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Financing Peace: International and National Resources for Postconflict Countries and Fragile States

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FINANCING PEACE:
INTERNATIONAL AND NATIONAL RESOURCES FOR POSTCONFLICT COUNTRIES AND FRAGILE STATES

James K. Boyce and Shepard Forman

Background paper for World Development Report 2011

October 2010

Abstract

This background paper for the World Bank's *World Development Report 2011* discusses current financing arrangements for postconflict countries and fragile states, with a focus on official development assistance. In recent years a consensus has emerged that in these "difficult environments" the core objective is to build effective and legitimate governance structures that secure public confidence through provision of personal security, equal justice and the rule of law, economic well-being, and essential social services including education and health. Yet tensions persist between business-as-usual development policies on the one hand and policies responsive to the demands of peacebuilding on the other. The preferential allocation of aid to "good performers," in the name of maximizing its payoff in terms of economic growth, militates against aid to fragile and conflict-affected states. Compelling arguments can be made for assistance to "poor performers" if this can help to prevent conflict and build peace, but the difficulties that prompted donors to become more selective in aid allocation remain all too real. The move to selectivity came in response to evidence that in some contexts aid has perverse effects on economic performance. The same dilemma arises when aid is assessed in terms of its impact on peace and conflict: sometimes aid helps to prevent conflict and build peace, but sometimes it can have the opposite effect. This paper considers how international aid can more effectively help to build resilient states and durable peace.

Keywords: aid; conflict; peacebuilding; statebuilding; fiscal capacity.

JEL codes: F35, F53, F59. H87, O19

1. Introduction

After more than a decade of experience and research on financing arrangements in postconflict countries and fragile states, a consensus has emerged on at least one matter: the core objective is to build effective and legitimate governance structures that secure public confidence through provision of personal security, equal justice and the rule of law, economic well-being, and essential social services including education and health. These governance structures are necessary to ensure that countries do not turn, or turn back, to violence as a means of negotiating state-societal relations.

Building institutional capacity and providing critical public goods and services in these settings requires financial resources. In many cases, these resources initially must come in substantial measure from international sources. In the long run, however, external resources must be replaced by domestic resources. Therefore, a key task is to build the national fiscal capacities and tax base that are necessary for a durable peace.

This understanding represents a shift from earlier years when peace-making, peacekeeping and peacebuilding were treated as discrete activities; political, security, and development objectives were pursued as if each was independent of the other; and conflict prevention was, to put matters bluntly, nobody's business.

Much remains to be done to translate this new consensus into effective policies, but its basic principles are now well-established in the normative frameworks of the United Nations,[1] the World Bank,[2] and bilateral donors as distilled in the OECD Principles for Good International Engagement in Fragile States and Situations.[3]

While an integrated approach to early recovery and political stabilization is becoming the norm, replacing the older notion of a sequential movement – starting with security, and moving through humanitarian assistance, infrastructure recovery, and justice and reconciliation, to development – critical sectors continue to be underfunded. Too little is invested in effective capacity building in recipient countries, and for that matter in building relevant capacities within bilateral and multilateral donor agencies themselves. Too little is invested in building national fiscal capacities; among other things, too few resources are channeled through national budgets and too little attention is paid to building civil society capacities to monitor government finances in the interest of ensuring transparency and accountability. Too little is invested in employment generation and sustainable livelihoods, notably in rural areas.

On top of these substantive weaknesses are institutional ones. The current architecture of international finance for aid to postconflict and fragile states militates against the timely,

[1] UN S/2009/304 Report of the Secretary-General on peacebuilding in the immediate aftermath of conflict.

[2] Zoellick (2009).

[3] OECD (2007).

predictable and effective delivery of resources. It lacks tracking, monitoring and evaluation mechanisms that would be necessary for accountability among donors, recipient governments, and their constituents. It is not well-suited to adapt to changing circumstances and opportunities. And it lacks the capacity to formulate coherent policies to address the regional dimensions of conflicts.

This paper discusses a number of the weaknesses in current financing arrangements for postconflict countries and fragile states, with a focus on official development assistance (ODA). We argue that tensions persist between business-as-usual development policies on the one hand and policies responsive to the demands of peacebuilding on the other. The preferential allocation of aid to "good performers," in the name of maximizing its payoff in terms of economic growth, militates against aid to fragile and conflict-affected states. If the aim of aid is redefined to include durable peace, the conventional performance criteria for aid allocation lose much of their force. Compelling arguments can be made for assistance to "poor performers" if this can help to prevent conflict.

Yet the difficulties that initially prompted donors to become more selective in aid allocation remain all too real. Experience has shown that aid can exacerbate problems rather than solving them. The donor move to selectivity came in response to accumulating evidence that in some contexts aid has perverse effects on economic performance. The same dilemma arises when aid is assessed in terms of its impact on peace and conflict: sometimes aid helps to prevent conflict and build peace, but sometimes it has the opposite effect. In responding to this dilemma, simply retreating from intractable problems in difficult settings does not offer a solution. The challenge is to devise policies that make the problems more tractable.

2. Literature Review

The OECD's *Principles for Good International Engagement in Fragile States & Situations* define states as fragile when "state structures 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" (OECD 2007, p. 2). This formulation suggests that states may have the capacity to provide these basic functions but lack political will to do so; that they may have political will but lack capacity; or that they may lack both.[4] A subsequent OECD/DAC discussion paper adds a third dimension

[4] The dual criteria of *will* and *capacity* are adopted by other authors, as well. For example, in proposing an "index for state weakness," Rice and Patrick (2008, p. 3) define "weak states" as lacking "the essential capacity and/or will to fulfill four sets of critical government responsibilities: fostering an environment conducive to sustainable and equitable economic growth; establishing and maintaining legitimate, transparent, and accountable political institutions, securing their populations from violent conflict and controlling their territory, and meeting the basic human needs of their population." Similarly, in a working paper for the UK Department for International Development, Moreno Torres and Anderson (2004, p. 12) similarly refer to both political will and capacity in defining "difficult environments" as settings where "the state is unable or unwilling to harness domestic and international resources effectively for poverty reduction."

to the definition: legitimacy, or the ability of the state to meet its population's expectations (OECD 2008, p. 16).[5]

Postconflict states are often fragile, and fragile states are often at risk of violent conflict. But the risk is especially high in postconflict settings. Describing this "conflict trap," Collier et al. (2003, p. 107) concluded that the risk of conflict is five times greater in postconflict countries than in the "typical marginalized country that has not had a war for 10 years." Peace agreements can turn out to be little more than ceasefires.

Public finance in the state-society contract

The term "statebuilding" is used in the literature to describe efforts to move from fragility to a situation where states have the political will and capacity to provide the basic functions to advance the economic well-being and safeguard the physical security of their populations, thereby gaining legitimacy and reducing the risk of violent conflict. "Peacebuilding" – the construction of a durable peace based in many cases in formal peace accords – is statebuilding in settings where the task is complicated and jeopardized by the legacy of conflict (Call and Wyeth 2008).

The twin goals of building resilient states and durable peace are increasingly understood to hinge on the relationship between states and their citizens. A robust relationship is sometimes termed the "state-society contract." This understanding represents a break from state-centric formulations that focus on capacity alone, as reflected, for example, in the following statement: "The question of whether security will be provided in a way that meets the needs of citizens, or will function primarily as an instrument of oppression, will not be dictated by capacity, but shaped – indeed, often usefully constrained – by the basic political process of state-society contract formation and reformation" (OECD 2008, p. 8).

Public finance – domestic revenue mobilization, budget allocation, and expenditure management – is the circulatory system of the state-society contract. Recent literature on peacebuilding and statebuilding has begun to make the public-finance connection (see, for example, Boyce and O'Donnell 2007; Brautigam, Fjeldstad and Moore 2008; FIAS 2009), but its intellectual pedigree is long and deep. The OECD's fragility triad – capacity, will, and legitimacy – mirrors very closely "three reasons to give taxation particular attention" enumerated by the historical sociologist Charles Tilly (2009, p. xiii):

> *First, over the long run it constitutes the largest intervention of governments in their subjects' private life, so much so that the history of state expansion becomes*

[5] The criterion of legitimacy has also been invoked by other authors. For example, Rotberg (2004, p. 1) writes: "Nation-states fail when they are consumed by internal violence and cease delivering positive political goods to their inhabitants. Their governments lose credibility, and the continuing nature of the particular nation-state itself becomes questionable and illegitimate in the hearts and minds of its citizens." In a similar vein, Ghani and Lockhart (2008, p. 126) write that "citizens provide the ultimate source of legitimacy for a social order," and Picciotto (2008, p. 9) characterizes fragility as a situation in which "the society is fractured, the economy is mismanaged and social service delivery is so weak that the social contract between the state and the people has been undermined or has broken down altogether."

> *a history of violent struggle over taxes, and the history of state consolidation becomes a history of tax evasion by those who have the guile and power to frustrate the fisc. Second, follow the money: the circulation of resources from subjects to government-initiated activities provides a sort of CT scan for a regime's entire operation. Third, it dramatizes the problem of consent.*

International financing can impact all three dimensions of fragility – capacity, will, and legitimacy – for better or for worse. The OECD's *Principles for Good International Engagement in Fragile States & Situations* recognizes, in its preamble, that "international actors can affect outcomes in fragile states in both positive and negative ways" (OECD 2007, p. 1). In other words, it is not only the quantity of international assistance to fragile states and postconflict countries that matters, but also the qualities that determine the sign and magnitude of its impact on peace and state resilience.

International financing

Very substantial international financial resources – and human resources – are now devoted to postconflict peacebuilding operations. To cite one indicator, UN troop levels rose by 600% from 2002 to 2008 (OECD 2008, p. 28). Direct international provision of security in postconflict states now engages more than 170,000 troops, a phenomenon that has been described as "a massive shift in global governance arrangements" (OECD 2008, p. 28). Official development assistance, the focus of this paper, is an important part of this international engagement.

Some literature has pointed to a pronounced disparity, however, between the generous international resources directed to postconflict states and the relatively few resources directed to other fragile states that are merely *at risk* of violent conflict. Analyzing aid flows to "difficult partnership countries," an earlier euphemism for fragile states, Levin and Dollar (2005) estimated that these countries received 58% less bilateral aid and 34% less multilateral aid than their non-fragile counterparts, when controlling for differences in population, per capita income, and CPIA (World Bank Country Policy and Institutional Assessment) scores; without controlling for CPIA scores the difference would be greater. Yet within this group, postconflict countries were an exception, receiving *more* aid per capita than the average for low-income countries as a whole, a finding the authors rather disarmingly characterize as supporting the "hypothesis that donors increasingly pay attention to post-conflict opportunities" (*ibid.*, pp. 14-15).

This disparity between the international financing devoted to postconflict and other fragile states is poignantly captured in the words of an ambassador from a fragile but not postconflict state: "Why do we have to wait until we have a war to get help with the transformation of our justice system or our military?"[6]

These generalizations conceal significant differences, however, within the postconflict and non-postconflict subsets of fragile states. The OECD *Principles* conclude with the

[6] Quoted in OECD (2008, p. 27).

admonition to donors to "avoid pockets of exclusion," citing the problem of "aid orphans," states (as well as sectors and groups within societies) where aid volumes remain low even in the absence of significant political barriers to engagement (OECD 2007, p. 3). Noting the disparities between "darlings" and "orphans," Levin and Dollar (2005, pp. 18, 25) observe that aid orphans are concentrated in Africa, particularly francophone Africa, and that their per capita aid flows are not only lower but also more volatile. These disparities cannot be explained by differences in needs; instead the explanation must be sought in the various motives of aid donors – which include geopolitical considerations and commercial interests in addition to humanitarian, developmental, and peacebuilding/statebuilding goals – and to the "strategic dilemmas" that arise when these objectives are mutually contradictory (Paris and Sisk 2007; OECD 2010a).

Apart from these inter-country allocation issues, concerns have been raised in the literature about the timing of aid disbursements in postconflict countries (Forman and Patrick 2002). Collier and Hoeffler (2004) observed that aid levels tend to be high in the first postconflict years but soon decline, and suggest that this pattern does not match absorptive capacity – the country's ability to translate aid into economic growth – which may move in the opposite direction. This argument is echoed in the World Bank publication *Breaking the Conflict Trap* (Collier *et al.* 2003, pp. 157-159). Kang and Meernik (2004) find a similar pattern but suggest that this is responsive to immediate postconflict needs. Suhrke and Buckmaster (2005), in contrast, offer evidence that this pattern is by no means universal, and point to the importance of distinguishing between commitments (when aid is pledged) and disbursements (when the money is actually spent). In addition, Suhrke, Villanger and Woodward (2005) dispute the Collier-Hoeffler conclusion that aid has significantly stronger impacts on growth in the period four to seven years after peace, on the grounds that this finding is sensitive to changes in sample selection and econometric specification.

The sectoral allocation of aid within postconflict countries and fragile states has also been subject to occasional scrutiny and questions. In an analysis of aid to postwar El Salvador, Boyce (1996, pp. 130-135) reported discrepancies between peace implementation priorities, as defined by the government and United Nations, and donor priorities: high-priority peace programs – including the National Civilian Police, the land transfer program for ex-combatants, and judicial and democratic institutions – remained under-funded, while donors directed more resources to lower-priority needs such as physical infrastructure. A recent OECD study of statebuilding assistance in six case-study countries observes that agriculture has received a small percentage of bilateral assistance, decreasing over time, despite the crucial role of this sector in livelihoods and economic growth (OECD 2010a, pp. 109-110).

Resolving allocation issues and achieving policy coherence in international financing is made difficult by lack of coordination among dozens of donor agencies, despite widespread recognition of its importance (Forman, Patrick and Salomons 2000). The 1997 OECD/DAC *Guidelines on Conflict, Peace and Development Co-operation* called upon donors to "attempt to formulate and agree on a common integrated strategic

framework" that would "provide a guide for prioritising resource allocations across sectors and geographical areas, determining the division of labour amongst actors, and defining common approaches towards key policy issues" (OECD 1997, pp. 20-22). To say that this is easier said than done would be an understatement. The latest effort to tackle this problem is the "integrated peacebuilding strategy" process initiated by the UN Peacebuilding Support Office with support from the World Bank.

In the meantime, multi-donor trust funds (MDTFs) have emerged as one way to address the coordination problem (Schiavo-Campo 2003; Leader and Colenso 2005), but they represent only a small share of total aid flows. Some individual donor governments have experimented with "whole-of-government" approaches in an effort to resolve coordination problems among their own agencies. Apart from the attendant risk that the bureaucratic balance-of-power within donor governments will elevate short-term security priorities above long-term statebuilding, these efforts carry the risks that they will further impede coordination among donors and efforts of recipient governments to forge their own whole-of-government strategies (OECD 2008, pp. 45-46).

National finance

The literature on the impact of international financing on domestic revenues in developing countries in general, and in fragile states in particular, has two main prongs. One examines whether aid "crowds out" or "crowds in" domestic revenues. Findings have been mixed (see Section 6 below), suggesting that outcomes are conditional on context and perhaps policy choices.

The second prong asks whether the tax policy prescriptions of the donors – a centerpiece of which has been a shift from tariffs to VAT – have had desirable effects. Baunsgaard and Keen (2005) find that trade tax reductions have had a significant negative effect on total revenue in low-income countries, with growth in other revenues making up only 30% of the resulting losses. In fragile states, where the tax/GDP ratio is often lower than in other low-income countries, and expenditure needs (particularly in postconflict countries) are often higher, the mismatch between revenue needs and tax policy prescriptions has been especially striking (for discussion, see Boyce 2002, Di John 2006, Boyce and O'Donnell 2007, and Fjeldstad and Moore 2008).

In countries with substantial revenues from extractive resources, such as petroleum and minerals, a related set of issues arises: how to ensure that these revenues do not undermine the state-society relationship by freeing the state from the need to enter into the fiscal compact that ties taxation to its delivery of public goods and services. By weakening capacities in "rentier states," resource rents can contribute to state fragility (Karl 1997, Fearon and Laitin 2003). The examples of Botswana and Malaysia, countries where resource rents have supported state capacities rather than undermining them, suggest that this outcome is not inevitable (FIAS 2009). As Di John (2008, p. 22) remarks, "factor endowments do not determine politics."

On the expenditure side of national fiscal capacity, the literature again cautions that international assistance can have crowding-out effects. Aid to fragile states and postconflict countries generally bypasses the government budget to a greater extent than aid to "good performers" (Leader and Colenso 2005, pp. 11-15; OECD 2009b, Table A.9). Apart from the opportunity cost of foregone development of state capacities to allocate resources and manage expenditures, the resulting "dual public sector" – one national, the other international – may diminish state capacities below what they would have been in the absence of aid, as human resources are siphoned off by international agencies and government administrative time is diverted into coping with the attendant coordination problems (Ghani *et al.* 2007; Birdsall 2007; Boyce 2008; OECD 2010a). "The largest adverse impact of the aid system," in the view of Ghani and Lockhart (2008, p. 100), "has been the undermining of a country's budget as the central instrument of policy."

Recommended policies to address this problem are context-specific. Where fragility takes the form of adequate political will but inadequate capacity, increasing the share of aid that is channeled through the budget, with technical assistance and "dual control" systems to minimize leakage and corruption, is seen as desirable (see, for example, Leader and Colenso 2005, pp. 22-23; Boyce and O'Donnell 2007, pp. 287-289; OECD 2008, pp. 40-41). Where the state lacks the political will to advance the economic well-being and protect the physical security of the population, efforts to work "around the state" have more appeal, although as Leader and Colenso (2005, p. 51) observe, "governments in fragile states are rarely homogeneous, and reformers and pro-poor constituencies will exist both within and without the state," creating possible openings for mixed strategies.

Galtung and Tisné (2009) emphasize the potential role of "social-accountability mechanisms" whereby communities and citizen-based groups provide "monitoring from below," noting that this has been successful in a number of developing countries albeit seldom in countries recovering from war. An example is the Poverty Action Fund established in Uganda in 1998, in which 5% of the fund is devoted to monitoring by civil society organizations (Krafchik 2001; Ndikumana and Nannyonjo 2007). Such initiatives could be facilitated by greater transparency on the part of aid donors themselves, an objective of the recently launched international "Publish What You Fund" campaign (http://www.publishwhatyoufund.org/).[7]

Insofar as international financing stimulates local economic activity, this may indirectly advance the fiscal dimension of statebuilding by expanding the country's tax base. Local procurement of goods and services, as opposed to external procurement, serves this goal. This opportunity is often neglected by donors, however, as illustrated in a study on the economic impact of peacekeeping operations in eight countries by Carnahan, Durch and Gilmore (2006). Durch (2009) reports that local content on average represented only 6% of peacekeeping mission procurement in the years 2004-2008; he concludes that for peacekeepers, their contribution to the host economy "is largely incidental to doing their

[7] For a discussion of tensions between "bottom-up" and "top-down" approaches to the measurement of government performance, see Radin (2007).

main job, yet what is incidental to them may be critical to those whose goods and services may be utilized by these sometimes-large civil-military operations" (*ibid.*, p. 15).

Finally, the ability of the state to fulfill the service delivery side of the state-society fiscal contract is affected by the extent to which tax revenue must be devoted instead to external debt service, a legacy of past international financing (Alvarez-Plata and Brück 2007). These debts – sometimes repackaged as new "emergency credits"[8] – drain scarce resources away from the needs of the population. If the original loans provided commensurate benefits to the country's people, this could be argued to justify the cost. But there is econometric as well as case-study evidence that a substantial fraction of past borrowing financed the accumulation of private external assets through capital flight.[9]

3. Trends in International Financing

This section reviews trends in international assistance to postconflict and fragile countries.[10] First we discuss the magnitude and timing of postconflict aid; then we discuss the allocation of aid between postconflict countries and fragile yet non-postconflict countries; finally we discuss sectoral priorities in the allocation of aid.

Postconflict aid: Magnitudes and timing

Postconflict states account for a substantial percentage of official development assistance (ODA) worldwide. Trends in their share of total aid disbursements since the end of the cold war in 1989 are shown in Figure 1, based on two alternative definitions of what constitutes a postconflict country: (i) "formal peace," defined as the period up to 10 years after the signing of a peace accord, as long as conflict does not resume; and (ii) "negative peace," defined as the period up to 10 years after battle-deaths fall below the level of 1,000/year, regardless of whether or not this was accompanied by a peace accord, again as long as conflict does not resume.[11] Although the percentages have declined in the last five years, postconflict countries by the formal-peace definition continue to receive almost 10% of total ODA; by the negative peace definition their share exceeds 15%.

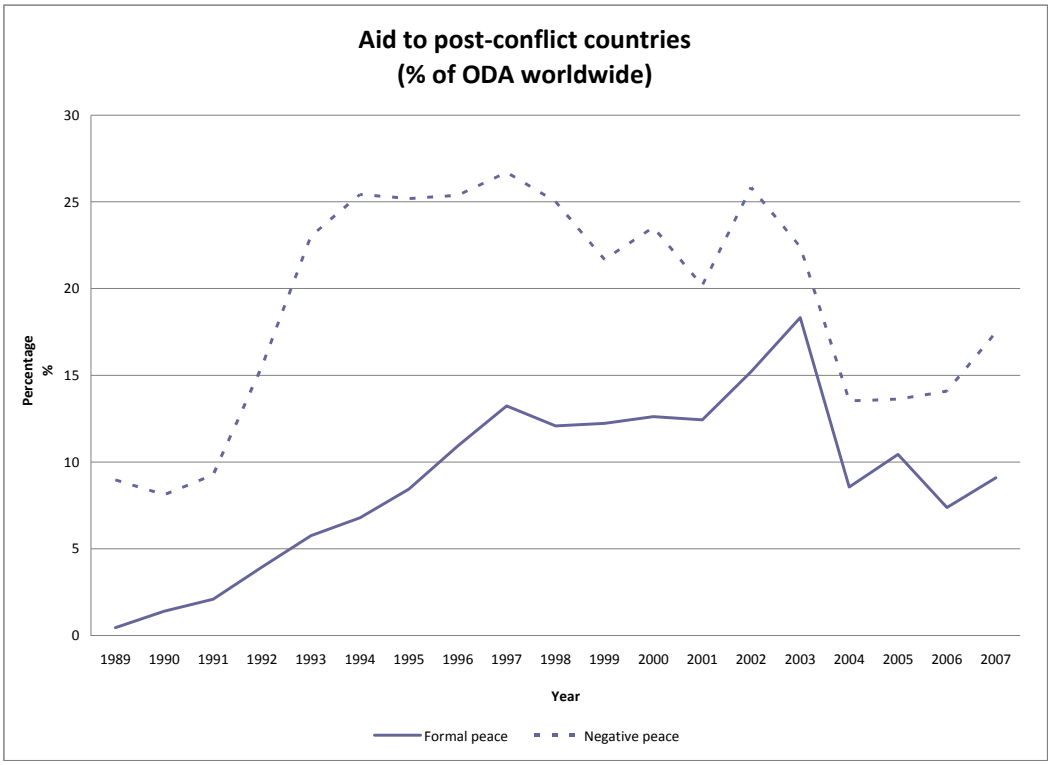
[8] For example, the IMF's emergency credit window for postconflict countries has provided loans to repay bridge loans that in turn were used to clear previous IMF arrears (Boyce 2002, p. 67).

[9] For a case study of the DRC, see Ndikumana and Boyce (1998); for an econometric analysis of the relationship between external borrowing and capital flight in sub-Saharan Africa, see Ndikumana and Boyce (2010).

[10] In this paper our focus is official development assistance (ODA). For discussion of other important elements of the external resource envelope in post-conflict settings, including peacekeeping expenditures and humanitarian assistance, see OECD (2010b).

[11] For this purpose, resumption of conflict is defined as at least 1,000 battle-related deaths/year, as measured by the "intensity of civil war" variable from the PRIO/Uppsala database.

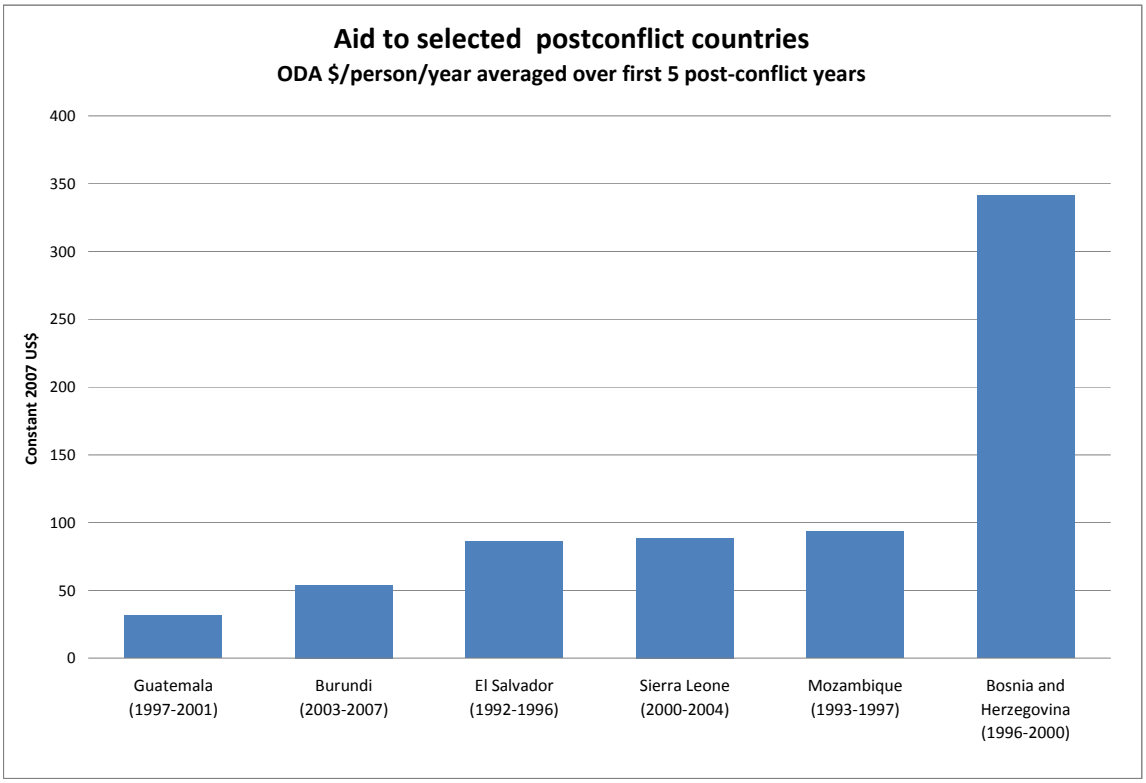
Figure 1



Source: Calculated from OECD-DAC database.

There are large differences among recipient countries in the amount of aid received. Figure 2 illustrates this by comparing annual aid per capita (in constant 2007 dollars) during the first five postconflict years across six countries. Bosnia and Herzegovina tops the list by a wide margin, receiving almost $350/person/year. The other five countries – all in sub-Saharan Africa or Central America – received less than $100/person/year, with aid to Guatemala being the lowest at barely $30 per capita. These disparities almost certainly reflect the geopolitical priorities of the donor countries more than differences in peacebuilding needs and human needs across recipient countries.

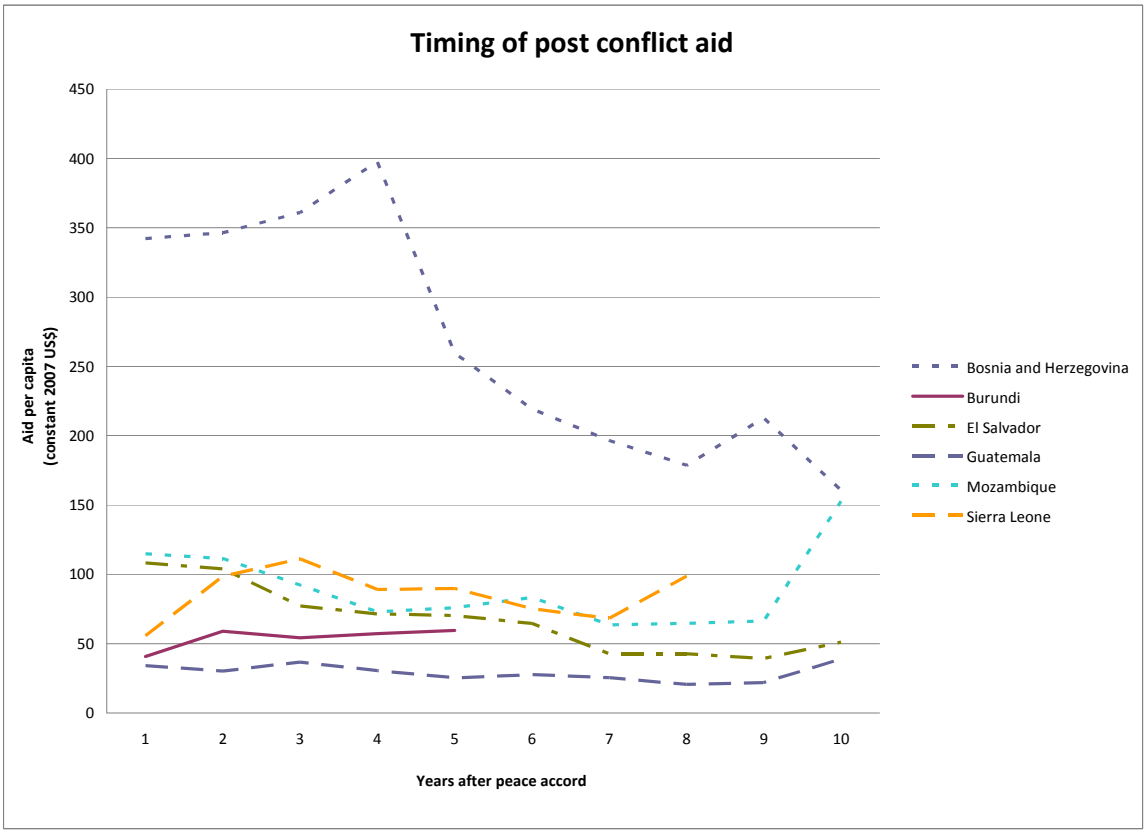
Figure 2



Source: Calculated from OECD-DAC database.

As noted above, some authors have argued that the timing of postconflict aid is poorly aligned with the "absorptive capacity" of recipients, at least if by the latter we mean opportunities to maximize positive impacts on economic growth: it is argued that aid peaks in the immediate postconflict years and subsequently declines, whereas growth impacts are greatest in the middle years of the postconflict decade. The trends depicted in Figure 3 for the same six countries suggest that this picture is not easily generalizable: significant "front-loading" of aid occurred only in Bosnia and Herzegovina, whereas in the other five countries aid was disbursed at a relatively constant level over the postconflict decade. Moreover, objectives other than economic growth underpin the rationale for immediate postconflict assistance.

Figure 3



Source: Calculated from OECD-DAC database.

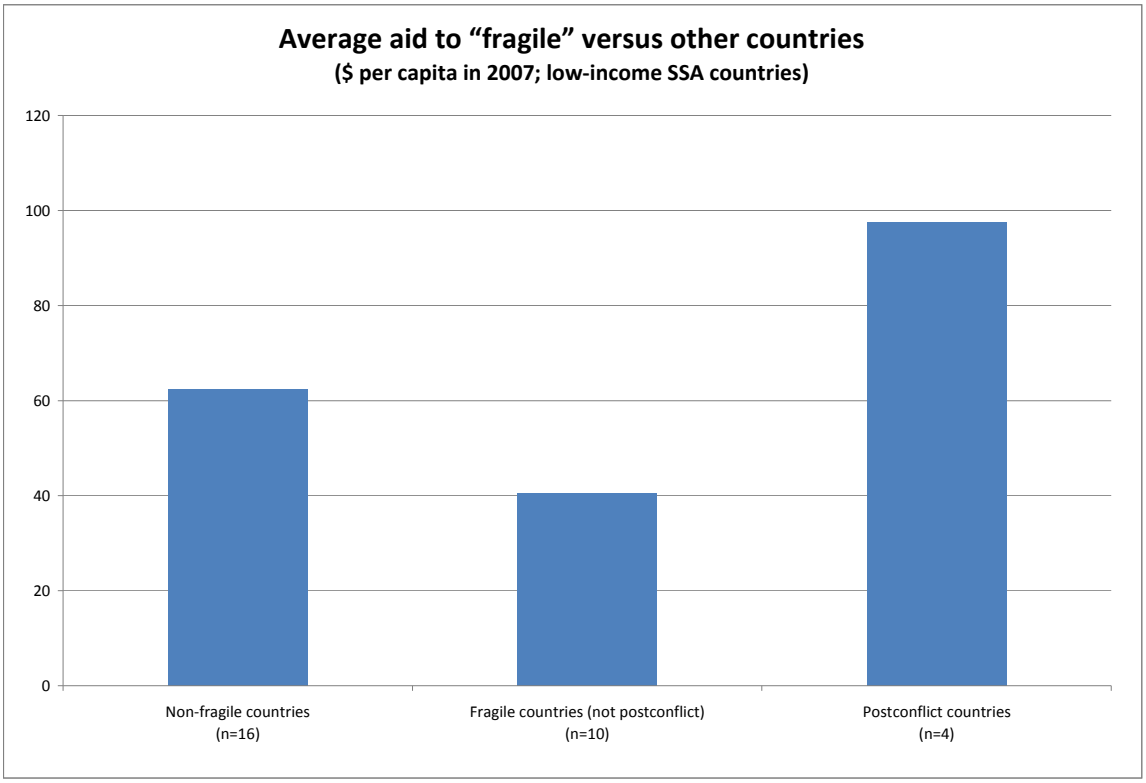
Speed of disbursement is widely regarded as a critical factor in postconflict and fragile state situations where actual and perceived progress is essential to confidence-building. Yet the international financing toolbox remains sluggish, sequential and unintegrated. The case of southern Sudan is illustrative. Sudan's Comprehensive Peace Accord (CPA) was signed in January 2005. A multi-donor trust fund in support of building domestic institutions in south Sudan was established in August 2005, but by January 2006 – a full year after the signing of the CPA – no significant spending from the MDTF had occurred. Limited spending began only in March 2006. Disbursements ran into a Catch-22 stumbling block: World Bank administrators of the trust fund could not disburse without south Sudanese officials themselves setting priorities and approving expenditures, but "the government officials in question had next to no human resources, and the purpose of the MTDF was precisely to help build that capacity" (Chandran *et al.* 2008, p. 20).

Comparison between aid to postconflict and other fragile states

Compared to the international resources provided to postconflict countries – which are substantial, albeit uneven across countries and in some cases over time – the resources provided to "fragile" states *at risk* of conflict (but not postconflict) are far more modest. Indeed, states that are not "postconflict" but are nevertheless classified as "fragile" by the

World Bank receive less aid per capita than non-fragile states. Figure 4 depicts average aid per capita in 2007 for three subsets of low-income sub-Saharan African countries: non-fragile, fragile (but not post conflict), and postconflict (by the formal peace definition). Fragile countries receive only 65% as much aid per capita as non-fragile countries and only 41% as much as postconflict countries.

Figure 4



Source: Net ODA disbursements from OECD-DAC database;
"fragile" as per World Bank definition.

Figure 5 shows per capita aid disbursements in the six low-income West African countries classified as "postconflict" (Guinea-Bissau, Sierra Leone, and Liberia) and "fragile" but not postconflict (Togo, Guinea, and the Gambia) in 2007. Controlling for region, the disparities between the two are even more striking.

Figure 5

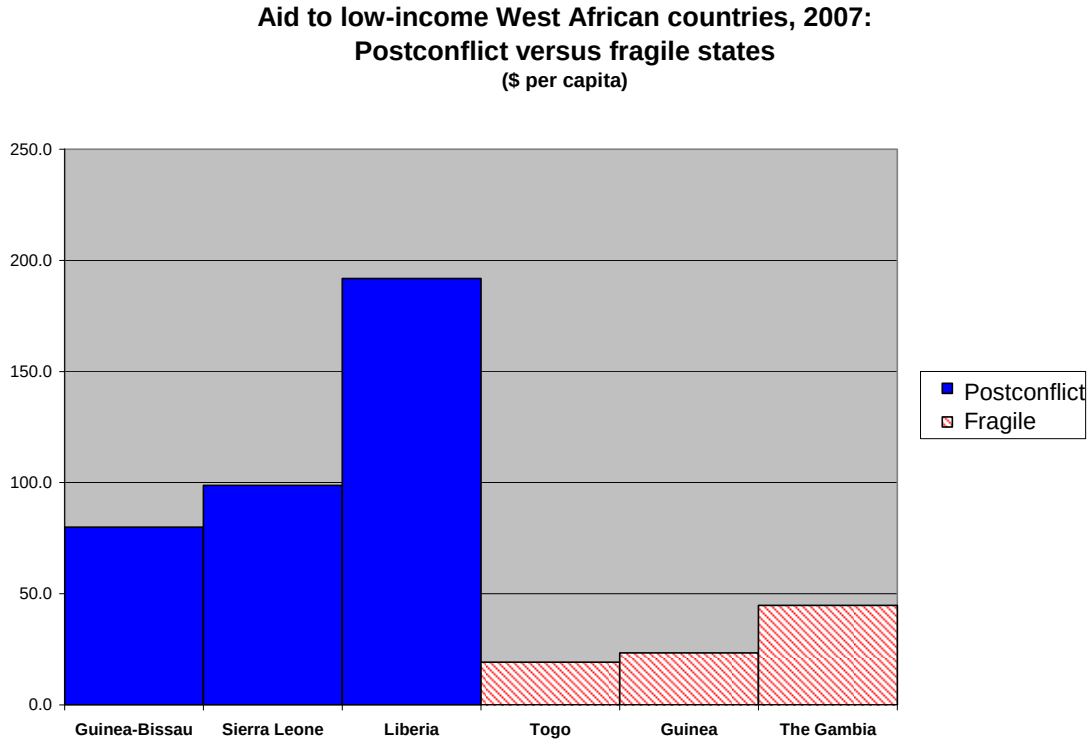
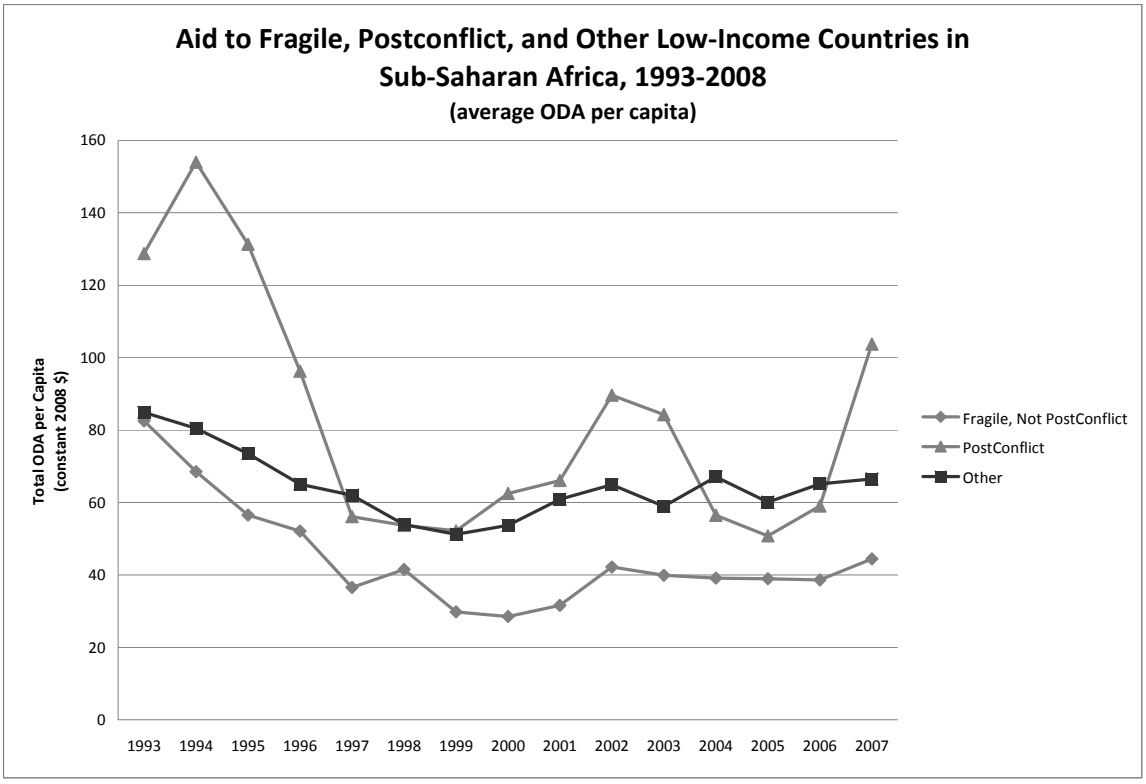


Figure 6 depicts per capita aid trends over the period 1993-2007, again for low-income sub-Saharan African countries. Here we can observe not only that postconflict countries consistently received more aid than fragile countries, but also that the disparity between the latter and other (non-fragile and non-postconflict) countries has widened over time. This trend coincides with a shift in donor policies towards greater "selectivity" (also known as "*ex post* conditionality") in inter-country aid allocation, and away from traditional ("*ex ante*") conditionality, in an effort to foster "country ownership" and "development partnerships" and to increase the impact of aid on economic growth.[12]

[12] For discussion, see World Bank (1998), Koeberle (2003), and Hout (2007).

Figure 6



Source: Net ODA disbursements from OECD-DAC database;
"fragile" as per World Bank definition.

Two observations can be made based on these comparisons. First, selectivity in aid allocation across countries, so as to favor "good performers" with "good policies," may contribute systematically to lower aid to fragile countries than to non-fragile countries. Donors face a dilemma: preferentially allocating aid to those countries where it is likely to have the strongest pro-growth impacts (at least, in the short run) means providing less to those countries classified as "fragile states." Second, if and when the latter "at-risk" countries descend into violent conflict, much greater resources ultimately are provided as postconflict aid. Together, these observations suggest that it would be more cost-effective to allocate more resources to fragile states *before* the onset of violent conflict.

This conclusion rests, however, on the less-than-certain premise that additional international assistance would reduce rather than increase the likelihood of conflict; in

other words, the assumption that aid to fragile states would support *conflict prevention.* It would be naïve to assume that this happy result necessarily holds. On the contrary, inappropriate aid can foster polarization and generate conflict.[13] As an OECD report on "Resource Flows to Fragile and Conflict-Affected States" observes, both natural resources *and ODA* are "particularly easy targets" for corrupt (loot-seeking) behavior (OECD 2009a, p. 96, emphasis added). Corruption, in turn, may feed, and feed upon weak governance and insecurity, combining in what Zoellick (2008) describes as a "downward spiral."

Yet the same caveat applies to postconflict countries: here, too, aid may have perverse effects, exacerbating the likelihood of renewed conflict and becoming a target for corruption. Indeed there is no reason to assume that these risks are greater in fragile states without a recent history of violent conflict than in postconflict countries. Hence the relatively low per capita aid provided to fragile states can be viewed as a symptom of resource misallocation by the international community. This said, the case for more aid to "at-risk" countries would be greatly strengthened by the development and use of analytical tools for *ex ante* conflict impact assessment and *ex post* evaluation of aid's effectiveness as an instrument for conflict prevention.[14]

Apart from the *level* of aid per capita, the *volatility* of aid flows may be important since greater volatility can exacerbate uncertainties and make budget and planning decisions more difficult.[15] Table 1 presents data on aid volatility, as measured by the coefficient of variation of annual ODA disbursements, in sub-Saharan African countries in the period 1989-2007. On average, aid flows to postconflict countries and fragile states are more volatile than flows to countries that are neither fragile nor postconflict. There are substantial differences among countries within each group, however, making generalization difficult. For example, if Nigeria and Republic of Congo were omitted from the "fragile, not postconflict" group, the average volatility among the remaining countries would be about the same as that in the "not fragile, not postconflict" group. Moreover, in some cases the greater volatility in the postconflict group can be explained, at least in part, by disruptions attributable to conflict itself. These observations suggest that greater aid volatility may be a country-specific issue rather than a general correlate of state fragility.

[13] For discussion, see Boyce (2002), Flores and Nooruddin (2009), and Hartzell and Hoddie (2010).

[14] For discussion, see Hoeffler and Billerbeck (2010).

[15] For discussion, see Bulir and Hamann (2003), Levin and Dollar (2005), and Kharas (2008).

Table 1: Aid Volatility
(Coefficient of variation of real ODA disbursements, 1989-2007)

Country	Volatility
Post Conflict	0.65
Angola	0.55
Burundi	0.53
Central African Republic	0.39
Congo, Dem. Rep.	1.38
Cote d'Ivoire	0.69
Guinea-Bissau	0.35
Liberia	0.98
Mozambique	0.30
Rwanda	0.37
Sierra Leone	0.58
Somalia	0.77
Sudan	0.91
Fragile, Not Post Conflict	0.62
Cameroon	0.62
Chad	0.26
Comoros	0.33
Congo, Rep.	1.40
Equatorial Guinea	0.47
Eritrea	0.56
Ethiopia	0.44
Gambia, The	0.36
Guinea	0.29
Niger	0.31
Nigeria	2.27
Sao Tome and Principe	0.35
Togo	0.53
Zimbabwe	0.47

Country	Volatility
Not Fragile, Not Post Conflict	0.39
Benin	0.24
Botswana	0.50
Burkina Faso	0.36
Cape Verde	0.21
Gabon	0.73
Ghana	0.34
Kenya	0.39
Lesotho	0.37
Madagascar	0.52
Malawi	0.20
Mali	0.34
Mauritania	0.22
Mauritius	0.67
Namibia	0.24
Senegal	0.28
Seychelles	0.44
South Africa	0.50
Swaziland	0.36
Tanzania	0.38
Togo	0.53
Zambia	0.47

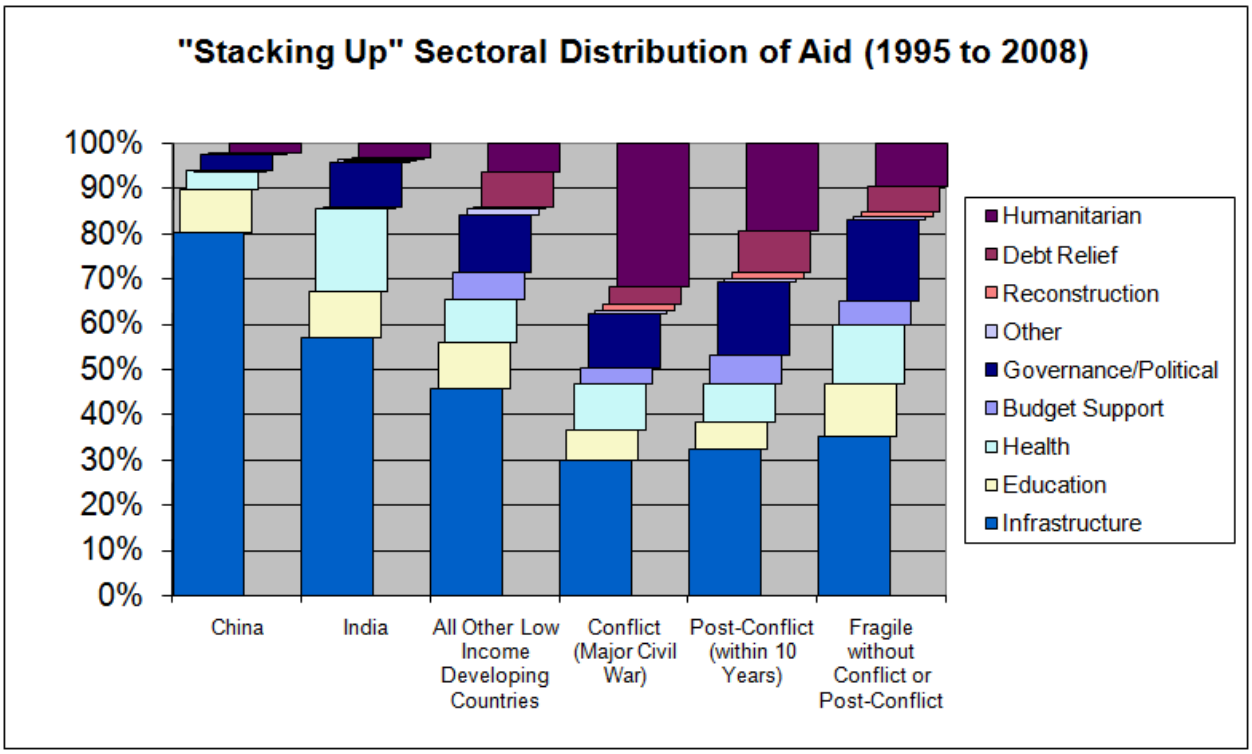
Definitions:
Postconflict: The country is classified as postconflict (by the formal peace definition) at some time during the period.
Fragile: The country is classified as fragile for three or more years during the period.

Sources:
Postconflict and fragile status from World Bank data files. ODA volatility calculated from OECD-DAC Creditor Reporting System database.

Sectoral allocation

The sectoral allocation of international assistance may be just as important as its overall magnitude and timing. The sectoral distribution of aid to fragile and postconflict countries differs from that of aid to other countries (see Figure 7). A lower fraction of aid is spent on infrastructure, although this remains the single largest category of assistance, accounting for more than 30% of total aid in both fragile and postconflict countries. Higher fractions are spent on governance aid and humanitarian relief. These differences are not surprising, and are consistent with reallocation in response to needs specific to these subsets of aid-receiving countries.

Figure 7



Source: OECD-DAC database.

This is not to say, however, that sectoral allocations are optimal. While inter-country differences in needs and aid allocations (as well as lack of finely disaggregated data) make generalizations difficult, there is evidence of a widespread tendency toward underinvestment in the agricultural sector. Table 2 presents data on the agricultural share of ODA in low-income sub-Saharan African countries. Overall, agriculture receives a small share of aid relative to its share of the labor force: it receives more than 10% of aid in only six of the 26 countries, while accounting on average for roughly three-quarters of

the labor force. Of course, some fraction of other sorts of aid (such as transportation, health and education) goes to rural areas, too, mitigating the apparent bias against rural areas if not offsetting it entirely.

What is striking in these data, however, is that the share of aid directed to agriculture in fragile and postconflict countries tends to be lower than in non-fragile countries. Insofar as this is correlated with a lower rural share of non-agricultural aid (for roads, schools, health clinics, etc.), this suggests that the rural population receives a lower percentage of aid in these countries despite the importance of inclusive economic development for conflict prevention and postconflict peacebuilding. Even if we acknowledge the existence of many other pressing needs, it is hard to avoid concluding that something is amiss in Burundi and Guinea-Bissau, for example, where agriculture's share of the labor force is more than 90% and yet agriculture receives barely 1% of ODA.[16]

To provide some idea of the extent to which aid directly supports statebuilding, Table 3 presents data on the share of ODA allocated to governance and budget support in sub-Saharan African countries. "Governance" here is broadly measured as the sum of two categories in the OECD Creditor Reporting System database: "government and civil society" and "other social infrastructure and services."[17] Budget support refers to money that is routed through government budgets, which can strengthen state capacities to allocate resources and manage expenditure. As might be expected, a somewhat larger fraction of aid is allocated to governance in fragile and postconflict countries (12.2% and 16.3%, respectively) than in non-fragile countries (10.3%). The reverse is true in the case of budget support, however: the average share is only 1.9% in fragile countries and 6.1% in postconflict countries, compared to 7.9% in non-fragile countries. Put differently, 98% of the aid to fragile countries in sub-Saharan Africa bypasses the government budget.

The share of aid allocated for support of the rule of law – an element of "good governance" that is often a critical weakness in fragile states and postconflict countries – generally is even smaller than the share for agriculture. Table 4 presents data on ODA disbursements in sub-Saharan Africa in the two sub-sectors in the OECD Creditor Reporting System database that correspond most closely to rule-of-law: "legal and judicial development" and "human rights." Although there is some evidence of responsiveness to the need for greater attention to this sector in fragile and postconflict countries – the share of ODA in these groups averaged 1.0% and 1.5%, respectively, as opposed to 0.7% in non-fragile countries – the most striking feature of these data is the small fraction of aid devoted to this sector.[18]

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[16] The OECD (2010a, pp. 109-110) similarly suggests that in recent years donors have accorded insufficient priority to the agricultural sector in fragile and postconflict countries.

[17] In the OECD classification scheme, the latter category includes not only aid for purposes closely related to statebuilding, such as "statistical capacity building" and "employment policy and administration management," but also aid for less closely related purposes, such as low-cost housing, narcotics control, and "social mitigation of HIV/AIDS." It would be useful if more precise classifications of governance-related assistance could be introduced in the OECD database.

[18] There is no obvious benchmark for ascertaining the "right" amount of aid that ought to be allocated to support for the rule of law (or, for that matter, to other sectors). The percentages of ODA reported in Table

Table 2: Agricultural share of labor force and ODA in low-income sub-Saharn African countries, 2005

Country	Agriculture share of labor force (%)	Agriculture share of ODA (%)
Non-fragile countries		
Mauritania	57.1	31.8
Malawi	89.4	14.7
Kenya	77.3	13.3
Burkina Faso	92.1	12.1
Mozambique	86.5	6.5
Tanzania	82.6	6.4
Senegal	81	4.5
Zambia	74.5	4.2
Madagascar	76.1	2.9
Benin	60	2.6
Ethiopia	78.8	2.4
Uganda	84.6	2.2
Ghana	65	1.9
Non-fragile average	**77.3**	**8.1**
Fragile (but not postconflict) countries		
Gambia	88.9	15.1
Zimbabwe	71.5	1.2
Guinea	86.1	2.1
Eritrea	88.4	2.1
Togo	61.1	1.4
Chad	75.8	0.9
Fragile average	**78.6**	**3.8**
Postconflict countries		
Central African Rep.	68	10.8
Sierra Leone	64.5	5.4
Congo, Dem. Rep.	65.5	1.2
Burundi	92.3	1.2
Somalia	80.1	1.1
Guinea-Bissau	90.9	1.1
Liberia	60.6	0.2
Postconflict average	**74.6**	**3.0**

Source: Calculated from WDI and OECD Creditor Reporting System databases.

3 are similar to the share of judicial and legal system expenditures in total government spending within the donor countries themselves: in 2006-07 these amounted for example to 0.7% in the U.K.; 0.9% in France; and 1.0% in the U.S. (calculated from data from the European Commission for the Efficiency of Justice and the U.S. Census Bureau).

Table 3:
ODA disbursements for governance and budget support in sub-Saharan African countries
(annual average 2006-2008)

Country	Governance ($ million)	Governance (% of ODA)	Budget support ($ million)	Budget support (% of ODA)
Non-fragile countries				
Benin	65.2	10.66	57.6	9.83
Botswana	8	4.89	0	0
Burkina Faso	89.3	8.16	152.1	14.35
Cape Verde	25.1	13.79	12.8	6.64
Ethiopia	335.8	10.98	0.2	0
Gabon	8.9	10.11	0.3	0.43
Ghana	141.6	9.11	201.2	13.14
Kenya	127.6	10.07	19.7	1.46
Lesotho	23.9	20.28	1	1.12
Madagascar	100	9.43	63	6.26
Malawi	97.4	7.38	92.9	7.4
Mali	119.1	9.96	91.9	6.94
Mauritania	40	10.16	10.5	2.95
Mauritius	7.1	6.7	71.1	51.19
Mozambique	223.2	11.09	339.6	16.82
Namibia	22	11.59	0	0
Niger	59.4	8.8	44.6	6.55
Senegal	97.6	8.56	28.8	2.78
South Africa	183.6	19.87	0.1	0.01
Swaziland	4.4	8.62	0	0
Tanzania	285.2	9.53	472.4	15.89
Uganda	199.3	9.34	136.2	5.33
Zambia	100	7.94	150.3	12.02
Non-fragile average	**102.8**	**10.31**	**84.6**	**7.87**
Fragile (but not postconflict) countries				
Cameroon	53.7	3.29	141.5	9.11
Chad	25.8	6.56	8.7	2.82
Congo, Rep.	15.4	5.16	19.1	4.75
Equatorial Guinea	5.3	15.87	0.1	0.25
Eritrea	15.9	11.65	0	0
Gambia, The	13.5	15.55	0	0
Guinea	37	12.7	0	0
Nigeria	201.4	7.8	8.8	0.45
Sao Tome and Principe	8.8	15.11	0.1	0.12
Togo	50.4	26.15	8.2	3.48
Zimbabwe	61	14.48	0.1	0.03
Fragile average	**44.4**	**12.21**	**17.0**	**1.91**
Postconflict Countries				
Angola	70.3	21.21	3.5	1.03
Burundi	57.4	12.42	42.9	9.14
Central African Republic	38.7	19.29	13.2	6.72
Congo, Dem. Rep.	230.2	13.03	2.1	0.11
Cote d'Ivoire	78	13.64	17.6	5.24
Guinea-Bissau	17.1	13.54	11.8	9.66
Liberia	155.6	21.76	3.1	0.46
Rwanda	110.1	11.88	112.1	12.54
Sierra Leone	87.8	20.24	43.9	9.81
Postconflict average	**93.9**	**16.33**	**27.8**	**6.08**

Source: Calculated from WDI and OECD Creditor Reporting System databases. http://bit.ly/cps66x

Table 4: ODA disbursements for rule of law in sub-Saharan African countries
(annual average 2006-2008)

Country	ODA for rule of law ($ millions)	Rule of law share of ODA (%)
Non-fragile countries		
Benin	9	1.58
Botswana	0.5	0.47
Burkina Faso	7.7	0.74
Cape Verde	1.1	0.68
Ethiopia	13.5	0.43
Gabon	0.1	0.15
Ghana	4.4	0.31
Kenya	21.1	1.68
Lesotho	1.7	1.69
Madagascar	4.3	0.44
Malawi	8.9	0.65
Mali	2.5	0.22
Mauritania	0.8	0.23
Mauritius	0.2	0.21
Mozambique	16	0.8
Namibia	1.5	0.81
Niger	3.1	0.5
Senegal	3.2	0.21
South Africa	14	1.61
Swaziland	0.3	0.61
Tanzania	11.7	0.41
Uganda	30.4	1.59
Zambia	5.5	0.42
Non-fragile average	**7.02**	**0.71**
Fragile (but not postconflict) countries		
Cameroon	3.4	0.17
Chad	1.4	0.38
Congo, Rep.	0.6	0.25
Equatorial Guinea	1.3	3.75
Eritrea	1	0.72
Gambia	0.7	0.88
Guinea	0.6	0.17
Nigeria	18.9	0.89
Sao Tome & Principe	0.1	0.21
Togo	1.3	0.88
Zimbabwe	11.9	2.88
Fragile average	**3.7**	**1.02**
Postconflict countries		
Angola	4.2	1.31
Burundi	4.9	1.04
Central African Rep.	2	1.01
Congo, Dem. Rep.	23.5	1.37
Cote d'Ivoire	1.8	0.42
Guinea-Bissau	1.9	1.55
Liberia	2.8	0.36
Rwanda	22.9	2.49
Sierra Leone	16.9	3.76
Postconflict average	**9.0**	**1.48**

Source: Calculated from WDI and OECD Creditor Reporting System databases. http://bit.ly/cps66x

Money is not the only metric for assessing donor priorities or their goodness-of-fit with recipient needs, however, nor is it necessarily the most important. A recent review of donor-supported justice-strengthening programs concluded that "absolute expenditures are often not a good measure of significance," because "some activities simply cost more than others, and some of the most important ones may cost donors very little as they ultimately hinge on cooperating countries' willingness to change policies" (Hammergren 2008, p. 13). Since inadequate donor support for justice and the rule of law is often cited as a problem, it is worth quoting the review at some length:

> *The problem arises when donors finance things (buildings and equipment in Guatemala or the rest of Central America for that matter) the government could easily fund, engage in piloting activities unlikely to be replicated (Cambodia's model court), duplicate each others' efforts, or fund activities likely to disappear once they leave the scene. This is where the imbalances occur – less between what is promised and what is financed, but as part of a more rational consideration of what makes the most sense.… If an activity does not support something that would not otherwise be done; if it does not leverage more change; and if it is redundant or not sustainable, perhaps it should not be funded.* (*Ibid.*, p. 14).

In other words, there is scope for improving the inter-sectoral allocation of aid in terms not only of "how much" but also "what" – that is, in terms of how the allocated funds are spent. In particular, we argue below that too little is invested in building national fiscal capacities to sustain the ability of the state to mobilize revenue and deliver public goods and services, and that too little attention is paid to building civil society capacities to monitor government finances in the interest of ensuring transparency and accountability. Such lacunae in the qualities of aid can be as important – indeed, sometimes more important – than shortfalls in the quantity of aid.

4. Modalities of International Financing

There are multiple channels and modalities by which bilateral and multilateral financing is provided to postconflict countries and fragile states. These include grants and loans directly provided by donors to recipient governments, global thematic trust funds, country-specific trust funds, and debt relief.

Disbursements of ODA by individual donors in 2007, and the percentages of their resources that went to postconflict countries (here defined by the "negative peace" criterion) and to fragile states are reported in Table 5.[19] These data indicate that top donors to postconflict countries were the United States, the European Community, IDA, and the United Kingdom, together accounting for more than half of the total. Among these donors, the UK devoted the largest fraction (37.6%) of its disbursements to the negative-peace countries. Overall, postconflict countries received 17% of ODA and fragile states received 25%.

[19] "Fragile states" as defined in the World Bank's fragile states list, on which a given country's classification can vary over time.

Table 5: ODA Disbursements: Total, Postconflict Countries, and Fragile States, 2007

Donor	Total ODA ($ million)	ODA to postconflict countries ($ million)	Percentage total ODA to postconflict countries	ODA to fragile countries ($ million)	Percentage total ODA to fragile countries
United States	13698	2222	16.2	3733	27.2
EC	9018	2186	24.2	2135	23.7
IDA	7450	1479	19.9	1653	22.2
United Kingdom	3545	1335	37.6	1116	31.5
Japan	4477	684	15.3	849	19.0
Germany	6391	549	8.6	1559	24.4
Norway	1750	503	28.7	580	33.2
France	5206	496	9.5	1234	23.7
Netherlands	2317	427	18.4	534	23.0
Belgium	782	333	42.5	390	49.9
Spain	2197	327	14.9	247	11.2
Global Fund (GFATM)	1600	295	18.4	374	23.4
Sweden	1524	285	18.7	520	34.1
Canada	1995	254	12.8	753	37.8
Denmark	1257	239	19.0	283	22.5
AfDF (African Dev. Fund)	1100	230	20.9	105	9.5
UNICEF	692	196	28.4	262	37.9
Switzerland	704	186	26.4	230	32.6
Ireland	613	174	28.4	193	31.5
Australia	1768	106	6.0	456	25.8
UNDP	428	101	23.5	164	38.2
Austria	1178	86	7.3	116	9.9
Italy	1121	73	6.5	153	13.6
Arab Countries	538	69	12.9	83	15.4
Finland	374	67	18.0	130	34.8
Korea	431	67	15.6	103	24.0
IFAD	322	67	20.8	98	30.4
Portugal	229	62	27.2	122	53.4
Arab Agencies	425	62	14.6	55	12.9
WFP	230	60	25.8	77	33.3
UNFPA	214	57	26.5	72	33.6
UNTA	278	54	19.5	83	29.7
Greece	174	47	27.0	45	26.0
UNHCR	114	38	33.2	36	32.0
Luxembourg	212	34	15.9	38	17.9
AsDF (Asian Dev. Fund)	1182	33	2.8	313	26.5
GEF	150	24	16.1	15	10.1
Slovak Republic	23	19	82.4	19	84.8
Turkey	522	19	3.7	165	31.6
MONTREAL PROTOCOL	94	19	19.8	0	0.0
Czech Republic	61	14	23.7	21	35.0
New Zealand	164	10	6.0	54	33.1
Nordic Dev. Fund	68	7	10.6	7	10.8
Iceland	23	3	13.0	5	21.8
Hungary	33	1	3.9	8	25.2
EBRD	6	1	15.3	1	16.7
CarDB (Caribbean Dev. Bank)	37	0	0.0	0	0.0
UNRWA	700	0	0.0	0	0.0
Poland	154	-1	-0.7	12	7.8
IDB Spec. Fund	206	-15	-7.2	94	45.8
SAF+ESAF+PRGF(IMF)	-72	-35	48.9	49	-68.8
Total	**77703**	**13548**	**17.4**	**19346**	**24.9**

Source: OECD Creditor Reporting System database.

The multiplicity of financing mechanisms has benefits and costs. On the plus side, they permit substantial resource flows, open channels for non-traditional funders, and may facilitate assistance in program areas that are critical to postconflict recovery and stabilization but are not included among traditional ODA activities. On the minus side, the fragmentation of financing among diverse agencies leads to serious planning, coordination, and evaluation problems that make it difficult or impossible to ensure that financial support gets to where it is most needed in a timely, predictable and effective manner. The systematic tracking of financial flows is itself a major challenge yet to be met, as illustrated by gaps in coverage in the OECD-DAC database. The many distribution channels open multiple pathways for corruption and manipulation of aid flows. For recipient governments with limited administrative capacities, the task of interacting with multiple donors, each with distinctive procedural and reporting requirements, can pose a formidable burden.

In this section we briefly discuss five international financing modalities that, one way or another, seek to address the aid fragmentation problem: IDA, the main window through which the World Bank channels resources to postconflict and fragile states; multi-donor trust funds; "whole-of-government" approaches to bilateral aid, that seek to foster coherence among different agencies within the same donor government; regional approaches to funding that seek to foster coherence across aid to different countries within the same conflict-affected region; and the UN Peacebuilding Fund, established in 2006 in response to perceived funding gaps particularly in the immediate aftermath of violent conflict.

IDA

The World Bank's main window for funding to postconflict and fragile states is IDA. The 2007 IDA-15 review of "Operational Approaches and Financing in Fragile States" reports that IDA allocated SDR 11 billion to fragile states (about 19% of its total resources) over the past decade, although in per capita terms IDA flows to non-fragile states (excluding capped blend countries, that qualify for a mix of IBRD and IDA lending) were 50% higher than to fragile states. The review recommends measures to close gaps in IDA's exceptional financing arrangements, where "exceptional" means arrangements that depart from its usual Performance-Based Allocation (PBA) that links aid to progress in improving performance indicators. This points to the inherent tension between "*ex post* conditionality" (or "selectivity"), which seeks to allocate aid so as to reward good performers, and the needs of postconflict and fragile states where performance according to the usual indicators is often weak.

In addition to IDA, the World Bank administers a State and Peacebuilding Fund (SPF) that provides support for countries in arrears (to which further lending is barred under Bank rules) and for small but urgent activities not easily funded by IDA. The SPF was created in 2008, replacing two earlier trust funds – the Post-Conflict Fund and the Low-Income Countries Under Stress Fund – on the grounds that conflict and fragility are closely related. Initial resources came from $100 million in World Bank administrative funds plus contributions from the governments of Norway and the Netherlands.

Multi-Donor Trust Funds

A diverse set of multi-donor trust funds (MDTFs) have been used to channel resources to postconflict countries and fragile states in recent years. As of 2007, the total funding through some eighteen operative MDTFs amounted to $1.2 billion, still a small fraction of the international financing for postconflict and fragile states. Over the preceding five years, MDTFs aimed at fragile states disbursed $2.6 billion, with the Afghanistan Reconstruction Trust Fund (ARTF) accounting for roughly half of this total (IDA 2007, p. 37). The resource-pooling achieved by MDTFs is intended to encourage joint assessment, planning and program implementation; provide an umbrella for donor participation in response to national development plans and priorities; and reduce transaction costs, especially for recipient governments with limited administrative capacity (UNDP Review of Trust Funds, 2007).

At present, both the World Bank and UNDP-UNDG operate MDTFs. The World Bank's trust funds can provide direct budget support to recipient governments, including recurrent costs, whereas UN trust funds must be disbursed through a UN cooperating agency, each of which operates under its own rules and procedures.[20]

While potentially competitive and/or duplicative, trust funds can complement each other, for example by providing direct budget support and sector-specific support. In Afghanistan, under the so-called "two window" approach, the Bank-administered ARTF has provided budget support, covering anything but humanitarian assistance and law enforcement, while the UNDP-administered Law and Order Trust Fund for Afghanistan (LOTFA) channeled resources to police salaries and other recurrent costs.[21] The UN PBF, the EU African Peace Facility (APF), and the EC Instrument for Stability are also able to fund non-ODA eligible activities. The Bank and the UNDG have engaged in efforts to standardize their procedures in order to facilitate their accessibility and use (Scanteam 2007; Development Initiatives 2006). The merits and complications of the two-window model are now being debated in what could either be defense of turf or a credible assessment of the value of complementary mechanisms.

As the use of MDTFs becomes more popular, it would be useful to have a comparative analysis of aggregate and sector financing over time by global, country, and country-thematic MDTFs to see where adjustments and improvements may be needed.

Whole-of-government approaches

Whole-of-government approaches have been initiated in several OECD donor countries in an effort to formulate an integrative approach to security, governance, and

[20] See OECD (2008), pp. 55-58, for a detailed review of operational challenges to the MDTFs.

[21] In addition, the UNDP-administered Afghan Interim Authority Fund provided initialsupport for the civil service and Loya Jirga.

development by bringing together defense, foreign, and development ministries. While these efforts hold potential for policy coherence and harmonization of procedures and regulations, they are still in the testing phase and suffer the usual problems of timely, predictable and effective funding. Since they tend not to pool their funds with other efforts, they also do not resolve the coordination problems that arise when multiple bilateral and multilateral donors operate in recipient countries. Moreover, the whole-of-government approaches have tended to focus on postconflict states, where defense ministries often take a lead role, rather than fragile states where development ministries would likely take the lead. Differing doctrinal stances and competition for resources have posed continuing problems in these integrative approaches.[22]

Regional approaches

While considerable attention has been paid to the regional dimension of conflicts and the importance of engaging neighboring states in processes of conflict mitigation and peacekeeping, there have been few concomitant developments in the financial architecture or structure of aid flows, and even fewer efforts to evaluate them. One such initiative was the Multi-Country Demobilization and Reintegration Program (MRDP) for the Great Lakes region of Africa, and this experience should be evaluated for its lessons on the benefits and difficulties of a regional approach. The UK government's Africa Pool and Global Conflict Prevention Pool contain regional initiatives, but these operate at small scale relative to direct country aid programs. Other initiatives aimed at resolving or staving off regional crises, that merit further examination, include: the OECD-sponsored Club du Sahel, which provided support and distributional planning for eight countries in the region subject to drought and famine; the recommended (but not implemented) proactive approach to regional conflict prevention in the Ferghana Valley in Central Asia[23]; the India, Nepal, Bangladesh watershed program aimed as preventing water resource conflicts in the region; the similarly intentioned Nile River Basin Initiative; and the Mano River Basin initiative, which focused on early warning and training in the forest area shared by Guinea, Liberia, and Sierra Leone.[24]

The potential for regional development banks, including the ADB, AfDB, and IDB, to play a role in conflict prevention and postconflict reconstruction via cross-border initiatives should be examined, as should the potential roles of the African sub-regional organizations that were established initially to promote regional economic integration but increasingly have become involved in conflict prevention, conflict mitigation and postconflict reconstruction. ECOWAS Bank for Investment and Development (EBID)

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[22] For discussion, see (Patrick and Browne 2009; CIC, "Recovering from War" 2008; OECD Resource Flows, 2008, pp. 52-59).

[23] Center for Preventive Action, "Calming the Ferghana Valley: Development and Dialogue in the Heart of Central Asia." New York: Council on Foreign Relations and Century Foundation, 1999.

[24] O'Brien, Graybow and Iacopetta (2000) compiled an inventory of 59 regional intergovernmental organizations. The fragmentary nature of the available data is reflected in the fact that this study provides total budgets for only 28 of them. We know of no more recent effort to collect this information.

and the Development Bank of Southern Africa (DBSA), affiliated with SADC, may also have some potential in this regard. While not a funding entity itself, the UN's regional office for West Africa (UNOWA) could extend its cross-border functions to advise on subregional funding opportunities to advance security and development.

The UN Peacebuilding Fund

The one financing modality established specifically to address early recovery in postconflict situations is of recent origin: the UN Peacebuilding Fund (PBF), created in 2006. It holds promise, but many observers agree that it has failed to utilize the more than $300 million raised as of February 2010 in the most effective manner. While exceeding its initial funding goal by some $50 million, with contributions from 45 donor countries, more than two-thirds of the PBF's finances come from its five lead donors, making it highly dependent on the preferences of donors who are able to "forum shop" among a variety of funding channels. As of March 2009, the PBF had disbursed $122 million to twelve recipient countries, with 70% of its resources going to the UN Peacebuilding Commission's four "adoptee" countries: Burundi, Central African Republic, Guinea-Bissau, and Sierra Leone. PBF is required to disburse its funds through UN agencies, and 73% of its total allocations have been passed through UNDP. Despite its early recovery mandate, PBF resources have often been provided in later stages of war-to-peace transitions.

Established with the goals of financing urgent but underfunded peacebuilding activities and mobilizing on-going resource flows, the PBF has run into the same constraints that characterize much of the international aid architecture: lack of strategic planning and prioritization; complex and time-consuming decision-making and disbursement procedures; role confusion and coordination failures; unpredictability and uncertain sustainability; limited staff capacities; and, stemming from all of these, questionable effectiveness in meeting peacebuilding objectives. On top of these generic problems, the PBF suffers from having a complicated management structure: it is part of a tripartite arrangement with the UN's Peacebuilding Commission and Peacebuilding Support Office, and it is subject to third-party management through UNDP's Multi-Donor Trust Fund office. Ball and van Biejnum (2009) offer a set of recommendations, in part developed by internal review, to re-align the Fund's early and medium-term funding windows, set more explicit peacebuilding priorities, and streamline responsibilities and procedures to help the PBF fulfill its promise.

5. Trends in National Government Finance

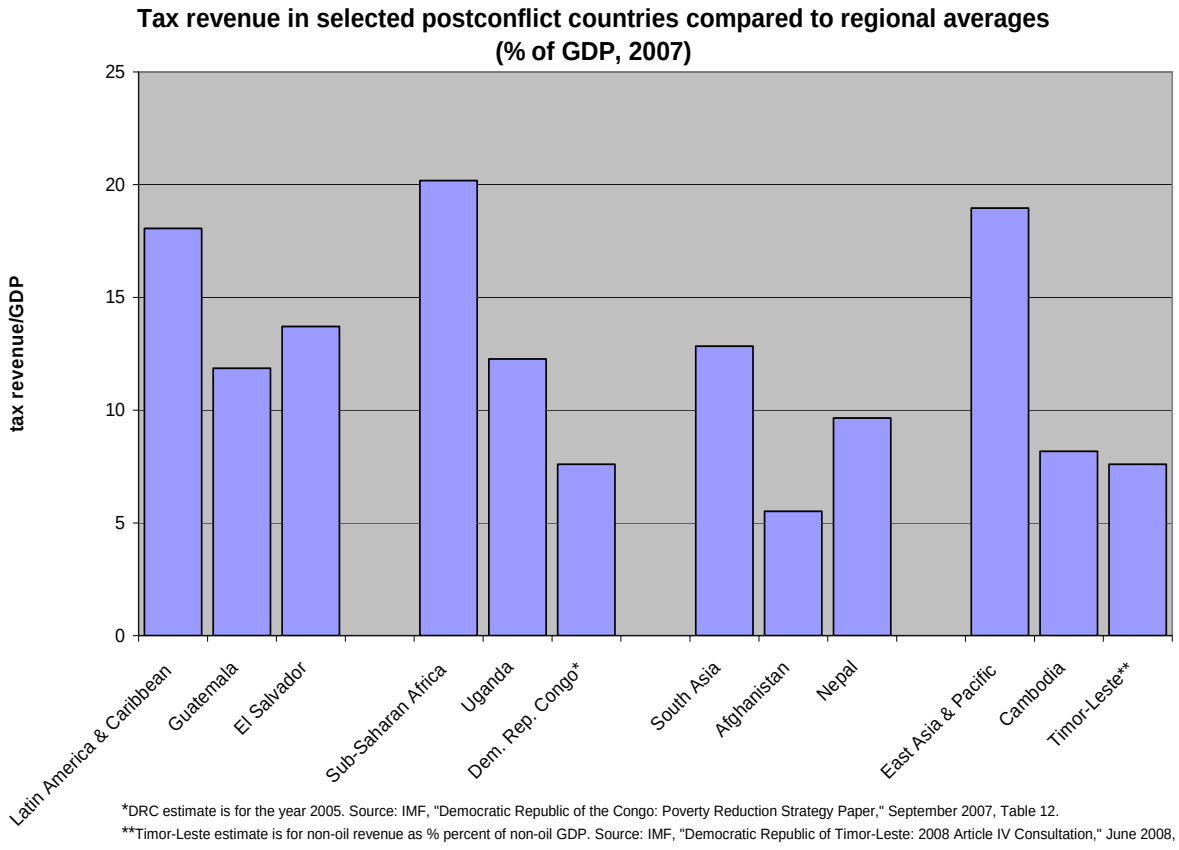
This section reviews trends in national government finance in postconflict and fragile countries. First we discuss domestic revenue; then we discuss the composition of government expenditure. In section 6, we discuss relationships between international financing and national government finance.

Domestic revenue

A critical feature of legitimate and effective states is the social contract between the government and the citizenry. The state provides services including physical security, economic infrastructure, health care, and education. The public, in turn, pays taxes based on the perception that the state will fund these services. In postconflict countries and fragile states, this nexus is often weak, and in some parts of a country it may be non-existent.

Postconflict countries often have a very low ratio of domestic revenue to national income. In many cases, they also have a relatively low national-income denominator, with the result that their ability to fund public goods and services is exceptionally limited. As shown in Figure 8, this pattern is found across regions, even in countries where a number of years have elapsed since the onset of peace. In Latin America, the tax coefficient (ratio of tax revenue to GDP) in Guatemala and El Salvador in 2007 was roughly two-thirds of the regional average. In sub-Saharan Africa, the tax coefficients in Uganda and the DRC were 61% and 38% of the regional average, respectively. In South Asia, those in Afghanistan and Nepal were 43% and 75% of the regional norm. And in the East Asia & Pacific region, the tax coefficients of Cambodia and Timor-Leste (apart from its offshore oil economy) were approximately two-fifths of the regional average.

Figure 8



*DRC estimate is for the year 2005. Source: IMF, "Democratic Republic of the Congo: Poverty Reduction Strategy Paper," September 2007, Table 12.

**Timor-Leste estimate is for non-oil revenue as % percent of non-oil GDP. Source: IMF, "Democratic Republic of Timor-Leste: 2008 Article IV Consultation," June 2008,

The sluggish growth of domestic revenue in postconflict countries reveals a serious lacuna in policies intended to promote statebuilding and peacebuilding. In many cases, the fiscal dimension is under-emphasized, if not missing altogether, in the postconflict policy priorities of national governments and international donors alike. Even in the case of Guatemala, where the 1996 peace accords explicitly mandated an increase in tax revenues from 8% of national income – the lowest level in the western hemisphere next to Haiti – to 12% by the year 2000, progress has been very slow: in 2000, the country's tax coefficient barely reached 10%, and six years later it had yet to reach the 12% target (see Figure 9).

Figure 9

One factor exacerbating the slow revenue growth in postconflict countries has been donor support for tariff reductions in the name of trade liberalization and economic efficiency. In Guatemala, for example, even as the IMF's Managing Director publicly endorsed the revenue-enhancement goal mandated by the peace accords, the Fund's staff urged the government to cut tariffs.[25] As shown in Figure 9, tariff revenue in Guatemala fell both

[25] Visiting Guatemala in May 1997, IMF Managing Director Michel Camdessus stated that the Fund's only condition for a stand-by agreement would be that the government complies with its peace-accord commitments, including a 50% increase in the revenue-to-GDP ratio. Yet at the 1998 meeting of the Consultative Group for Guatemala, the IMF representative urged the government to 'resist pressures to increase import duties or delay the scheduled reduction in customs tariffs,' arguing that 'these actions will have adverse effects on output growth.' For discussion, see Boyce (2002, pp. 40-47).

relative to total tax revenue and absolutely. Yet tariffs are often a major component of tax revenue in low-income countries, among other reasons because the administrative costs of collecting customs duties are relatively low. Moreover, the efficiency argument for trade liberalization – that domestic industries should not be protected from international competitors who can produce at lower cost – is largely irrelevant in contexts where trade-competing industries do not exist. Guatemala, for example, does not have an automobile industry, nor is it likely to have one in the foreseeable future; hence there is no efficiency argument against substantial tariffs on Guatemala's automobile imports, which could provide a significant source of tax revenue.

We return to this topic in section 6, where we consider ways that the international community can actively support – rather than obstruct – revenue generation in low-income countries in general, and in postconflict countries in particular.

Managing revenues from extractive resources

Extractive industries, such as petroleum and mining, can provide the state with substantial revenues to fund public expenditure without taxing its citizens directly. There is a risk, however, that this "easy money" will weaken the state-society fiscal contract by reducing the government's accountability to taxpayers, as well as fostering rent-seeking behavior and exacerbating social tensions. Whether extractive resources prove to be a blessing or a curse is not a foregone conclusion: the results are contingent on policies and politics. The establishment of resource-specific revenue instruments, like the Petroleum Fund of Timor-Leste (see sidebar), is one recent strategy to address these concerns. Another, complementary, strategy would be to set up an extractive sector forum, bringing together citizens, political leaders and companies to forge a "resource compact" that includes an independent body to monitor the extractive sector (Le Billon 2008).

Expenditure priorities

The other side of the state-society contract is the delivery of services by the state that the public expects in return for paying taxes. Expenditure patterns in postconflict countries often differ from regional norms, with relatively high levels of military expenditure and relatively low levels of expenditure on social services, such as health and education. This is illustrated in Figure 10, which compares the ratio of military expenditure to public health expenditure in four postconflict states – Burundi, Angola, Cote d'Ivoire, and Sierra Leone – to the average ratio in other countries in sub-Saharan Africa. In Sierra Leone, military expenditure is nearly 40% higher than public health expenditure, and in Burundi it is more than six times higher; in contrast, the regional norm is for public health expenditures to be roughly 65% higher than military spending.

RESOURCE BLESSING?
The Timor-Leste Petroleum Fund

When Timor-Leste became an independent nation in 2002 it ranked among the poorest countries in the world, with an annual per capita income of less than US$1/day. With the onset of offshore petroleum production two years later, oil and natural gas suddenly became the country's largest source of national income and government revenue.

In an effort to ensure that this new wealth will turn out to be a blessing rather than a "resource curse," the Timorese Parliament established a Petroleum Fund (PF) in 2004, modeled on Norway's, with technical assistance from the IMF.

All petroleum earnings must be deposited into the PF, to be invested in U.S. Treasury bills or other sovereign debt instruments. By 2009, the Fund had grown to more than US$5 billion. The government can withdraw money from the PF for public expenditure, but annual withdrawals are limited to the PF's "estimated sustainable income." Any withdrawal beyond this limit would require the government to provide Parliament with a detailed explanation of why it is in the long-term interests of the country, along with a report certified by the PF's independent auditor on the impact on future sustainable income.

The PF aims:

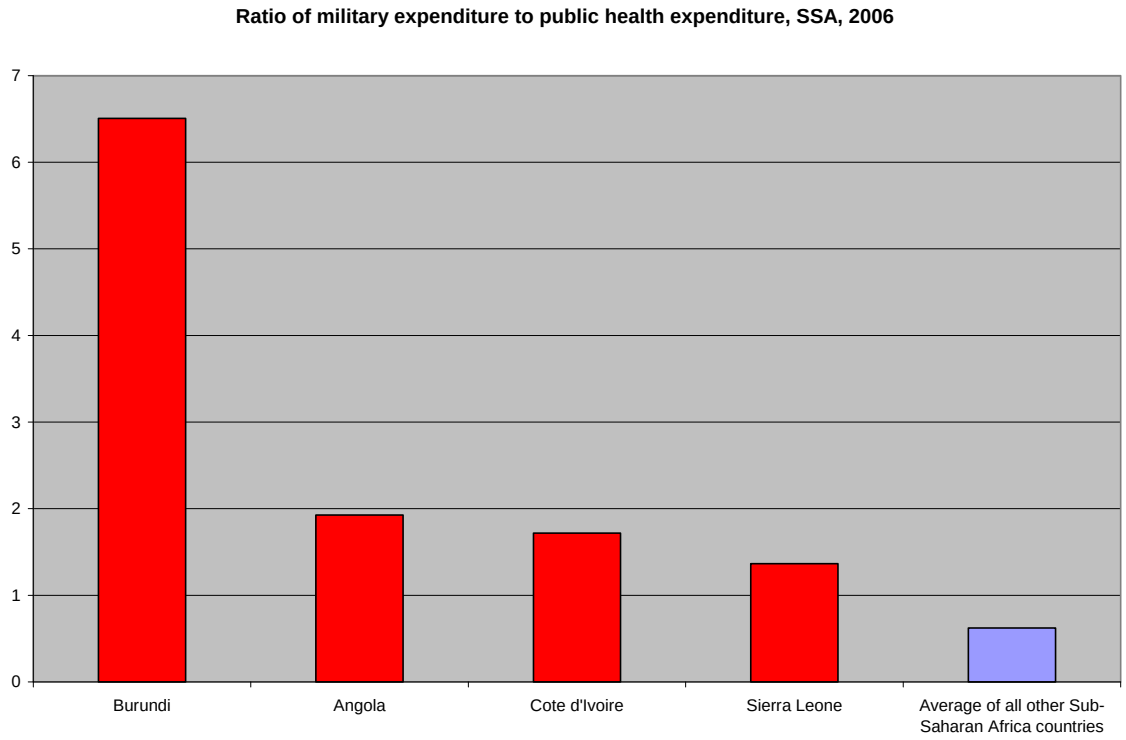
- to preserve the value of the country's petroleum wealth for future generations;
- to limit the risk of "Dutch disease" from exchange-rate appreciation;
- to insulate the national budget from the impact of oil price instability; and
- to ensure transparency in the use of petroleum revenues.

Transparency is important for statebuilding as well as for economic reasons. An IMF report (2009, p. 5) remarks that the PF aims at "avoiding that rent seeking leads to economic and social divisions and weakened institutions." The IMF (p. 13) cautions, however, that "transparency helps, but easy access to petroleum revenue still alters the balance between governments and taxpayers and reduces the pressure for accountability."

These differences are not surprising, but they suggest a need for careful attention to the composition of government expenditure in light of the requirements of statebuilding and peacebuilding. Postconflict countries often inherit relatively large military forces; expenditures associated with postwar disarmament, demobilization, and reintegration (DDR) may continue to lead to larger-than-normal military budgets and yet be fully consistent with peace implementation goals. Moreover, in some cases ongoing security

challenges may provide a rationale for above-average military expenditures. But the political influence of the military may also play a role, independent of security needs that carry legitimacy in the eyes of the wider public. In the immediate postwar years in El Salvador, for example, military spending remained three times higher as a percentage of GDP than it had been before the war; meanwhile inadequate funding for new democratic institutions, including the National Civilian Police, threatened to undermine the peace implementation process.[26] In such cases, the goals of building an effective and legitimate state and securing a durable peace require reallocations of expenditure in accord with these priorities.

Figure 10



6. International Assistance and National Finance

This section considers how the provision of external resources affects national finance in postconflict countries and fragile states. First, we consider the relation between inflows of international assistance and the national tax effort. We then discuss several policies by which the international community could strengthen the contribution of aid to building sustainable fiscal systems. Lastly, we examine the impediments to building effective and legitimate states posed by external debt legacies.

[26] For discussion, see De Soto and Castillo (1994) and Boyce (1996, Chapters 5-7).

The issues discussed in this section are relevant to aid in general; they are not entirely unique to postconflict countries and fragile states. But in these countries, where the fiscal dimension of statebuilding is (or ought to be) a high priority, these issues stand out in particularly sharp relief. Elsewhere the relationship between international assistance and national finance may be dismissed as a matter of less-than-critical importance, but in postconflict countries and fragile states it cannot.

Aid and tax revenue

In principle, international financing can help in building, or repairing, the state-society contract that ties taxation to the provision of public goods and services. Aid can be used to increase government expenditures beyond what domestic revenue would otherwise allow, and if this builds public confidence in the willingness and ability of the state to provide desired goods and services this can, in turn, help to build support for increased taxation.

In practice, however, this effect is not a foregone conclusion. By providing a soft option for recipient states to obtain revenue – compared to the harder route of collecting taxes – aid may "crowd out" domestic revenue mobilization rather than promoting it. There is no *a priori* reason to assume that one effect always will prevail over the other (see Figure 11). More importantly, there is scope for donor policy decisions to influence the direction and magnitude of the net effect of aid on tax revenue, as discussed below.

Figure 11

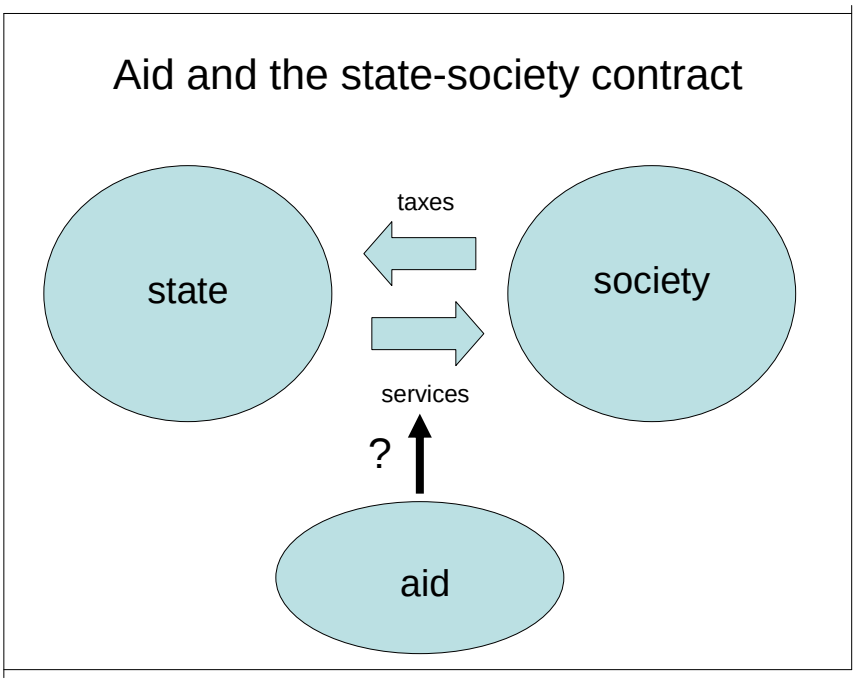
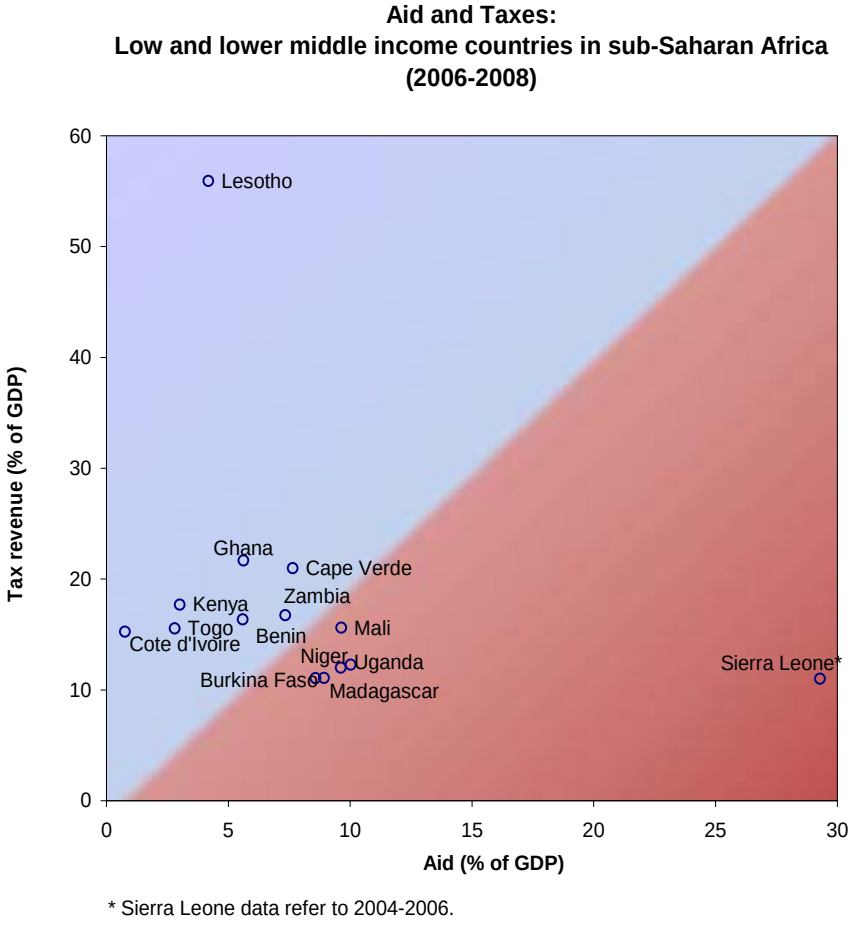


Figure 12a shows the relationship between aid and tax revenue (as percentages of GDP) in the low and lower-middle income countries of sub-Saharan Africa in 2006-08. Two observations can be made on these data. First, there is some evidence of an inverse relationship between the two variables – a constant-elasticity estimate of the relationship indicates that a 10% increase in aid is associated with a 2.4% reduction in taxes[27] – but this relationship is primarily attributable to two outliers, Lesotho (with relatively low aid and high tax revenues) and Sierra Leone (with relatively high aid and low tax revenues). Second, among the other countries there is no indication that higher aid is associated with higher tax revenues.

Figure 12a



* Sierra Leone data refer to 2004-2006.

Source: Authors' calculations, using WDI data.

[27] The estimating equation: ln(taxes) = 3.003 - 0.239ln(aid).

Cross-sectional correlations cannot prove causation, of course. In the case of a negative correlation, higher aid could lead to lower taxes, or lower taxes could lead to higher aid, or both could be affected by other variables, or some combination of these could be at work. But we can say that the absence of a positive correlation between aid and taxes suggests that aid may not be doing much to improve tax revenues.

Econometric studies that have sought to identify causal relationships in the effect of aid on tax revenues have not settled this issue, but many researchers have found negative or insignificant impacts. In a review of evidence from sub-Saharan Africa, Moss, Pettersson and van de Valle (2006) conclude that aid "may have undercut incentives for revenue collection." To illustrate, they note that a scattergram showing aid and tax shares in low and lower-middle income countries in the 28-year period from 1972 to 1999 (reproduced here as Figure 12b), the top right quadrant (high aid and high taxes) is empty. They also conclude that aid has adversely affected the quality of governance: "states which can raise a substantial portion of their revenues from the international community are less accountable to their citizens and under less pressure to maintain popular legitimacy."

Figure 12b

Source: Moss, Pettersson and van de Walle (2006, p. 12).

An IMF study of 107 recipient countries found that the effects of grant aid differed from those of loans. Grants had a negative impact on domestic revenues, an effect that was strongest in countries plagued by "high levels of corruption" where "the decline in revenues completely offsets the increase in grants" (Gupta *et al.* 2003). Concessional loans were associated with higher domestic revenue mobilization, an effect the authors suggest may be due to the need to raise revenue to repay the loans. From the standpoint of assisting in building the state-society contract, however, increasing revenue for the purpose of servicing debt to external creditors is a less than resounding success, for it fails to uphold the state's side of the state-society contract: the delivery of services to its citizenry.

Can Aid Crowd in Fiscal Capacity?

There are several ways that aid donor policies could seek to "crowd in" greater fiscal capacity – the capacity of states to raise revenue, allocate resources, and manage expenditure – in recipient countries. These include:

- *Technical assistance:* Donors can – and, to a limited extent, do – provide assistance in the area of tax policy and administration. The amounts are generally small, however: the OECD (2009a, p. 95) reports that in 2006 only 0.087% of official development assistance was dedicated to "tax-related tasks," and that only one-eighth of this ($11 million worldwide) went to fragile and conflict-affected countries, primarily Afghanistan, Rwanda, and Kenya.

- *Budget support:* Channeling aid through the national budget could not only build government capacity to allocate and manage expenditure but also strengthen public confidence in the ability of the government to deliver goods and services, thus enhancing their willingness to pay taxes. Yet at present, only a small fraction of aid is allocated to budget support. Aid agencies have a fiduciary responsibility to see that their money is well spent, but this can be met by "dual control" systems that seek to ensure accountability and transparency. Such a system has been implemented by the Afghanistan Reconstruction Trust Fund (ARTF), discussed in section 4: recurrent budget expenditures are submitted to the ARTF for reimbursement, which is disbursed after review by an external monitoring agent whose function is akin to that of an internal auditor.[28]

- *Revenue conditionality:* Donors could (but rarely do) make access to aid conditional upon progress in domestic revenue mobilization, a policy that would be akin to the provision of matching grants by philanthropic foundations. DfID's former chief economist has proposed that donors collectively limit aid to 50% of the tax revenue collected by the recipient government, excluding oil and mineral revenues (Wood 2008). Among the low and lower-middle income countries of sub-Saharan Africa, this ceiling would require aid reductions (and/or tax increases) in the countries in the red half of the scattergram in Figure 12a. A

[28] For more on the ARTF, see Ghani *et al.* (2007) and Peace Dividend Trust (2009).

"matching funds" approach could be facilitated if inter-donor coordination were enhanced by channeling more medium-to-long term aid commitments through multi-donor trust funds (FIAS 2009, p. 27). Alternatively, revenue conditionality could be applied by individual donors to a subset of total aid.[29] For example, budget support in Afghanistan through the ARTF now includes an incremental amount tied to revenue performance in addition to a gradually declining base level.

- *Taxing aid:* Currently, not only aid itself but also aid-generated income flows are largely tax-exempt in the recipient countries. This deprives governments of needed revenues, impedes learning-by-doing in tax administration, and, above all, sends a perverse message to the populace: powerful people do not trust the government with their money and do not pay taxes. Efforts to tax aid – including tariffs on aid-financed imports, taxes on the incomes of national and expatriate aid agency employees and private contractors, and taxes on rental incomes of the owners of housing and offices leased to aid agencies and their staff – could help to prime the pump of domestic tax collection. This would require substantial, and in our view quite sensible, changes in current aid protocols.[30]

- *Local procurement:* It is estimated that only one of every ten dollars spent by the UN Transitional Administration in East Timor 'actually reached the East Timorese' (Chesterman 2004, p. 183).[31] Local procurement can help to spur economic recovery and development (see sidebar on "spending the development dollar twice" in Afghanistan).[32] In so doing, it can also help to expand the country's tax base, particularly if procurement policies are tied where appropriate to tax compliance by local firms. Channeling a larger share of donor expenditure into local economies will require measures beyond the formal "untying" of aid envisioned in the 2005 Paris Declaration on Aid Effectiveness (Clay, Geddes and Natali 2009): it will require preferential policies to favor local procurement. Even when local procurement would entail higher transaction costs (or other costs), such policies cannot be dismissed as "inefficient" once we recognize that what is being procured is not only a given volume of goods and services, but also positive externalities created in their provision.

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[29] Revenue conditionality also has been proposed in a study by the IMF Fiscal Affairs Department (Gupta *et al.* 2003, p. 18): "Traditionally, donors have imposed conditions on the expenditure side on how their resources could be utilized, without taking into account the impact of assistance on revenues… A similar type of requirement could be considered for the revenue side."

[30] For further discussion, see Boyce and O'Donnell (2007); Carnahan (2007); and OECD (2010a, pp. 105-107).

[31] Chesterman (2004, pp. 183-4) gives this telling example: "At one point, $27 million was spent annually on bottled water for the international staff – approximately half the budget of the embryonic Timorese government, and money that might have paid for water purification plants to serve both international staff and locals well beyond the life of the mission."

[32] Peace Dividend Trust (2009). See also Carnahan, Durch and Gilmore (2006).

SPENDING THE DEVELOPMENT DOLLAR TWICE:
Local Procurement in Afghanistan

The Afghan Compact, signed by more than 60 nations in early 2006, committed aid donors to increasing the share of assistance channeled through the government budget and increasing local procurement of goods and services. A study of ODA disbursements by the Peace Dividend Trust (2009) found that in the following year approximately 38% of donor spending entered the Afghan economy.

"Using local goods and services to carry out project work," the study observes (p. 30), "allows a development dollar to be spent twice – providing much-needed goods and services to Afghan citizens and communities while simultaneously creating jobs, generating revenue, and promoting a more sustainable marketplace – all of which can ultimately reduce the likelihood of a relapse into conflict."

Among the eight large ODA donors surveyed by PDT researchers, the share of local content in their spending ranged from 23% (in the case of the United States) to 71% (in the case of the United Kingdom).

The study found that 70-80% of aid channeled to the government in direct budget support or through multi-donor trust funds went into the local economy, compared to 10-20% of aid disbursed via contracts with international companies and international NGOs for construction, technical assistance, service delivery, and the supply of specific goods. Smaller amounts of ODA were disbursed through contracts with local providers, mostly for construction and rehabilitation of buildings and other infrastructure; in these cases, local content was found to be 35-50%, since many inputs were imported.

Three main recommendations emerged from this analysis:

- First, donors should increase the share of aid channeled into budget support and trust funds, so as to increase spillover benefits to the local economy.

- Second, donors should make efforts to increase local procurement, among other ways by translating tenders into local languages, supporting seminars for local small and medium enterprises on procurement procedures, and educating international staff on the economic benefits of local spending.

- Finally, donors should monitor and collect systematic data on the share of local procurement in their aid disbursements.

- *Support for civil society capacity to demand transparency and accountability:* Aid donors can seek to strengthen the society side of the state-society fiscal contract, too. In particular, efforts to promote transparency and accountability can work from the demand side as well as the supply side. The public expenditure monitoring by civil society organizations in Uganda's Poverty Action Fund, mentioned earlier, is an example. Ugandan civil society groups have received support for this work from ODA donors, including DANIDA and DfID, as well as

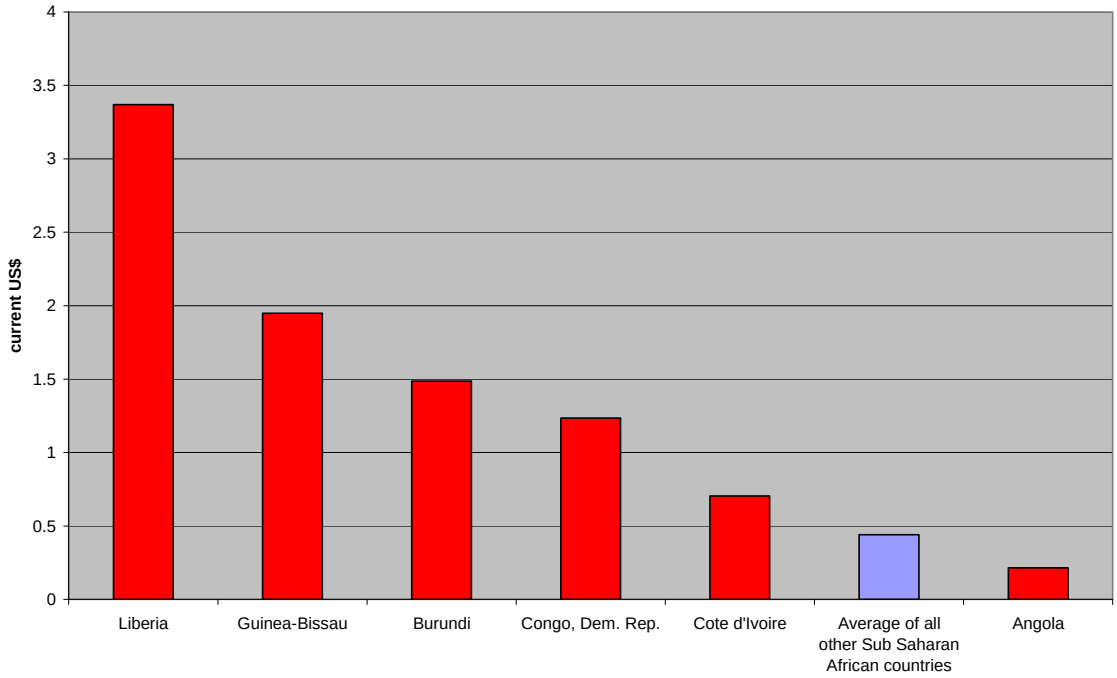
from private agencies such as OXFAM (de Renzio *et al.* 2006). Similar initiatives have been launched in other countries, including Croatia and South Africa (Robinson 2006). To date, however, support for such efforts has been the exception rather than the rule.

Postconflict debt burdens

Many postconflict countries face high external debt burdens. These debts are often a legacy, at least in part, of borrowing that fed into social tensions that precipitated the conflict and of borrowing that was used to finance military expenditure during the conflict. Figure 13 illustrates this pattern in sub-Saharan African countries: in Liberia, Guinea-Bissau, Burundi and the DRC, the ratio of external debt to GDP in 2007 exceeded 1.0, compared to an average of 0.4 in other countries in the region.

Figure 13

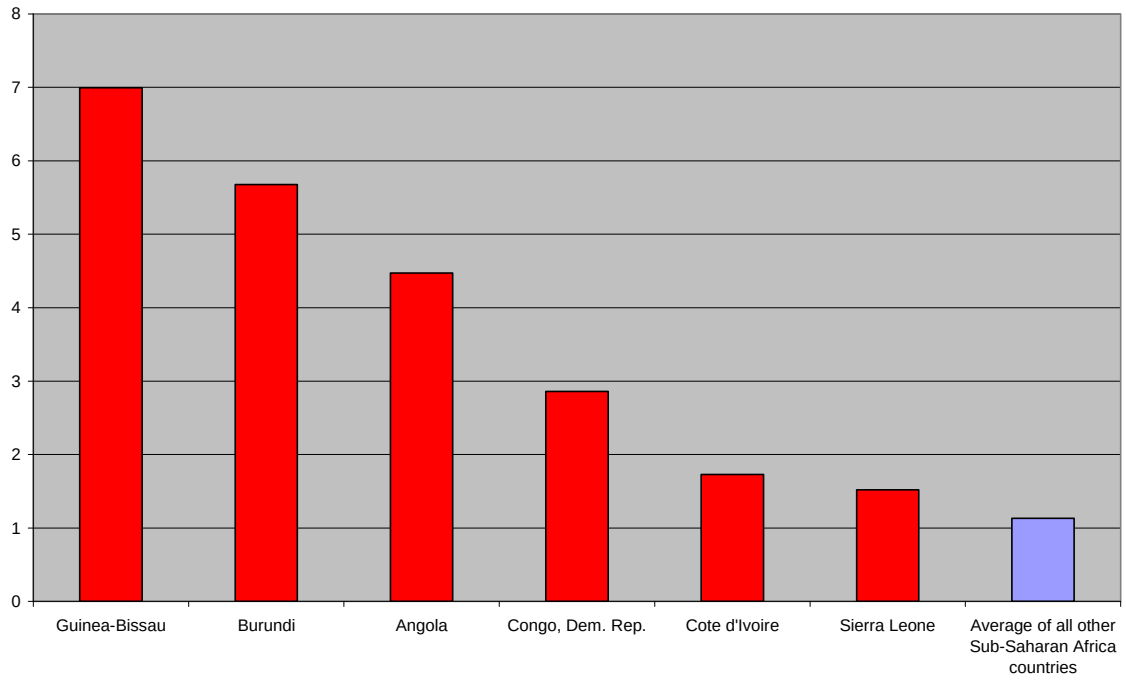
External debt burdens: Debt/GDP ratios for postconflict countries in Africa, 2007



As a result, postconflict countries often are obliged to devote a substantial share of scarce government resources to the payment of debt service. As shown in Figure 14, in 2006 debt-service payments were seven times greater than public health expenditure in Guinea-Bissau, more than five times greater in Burundi, and more than four times greater in Angola. In the average sub-Saharan African country, the ratio was considerably lower although debt service still exceeded public health expenditures. Along with its human cost, the diversion of African government resources into debt service may impose a political cost by weakening the state-society contract that underpins peace.

Figure 14

Ratio of debt service to public health expenditure, SSA, 2006



One way that donors can ease debt burdens is by offering debt relief. Some relief has been provided by bilateral creditors. The Heavily Indebted Poor Countries (HIPC) initiative has provided some temporary and provisional relief for countries that have passed its "decision point," but relatively few countries have reached the "completion point" at which time debt relief becomes irrevocable. At present, debt burdens in many countries remain high as shown Figures 13 and 14.

Moreover, the conditions countries are required to meet to qualify for debt relief may be problematic, if not simply infeasible, in the wake of violent conflict. Announcing an emergency postconflict loan to the Central African Republic in 2004, for example, a senior IMF official remarked: "It will be important to resist political pressures to increase spending ahead of the elections, and to sustain and deepen the effort to contain the wage bill, given the large share of public expenditure absorbed by salary payments."[33] Noting the singular importance during postconflict transitions of efforts "to improve the well-being of public servants and other groups that need to feel part of the peace process," del Castillo (2008, p. 71) comments that such business-as-usual demands from donors "have not contributed to national reconciliation, and have even endangered peace."

[33] "IMF Approves US$8.2 million Emergency Post-Conflict Assistance for the Central African Republic," IMF Press Release No. 04/158, July 23, 2004.

Another potential way to ease debt burdens is by the selective erasure of "odious" debts, defined as debts contracted for purposes that did not benefit the people of the country, without their consent, in situations where creditors knew or should have known that this was the case. The establishment of an international arbitration body where claims of odious debt could be adjudicated at low cost – a step proposed by the government of Norway in 2005 – would make this policy more feasible.[34]

7. Conclusions

This review of financing for fragile and conflict-affected states has revealed a variety of weaknesses in current arrangements. The performance and eligibility criteria that have been introduced for much of ODA are not well-suited to addressing the challenges posed by weak state-society relationships and the risk of violent conflict. The large number of bilateral and multilateral donors provides diversity of funding sources but impedes policy coordination and strategy coherence, while placing substantial burdens on recipient countries with limited administrative and managerial capacity. Multi-donor trust funds and other forms of pooled funding have in some instances resulted in greater collaboration among donors and recipients, but lack of agreement on strategic goals and competition among donors with diverse national and institutional interests continue to impede coordination and progress on the ground. International assistance, conditioned by donors' postcolonial and strategic interests, is characterized by an uneven distribution of resources across countries and regions. Short-term mandates, a paucity of multi-year funding, volatility in aid flows and delays in disbursements impede both planning and timely implementation.

The lack of credible and consistent data on aid flows impedes systematic analysis, evaluation, and learning, especially in fragile and conflict states where studies are forced to rely on incomplete and anecdotal evidence. Despite on-going attempts to improve data collection and recording, it remains difficult to track the gaps between pledges, commitments and disbursement of aid, and impossible to document its final resting place, whether in the administrative bureaucracies of funders or recipients, external service providers and consultants, or actual program deliverables on the ground. OECD recording codes are not universally agreed, nor are non-eligible ODA activities systematically recorded. At present, neither donors nor recipients have anything close to an adequate idea of how aid monies are being spent, let alone the impacts of this spending on peacebuilding and statebuilding.

All too often, funding is geared to priorities other than strengthening the state-society contract and building durable peace. Donors often target projects that provide banner visibility and reflect the perceived interests of constituents in donor countries rather than pressing postconflict needs that build confidence in recipient countries. Off-the-shelf "templates" for postconflict reconstruction substitute for the hard work of designing projects around local political, economic, environmental and socio-cultural needs.

[34] For discussion, see Ndikumana and Boyce (2010).

Substantial amounts of international aid fail to touch ground in the recipient countries, instead paying for foreign consultants and the administrative costs of the international presence. External funds can crowd out incentives for domestic revenue generation, deferring steps toward national self-sufficiency and fiscal sustainability. Most aid bypasses the government budget, failing to build capacity in resource allocation, public expenditure management, and transparent and accountable governance. The international presence itself creates fleeting and detached economic enclaves that fail to provide the building blocks for local enterprise, leaving the national economy on the sidelines in processes of procurement, service provision, and employment generation.

Recommendations

With this daunting constellation of problems in mind, we offer the following recommendations:

- Create an international, comprehensive database on aid to fragile and conflict states in order to facilitate monitoring, evaluation and accountability for both donors and recipients.
- Create national-level databases on aid commitments and actual and planned disbursements, including mechanisms (e.g., direct budget support, service delivery through NGOs, etc.) and sectoral allocations, a step that would require that donors track this information internally and share it.
- Develop criteria for international funding for fragile and conflict-affected states that do not meet generic performance criteria.
- Strengthen aid for conflict prevention, not only by devoting more resources to preventive action but also by mainstreaming conflict impact assessment in aid programming and project appraisal in fragile states.
- Strengthen the capacity of regional and sub-regional organizations and development banks to address the regional causes and effects of conflict and seek programmatic solutions.
- Capitalize multilateral funding mechanisms that can accommodate “aid orphans” – including both countries and sectors within countries – independent of donor interests and priorities.
- Establish a “stand-by” window for rapid needs assessment, deployment of personnel and disbursement of funds to meet immediate stabilization and conflict-recovery needs beyond humanitarian relief.
- Provide funding, including budget support, nationally to support locally determined plans for recovery and stabilization and help build public confidence in the state’s capacity to fulfill the social contract.
- Structure aid in ways that develop national public finance and management capacity with attention to fiduciary responsibility and accountability, including through civil society watchdog mechanisms.
- Explore ways to bring aid and the associated income flows into the tax base of recipient countries – so as to increase domestic revenue, build revenue-collection capacities, and affirm the principles of good fiscal governance – an effort that could begin with clarification of what is now taxable and non-

taxable so as to eliminate blurred lines that currently leave much scope for tax evasion.

- Design and implement procurement policies that favor – or, at a minimum, do not exclude – local contractors, service providers, and labor, with an eye to stimulating economic sectors that ensure local livelihoods and generate employment.

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