

Helpdesk Research Report

Economic growth and fragility

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Question

Identify evidence on the role of economic growth and/or economic development in helping countries break out of fragility (not just conflict).

Contents

1. Overview
2. Links between economic growth/development and reduced fragility
3. Country studies
4. References

1. Overview

This rapid review identifies evidence on the role of economic growth and economic development in helping countries break out of fragility¹. There is **no commonly agreed definition** of the terms ‘fragile states’ or ‘fragility’, and use of the terms are contested² Most development agencies define fragility as ‘a fundamental failure of the state to perform functions necessary to meet citizens’ basic needs’ (Mcloughlin 2012, p. 9). Key characteristics of fragile states commonly include an inability to provide basic security, maintain rule of law and justice, and provide economic opportunities and services for citizens (Mcloughlin 2012). Fragile states also tend to be characterised by lower economic growth rates than the average for low-income countries, and have uneven income and wealth distributions (Hilker 2012).

There is fairly consistent evidence of a correlation between low levels of economic development and state fragility. However, there is **less comprehensive literature available** looking at the role economic growth has played in helping countries break out of fragility. While much of the evidence on the relationship between economic development and state fragility draws from conflict-affected states, many

¹ There is some existing GSDRC research in this area. See Haider (2010; 2009); Herbert (2014); Mcloughlin (2012).

² See for example: Grimm, Lemay-Hébert and Nay (2014).

of the themes and findings can be relevant to other fragile contexts. In practice, it is not always possible to remove conflict-affected countries from the fragile states concept.

The strength and basis of the economy are important factors affecting the stability and resilience of states, yet are often an under-emphasised aspect of statebuilding (Mcloughlin 2012). While acknowledging the links between the two aspects, some experts caution that economic growth is ‘not a panacea for state fragility’ (Naudé 2012, p. 3) and that other risks and factors can have more significant stabilising and de-stabilising influences (E.C. 2009).

Some of the economic factors identified in the literature that can offer opportunities to transition out of fragility include:

- **Employment and job creation:** There is some, albeit limited, evidence that links unemployment to instability. Some of the commonly cited elements for sustainable job creation in fragile states include an enabling framework, a consultative process that involves social dialogue, and the adoption of market development and supply chain approaches (Haider 2009, pp. 1-2).
- **Infrastructure development:** The relationship between infrastructure and state fragility is unclear, with little evidence to suggest that infrastructure investment plays a significant role in the processes of stabilisation (Jones and Howarth 2012, p. iv). The strongest evidence about how infrastructure can contribute to effective stabilisation concludes that community involvement is key (Ibid, p. iv).
- **Foreign Direct Investment:** There is inconsistent evidence on the links between FDI and conflict and fragility. Much of the available literature emphasises the importance of effective state institutions to manage investment and ensure stability (Zhu 2007; E.C 2009).
- **Trade openness:** One study finds that in well-defined institutional settings, trade openness can contribute to stability. However, in weak institutional settings this is often not the case (E.C 2009).
- **Natural resources:** There is a broad body of evidence looking at the links between natural resource endowments and political instability and conflict. Some authors argue that natural resource wealth can make some democracies malfunction because it encourages the politics of patronage and removes the need for the state to make bargains or pacts in support of a social contract (Mcloughlin 2012).

Some of the key findings emerging from the case study literature include:

- Economic growth can be **less important than other stabilising factors**, particularly political stability. Analysis from Rwanda, for instance, notes that demands for political change are likely to outstrip the stabilising effects of economic growth (Cooke 2011).
- **Economic growth can be a driver of fragility.** In Cambodia, there is evidence that political elites - who depend on high-rent industries for their survival – have been complacent when it comes to **building state capacity** in other areas. This has led the country’s political settlement has become more unstable (Kelsall and Seiha 2014; See also Stewart 2015).

2. Links between economic growth/development and reduced fragility

There is fairly broad evidence of a correlation between low levels of economic development and state fragility (European University Institute 2009; Mcloughlin 2012). The strength and basis of the economy - including historical patterns of economic growth and levels of Foreign Direct Investment - are key factors that can impact on the stability and resilience of states (Mcloughlin 2012; E.C 2009).

Providing economic opportunities for citizens is a **critical state function**, and many authors argue that it is a 'vital, although often under-emphasised aspect of state-building in fragile states' (Mcloughlin 2012, p. 58). The OECD (2011) note that growth in productive activities - such as credit programmes, infrastructure, and extension services - are a necessary condition for developing a tax base and therefore central to state-building processes, but that overall these sectors have not figured prominently in donor policies. Based on statistical analysis of 74 post-conflict countries, Collier, Hoeffler and Söderbom (2007) conclude that economic development (both growth and higher income levels) substantially **reduces the risk of reversion to conflict**; however, economic growth can take a decade³.

Much of the literature acknowledges that the predominant form of economic activity, and employment, in fragile states is likely to be **informal** (operating outside of formal rules) (Mcloughlin 2012). In an evaluation of Afghan perceptions of UK aid, Thompson (2011) finds that an insufficient understanding of informal economy actors can lead to policies that attempt to regulate, disrupt, or replace them with 'formal' structures. This can exacerbate missed opportunities in engaging with actors that are central to building peace and restoring normalcy after conflict (ibid.).

Despite a relationship between fragility and economic development, economic growth is just one of many factors that can contribute to a state's transition out of fragility. Some authors caution that **economic growth is not always inclusive** and that poor and marginalised people do not always benefit from it (Jones 2013; OECD 2011). An OECD (2011, p. 27) report notes, 'structures of poverty and inequality can be drivers of fragility and in turn are the consequence of the political and power structures that contribute to patterns of exclusion, discrimination and patrimonialism at multiple levels'. Horizontal inequalities (along economic, social, political and cultural dimensions) have been shown to be associated with conflict (Stewart 2015).

In a policy brief from UNU-WIDER, Naudé (2012, p. 3) cautions that '**economic growth is not a panacea for state fragility**'. The relationship between economic growth and peacebuilding has also been challenged. Drawing from case studies of seven post-conflict countries (Bosnia, El Salvador, Guatemala, Nicaragua, Cambodia, Mozambique and Rwanda), Suhrke and Buckmaster (2006) find no obvious relationship between economic growth and peace.

Some of the economic factors identified in the literature as offering opportunities to change the negative dynamics of fragility include:

Employment and job creation

There is mixed evidence on the links between **unemployment**, stability and conflict. The 2011 World Development Report, for instance, comments that 'unemployment is by far the single most important motivation for youths to join rebel groups or gangs' (Naudé 2012, p. 6). However, a recent systematic

³ For details on sequencing reforms in fragile states see Herbert (2014).

review of the impact of employment creation on stability and poverty reduction in fragile states finds a notable **lack of evidence** (Holmes et al. 2013; See also Cramer 2015). Of the seven studies included in the review, only one looked at the impact of employment programmes on stability. The dearth of evidence is attributed, in part, to the ‘methodological problems in quantifying stability as a dependent variable’ (Ibid, p. v). The authors call for future research which adopts robust qualitative and quantitative methodologies to address evidence gaps.

A 2009 rapid literature review notes that there is very limited literature which details approaches to promoting sustainable longer-term employment in fragile states (Haider 2009). Most resources focus on short-term job creation and income-generation in conflict-affected contexts. Some of the commonly cited elements for sustainable job creation in fragile states include (Haider 2009, pp. 1-2):

- An enabling framework for economic growth and sustainable job creation that includes physical and microeconomic stability and the design of laws that protect land and property rights, protect the rights of workers, and minimise investors exposure risk;
- A consultative process that involves social dialogue between government, workers, employers organisations and civil society engagement is essential for longer-term efforts to promote economic growth and employment;
- The adoption of market development and value chain approaches can help to move beyond short-term job creation and supply-side problems to targeting longer-term increase in demand for skilled employment.

Infrastructure development

The relationship between infrastructure and state fragility is unclear, with little evidence to suggest that infrastructure investment plays a significant role in the processes of stabilisation (Jones and Howarth 2012, p. iv). Case studies find that coordinating stabilisation and infrastructure programmes can be difficult to achieve, and emphasise the importance of local ownership and involvement (Ibid). The strongest evidence about the role of infrastructure in stabilisation concludes that **community involvement** is ‘critically important’ (Ibid, p. iv). Infrastructure implemented through community structures ‘generally [has] a good record in development, stabilisation and peace-building’ (Ibid, p. iv).

In a study for DFID, Jones and Howarth (2012) identify the main causal links by which infrastructure programmes can contribute to economic growth, poverty reduction, and improved access to services in fragile and conflict-affected states (Jones and Howarth 2012). The authors note that infrastructure investments are likely to have high economic returns, and that power and transport infrastructure in particular are ‘likely to present the highest immediate economic returns’ (Ibid, p. ii). Road and other transport infrastructure can additionally provide notable short-term employment opportunities, as well as boosting economic opportunities (Ibid).

Foreign Direct Investment

There is inconsistent evidence on the links between FDI and conflict and fragility. While some authors find that FDI reduces the risk of international conflicts, others note that FDI has had a positive effect on economic welfare, but negative effectives on political unrest (E.C 2009). One cross-country analysis suggests that FDI can significantly decrease corruption in the host country (Larraín and Tavares 2007); however, another analysis finds that this is dependent on the level of development and democracy (Zhu 2007). A study for the E.C (2009, p. 59) concludes that ‘while FDI can potentially have a positive impact on

growth and poverty reduction, negative externalities prevail when the quality of institutions is low, enhancing the likelihood of conflict and bad management’.

Trade openness

There is some evidence on the extent to which trade openness can impact on state fragility. In a summary of available literature, the E.C. (2009, p. 58) identify that in well-defined institutional settings, trade openness ‘generally produces global gains’, but in weak institutional settings this is not the case. Key factors include how widely distributed economic and production benefits are across geographical areas, ethnic groups, and urban areas. Recent studies find that open countries are more stable than autarkic ones, however there can be important trade-offs. One peer-reviewed article based on cross-country evidence concludes that ‘trade openness may deter the most severe civil wars...but may increase the risk of lower-scale conflicts’ (Martin, Thoenig and Mayer 2008).

Natural resources

Natural resource wealth can be used by states to support socioeconomic development (Coyle and Bruch 2014). However, perverse incentives and mechanisms can impede this process and create ‘economic instability which can turn into political instability’ (E.C. 2009, p. 60).

The ‘rentier state’ model argues that natural resource wealth makes democracies malfunction because it removes the need for the state to make bargains or pacts in support of a social contract and encourages the politics of patronage (Mcloughlin 2012). Other authors find that natural resource wealth can lead to conflict over control of those resources. While there is a broad body of literature examining the links between mineral resources and the incidence and duration of conflict, claims that an abundance of natural resources increases the likelihood of conflict have been widely disputed (Walton 2010). Some call for a more nuanced understanding for why some states with natural resource wealth are more stable than others. Others argue that not having natural resource endowments can actually lead to state failure because it reduces incentives to form a central authority (Mcloughlin 2012).

3. Country studies

Rwanda

Since 1994, the Rwandan government has made some progress in re-starting economic growth, driving the real GDP to grow more than 10 per cent between 1996 and 2000 (OECD-DAC 2009). More recently, however, economic growth has slowed. There is considerable concern about large and growing inequalities, particularly for the rural poor, who some authors caution have not received the benefits of economic growth (Cooke 2011).

Evidence on the relationship between economic growth and stability in Rwanda is limited; however, some authors hypothesise links between the nature of economic growth and state-building. Tangible poverty reduction at the grassroots level can help strengthen social cohesion and build stability; however, there is a need to ensure that economic development brings about inclusive benefits. A case study report by the OECD-DAC (2009, p. 6) notes that ‘for state-building to progress, Rwanda desperately needs to **expand its economic base**, with a radical increase in agricultural productivity and the development of

manufacturing and service sectors to provide employment for the vast numbers of underemployed rural inhabitants’.

Others find that economic growth is less important than **other state-building factors**, including political stability. In a report for the Center for Strategic and International Studies, Cooke (2011, pp. 2-3) cautions that ‘although Rwanda’s economic performance has been impressive, demands for political change will likely outstrip the stabilizing or conciliating effect of economic growth, which itself will be inhibited by the country’s size and resource based and is vulnerable to exogenous shocks’.

Burundi

In a paper for the Clingendael Institute, Specker and Briscoe (2010) emphasise the need to **prioritise economic recovery** in Burundi as a ‘requirement for creating a peace dividend and maintaining stability’. However, various operational challenges have impeded progress in economic development. Economic recovery was not treated as a peacebuilding priority in Burundi, meaning there was a lack of comprehensive strategy development and clear priority-setting (Specker and Briscoe 2010).

Cambodia

Over the past 40 years, Cambodia has experienced one of the world’s most ‘volatile growth’ patterns (Kelsall and Seiha 2014, p. 2). A prolonged economic collapse until the early 1980s was followed by a gradual but unstable economic recovery until 1998. Post-1998 saw further growth acceleration and sustained high growth (Ibid). An evaluation of DFID programmes notes that though Cambodia is ‘no longer fragile in terms of active conflict, insecure basic service delivery and political instability’, there are continuing fragilities including corruption, social exclusion, contested property rights, and lack of regard for rule of law (Thornton et al. 2009, p. v). Economic growth has been ‘impressive’, however it is narrowly based and poverty and inequality remain widespread challenges (Ibid, p. v).

A recent analysis on political settlement and economic growth finds that Cambodia’s growth experience has had ‘two faces’ (Kelsall and Seiha 2014, p. 53). There has been a ‘positive feedback loop between support for competitive export industries, state capacity, and structural transformation’ (Ibid, p. 2). However, there is also evidence that political elites - who depend on high-rent industries for their survival – have been complacent when it comes to **building state capacity** in other areas. This has led the country’s political settlement to become more unstable (Ibid).

An independent evaluation of the Asian Development Bank’s work in Cambodia found that **investment in physical assets and sector reforms** boosted connectivity, encouraged foreign direct investment, and lowered production costs (ADB 2009). The evaluation recommends that ADB assistance promote private sector-led growth and income generation through improved infrastructure services, and advocates the need to focus on fewer subsectors and explore other financing modalities to meet evolving needs.

Botswana

In a paper for the United Nations University, Robinson (2009) notes that Botswana illustrates the interactions between state consolidation and economic development. At independence, Botswana shared some of the characteristics of other less successful states in the region, including deep structural poverty, widespread illiteracy, poor infrastructure and a colonial legacy. The formation of the modern state in Botswana - which involved a long process of state and institution building inherited from the

Tswana states - demonstrates the **critical role of state institutions** in economic development and shows how economic development can contribute to the stability of the state (Robinson 2009).

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