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Ten Years of Fragile States: What Have We Learned?

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Introduction

Ten years ago this month, the World Bank established a taskforce to examine how the development community, and the bank in particular, should approach fragile states. This project took on special significance in the wake of the September 11th terrorist attacks, as Western governments awoke to the threats posed by weak and unstable countries, and expressed a new willingness to engage with them.

The taskforce was led by Paul Collier and Ngozi Okonjo-Iweala, then two of the World Bank's leading lights and today considered among the world's foremost development experts. Their report had a profound influence both in shaping how fragility is perceived through a development lens and in defining the emerging fragile states paradigm.

This is not to say that thinking on fragile states has stalled over the past decade. On the contrary, the intervening years have been a period of rapid learning. Many more studies and strategies have been written, not least by the World Bank itself, which is currently in the process of rolling out policy reforms informed by the groundbreaking 2011 World Development Report on conflict, security and development. A supporting set of institutions has sprouted, built around the g7+ group of fragile states and the network of donors with whom they partner, resulting in more honest dialogue, the sharing of experience, and the agreement of shared objectives, norms and metrics of progress. These have tended to build upon the taskforce's initial insights rather than challenge them.

Looking back at the taskforce's report, there is much that remains salient and even prescient. For instance, the report frames the development agenda for fragile states around a narrow prioritization of reforms, starting with security, stability and the rule of law; emphasizes the attainment of feasible, quick wins; and advocates looking beyond government channels for service delivery. Engagement strategies stress the need for socio-political analysis and much deeper forms of donor coordination. Many of these same ideas will, ironically, be presented as new innovations at the High Level Forum on Aid Effectiveness in Busan, Korea later this month.

In three important respects, however, the taskforce's judgments were mistaken. Rather than being rebuked, these mistakes have been echoed in subsequent policy statements by the World Bank and others, and inform the prevailing narrative on fragile states which guides the international development community.

Low-Income Countries Under Stress (LICUS)

At the time when the World Bank's taskforce was assembled, the notion of fragile states was not yet fully fledged. It would be another three years before the term entered the development lexicon. The taskforce instead focused on so-called "Low-Income Countries Under Stress", or LICUS, which became the institution's official term for fragile states.

The World Bank classified countries as LICUS based on their meeting two criteria: a per capita income level below the low-income/middle-income threshold; and poor scores on the bank's Country Policy and Institutional Assessment (CPIA) to connote stress.

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The first criterion is of particular significance. By making low-income a condition of fragility, the World Bank placed fragile states at the very bottom of the development ladder: fragile states were deficient politically, administratively and economically. The report went further, implying a theory of development whereby progress in strengthening capacity, policy and institutions must precede other measures of progress:

> "A key characteristic of LICUS is that they fail to meet the most basic governance requirements for development." (p.8)

There is a flipside to this theory. Just as satisfactory governance is perceived as a necessary condition for economic progress, an income level beyond the low-income/middle-income threshold is seen as sufficient evidence that countries are no longer fragile.

The reality is more complex. Weak governance is undoubtedly a hindrance to development, yet some countries have managed to achieve certain development objectives or attain higher standards of living in spite of their fragility.

Some countries that began poor have progressed so far as to achieve middle-income status, moving ahead economically of those with better policies and institutions.[1] This phenomenon is not new. However, it has become harder to ignore in recent years as Pakistan and Yemen—two of the world's most prominent and quintessential fragile states—have surpassed the low-income/middle-income threshold while appearing as unstable as ever. Other countries that have long been middle-income, such as Iraq, display all the characteristics typically associated with fragile states.

The theory is also being challenged by the growing divergence of standards of political and economic governance seen in the developing world. While much has been written about the rise of the autocratic developmental state, a less remarked upon phenomena is the growing number of countries that can claim to have mastered the basics of economic management, such as price control, public finance management and the enforcement of contracts and property rights. For instance, 20 years ago, 44 countries had rates of inflation exceeding 20 percent. Today the number is only four—much less than the number of countries plagued by conflict, corruption and weak capacity.

To its credit, the World Bank has now retired the LICUS epithet and its latest fragile state classification allows the inclusion of middle-income countries, though only in very restricted circumstances. This falls short, however, of a more systematic policy shift. Certainly few donors have a clear strategy for how to as-

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sist fragile middle-income countries—a group which today contains an estimated one-sixth of the world's extreme poor.[2] An exception is the International Monetary Fund, whose Strategy, Policy and Review Department recently proposed the establishment of a special facility to assist these countries.[3] This facility would be modeled on the fund's approach to low-income fragile states, allowing greater flexibility and more stable engagement but on financial terms appropriate for middle-income countries.

Fragile States Typology

The taskforce report recognized that fragile states are a diverse group and that no single strategy could be appropriate for all of them. Nevertheless, it recommended a typology of six stylized country categories under which fragile states could be organized to guide the World Bank's approach and its choice of policy instruments.

By 2004, these categories had been consolidated into four, each defined in terms of a country's development trajectory: "deterioration"; "prolonged crisis or impasse"; "post-conflict or political transition"; and "gradual improvement". By the following year, these four labels had been subsumed into the OECD Development Assistance Committee's draft principles for good international engagement in fragile states, resulting in their wider adoption across the international donor community.

The idea that fragile states can each be identified by their particular trajectory is appealing to donors. Indeed, it is embedded in the logic of country assistance strategies, which cast the role of donors as assisting a country to transition from point A to point B over the agreement's timeframe. Describing country performance in terms of a series of directional paths provides donors with a simple narrative with which to explain past partner behavior and helps in making difficult decisions regarding country selectivity and engagement strategies.

In practice, however, such trajectories rarely exist. Fragile states are, by their nature, changeable environments given their weak institutions, proneness to internal shocks and low levels of resilience. These vicissitudes rarely follow an obvious pattern and the only meaningful prediction of a country's future position is that it will likely remain fragile.

Where trajectories are most applicable is in post-conflict countries, which are often capable of making rapid recoveries where reforms and progress develop momentum. However, contrary to assumptions, post-conflict transitions make up only a minority of fragile states. For the majority, there is no discernible path.

This does not stop donors from seeing a trajectory where there is not one. Donors are prone to interpret short-term events in fragile states as a sign of longer-term trends. The taskforce report admits as much, describing the regularity with which overtures were made to the World Bank's board in the 1990s for in-

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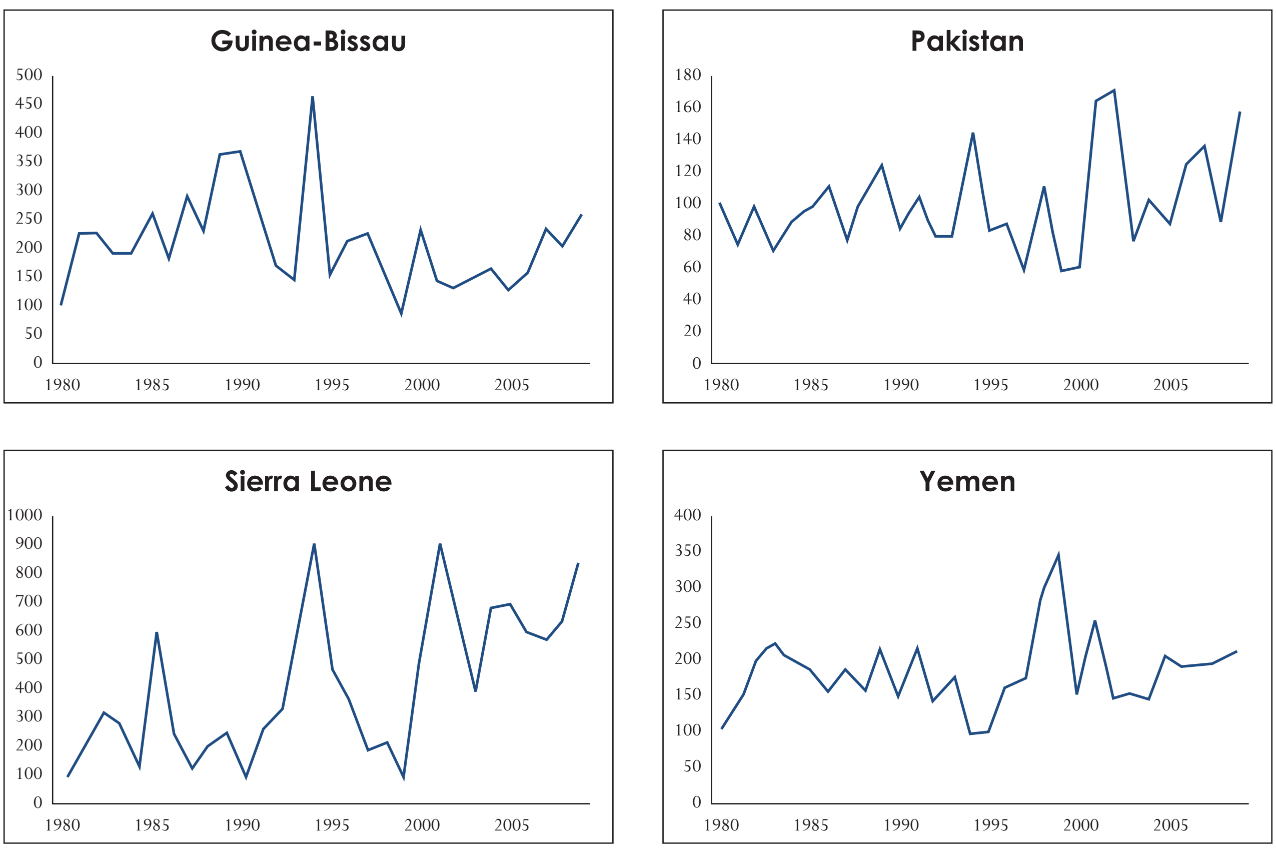
creases in country resources on the basis of a supposed positive turnaround. Equally common are donors' tendencies to overreact to negative events in a country, even when they are consistent with a legacy of mixed but generally poor performance.

The result is that aid flows to fragile states tend to be highly volatile—according to one study, twice as volatile as aid to stable countries.[4] Rather than buttressing countries against their internal instability, aid flows often reinforce these effects (Figure 1). Aid volatility has been found to negatively affect recipients' economic growth and to reduce levels of domestic investment.

Figure 1: Volatile Aid Flows



Source: Author's calculations of strict Country Programmable Aid (CPA) using data from OECD DAC, 2011. CPA is a narrow measure of aid, limited to flows available for development projects and program. Strict CPA excludes technical assistance and net interest. CPA values are individually derived rather than using the DAC's CPA estimates. In the above figure, values are indexed with the average levels between 1970 and 1980 equal to 100.

Over the past year, the detrimental effects of aid volatility in fragile states have been recognized as a serious problem. The 2011 World Development Report raised this issue and the New Deal for fragile states, which will be presented in Busan, commits donors to more stable financing. However, this commitment is unlikely to be fulfilled unless donors change the way they assess and react to events in partner countries.

A donor's response to internal and external shocks in a partner country ultimately reflects the quality of its risk management. When donors postulate a particular trajectory for a fragile state, they are betting on that country's future rather than offsetting the risks inherent to the environment. A more patient approach, consistent with a better risk-result balance, is required to achieve the transformative impact that donors seek in fragile states, recognizing that results can take longer to manifest than in stable settings. A step in the right direction would be for donors to abandon the flawed fragile states typology.

Aid Effectiveness

The most significant claim by the taskforce, and the one with direct implications for the development community, was its judgment on the effectiveness of aid in fragile states. The taskforce did not equivocate on this issue, stating that aid "does not work well in these environments", "may even be counterproductive" and that "donors are impotent against poverty" when operating in these countries.

To understand how the taskforce arrived at such an emphatic conclusion, one must consider the weight of evidence offered in its support.

First was the macroeconomic evidence drawn from cross-country regressions, which found that the impact of aid on growth and poverty is diminished in countries with poor policies and institutions.[5] This research emerged from inside the World Bank in the late 1990s and has been enormously influential in shaping resource allocation decisions by multilateral and bilateral aid agencies.

A second set of arguments concerned the political economy of aid. At the start of the new millennium, two rival models of engagement vied for supremacy within the aid community, each founded on its own theory of change. These were conditionality, which had been a dominant feature of aid relationships in the preceding two decades, and country-ownership, which would later be enshrined in the Paris Declaration on Aid Effectiveness. Neither of these models appeared compatible with fragile states. Experience showed that conditionality had been least effective in bringing about sustained results in countries whose governments lacked commitment to reform and where reform efforts were newly conceived and initiated only under duress. Meanwhile, the merits of country ownership were undermined when partner governments suffered from weak capacity and where elites were more concerned with rent-seeking and clientelism than public good provision.

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Third and final was the micro evidence drawn from individual project assessments. Project ratings by the World Bank's evaluation department and quality assurance group were consistently lower in fragile states than in other countries; on average, projects were twice as likely to be rated as unsatisfactory over the 1990s. This represented, in the words of the taskforce, "a disturbingly high failure rate."

On the strength of these arguments, the taskforce recommended that the development community look to other instruments, such as technical assistance, to engage with fragile states. In other words, aid effectiveness would be best served by avoiding traditional aid giving in the first place.

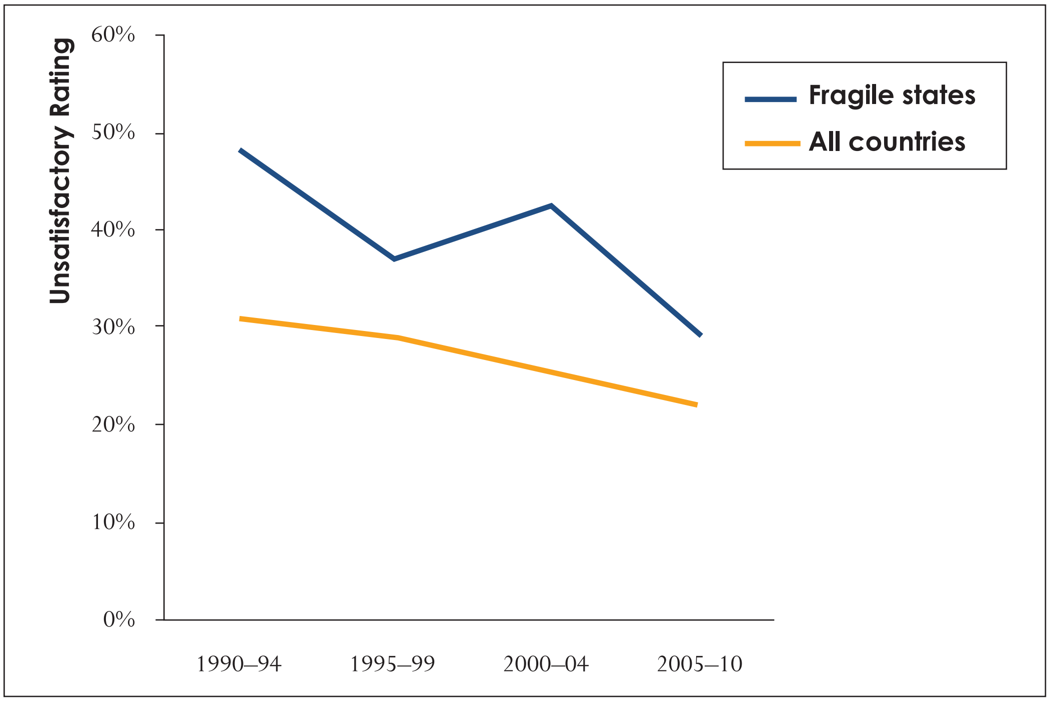
However, reevaluating these same arguments today leads to a very different conclusion.

The macroeconomic evidence cited by the taskforce turned out to be less than robust when replicated with better data and under different specifications. A 2006 report on fragile states by the World Bank's Independent Evaluation Group cited no less than eight papers that countered the original findings.[6]

The emergence of new aid models that are better suited to fragile states has gone a long way to address the political economy constraints that undermined earlier donor-partner relationships. Donor-recipient compacts offer a form of partnership particularly suited to fragile states, where the onus is on achieving high-level political buy-in from the partner country and where objectives are defined in terms of the outcomes being sought rather than the means by which they will be reached. Budget support is currently being employed in some of the world's weakest states—including Afghanistan, Burundi and Central African Republic—through the application of measures that protect against mismanagement and misappropriation, such as budget tracking devices, oversight arrangements, and a reliance on third parties to conduct procurement and audit services. In another example, country ownership has been reconfigured in certain countries, such as Nigeria and Papua New Guinea, to recognize the potential for sub-national governments and communities to substitute for a weak central state in defining development priorities and acting as a reliable partner to donors.

Finally, and perhaps most significantly, the performance ratings of aid projects in fragile states have undergone a remarkable turnaround. In the past 20 years, the gap between project performance in fragile and stable settings has closed (Figure 2). Thus, the World Bank's 2011 annual evaluation report noted that the satisfactory rating for projects in fragile states is no longer significantly different to that for other countries.[7] The strong performance of today's aid projects in fragile states is not limited to the World Bank. A recent report on the Global Fund to Fight AIDS, Tuberculosis and Malaria found that their grants to fragile states on average performed well across all measures, with 83 percent of targets met.[8]

Figure 2: World Bank Project Performance Ratings



Source: Author's calculations based on World Bank, 2002; IEG, 2006; IEG, 2010; IEG 2011a; IEG 2011b.

Can the improvement in project ratings really be believed? A skeptic would likely question the veracity of project evaluations, arguing that they pay insufficient attention to the sustainability of results, which is a critical issue in fragile states, and that the timeframe within which projects are evaluated needs to be modified to provide a true assessment of impact. One might also suspect whether the improvement in project ratings reflects donors' capacity to bring about change or rather donors' realization of their limited capacity and corresponding adjustments to project design. If the focus, scope and ambition of contemporary aid projects in fragile states have been discounted, then the overall impact of aid is likely diminished. This we could call the "soft bigotry of low expectations" effect.

These claims probably contain at least a sliver of truth and provide useful lessons for donors: the need for more frequent and tailored evaluations for aid to fragile states, and the importance of focusing aid on delivering results at scale in priority areas, as opposed to trivial interventions of limited scope. However, they cannot invalidate the core inference that the performance of aid in fragile states has improved. Today's aid projects are informed by a decade of experience, as evidenced by the emergence of new models of donor engagement that adjust to the political economy challenges of fragile settings. This learning has reaped dividends.

For now, much of the development community remains oblivious to this reality and is convinced that aid in fragile states is largely ineffective, in keeping with the findings of the taskforce. Donors that are especially committed to supporting fragile states, such as the U.K. Department for International Development and the Australian Agency for International Development, have had to defend their country selectivity against critics who view their efforts as futile. Other donors are themselves among the skeptics and have steered clear of aiding fragile states. In both cases, this cynicism has lessened aid's potential to address critical development needs.

Notwithstanding the taskforce's recommendations, the World Bank has continued to provide aid to many fragile states over the past decade. In fact, it has been a leading proponent and source of improved approaches to aid giving in fragile settings. This is set to continue with the World Bank's current reform program, which includes the establishment of a Global Center for Conflict, Security and Development in Nairobi to conduct research and provide technical support to country teams.

However, the taskforce's judgments maintain a hold over the World Bank's activities. This can be seen in the bank's predilection for allocating aid on the basis of countries' institutional performance—a policy which remains deeply embedded in the agency. Given that fragile states score poorly on CPIA ratings by definition, it makes little sense to base allocations to these countries on institutional quality. But that is exactly what the World Bank has tried to do, establishing a special allocation index to determine access to concessional finance for post-conflict and reengaging countries, which closely resembles the CPIA. This kind of cognitive dissonance undermines the World Bank's efforts.

A New Approach to Resource Allocation

After 10 years of fragile states policy, ranging from the successful to the ineffective, the development community is a lot wiser. This period— book-ended by the formation of the World Bank's fragile states taskforce and the fourth High Level Forum on Aid Effectiveness—has generated a wealth of knowledge which can inform future policy development and engagement strategies. Busan provides an opportunity to update the narrative around fragile states and to explode some of the falsehoods that have endured since the taskforce's report was completed.

The establishment of the World Bank taskforce was motivated first and foremost by a desire to help fragile states. This desire was borne out of recognition of the development needs facing these countries and the external costs posed by instability, state failure and conflict.

Yet the taskforce could not justify giving aid to fragile states if that aid risked being a waste of money, as the evidence of the time attested. Reinforcing this belief was the preponderance of other developing countries competing for aid dollars, where donors had much greater confidence that their money could be spent effectively and where development needs were equally pressing. For many aid agencies, the trade-offs to supporting fragile states were perceived as too great—a judgment institutionalized in their resource allocation models.

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Today, there is mounting evidence that aid to fragile states can work. Furthermore, with less than a dozen stable low-income countries left, donors no longer have the same excuse for overlooking the needs of the 30 or more fragile states.[9] These needs loom ever larger. Over just the past six years, the share of the world's poor living in fragile states is estimated to have doubled from 20 to 40 percent.[10] No fragile state has yet achieved a single Millennium Development Goal.

Nevertheless, donors still face a difficult decision in determining whether to aid fragile states, and if so, by how much. Achieving results in these settings almost certainly requires greater expertise and time, which translate into higher cost and risk. A successful start to the second decade of fragile states policy would see donors redesign their resource allocation models to capture this reality. New models should:

- *Recognize that fragility does not end with graduation to middle-income status.* Where donors make special allocations to low-income fragile states compared to low-income stable countries, an equivalent policy should be employed to distinguish allocations between fragile and stable middle-income countries.
- *Allow for more stable financing to fragile states.* Donors should avoid trying to pin a trajectory on each partner country and instead concentrate on mitigating the instability inherent to fragile states by providing stable aid flows, supported by improved approaches to risk management. Aid commitments should be embedded in country compacts, which can serve as a useful tool for stabilizing flows.
- *Reassess the cost-effectiveness of aiding fragile states* There is an enormous potential for aid to help fragile states if it is properly designed and managed. This potential needs to be weighed up against an accurate sense of the costs of aid delivery. The effectiveness of aid flows to fragile states could be enhanced further by establishing a more systematic approach to documenting and learning from development interventions. This effort should be carried out under the supervision of the g7+ and focus on interventions with significant scope and scale.

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