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BRIEFING PAPER

Economic development in fragile contexts

Learning from success and failure

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Key messages

- Transformative economic progress is very challenging in conflict-affected states – but it is not impossible.
- We identify a number of rare successful cases and examine factors behind progress.
- Technically robust innovations that respond to market conditions and that are implemented in a politically smart way through quality, targeted local leadership are critical to achieving progress.

Introduction

Economic development that involves increases in productivity, growth and employment in fragile states is very challenging but not impossible. We examine successful cases of private sector development in fragile contexts to reveal deep-seated, context-specific factors *why* progress may have happened in such cases. A summary of these points to the importance of **enabling technically robust innovations that respond to market conditions and that are implemented in a politically smart way through quality, targeted local leadership**. In short, identifying the links between economic analysis and politically smart action is crucial.

Why fragile states perform poorly

Fragile states tend not to achieve the levels of growth and productivity-enhancing change of resilient states. We identify five reasons for poor performance in such states, which guide the analysis in case studies:

1. Pervasive **insecurity** or actual armed conflict
2. **Governance** that falls short of the minimum needed to support a modern market economy;
3. Inadequate physical and soft **infrastructure**, such as a basic financial sector and institutions that support trade
4. Meso-level or **sectoral deficiencies** that constrain inter-sectoral and inter-firm activity, which sets back productivity and growth
5. **Micro-level characteristics** of firms in fragile contexts that constrain their productivity and contribution to economic transformation.

Identifying cases of success

We identify four groups of countries affected by fragility: those where there is active conflict; those in transition from conflict to resilience; those with subnational conflict; and those at risk of conflict.

We statistically identify (using SET, 2018) in each of the four categories a range of country-variable pairs that demonstrate success. These countries include Afghanistan, Burundi, Liberia, Mozambique, Sierra Leone and Somalia, among others. We then identify sector- or industry-level case studies with positive results in these countries, including:

- Rapid growth **of mobile phones in Afghanistan** and the economy-wide transformative impacts of information and communication technology
- Development of the **construction industry in Liberia**: infrastructure is often a key binding constraint to economic growth, one which high-capability local and foreign firms are tackling
- **Public accounting in Liberia**: services that underpin economic development
- **Telecommunications and money transfer in Somalia** unlocking transformative opportunities
- **Investment in cocoa in Sierra Leone**: agro-business as a step to economic transformation
- **Breweries in Burundi and Kenya**: high-productivity manufacturing with supply chain and distribution linkages supports economic transformation and creates many jobs
- **Sugar in Mozambique**: sluggish in 1992, sugar is now the most successful industry in post-conflict Mozambique, providing a significant number of jobs and improving livelihoods.

Factors behind success

A number of factors have determined success in the cases listed above:

- **Politically smart and productive relationships between investors and the state.** The Afghan state allowed a temporary monopoly before competition from new entrants lowered prices and added new services. Telecommunications and money transfer firms in Somalia are politically engaged, lobbying for their interests and building constituencies of customers that enable them to manage risk. Large firms with significant sunk costs, such as breweries, have close relationships with government.
- **Large firms may be able to manage risks better than small firms.** Large firms may have more access to policy-makers, raising the stakes of failure if governments jeopardise their operations, and may be better placed to mobilise external support against political interference. However, large firms with political access can also suppress competition or entrench political incumbents. First-mover firms must not become perpetuating rent-seeking monopolies.
- **Private sector firms engage in a wide variety of strategies to reduce risk.** Producing widely consumed products, such as beer and mobile phones, lowers risk; governments are reluctant to meddle if this could affect supply. Companies have managed risk also through being good corporate citizens. Money transfer firms in Somalia aligned themselves with religious principles and local values. Chinese investors in Liberian construction maximised local hiring. Cocoa investors in Sierra Leone built infrastructure normally provided by government.
- Lack of capacity constrains the role of the public sector in fragile contexts, but **investors eventually look for a credible commitment from government**. Fiscal incentives for breweries in Kenya and longer-term output- and performance-based contracting in construction in Liberia are good examples. Public support to the sugar industry (loans, training, access) attracted private investment in Mozambique.
- **Private sector leadership can enable the sector's development despite limited state engagement.** Liberia's professional accountancy organisation responded to competition and developed the industry, building local and international linkages. Foreign investment helped upgrade the sugar industry in Mozambique.
- **Foreign actors have a role to play.** Development finance institutes can invest in manufacturing and aid agencies can support removal of policy constraints, provide grants to business associations, improve contracting and construction procedures, promote local sourcing and help develop farmer cooperatives.

The core drivers of success

Success has depended on investors promoting technically sound innovations that respond to markets, that are politically smart and that make use of limited government capacity. While sector characteristics played a role in the success of telecommunications in Afghanistan, **local factors were also decisive**, such as the short-term monopoly permitted by the state for the first-mover firm. The government's international partners provided technical support to forward-thinking ministers to develop a competitive telecommunications regime. In another instance, in Liberia **a technical fix such as performance-based road construction and maintenance could be introduced successfully in part because of a willing government and support from an international partner**.

We also find that business-led approaches can achieve results. Outward-looking **business associations were responsible for introducing international standards** to accountancy in Liberia. Successful expansion of the money transfer system by a **locally aware private sector** in Somalia allowed them to circumvent the state's shortcomings. Further, the synergetic relationship between state and business can be used to scale-up impact. In the beer sector in Burundi, there is **mutual dependence between state and business** in terms of consumption, tax revenues and job creation. Such a relationship can lead to broader economic transformation, for instance by driving local sourcing.

To conclude, **contextual knowledge** is crucial. Once the economic, market and political context is well understood, it is much easier to define **interventions that will work with officials or willing businesses**.

References

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