fragile states have diverged dramatically from other developing and developed countries. The growth divergence between fragile states and the rest of the world is projected to widen. The new real global divide will not be between the West and the rest, but between the extreme poor and everyone else.

Reversing this growing divergence and helping fragile states pull themselves out of poverty will be even more challenging than it was for middle-income countries. The new players are advancing in a whole range of industries—from textiles to automotive, from financial services to biotechnology. They are competing head on with the United States and Europe in many areas. They have jumped-up the economic ladder to the next rung and dominate in many industries that would otherwise offer fragile states a development path. Fragile states will not be able to mimic the development strategies that South Korea, Singapore, China, and India chose.

Fragile states miss out on the benefits of globalization because they often suffer from a combination of "traps" or a set of self-reinforcing negative conditions that are extremely difficult to overcome. Countries with low incomes are prone to civil war. Conflict destroys infrastructure, erodes institutions, decimates the labor force, and undermines growth. The economy shrinks, adding to social and political tensions and in turn increasing the risk of renewed conflict. This so-called "conflict trap" is one among many traps that hold back fragile states or the "bottom billion" as identified by Paul Collier:

- The conflict trap, where extremely low incomes make countries vulnerable to conflict, and conflict further reduces incomes in a negative cycle.
- The natural resource trap, where economies that are overly dependent on a few natural resources are subject to booms and busts, rampant corruption, conflict, and disincentives for investment in the rest of the economy.
- The geography trap, where countries that are landlocked and surrounded by bad neighbors have few options to expand production and economic growth.
- The governance trap, where mismanagement keeps economies stagnant (or worse), often with large financial gains to a small elite in control. Low incomes make it difficult to build the institutions and train the people needed for good governance.[16]

Paul Collier estimates that the cost of a fragile state to itself and its neighbors is about $100 billion.[17] Given these costs, why has foreign aid failed to address these traps and help fragile states globalize? The importance of regional economic integration is well recognized, but most aid programs remain country-based. For instance, African intra-regional trade is the lowest in the world—only 10 percent—with the other 90 percent of trade flows outside Africa.[18] Despite the decline of trade barriers in Africa, tariff and non-tariff barriers (such as bad roads and rail) at the regional level remain high—raising the cost of business and limiting growth

[16] Ellen Johnson Sirleaf and Steven Radelet, *The Good News Out of Africa: Democracy, Stability, and the Renewal of Growth and Development*, Center for Global Development, February 2008.

[17] Paul Collier, *The Bottom Billion: Why the Poorest Countries Are Failing and What Can be Done About It*, (Oxford: Oxford University Press, 2007).

[18] World Trade Organization.

opportunities. Sometimes governing well and putting corrupt officials in jail is not enough. Such reforms may help but only marginally if the country is landlocked and has neighboring countries with poor infrastructure, corruption, or conflicts that spill over.

There is evidence that growth would have been slower in fragile states in the absence of aid. Over the past three decades, aid contributed between 1 percent and 1.4 percent GDP annually in these countries.[19] This does not mean that these countries enjoyed relatively higher positive growth as a result of aid. Overall, their growth was around zero during this period. So, aid essentially prevented them from being worse off. Despite keeping these countries from falling completely into the abyss and the good intentions of many, there are instances where aid may disrupt the institutions, society, or the economy. Aid has brought benefits to the bottom billion, but it's been insufficient, and aid can do harm.

Fragile states have twice the aid volatility compared to other low income countries. Aid flows are known to be more volatile compared to other macroeconomic variables, such as public sector revenues, consumption, and Gross Domestic Product (GDP). Aid volatility has been shown to cause disruptions in inflation, real exchange rates and fiscal policy, negatively impacting economic growth. This can create turmoil in fragile states whose budgets for key sectors like health and education may depend heavily on foreign assistance. These so called "aid shocks" in developing countries have triggered disruptions equivalent to the magnitude of the income shocks endured by developed countries during the two World Wars, the Great Depression, and the Spanish Civil War.[20]

Large and sustained aid flows have been known to produce adverse macroeconomic effects. They can result in a real exchange rate appreciation and undermine economic competitiveness—often referred to as a form of "Dutch disease."[21] Although aid can have a positive budget impact at first, over time it can erode the capacity of tax raising mechanisms. Taxes form the basis of the country's own capacity to provide public services; invest in infrastructure, education, and health; and foster conditions that spur economic growth.

Another practice that can erode state capacities is the use of "project" aid. It is one of the primary instruments for delivering foreign assistance. Projects come in numerous forms. They may be implemented by donors and multilateral agencies, or contracted out to NGOs, or the private sector. Most often their purpose is to deliver a service—building roads, training teachers, or providing healthcare—sometimes with little consultation with the local authorities or communities. This can break the accountability link between citizens and the state. There is a risk of focusing on projects that ensure high visibility and quick results at the expense of longer-term capacity-building. As a result, aid can displace state functions, undermine the legitimacy of local authorities, and foster a culture of aid dependency. If designed in consultation with local governments and other stakeholders like civil society, project aid can be very useful.

"Aid shocks" in developing countries have triggered disruptions equivalent to the magnitude of the income shocks endured by developed countries during the two World Wars, the Great Depression, and the Spanish Civil War.

[19] Mark McGillivray and Simon Feeny, *Aid and Growth in Fragile States*, UNU-WIDER, January 2008; Paul Collier, *The Bottom Billion: Why the Poorest Countries Are Failing and What Can be Done About It*, (Oxford: Oxford University Press, 2007). There has been an on-going debate over the links between aid and growth; see William Easter, Paul Collier, and Jeffrey Sachs.

[20] Homi Kharas, "Measuring the Cost of Aid Volatility," Wolfensohn Center for Development, Working Paper 3, Brookings Institution, 2008.

[21] Raghuram G. Rajan and Arvind Subramanian, "What Undermines Aid's Impact on Growth?" International Monetary Fund, Working Paper, June 2005.

The ideas of the post-World War II reformers, who had been influenced by John Maynard Keynes and recognized the central role of the state in development, faded with the rise of neoliberalism.

There is a chicken-and-egg problem here. Fragile and post-conflict states by definition often lack state capacities to steer themselves toward a development path that links them with the global economy. Since they are corrupt or lack the institutions necessary to provide for their citizens, service delivery is necessary to avoid a humanitarian crisis. However, once project aid starts, it can potentially undermine any nascent local leadership or institutions. *The Paris Declaration on Aid Effectiveness* calls for local ownership to help ensure that aid supports capacity-building and engages local stakeholders including the government and civil society. It also calls for aid to be better aligned with national development strategies. But, in the face of a leadership vacuum, fractional or divisive government or fragmented civil society alignment and ownership are highly problematic.

The tricky part is transitioning from service delivery to actually helping the country build its own capacities. In cases when the government lacks capacity or legitimacy, donors may engage civil society and the private sector to foster accountability and governance. Ultimately, it requires local leadership and institutions to address the severe poverty in and insecurity emanating from fragile states. Today, however, there is little understanding of nation-building—despite numerous efforts over the years from the Marshall Plan to Kosovo. According to Francis Fukuyama, the zeal of the neoliberal agenda and the failure of institutional memory are responsible for this.[22]

The neoliberal policies espoused by the Reagan and Thatcher administration's moved development policy toward supply-side economics, which implied a minimal role for the state. The "Washington Consensus" approach of the 1990s encouraged fiscal austerity, liberalization, deregulation, and privatization. Structural adjustment programs pursued by the international financial institutions have been viewed as giving priority to economic orthodoxy at the expense of helping to strengthen national institutions and peacebuilding efforts. The ideas of the post-World War II reformers, who had been influenced by John Maynard Keynes and recognized the central role of the state in development, faded with the rise of neoliberalism.

By disregarding local governance, regulatory safeguards, social safety nets, and the democratic legitimacy of the aid recipient, these policies have been criticized for creating an environment vulnerable to corruption, financial turmoil, and sharp declines in living standards.[23] The Asian financial crisis of 1997 and the problematic privatization of Russian state assets are often noted as examples of the shortcomings of such development efforts. Overall, some countries managed these reforms well (such as East Asia) and others did not (such as Sub-Sahara Africa). In some cases, countries invested in public goods—infrastructure, educational systems, export-processing zones, business incubators, and technology centers. The key factor determining success was leadership on the part of domestic elites who were good stewards of state institutions and used them to implement their own development strategies. Aid played a limited role in these countries, while in places like Sub-Saharan Africa aid was higher as a share of GDP.

Some point to a "policy incoherence" or "policy gap," where development is seen through the narrow lens of foreign assistance. The potential development impacts of other policies—for good or ill—are ignored. Despite important initiatives

[22] Francis Fukuyama, *Nation Building: Beyond Afghanistan and Iraq*, (Baltimore: John Hopkins University 2006).

[23] The most notable critic of these neo-liberal policies has been Nobel-prize-winning and former World Bank Senior Vice President and Chief Economist, Joseph Stiglitz.

like the U.S. African Growth and Opportunity Act (AGOA), the U.S. tariff structure discriminates against products from poor countries. The overall U.S. average tariff rate is relatively low. However, for labor-intensive manufacturing (such as apparel, footwear and travel goods) where poor countries are potentially competitive, the average U.S. tariff is more than three times the average for all U.S. imports.[24] The U.S. import tariff bill collected from Bangladesh is the same as from the United Kingdom, even though the import volume from the United Kingdom is 12 times as great in dollar terms.[25]

In 2007, the United States, Europe, and other developed countries provided $258 billion in support to their farmers. Such policies generate trade and market distortions that harm poor countries whose incomes are significantly more dependent on agriculture.[26] The vast majority of people in fragile states live in rural farming communities. Certain U.S. prohibitions required by the Overseas Private Investment Corporation, the United States Agency for International Development (USAID), and the MCC limit the expansion of FDI to developing countries.[27] Remittances are another underleveraged financial resource for the poor that could benefit from greater policy attention. This inability to get beyond ODA and think more broadly in terms of development policy across the entire government spectrum has severely hindered the ability of fragile states to participate in the global economy.

The role of the private sector is universally acknowledged as key to economic growth and vital to connecting the poor to the global economy. Yet, according to the OECD, only 15 to 20 percent of ODA is channeled into enterprise development. There seems to be a preoccupation with other more attractive issues such as health, education, or microfinance. While these are all important to a healthy business environment, countries ultimately require firms beyond the micro-level to grow. Small- and medium-sized enterprises (SMEs) are important catalysts for employment and income generation. Private sector actors can be important stakeholders in helping reinforce peacebuilding efforts in fragile and conflict-affected states, especially when the government is unwilling or incapable of committing to poverty reduction. A greater emphasis on entrepreneurship on the part of post-conflict and peacebuilding units within donor governments is emerging. Nevertheless, development policy tends to undervalue enterprise development.[28]

The inability to think more broadly in terms of development policy across the entire government spectrum has severely hindered the ability of fragile states to participate in the global economy.

[24] Nancy Birdsall, *The White House and the World: A Global Development Agenda for the Next U.S. President*, (Washington, DC: Center for Global Development, 2008).

[25] Ibid.

[26] OECD, *Agricultural Policies in OECD Countries 2008: At a Glance,* OECD, July 2008.

[27] USAID's Global Development Alliance forges public-private partnerships to stimulate economic growth, develop businesses and workforces, address health and environmental issues, and expand access to education and technology. Nevertheless, there remain U.S. policy obstacles to fully leveraging U.S. corporate investments to alleviate poverty.

[28] For instance, many experts now argue that a "golden opportunity" was missed after the fall of the Taliban in Afghanistan to connect small farmers and traders with global and regional firms to help jump start the economy.

4 Failing to Prevent Conflict in Fragile States

Sometimes aid may foster economic growth while undermining security by empowering certain ethnic groups, disenfranchising others, and disrupting social relations.

The Cold War heavily influenced development institutions and practices. Military and economic aid was primarily a function of the strategic imperative of defeating communism. The emphasis was on state security institutions—building armies, police, and intelligence forces and also socio-economic development. Aid decisions paid less attention to governance, corruption, or whether states provided for or protected their citizens. As the superpowers withdrew from many countries, ethnic conflicts, genocide, starvation, refugee, and other crises emerged.

During the 1990s, the international community responded with a mixture of peacekeepers and civilian observers, multinational peace agreements, humanitarian relief, and development aid, sometimes coupled with military intervention, aimed at fostering free markets, democracy, and stability. Known as "liberal peacebuilding," these efforts intended to consolidate the expected dividends resulting from the ending of the Cold War. Given the limited success and huge sums of money involved, many began to question the wisdom of these operations. Seminal reports and initiatives such as the Brahimi Report, the Carnegie Commission, and the United Nations Millennium Declaration offered recommendations. Numerous UN, OECD DAC, and regional and national authorities issued policy statements bringing attention to the deficit in international coordination, and the importance of governance, democratic institutions, conflict prevention, and the links between development and security.

A consensus has emerged that development and security are intertwined. Understanding their dynamic relationship is key to helping fragile states. Roughly one billion people live in fragile states, accounting for one-third of all the HIV/AIDs-related deaths in poor countries, one-third of those who lack access to clean water and one-third of children who do not complete primary education. Poverty rates are more than double the levels in other low-income countries. In cases where they suffer from low income, slow growth, and primary commodity dependency, these countries are prone to civil wars. In fragile states, economic decline in turn reinforces the likelihood of renewed conflict.

Aid can help mitigate social tensions and reduce conflict, but it may also exacerbate the risks of conflict. For instance, the international financial institutions and some donors have sponsored macroeconomic policies with limited consideration for broader "peacebuilding" efforts.[29] The chief UN mediator in the El Salvador peace talks, Alvaro de Soto, reported that the structural adjustment program negotiated between the government and the international community undermined the peace accords. Fiscal measures limited the government's ability to implement key aspects of the accords, such as establishing a new civilian police force. Sometimes aid may foster economic growth while undermining security by empowering certain ethnic groups, disenfranchising others, and disrupting the social relations. Such shortcomings in development policy reveal a lack of knowledge of local conditions and a deeper understanding of the dynamic forces at work in these countries.

During the course of the aid effectiveness debate, development experts working on peacebuilding and conflict prevention units have expressed concerns about over emphasis on "good performers" at the expense of fragile states. As mentioned, the majority of foreign assistance is channeled to moderately well-off countries or those recently emerging from a conflict. Unless they possess special geopolitical significance, the remaining fragile states are "aid orphans." Despite the high probability that many of these countries may collapse or erupt in violence within a few years,

[29] Stephen Baranyi, ed, *The Paradoxes of Peacebuilding Post 9/11*, The North South Institute, (Vancouver: UBC Press, 2008).

especially if they have suffered from conflict in the recent past, they are not the focus of development policy. Accordingly, development does not effectively support conflict prevention.

Although it is not clear that performance-based aid is biased against fragile states, certain forms of selectivity can ignore important political, social, conflict-sensitive, and regional dimensions of development; these are especially critical in fragile, post-conflict countries. The World Bank has acknowledged that the CPIA rankings can lead to an "overly technical" approach that may miss critical power dynamics, local politics, and conflict realities. The World Bank has recommended that multidisciplinary analysis be integrated into its internal decision-making to address these more complicated development environments.[30] The U.K. Department for International Development (DFID) has been advocating for the inclusion of social analysis and a better understanding of the human dynamics in fragile country contexts.

Nevertheless, donors have a long way to go to formulate aid policies that are informed by in-depth, country-specific research that incorporates the variables associated with conflict. According to one former World Bank official, "many of the factors that have been repeatedly identified by research studies on the economic and social correlates of war are not taken into account in the design of development policies of national governments or in the policy work of donors active in fragile states."[31]

Donors have a long way to go to formulate aid policies that are informed by in-depth, country-specific research that incorporates the variables associated with conflict.

[30] Edward Bell, *The World Bank in Fragile State and Conflict-Affected Countries: How, Not How Much,* (London: International Alert, 2008).

[31] Sakiko Fukuda-Parr and Robert Picciotto, "Conflict Prevention and development cooperation: Joint project of JICA and UNDP—A concept paper," Background paper for Wilton Park Policy workshop on Conflict Prevention and Development Cooperation in Africa, November 2007.

5 Redesigning Development for Fragile States

Frontier donors are recalibrating aid instruments with an appreciation for the central roles of the state and good governance.

Although there has been a failure to fund fragile states, globalize their economies, and prevent conflict in these countries, there are some specific examples of leadership aimed at reversing this situation. In 2005, the OECD DAC produced the "Principles for Good International Engagement in Fragile States" recognizing the potentially harmful impact of development policies, the need for conflict sensitive approaches, the importance of state institution building, and local ownership (see box). Many of these principles were committed to by donors and developing countries alike in the *Paris Declaration on Aid Effectiveness*.

More recently, at the High Level Forum on Aid Effectiveness in Accra, donors, NGOs, and developing countries agreed to a step change regarding fragile states. Fresh commitments were made to support them. These pledges sought to address the unique challenges in pursuing aid effectiveness in fragile states and were very specific with regard to statebuilding and peacebuilding, joint assessments on governance and the causes of conflict, the protection and participation of women, bridging the relief to development gap, and tailored, longer-term, and more predictable financing modalities. Many of these efforts have sought to deal with the underlying problems. USAID, the MCC, DFID, and the World Bank have developed fragile states strategies many of which seek similar improvements in aid. These frontier donors are recalibrating aid instruments with an appreciation for the central roles of the state and good governance.

Under the Bush administration, the United States adopted the strategy of "transformational diplomacy," which, among other things, sought to raise the importance of development alongside diplomacy and defense. The 2002 National Security Strategy of the United States directly noted the need for dealing with failing states and stated that diplomacy, defense, and development—also known as the "three Ds"—were the three pillars of U.S. foreign policy. The report concluded that, "America is now threatened less by conquering states than we are by failing ones."[32] USAID's 2005 *Fragile States Strategy* categorized these countries into vulnerable and crisis states.[33] It intended to raise the visibility of development, alongside diplomacy and defense, in U.S. policy and supported a wider government approach. It recommended a number of management and programmatic reforms to implement a strategy around the following priorities aimed at strengthening fragile states:

- *Enhance stability*, addressing the sources of stress and conflict in the political, economic, and social spheres. In some cases, lack of political will to foster greater effectiveness and legitimacy of government institutions may be driving fragility. Supporting reformers outside the government may contribute to political instability in the short term, but may, in the medium to long term, avoid violent conflict and state failure. Support for economic activities that lead to job creation, improved family incomes, and better functioning markets can, in most cases, contribute to greater economic stability.
- *Improve security*, providing an environment that enhances personal safety, but also establishes the conditions under which serious outbreaks of violence are averted.
- *Encourage reform* related to the conditions that are driving fragility and that will increase the likelihood of long-term stability. While governance is clearly a linchpin to recovery, reforms may well be required

[32] 2002 U.S. National Security Strategy.

[33] Vulnerable states are defined as "unable or unwilling to adequately assure the provision of security and basic services to significant portions of their populations and where the legitimacy of the government is in question." Crisis states are defined similarly but are not able to control their territories and are marked by actual or the risk of violent conflict.

The Principles for Good International Engagement in Fragile States recognize that:

- Fragile states confront particularly severe development challenges such as weak governance, limited administrative capacity, chronic humanitarian crisis, persistent social tensions, violence, or the legacy of civil war.
- A durable exit from poverty and insecurity for the world's most fragile states will need to be driven by their own leadership and people.
- Although international engagement will not by itself put an end to state fragility, the adoption of the shared principles can help maximize the positive impact of engagement and minimize unintentional harm.

The long-term vision for international engagement in fragile states is to help national reformers build legitimate, effective, and resilient state institutions. Progress toward this goal requires joint and coherent action within and among governments and organizations. The Principles, therefore, emphasize the need to:

- Ensure all activities do no harm
- Focus on state-building as the central objective
- Prioritise prevention
- Recognise the links between, political, security, and development objectives
- Promote non-discrimination as a basis for inclusive and stable societies
- Align with local priorities in different ways in different contexts
- Agree on practical coordination mechanisms between international actors
- Act fast, but stay engaged long enough to give success a chance
- Avoid pockets of exclusion ("aid orphans")

Source: Organisation for Economic Co-operation and Development

Elections can be a vital tool for enhancing the legitimacy of a new government, but they can be hollow in the absence of capable civil servants both nationally and locally.

early on in multiple sectors, such as the critical social and economic areas.

- *Develop the capacity of institutions* that are fundamental to lasting recovery and transformational development. Building the capacity of institutions that serve key social and economic sectors—such as those providing healthcare, education, and financial services—will reduce stress and vulnerability, especially among poorer populations. Viable institutions will also speed recovery from conflict.[34]

The USAID strategy also covered a set of principles, such as recognizing the challenges of constructive engagement with fragile states and issues around state legitimacy. An emphasis was placed on "strategic engagement" based on the importance of the country to U.S. foreign policy. A deeper examination of the sources—not the symptoms—of fragility, such as ethnic and religious tensions, was noted. The question of short-term needs versus longer-term structural reforms was also considered. Additionally, measurement systems tailored to fragile states were mentioned.

USAID operations in Afghanistan have produced lessons, bringing greater attention to governance and institution building. Initially, there was heavy emphasis on service delivery to avoid a humanitarian crisis in Afghanistan. Programs engaged Afghan society directly and tended to neglect local authorities. Some contend this undermined the legitimacy of the Afghan state. Elections can be a vital tool for enhancing the legitimacy of a new government, but they can be hollow in the absence of capable civil servants both nationally and locally. Bilateral donors have been operating in an uncoordinated manner and often fail to align with the Afghanistan National Development Strategy (ANDS).[35] Two-thirds of international foreign aid bypasses the Afghan government.[36]

However, the initial belief in the transformative role of civil society without considering state institutions began to fade. USAID is seeking to improve coordination through the Joint Coordination and Monitoring Board (JCMB)[37] and is more actively engaging with the Afghan government to align with its national priorities.[38] USAID's strategy in Afghanistan aims to strengthen revenue collection. It also focuses on the legal and regulatory environment to accelerate private sector growth and improve human resources, financial resources, and service delivery of key national ministries and municipalities. Recent statements by U.S. Secretary of State Hillary Clinton reveal that the Obama administration will focus on governance and enabling an Afghan state that is responsive to the needs and security of its citizens. Afghanistan suffers from multiple traps being landlocked in a bad neighborhood with poor governance, the corrosive effects of the opium trade, and on-going conflict. The administration's pursuit of a regional strategy, that includes Pakistan and India, will not only open opportunities for cross-border economic development, but also security cooperation. Until the safe haven enjoyed by Taliban militants and al Qaeda terrorists in Pakistan's ungoverned frontier regions is eliminated, statebuilding in Afghanistan will never progress.

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[34] USAID, *Fragile States Strategy*, USAID (Washington, DC: USAID, 2005).

[35] The 2008 survey on the Paris Monitoring Survey for Afghanistan presented at Accra in September 2008 revealed that "ownership is low and large external aid is not concretely linked to implementing the Afghan National Development Strategy." With regard to donor harmonization, it states that there is a "lack of clear sector prioritization and divergence between government and donor strategies."

[36] Matt Waldman, *Falling Short: Aid Effectiveness in Afghanistan*. ACBAR Advocacy Series, Oxford (Oxfam International, 2008).

[37] JCMB manages United Nation agencies, International Financial Institutions, donor agencies, international security forces, and relevant NGOs and civil society representatives in Afghanistan.

[38] Closing Remarks for Donor Coordination Forum, USAID Administrator Henrietta Fore, Kabul, Afghanistan on April 21, 2008.

The MCC employs objective, independent indicators to determine a country's suitability for funding (known as the MCC criteria),[39] pursues poverty reduction through economic growth, encourages local ownership, and focuses on results. The MCC's eligibility criteria act as an incentive for countries to pursue economic reforms and democratic transition (i.e., the "MCC effect"). The MCC Compact process involves direct consultation with civic, private, and political sector actors. The country takes responsibility for identifying barriers to growth, determining the Compact's priorities, and implementing it. MCC funding is untied and not subject to "Buy America" provisions, allowing it greater flexibility to align and coordinate aid.[40] It also seeks to build-in predictable funding by making five-year commitments, which directly addresses the problems associated with aid volatility.

While the MCC criteria focuses on and encourages "good performers," the MCC also recognizes the importance of assisting fragile states. The MCC's Threshold Program is specifically designed to assist those countries that fall short of the MCC criteria. Currently, there are MCC Threshold programs with seven fragile states—Liberia, Malawi, Niger, São Tomé and Principe, Timor-Leste, Uganda, and Yemen.[41] These programs are intended to help countries improve their MCC indicator scores and eventually qualify for a full MCC Compact. Like MCC Compacts, Threshold Program Agreements are a contract with the aid recipient and the principles of local ownership and focusing on results also apply. Eligibility is determined by the country's MCC indicator performance and willingness and ability to pursue reforms. As is the case with Compacts, the country is responsible for creating a plan for improving performance and submitting it for review and approval.

Key elements of the MCC approach include:

- The MCC asks partner governments to maintain a public consultative process throughout its Compact development and implementation phases. This allows civic, private, and political sector actors to play meaningful roles in setting priorities for the development of the country, and has empowered elected officials to exercise their representative rights and responsibilities. During implementation, civil society representatives participate directly in advisory boards that oversee implementation of the MCC Compact.
- Compact programs must adhere to domestic legal or constitutional requirements, such as compact ratification, notification, or the budget processes.
- Compact implementation must be transparent, which can strengthen domestic accountability, and in some cases, set precedents for access to information or civic participation in government.[42]

MCC indicators incorporate important variables such as political rights, civil liberties, and voice and accountability, and its consultative process seeks to engage government and civil society actors broadly. The MCC recognizes that aid can potentially undermine institutions or state-civic relationships, exacerbating the risks of conflict.

A meaningful consultative process recognizes the importance of local checks and balances and ensures that MCC programs strengthen local institutions and civil society, and in doing so mitigate the risk of conflict.

[39] Countries must demonstrate a commitment to policies that promote political and economic freedom, investments in education and health, control of corruption, and respect for civil liberties and the rule of law as measured by 17 different policy indicators.

[40] According to the OECD/DAC "untied aid" is defined as loans and grants whose proceeds are fully and freely available to finance procurement from all OECD countries and substantially all developing countries. "Partially untied aid" is defined as loans and grants which are tied, contractually or in effect, to procurement of goods and services from a restricted number of countries which must include substantially all developing countries and can include the donor country. All other loans and grants are classified as "tied aid," whether they are tied formally or through informal arrangements.

[41] These countries are categorized as fragile states based on one or more of the following: the OECD, LICUS, Difficult Partnership Countries, and The Fund for Peace Fragile States Index.

[42] Millennium Challenge Corporation, *MCC and the Long Term Goal of Deepening Democracy*, November 2007.

DFID has been developing a deep knowledge around engaging fragile states and has been refining a number of analytical tools to strength the organization's expertise in this area.

Aid can displace accountability when local officials do not have to be held accountable to citizens and legislatures for programs and they only require that donors support them. The flip side of this is the potential for aid to discourage civic participation, as citizens see elected officials being more responsive to international donor priorities and less to domestic ones.[43] A meaningful consultative process recognizes the importance of local checks and balances and ensures that MCC programs strengthen local institutions and civil society, and in doing so mitigate the risk of conflict.

On the other side of the Atlantic, fragile states have also gained attention. The creation of the DFID in 1997 marked a major break with the past by creating a new Cabinet-level Secretary for Development. DFID's central objective for U.K. development policy is poverty alleviation as mandated by law in the International Development Act of 2002. DFID policy has also affirmed the role of the state in ensuring economic growth, social justice, and services such as health, education, and respect for human rights.[44] After 9/11, U.K. policy focused attention on weak and failing states also. The Ministry of Finance and DFID agreed to concentrate 90 percent of foreign assistance in low income countries. More recently, DFID has made plans to scale up its funding for fragile states by 35 percent over the next three years.

DFID is also committed to medium-term predictability and it often signs three-year agreements with governments and even has some ten-year partnership agreements.[45] It acknowledges the importance of development in enhancing security particularly in weak states. However, it does not initiate programs exclusively linked to U.K. or global security concerns as such; instead it seeks to address "human security" of the poor in developing countries in order to "benefit everyone's safety, whether rich or poor."[46] To this end, DFID aims to consider regional conflict and insecurity, improvements to governance and accountability that foster security, and conflict reduction mechanisms like conflict prevention pools and transparency of payments for extractive industries.[47] DFID has been developing a deep knowledge around engaging fragile states and has been refining a number of analytical tools to strength the organization's expertise in this area. It also has been employing a "portfolio quality measure" to assess performance over time in fragile states.

DFID recognizes some have bypassed fragile states and the need to engage them more actively by bridging the gap between humanitarian relief and development.

> Fragile states are the hardest countries in the world to help develop. Working with them is difficult and costly and carries significant risks. Aid programs in fragile states pose difficult policy dilemmas. All too often, donors have made the calculation that it is less harmful to do nothing or to rely on humanitarian responses. As repeated crises in Darfur show, this matters because, while humanitarian aid can save lives in the short term, it cannot address chronic state weakness.[48]

In November 2001, the World Bank launched its low-income countries under stress or LICUS

[43] Millennium Challenge Corporation, *MCC and the Long Term Goal of Deepening Democracy*, November 2007.

[44] DFID (1997).

[45] OECD/DAC (2006).

[46] U.K. International Development Act 2002.

[47] Owen Barder, "Reforming Development Assistance: Lessons from the U.K. Experience," Center for Global Development. Working Paper, October 2005.

[48] DFID, *Why we need to work more effectively in fragile states*. U.K. Department for International Development (London: DFID 2005).

The World Bank Group's financial support going to fragile states:

- Bank's contributions to trust funds have increased from $136 million in 2002 to $821 million in 2006.
- Parallel increase in trust fund disbursements have grown from $130 million in 2002 to $679 million in 2006, to an aggregate five-year total of over $2.2 billion.
- Post-conflict funds have received a total of $90.3 million of which 56 percent goes toward fragile states (20 middle and low-income countries covered by the PCF), while five countries (Afghanistan, Burundi, Haiti, Somalia, and Sudan) account for 51 percent of total grants approved for fragile states.
- September 2007: World Bank contributes $3.5 billion from its income to provide grants and credits to the world's poorest countries through the 15th replenishment of the International Donor Association (IDA).
- December 2007: Donors contribute to the World Bank funding amounting to $41.6 billion to help overcome poverty in some of the world fragile states.
- Over the past decade, the IDA has allocated 19 percent of its total resources to fragile states. Fragile states have also benefited from the increased concessionality of IDA assistance that has resulted from the introduction of grants in IDA13 and IDA14.
- Total HIPC and Multilateral Debt Relief Initiative (MDRI) assistance delivered as of mid June 2007 to fragile states is around $13.4 billion in NPV terms.

Source: *The World Bank in Fragile Situations: An Issues Paper.*

Taskforce. The LICUS initiative was intended to address those countries at the bottom of the World Bank's Country Policy and Institutional Assessment (CPIA) rankings that suffer from extreme institutional capacity and conflict-related problems. This effort sought to fill the void in research and expertise on these uniquely challenging development contexts and generate operational strategies and reforms to more effectively support them. It identified the need for scaling up "peacebuilding" and "statebuilding" in fragile states by mainstreaming these efforts into development activities in all sectors, as appropriate to the country context; taking an integrated approach by building stronger partnerships with other organizations; and strengthening the Bank's organizational response (as of 2005, over 70 percent of LICUS country offices had zero or one internationally recruited staff person).[49]

The Bank has employed a number of instruments to target fragile states, such as the LICUS Implementation Trust Fund (LICUS TF), the post-Conflict Fund (PCF), Multi-Donor Trust Funds (MDTFs), and debt relief. The World Bank's International Development Association (IDA) benefited from the largest increase in donor financing its history in December 2007, amounting to $41.6 billion over the next three years and a 42 percent rise over previous commitments. Among the 80 countries eligible for World Bank IDA funds, about half of them either suffer from or are prone to conflict. Along with reforms to increase the quality and quantity of staff working on fragile states, there has been an increase in funding for these countries (see Box).

Among the 80 countries eligible for World Bank IDA funds, about half of them either suffer from or are prone to conflict.

[49] The World Bank, *Low-Income Countries Under Stress: Update,* December 19, 2005.

6 Conclusion

The amount of investments, social analysis, and conflict-sensitive planning currently committed are not commensurate with the obvious threat fragile states pose.

Despite these noble efforts, American, European, and other donors have failed to fund fragile states, failed to help them globalize, and failed to prevent conflict in and around them. Development policy is not often seen through the lens of security. Some donors have demonstrated leadership by formulating fragile state strategies. But, the evidence suggests development policies remain severely misaligned, risk averse, and unable to address this global security challenge. These countries represent the most intractable political, social, and economic problems faced by the international community. They are among the biggest threats to the United States, Europe, and the world. They are a substantial drag on efforts to achieve the MDGs. Yet, the amount of investments, social analysis, and conflict-sensitive planning currently committed are not commensurate with the obvious threat fragile states pose.

Even though aid flows to fragile states have increased in recent years, they are concentrated in a few countries with the majority left behind as "aid orphans." Fragile state aid has largely been in the form of humanitarian and debt relief with limited amounts of technical assistance necessary to help build institutions. Despite the enormous impact aid has on security—for good or ill—aid decisions are not often executed with an eye to the implications on fragile societies and potential conflict. Overall, aid does not prevent conflict; it manages it once it erupts. An emphasis on "good performers" has likely taken attention away from fragile states. The lack of incentives within donors insititutions to invest staff and resources in these more complicated environments has also contributed to this failure. Bridging from humanitarian "life support" to long-term institution building in fragile states remains problematic.

Globalization is leading to a new divide—not between the West and the rest, but between the extreme poor and everyone else. While Collier's development "traps" are well-known and aid agencies are focusing on them, there remains little understanding of how to solve them in these complex contexts. Aid can be too volatile (leading to shocks), too much (leading to Dutch disease) or too project-focused (undermining local institutions). The private sector that is central to globalizing any economy has played a limited role in development policy, especially in fragile and conflict-affected countries. Neoliberal policies often disfavor the world's poorest countries and may undermine peacebuilding efforts. In the absence of policy coherence, there is a kind of myopic thinking among policymakers where aid, trade, and investment operate independently and may undermine poor country efforts to globalize.

USAID, the MCC, DFID, and the World Bank have recognized the challenge of fragile states. Many of their policies seek to adhere to international guidelines such as the "Principles for Good International Engagement in Fragile States." They acknowledge the need for greater internal capacities and external instruments to help fragile states. DFID's focus on "human security" and USAID's focus on "strategic partnerships" reveal a transatlantic difference regarding the role of foreign policy in determining aid allocation decisions. Nevertheless, these cases represent greater momentum toward more comprehensive approaches that recognize the linkages between conflict, society, governance, and local institutions.

As opposed to neoliberal policies, these frontier donors demonstrate an appreciation of the central role of the state as a provider of public services. They consider the importance of governance and accountability. While volatile aid remains a problem, DFID and the MCC have adopted more predictable, longer-term funding strategies. Many donors increasingly recognize the need to design programs with an awareness of the social dynamics in fragile states. For instance, the French Development Agency (AFD) notes how aid can cause great disruption in fragile states—exacerbating tensions, inequalities, predatory behavior, and power struggles. It also notes how it can serve the purpose of social mediation between groups with conflicting interests and strengthen the "microeconomic fabric" of these societies.[50] This idea is echoed by other donors who are calling for peacebuilding to be mainstreamed into development efforts.

Nevertheless, these efforts remain insufficient. The prevailing data show how fragile states remain marginalized. Program design and performance rankings remain "overly technical," often missing critical power dynamics, local politics, and conflict realities. Many donors face constraints from their legislatures. These can prevent donor coordination and restrict the use of alternative aid modalities or heavily influence aid toward states of geopolitical interest, with little regard to conflict prevention. Often the debate over aid to fragile states is narrowly defined in terms of either working with the government or simply by passing it and delivering services through humanitarian and NGO providers. There is limited understanding of the full range of aid instruments for helping fragile states.

Given the limited knowledge about and low level of investments in fragile states, transatlantic learning will be vital to helping improve development practice. For instance, USAID is heavily focused on Afghanistan and Iraq, while DFID and the World Bank are taking on a range of fragile states worldwide. Cross-country and cross-program lessons must be shared. This must not only inform program design, but donor management practices broadly to encourage and help build a cadre of development professionals with fragile state expertise. Staff turnover, training, and a range of incentives must be re-examined.

Cooperation must extend beyond knowledge sharing and translate into transatlantic and global cooperation at the country level to make aid more effective. For instance, there are 13 aid agencies operating in the energy sector alone in Afghanistan, but electricity is woefully inadequate. Some promising aid instruments offer a means to greater cooperation: budget support via Trust Funds (e.g. East Timor and Afghanistan), social funds which provide money directly to communities for small investments and are aligned with local authorities (e.g. the World Bank's National Solidarity Program), pooling funds (e.g. multi-donor trusts and joint programs) and joint assistance frameworks. Sector-wide approaches (SWAps) bring together multiple agencies operating in a single sector to harmonize efforts and align with the local government's priorities. Such approaches offer a wider range of policy options, with various degrees of state and non-state engagement based on different country contexts.

The transatlantic community faces a massive opportunity cost by not redesigning aid to fragile states and lifting millions of people out of poverty, raising incomes, and strengthening global security. This is not only the responsibility of aid agencies, but other government bureaus overseeing foreign affairs, defense, trade, and agriculture, as well as legislatures. This report aims to engage these stakeholders in a broader dialogue to ensure development policy strengthens security through government-wide and transatlantic solutions. Without redesigning aid to fragile states, the livelihoods of the rich and poor alike will remain at risk.

Given the limited knowledge about and low level of investments in fragile states, transatlantic learning will be vital to helping improve development practice.

[50] Jean-Marc Châtaigner and François Gaulme, *Beyond the Fragile State: Taking Action to Assist Fragile Actors and Societies,* Agence Française de Développement, November 2005. To support fragile societies these efforts aim to strengthen and rebuild "micro" relationships and networks through professional organizations, associations, trade unions, communal institutions and chambers of commerce, for instance. These ideas are linked to grassroots democratization and empowerment.

7 Appendix: Fragile States

WB LICUS (2006)	Failed States Index (2008)	OECD (2007)	Difficult Partnership Countries (2002)
Afghanistan	Afghanistan	Afghanistan	Afghanistan
Angola	Bangladesh	Angola	Angola
Burundi	Burundi	Burundi	Burundi
Cambodia	Cameroon	Cambodia	Cambodia
Central African Rep.	Central African Rep.	Cameroon	Cameroon
Comoros	Chad	Central African Rep.	Central African Rep.
Congo, Dem. Rep.	Congo, Dem. Rep.	Chad	Chad
Congo, Rep.	Congo, Rep.	Comoros	Comoros
Cote d'Ivoire	Cote d'Ivoire	Congo, Dem. Rep.	Congo, Dem. Rep.
Eritrea	Ethiopia	Congo, Rep.	Congo, Rep.
Guinea	Guinea	Cote d'Ivoire	Guinea
Guinea-Bissau	Guinea-Bissau	Djibouti	Guinea-Bissau
Haiti	Haiti	Eritrea	Haiti
Kosovo (territory)	Iraq	Gambia	Laos
Lao PDR	Kenya	Guinea	Liberia
Liberia	Lebanon	Guinea-Bissau	Myanmar (Burma)
Myanmar (Burma)	Liberia	Haiti	Niger
Nigeria	Malawi	Kiribati	Nigeria
Solomon Islands	Myanmar (Burma)	Laos	Papua New Guinea
Somalia	Nepal	Liberia	São Tomé and Principe
Sudan	Niger	Mauritania	Sierra Leone
Timor-Leste	Nigeria	Myanmar (Burma)	Solomon Islands
Togo	North Korea	Niger	Somalia
Vanuatu	Pakistan	Nigeria	Sudan
West Bank and Gaza	Sierra Leone	Papua New Guinea	Tajikistan
Zimbabwe	Solomon Islands	São Tomé and Principe	Togo
	Somalia	Sierra Leone	Uzbekistan
	Sri Lanka	Solomon Islands	Yemen
	Sudan	Somalia	Zimbabwe
	Syria	Sudan	
	Timor-Leste	Tajikistan	
	Uganda	Timor-Leste	
	Uzbekistan	Togo	
	Yemen	Tonga	
	Zimbabwe	Uzbekistan	
		Vanuatu	
		Yemen	
		Zimbabwe	

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