



Fragility, conflict and violence as global public goods

Strengthening engagement by multilateral development banks

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Key messages

- Fragility, conflict and violence (FCV) are negative regional and global public goods.
- Multilateral development banks (MDBs) have comparative advantages in providing assistance to countries affected by FCV that overcome some of the pitfalls of conventional aid delivery.
- However, MDBs have some constraints to their activities, such as their ability to operate in political space and to finance projects that cross borders, and their operational modalities.
- Actions to strengthen the abilities of MDBs in countries affected by FCV is needed at the global level, both within the MDBs themselves and collectively by the MDBs working together.

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Abbreviations

ADF	African Development Fund (part of African Development Bank)
AfDB	African Development Bank
AFESD	Arab Fund for Economic and Social Development
AsDB	Asian Development Bank
AU	African Union
CDB	Caribbean Development Bank
DfID	Department for International Development (UK)
EADB	East African Development Bank
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EU	European Union
FCV	Fragility, conflict and violence
GAVI	Global Alliance for Vaccines and Immunization
GEF	Global Environment Facility
GPG	global public good
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development (part of World Bank Group)
IDA	International Development Association (part of World Bank Group)
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IsDB	Islamic Development Bank
g7+	Group of 16 governments of fragile states
G20	Group of 20 governments
MDB	multilateral development bank
MDTF	multi-donor trust fund
MOPAN	Multilateral Organisation Performance Assessment Network
NDF	Nordic Development Fund
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OFID	OPEC Fund for International Development
OIC	Organisation of Islamic Cooperation
OSCE	Organization for Security and Co-operation in Europe
RDB	regional development bank
RPG	regional public good
SDG	Sustainable Development Goal
UN	United Nations

Executive summary

This paper shows that fragility, conflict and violence (FCV) fit the classic definition of regional and global public goods, albeit negative public goods or public ‘bads’. FCV tends to have regional and even global impacts that directly or indirectly affect everyone to some extent.

Multilateral development banks (MDBs) have comparative advantages that enable them to avoid many of the pitfalls encountered by other aid modalities. Such advantages include: the avoidance of fragmented, small-scale projects; insulation from the political pressures that can cause volatility in aid flows; long-term country engagement, enabling them to support the institutional development that characterises the transition from fragility to resilience; and the use of country systems that strengthen local capacity.

However, MDBs also have some limitations, caused by: their inability and unwillingness to operate in political space; a country-based operational model that makes their engagement on regional and global issues difficult; a financing allocation model that underfunds countries affected by FCV; and some operational procedures that inhibit a timely and effective response in situations of fragility and in the aftermath of violence. MDBs finance only around 15% of country programmable official development assistance in FCV-affected countries and have the capacity to do more, particularly when FCV is recognised as a global and regional public good.

The paper sets out a number of actions that the global community can take to deepen the effectiveness of MDBs, other actions that the MDBs themselves can take at the level of their country operations, and actions that MDBs can take collectively to strengthen their ability to address FCV. These can be summarised as follows:

Clarify MDBs’ political non-interference mandates, and review how MDBs should operate in the modern world, where FCV, development and politics inevitably intersect.

Work around the limitations of MDBs’ country-based operational model, particularly how to provide funding for activities that cut across national borders or where support is needed for organisations that are independent of government. One option is more creative use of MDBs’ grant instruments, where there is no repayment obligation or concerns about creditworthiness, to fund both national and regional projects that reduce FCV.

Undertake a major reallocation of MDB financing to countries affected by FCV to address the distortions in aid allocation.

Strengthen the legitimacy of global and regional organisations that have a mandate to deliver both policy and action in the development, humanitarian, diplomatic and security arenas. MDBs can play a big role in shoring up banking systems and supporting international rules on illicit financial flows and tax avoidance. MDBs are already invited to high-level meetings of the OECD and G20; they need to continue on this path of participation in global fora to build their international legitimacy and to build bridges between parties.

Utilise MDBs' finance and banking expertise to develop more innovative financing coordination and financing instruments to tackle FCV. MDBs can use their grant, concessional and trust funds more creatively in certain country-based financing models. Multi-donor trust funds can also address many of the shortcomings of the international aid system – accountability is key, particularly to the recipients of international assistance. MDBs can fill the current gap in financial instruments that specifically address FCV in middle-income countries. MDBs also need to strengthen their operational engagement in FCV-affected countries, especially through: decentralising highly qualified, empowered staff to country offices; using country systems wherever possible; and providing hands-on support to counterparts in low-capacity countries.

Promote deeper engagement and collective action by MDBs to maximise their impact on FCV. MDBs have varying degrees of engagement with FCV, but there is scope for better collaboration between banks. Moreover, MDBs can transfer much-needed knowledge and expertise to other banks and, potentially, share in the risk and overall exposure of each bank, as well as harmonise MDB processes to increase their effectiveness in tackling FCV.

Introduction

From climate change to migration, security to pandemics, global challenges are multiplying and require urgent action. This paper is part of a broader study on whether the multilateral development banks (MDBs) should contribute to the financing of global public goods (GPGs) and related regional public goods (RPGs) and, if so, how this could be achieved. MDBs are taking a fresh look at their mandates, areas of intervention and comparative advantages. Several MDBs are in the process of reviewing their medium-term strategic directions – notably the World Bank Group through its “Forward Look” exercise and the Asian Development Bank (AsDB) with its “Strategy 2030” – which also include global and regional issues.

Taking the example of fragility, conflict and violence (FCV), and in the context of the International Development Association’s (IDA) ongoing eighteenth replenishment round (IDA18), which is seeking to substantially strengthen IDA’s effectiveness in addressing FCV, this paper provides examples of: (i) the rationale for MDBs to contribute to GPGs and RPGs; (ii) the ways in which MDBs have contributed so far; and (iii) the lessons for scaling-up MDB support for addressing GPGs and RPGs.

Action on GPGs and related RPGs is an even greater challenge in countries affected by FCV, particularly as these countries are especially vulnerable to GPGs, such as climate change, pandemics and forced migration, which can affect their fragile institutional arrangements and increase the risk of conflict. The importance of FCV to international development has been recognised in the Sustainable Development Goals (SDGs); specifically in SDG 16, which covers Peace and Justice. As this paper will show, FCV is itself a negative RPG and GPG, i.e. a public ‘bad’. MDBs have a crucial part to play in tackling these issues by facilitating more decisive policy responses, scaling up their financial support and contributing to the overall urgent corrective action.

Structure of this paper

This paper explores the ways in which MDBs can facilitate better support to FCV-affected countries. It is organised as follows:

Section 1 offers a definition of FCV as a GPG/RPG, providing examples of how FCV crosses borders and can cause regional global disruption.

Section 2 examines the operational modalities of MDBs that give them a comparative advantage over other international partners in key areas of engagement in fragile situations. Namely, that MDBs have the knowledge and risk management capacity to scale up finance support in FCV-affected countries; they are able to pool funds to avoid fragmented assistance that overloads countries with weak institutions; they can smooth aid volatility; they possess better long-term perspectives; and they use country systems that can strengthen institutions.

Section 3 addresses some of the barriers that are inhibiting MDBs' efforts in supporting FCV-affected countries. Some of these are fundamental to MDBs' mandates, preventing them from entering the political space of member countries. Others relate to MDBs operating a limited country-based business model and to country allocation models that underfund FCV-affected countries. This section puts forward a number of actions that banks can take themselves to fix some of these operational issues. In doing so, they can make their contribution to addressing FCV more effective.

Section 4 identifies a way forward for MDBs to begin better engagement with reducing global and regional FCV. This section offers actions at the global and country levels, and actions that need to be taken by MDBs individually and collectively that will strengthen the MDBs' impact on FCV:

Global actions are intended to strengthen the legitimacy of multilateral organisations to respond to the global challenge of FCV. This will be difficult without strengthening MDBs' relations with the United Nations and capacitating the United Nations as it is the only organisation with a mandate in all global policy and delivery areas. Other global actions to reinforce the impact of MDBs include reinforcing rules on illicit financial flows and tax avoidance, and strengthening codes of practice influencing the activities of private investors in fragile states.

Country-level actions include: reforms to coordination; an MDB operating model that is fit for the modern world, that recognises the inevitable intersect between development and politics; better use of pooled funds to address fragmentation, coordination and risk aversion; financing instruments that address fragility in middle-income countries; deepening reforms in operational rules; ways to strengthen mutual accountability; and facilitation of job-creating private investment.

Collective actions strengthen the collective impact of MDBs on FCV. These include: deepening engagement with g7+ group of fragile states; engagement in high-level platforms; knowledge exchange; harmonisation of MDB processes; and co-financing and risk pooling.

Section 5, the conclusions to the paper, provides a synthesis of the key points to be taken forward, to allow MDBs to make a better impact in reducing FCV.

1 Why is fragility, conflict and violence a GPG/RPG?

FCV tends to cross borders, and the financing of conflict often involves trafficking and organised crime (Collier, 2007 World Bank, 2011). Even when conflict subsides, violent networks can continue as entrepreneurs in violence shift from political to criminal activities. Human rights, particularly the rights of women and children, suffer under violence and transnational crimes, such as human trafficking. Ungoverned space and fragile polities provide fertile ground for violent political or religious movements to thrive, incubating and further propagating their activities. Some examples of how local conflicts can create regional global disruption include: the Balkan tinderbox of 1914; Afghanistan between 1995 and 2001, when the Taliban administration permitted an Al Qaeda haven; the flourishing of piracy off the coast of Somalia around 2005-2012, which disrupted sea trade; and the recent conflicts in Iraq that have spread to Syria, precipitating so-called Islamic State (IS); and the flow of refugees to Europe in 2015-2016.

FCV meets the classic definition of a public good (see Kaul et al., 1999). More precisely, it is a *negative* or *noxious* public good, a *public bad* – in that FCV is *non-excludable*, because everyone who lives in an area prone to FCV is affected to some extent. FCV is also *non-rivalrous*, as becoming a victim of FCV usually does not prevent someone else becoming a victim. FCV tends to become at least a regional problem, but sometimes it becomes a global problem, where all or most people in the region beyond the conflict are affected to some extent. Some might argue that FCV is not non-excludable since it is possible for an individual or country to take preventive measures to insulate FCV, for example by building a wall or investing in security. However, the costs of such measures, which would otherwise not have been incurred, are themselves an impact of FCV. And such costs may not be trivial– the 525 kilometre border fence and wall separating Israel from the West Bank cost around \$2.6 billion, while the wall a US presidential candidate has proposed between the US and Mexico would cost between \$8 billion and \$25 billion if it were ever built (Kessler, 2016). Additional aviation security in the United States after the September 2001 attacks on New York and Washington has been estimated to cost \$1.1 trillion during the period 2002-2011 (Mueller and Stewart, 2011).

In addition, FCV could be considered weakly non-rivalrous if there are so many victims that the perpetrator lacks the capacity to create more, for example they run out of weapons or explosives, or become overextended or exhausted. While this might be a short-term problem, the general availability of small arms and the potential for motivated young men with primitive weapons to inflict huge damage – a ‘pitchfork rebellion’ like the Rwandan genocide, which was largely perpetrated by men armed with machetes – suggests that FCV is, indeed, non-rivalrous.

Recent history has shown that a small group, or even individuals, can create mayhem and impose costs that are orders of magnitude greater than their effort. The September 2001 hijackings may have cost as little as \$400,000 to \$500,000 (National Commission on Terrorist Attacks, 2004), but have imposed costs of \$3.3 trillion that

go far beyond the immediate costs of strengthening aviation security (Carter and Cox, 2011). Another example is the cost of piracy off the coast of Somalia, which has been estimated to have been around \$6 billion in 2012 alone (One Earth Future Foundation, 2012).

2 The comparative advantages of MDBs in reducing FCV

MDBs can be defined according to several characteristics that separate them from other providers of international public finance. Such characteristics include:

- structured as publicly owned corporate entities, i.e. banks, with balance sheets, shareholder provided capital and boards of directors
- sovereign ownership by both capital-contributing and borrower countries (shareholding tends to be balanced between contributing shareholders and borrowers or weighted towards capital contributors)
- mandates to facilitate economic and social development, and prohibitions on taking financing decisions on political grounds
- intermediation in knowledge as well as development finance, and provision of support for capacity development as well as physical investment
- operational activities in more than one sector
- provision of wide range of financing instruments, including grants, loans, lines of credit, technical assistance, guarantees and insurance and equity investments, though no MDB provides all of these.

MDBs can be divided into *global banks*, which have activities in developing countries across multiple regions, *regional development banks* (RDBs), where the borrowers and many non-borrowing shareholders are located within a specific region, and *sub-regional banks*, which operate within a sub-region, e.g. East Africa, and which are owned by two or more sovereigns. A list of 19 MDBs is given in Table 1. Profiles of many of these MDBs can be found in Faure et al. (2015).

Table 1: List of multilateral development banks

Global Banks	
World Bank Group	
New Development Bank ('BRICs Bank')	
Regional Development Banks	
AsDB	Asian Development Bank
AfDB	African Development Bank
AFED	Arab Fund for Economic and Social Development
AIIB	Asian Infrastructure Investment Bank
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
IADB	Inter-American Development Bank
IFAD	International Fund for Agricultural Development
IsDB	Islamic Development Bank
NDB/NDF	Nordic Development Bank/Fund
OFID	OPEC Fund for International Development
Sub-Regional Banks	
BCIE	Banco Centroamericano de Integración Económica (Central American Bank for Economic Integration)
BOAD	Banque Ouest Africaine de Développement (West Africa Development Bank)
CAF	Development Bank of Latin America (formerly Corporación Andina de Fomento)
CDB	Caribbean Development Bank
EADB	East African Development Bank
PTA	Eastern and Southern African Trade and Development Bank, or the Preferential Trade Area Bank

Source: Faure et al. (2015) and World Bank.¹

Note: AIIB and IFAD do not strictly meet the definition of an RDB because their activities are confined to one sector, but infrastructure and rural development can be considered as covering several distinct subsectors with their own professional communities of practice.

¹ The World Bank website contains a list of MDBs

<http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20040612~menuPK:8336267~pagePK:51123644~piPK:329829~theSitePK:29708,00.html>

Ending poverty will not happen unless poverty is reduced in countries affected by FCV. Since poverty reduction is the *raison d'être* of MDBs, their success in helping countries meet poverty goals such as the SDGs is dependent on reducing conflict. The operational modalities of MDBs give them a comparative advantage over other partners in some critical areas of engagement in fragile situations.

MDBs have the finance, depth of expertise and scope that can support full-scale comprehensive approaches. The opposite to the fragmented, project-based aid approach is the programmatic approach, which is designed to have national or regional impacts that sustain peace and development. MDBs can achieve economies of scale in financing and knowledge intermediation that bilateral or smaller agencies cannot. Countries trapped in a low-development equilibrium caused by poor institutions – such as fragile states – need a substantial incentive for reform to prevent them remaining stuck in the trap, and MDBs can provide the scale of incentives to do this (Ravallion, 2015: 5-8).

Achieving scale does not just mean applying more money, but also opening up fiscal, political, policy, cultural, partnership and learning spaces for country-led innovations (see Chandy and Linn, 2011). MDBs are well placed to use their financial, convening and knowledge-transfer capacities to ensure that peacebuilding and development is not small scale and irrelevant, but impacts positively the whole country, the immediate region and, sometimes, even the wider world.

The global and large regional MDBs already have significant financial resources and it is inefficient for them to process small lending operations. Consequently, they have an incentive for interventions at scale. In addition, these MDBs cover most sectors and this scope enables them to adopt comprehensive approaches to development that ensure that all priority areas are covered, such that development in one area is not compromised by shortcomings elsewhere.

The MDBs' scope is complemented by their wide range of instruments. They can therefore support both programmatic investment and lumpy infrastructure projects, public and private investment, and directly finance policy change and development initiatives. MDBs can also address policy constraints that may be politically sensitive for bilateral agencies engaging with governments of recipient countries.

Because the MDBs can generate economies of scale in knowledge and learning (Nelson, 2015: 16-17; Ravallion, 2015), it is not surprising that they have been rated highly for providing value for money, although European Union (EU) organisations and vertical funds such as the Global Alliance for Vaccines and Immunization (GAVI) also rank highly (DfID, 2013).

MDBs can pool funds. This enables them to avoid providing the fragmented assistance that overloads countries with weak institutions and which can be ineffective in meeting peacebuilding and development goals. Multilateral aid channels are less fragmented than bilateral channels (Gulrajani, 2016: 14). While having a greater choice of international partners may benefit countries with good government capacity, for fragile states the proliferation of channels for delivering international assistance and the fragmentation of this assistance into thousands of micro projects means that coordination becomes almost impossible.

Partial data for fragile states suggest that the fragmentation of donor assistance into multitudinous small projects is as bad as in other low-income countries, if not worse. The following are some examples from the data:

- In 2004, across the 11 countries where government capacity was very low, there were 23 donors, which together allocated funds to 427

activities – i.e. over 18 activities per donor, amounting to only \$1.1 million per activity (World Bank, 2008). Part of this can be explained by the proliferation of technical cooperation projects, which typically have a poor record in building country capacity.

- At the 2009 conference on aid effectiveness in the Democratic Republic of Congo, it was reported that there were more than 30 donors delivering assistance to the country. Of the proliferation of small projects being delivered, 362 were in the health sector (262 of which were less than \$1 million) and 305 were in the justice sector (199 of which were less than \$1 million).
- Ghani and Lockhart (2008) report that after the new government was established in Afghanistan in 2001, UN agencies prepared 400 projects, far beyond the capacity of government engagement at that time.

MDBs are designed to pool funds from shareholders through their soft lending windows, such as the IDA, the African Development Fund (ADF) and the Asian Development Fund. MDBs wish to avoid the administrative costs of small projects and either consolidate small activities into larger, coherent programmes (such as in the social sectors) or fund large-scale, high impact projects (such as in the infrastructure sector). MDBs have been rated above bilateral agencies, vertical funds and others in reducing the burden of foreign assistance on partner countries, which includes reducing fragmentation, higher median project size and providing programmatic aid (Birdsall and Kharas, 2014).

MDBs still only accounted for around 15% of programmable official development assistance (ODA) provided to fragile states in 2012. OECD data for a list of 50 countries it considers ‘fragile’, some of which are middle-income countries, show that ODA to these countries in 2012 amounted to \$54.5 billion. Of this, country programmable aid, over which recipient partner countries have considerable influence and which excludes spending that is inherently unpredictable or entails no flow to the recipient country,² amounted to \$41.4 billion (OECD, 2015). MDBs provided \$6.3 billion, which would have been country programmable, and other multilateral organisations provided a further \$10.0 billion, with bilateral assistance accounting for about \$38 billion. MDB-provided ODA accounted for 12% of total ODA and 15% of country programmable aid. Most of the MDB finance was provided by the IDA and the African Development Bank (AfDB) (see the Appendix). Significant non-ODA funding, i.e. loans at quasi-market terms, was provided by the IBRD, EIB and EBRD, mainly to middle-income countries or countries transitioning from low-income country classification. Annual reports of these banks report loan approvals, rather than disbursements (which are shown in the OECD data), and their commitments to countries on the OECD list of fragile states in 2012 amounted to about \$2.5 billion.

MDBs can pool and manage risks.³ FCV countries are some of the riskiest places to do any kind of business. They are therefore even riskier places to conduct development activities. In such countries, development activities require interaction with governments that typically lack administrative capacity, have developing fiduciary controls and are based on fragile political settlements, requiring distribution of economic rents to maintain stability and avert chaos. MDBs enable bilateral donors to pool risks and transfer them to organisations that have developed the expertise to manage them. If money does go to an unintended purpose, exposure of the donor is limited in terms of both financial, reputational and political risks and the donor can hold the MDB accountable for any weaknesses in risk management. This

² Such expenditures include humanitarian aid for disasters and debt relief.

³ This section draws heavily from OECD, 2012: 78-82.

contrasts with a purely bilateral programme, where responsibility for funds being well spent is directly to the donor's legislature that appropriates the funds. It is also where opposition parties may exploit opportunities to criticise the aid programme, particularly if the aid budget can be diverted to interests of their constituents. Bilateral programmes, even when implemented by non-governmental organisations or United Nations (UN) agencies, may have limited influence with the government if things do go wrong. This contrasts with MDBs, which have more financial leverage and which act together to sanction both firms and individuals.

While much of the literature on risk pooling applies to multi-donor trust funds (MDTFs), the analysis is applicable more generally to MDBs, essentially because MDB financing windows applicable to fragile situations (such as IDA and ADF) share most of the characteristics of MDTFs. Such windows are financed primarily by donor contributions, have separate financial accounts and have oversight by boards representing financial contributors and recipients.

Fiduciary risks are not the only risks that matter in reducing FCV. Programmatic risks (failure to achieve programme objectives), strategic risks (which include state failure and descent into violence and chaos) and risks to the country (such as aid dependence and corrosion of institutions) are also relevant, depending on the level of violence in the country. MDBs have a comparative advantage in preventing or managing these risks, given their incentives to facilitate development results, their use of country systems and their extended engagement with countries. However, their current modes of operation are less suited to managing strategic risks, given their reluctance to engage in political governance and security issues. Nevertheless, MDBs will be effective in managing risks only if they put the minimum necessary controls in place to manage them, do not become excessively risk averse (so as to increase the risks of programme or strategic failure) and are held accountable by their shareholders and funding contributors.

MDBs may smooth aid volatility in fragile situations. Stop-go aid has been the norm in fragile states. It is often in response to political and security setbacks, or because bilateral aid is easy to mobilise in response to a crisis, compared with the long slog of institution building and development. Every fragile state received at least one aid shock during the decade 2000-2010 (OECD, 2010a: 65-66).⁴ Donor funding tends to be large after a crisis or at the end of hostilities, but to decline over a few years, even though it takes at least 20 years to build basic institutions in a fragile state (World Bank, 2011).

Bilateral aid channels are more politicised than multilateral channels (Gulrajani, 2016: 10-11). MDBs respond more slowly to political or human rights setbacks because their governance structures require collective decision-making and their mandates preclude overtly political decision-making. If there is a downward trend in the political settlement or human rights, MDB financing will adjust, particularly if the UN imposes sanctions – but MDBs do not overreact to news stories.⁵ MDB allocation criteria, typically based on a measurement of country policy or institutional performance that changes slowly, causes funding to react gradually to a deterioration in the index. This might be expected to reduce volatility. However, the evidence that MDB finance is indeed less volatile is inconclusive. An OECD-supported study (Frot and Santiso, 2008: 18-20) examined the volatility of total aid flows through bilateral and multilateral channels by decade over the period 1960 to 2006 and concluded that multilateral aid was consistently more volatile than bilateral aid. One might interpret

⁴ Shock is defined by OECD Development Assistance Committee as a change of more than 15% in aid per capita, from one year to another.

⁵ In a conversation with the author, a former Nordic minister for development cooperation described the parliamentary pressures on the ministry to curtail aid every time an incident in a country was reported in the donor country media. The converse argument of course is that MDBs are insufficiently sensitive to deterioration in governance or human rights in a country.

this as while bilateral aid is sensitive to political events, multilateral aid – which is often associated with policy conditionality – is more sensitive to changes in policy (the dataset includes the period when MDBs supported structural adjustment, including budget support linked explicitly to policy change). Frot and Santiso’s analysis does not differentiate between countries affected by FCV – such as those on the harmonised MDB list of fragile states – and other countries. As the policies of MDBs during this period did not support policy conditionality in lending to these countries,⁶ MDB financing may not have been as volatile as politically sensitive bilateral assistance, but evidence is lacking to support this hypothesis. In addition, reversals in security can also slow aid transfers, but these affect both bilateral and multilateral assistance.

MDBs potentially have a better long-term perspective than bilateral aid or most UN programmes. This is because the latter often use humanitarian instruments to finance development. Developing institutional capacity is at the heart of the transition of states from fragility to resilience. Here, the record of international assistance has been mixed. Institutional development is a very long-term process that takes decades to achieve. Expectations of international partners have been unrealistic and have failed to recognise the time needed for international partners themselves to build their institutions (Pritchett and de Weijer, 2010; World Bank, 2011). Many of the promises made and expectations for the impact of aid on institutional development in fragile states were unrealistic to begin with. In addition, institutional models do not travel well and may not deliver functions in a foreign setting, even though they conform to the forms of international best practice (Pritchett et al., 2012). Institutions that fail to work are a huge waste of scarce resource and time, and research on six countries has shown that foreign assistance can actually do harm to the state-building process (Putzel, 2010).

MDBs are well positioned to take a long view on development. They have an institutional legacy in financing infrastructure, where projects can take more than five years to yield results, and governance arrangements that insulate their management from short-term political pressures. MDBs are also used to long-term relationships with countries, which might span over 50 years. As the country begins building a development trajectory and the country context changes, MDB partners will seek to calibrate their financing and advisory instruments as required. Bilateral governments face elections every two to six years, and development ministers tend to have a short tenure of around three years to demonstrate results. Coupled with government aid budgets that may have a horizon of only three years – the US has budgets for only one year at a time, and Congress may fail to agree even that – bilateral donors have a bias towards a short-term approach. The UN has the institutional longevity but does not have a stable funding model for development activities in fragile settings. Moreover, UN country budgets are often based on appeals to donor countries, which makes them both volatile and short-termist by nature. Ravallion (2015:9) argues that the World Bank does tend to take a longer perspective on development than most other aid agencies.

MDBs use most country systems, which strengthens institutions. Use of country systems by international partners strengthens these systems, at a minimum the partner needs to ensure there is a functioning system to manage aid funds and ensure development results. There are compelling theoretical arguments that using country systems strengthens institutions. The empirical evidence to support this proposition

⁶ For example, the World Bank’s Operational Policy 8.00 Rapid response to crises and emergencies, which governed most post-conflict operations, and which has now been superseded, stated in Section 6: ‘Emergency operations do not address long-term economic issues, including those that are triggered by economic shocks and require a policy response from the government that the Bank normally supports through development policy operations. They should also not include conditions other than those directly related to the emergency recovery activities and, if appropriate, to preparedness and mitigation.’

is not conclusive, but there are positive signals in this direction (see Hart et al., 2015: 10-12). Furthermore, donors who are willing and able to localise their aid will be at a significant advantage. Evidence from corrupt or fragile countries suggests that localising aid, when managed successfully, can have strengthening benefits; and while the evidence that using country systems strengthens institutions is not conclusive, there is stronger evidence that bypassing them can undermine institutions (see: Glennie et al., 2013; Hart et al., 2015).

In 2011, the New Deal for Engagement in Fragile States⁷ called for greater use of country systems in fragile states. However, this has not taken place to a large enough degree (see International Dialogue, 2014). While donors generally have been tending towards using country systems when they are adequate, as agreed under the Paris Declaration on Aid Effectiveness (Knack, 2014), they are much less likely to do this in FCV-affected countries where public financial management capacity is low. Even though the evidence is mixed, it does seem from Knack (2014) that MDBs are more able to bear the risks of using country systems in fragile settings than all but a few bilateral donors. While MDBs use most dimensions of country systems in their operations (Table 2), they do impose their own procurement rules, especially for international procurement. In addition, they may ring-fence their funds through special accounts managed by the recipient government's treasury. MDBs may also impose their own environmental standards and policies for compensating and resettling people displaced from project areas (see Hart et al., 2015). Recently, there has been a shift by MDBs to using country systems, including for procurement, but this shift is based on risk assessments that typically preclude countries affected by FCV (see World Bank, 2015; AfDB, 2015). While MDBs tend to use country systems in fragile settings more than most other providers of ODA, they still have a tendency to ring-fence the projects they finance, and could do more to rebalance the fiduciary risks with the risks of missing opportunities to develop local institutions. As the New Deal monitoring report states: 'direct country-systems use appears to be more difficult for bilateral INCAF members, than if their money is passed into a pooled fund. This suggests that pooled funds offer a valuable pathway towards greater use of country systems in fragile states by sharing risk' (International Dialogue, 2014: 19).

⁷ The New Deal was agreed between the g7+ group of fragile states and their international partners in Busan, Republic of Korea, in 2011 (g7+, 2011).

Table 2: Dimensions of use of country systems

Term	Definition
On plan	Aid is integrated into spending agencies' strategic planning and supporting documentation for policy intentions behind budget submissions.
On budget	Aid is integrated into budgeting processes and is reflected in the documentation submitted with the budget to the legislature.
On parliament	Aid is included in the revenue and appropriations approved by parliament.
On treasury	Aid is disbursed into the government's main revenue funds and is managed through the government's funds.
On procurement	Procurement using aid funds follows the government's standard procurement procedures.
On account	Aid is recorded and accounted for in the government's accounting system, in line with the government's classification system.
On audit	Aid is audited by the government's auditing system.
On report	Aid is included in ex-post reports by the government

Source: CABRI (2008), Hart et al. (2015).

MDBs can contribute to addressing external drivers of conflict that corrode governance in countries affected by FCV. External economic factors such as transnational corruption, illicit international financial flows and trafficking create stresses on countries that can lead to FCV (World Bank, 2011: 119-228). Issues such as corruption control, taxation and revenue management, management of cross-border financial flows, the regulatory environment for private investment, trade facilitation, natural resources management and the development of regions where narcotics are produced fall wholly or at least partly within the current mandates of MDBs. Recognising the GPG/RPG dimensions of these problems can give an extra impetus to activities of MDBs to address them at the country level. However, the effectiveness of MDBs' efforts will depend also on international action to tackle problems such as illicit financial flows, tax avoidance and corruption associated with foreign trade and investment. MDBs can play an advocacy role in global fora, to accelerate international actions to strengthen incentives against international economic drivers of conflict.

3 Issues with MDB support to tackling the FCV GPG/RPG

Despite their comparative advantages in supporting activities that address the FCV GPG/RPG, MDBs also face barriers that inhibit their efforts in this area. Some of these are fundamental and related to their mandates, or how they have been interpreted. Others relate to the fact that MDBs are, first and foremost, banks that make loans to creditworthy borrowers that must be repaid. Furthermore, FCV-affected countries are underfunded by the development performance-based country allocation model. Despite these problems, there are a number of operational issues that banks themselves should be capable of fixing, to make their efforts in addressing the FCV GPG/RPG more effective.

3.1 Operating in political space and issues of mandate

MDBs have articles in their charters that prevent them from interfering in the political affairs of a member country, and that require decisions to be impartial and based only on economic or social development considerations.⁸ In addition, MDB charters contain clauses precluding activities to which the member countries object (i.e. a government represented by its finance or planning ministry). These clauses have been interpreted by MDB lawyers to prohibit a number of activities that may be vital to enabling good governance and peace. These include: engagement with the security sectors, such as financing of police salaries in post-conflict situations; the disarming of militias, although their reintegration can be financed; advising on security sector budgets and their financial management, although high-level budget advice on the security sectors has been undertaken at the request of a few governments; and direct engagement in facilitating peace negotiations and constitutions, even when issues of allocation of natural resources rents are under discussion.

Despite the apparent clarity of the ban on political activity and the requirement for strictly economic development decision criteria, the MDBs have demonstrated flexibility since their creation, though not always in the interest of the borrowing countries. World Bank lending for reconstruction in European countries during the late 1940s and 1950s was motivated not only by reconstruction and development, but also by stopping the expansion of Communism. During the Cold War, loans were directed to countries where there was competition between the Soviets and the West, such as in the Horn of Africa. Somalia, South Sudan and Sudan are still obliged to

⁸ The Association and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in this Agreement', World Bank (1960), IDA Articles of Agreement, Article 5, Section 6. Neither the Fund, nor any officials or other persons acting on its behalf, shall interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only considerations relevant to the economic and social development of members shall be relevant to such decisions, and these considerations shall be weighed impartially to achieve the purposes stated in this Agreement', African Development Bank (2011), Agreement Establishing the African Development Fund, 1972, Chapter V, Article 21.

repay their debts from this time, and the remaining arrears are an obstacle to new MDB lending in these countries. More recently, MDB lending has been curtailed in response to non-constitutional changes in the governments of several African countries, even when these have taken place when corrupt governments were overthrown by popular movements. However, lending to countries of geostrategic interest to large shareholders, such as to Egypt and Pakistan, has always been maintained (although MDB lending was curtailed when Pakistan and India tested nuclear weapons, only to be resumed three years later). Such decisions had been justified on economic grounds, however shaky, but their rationale was nearly always political.⁹

MDBs comply with sanctions imposed by the UN. The UN has legitimacy to impose sanctions, which is strengthened by the governance arrangements of the Security Council. (The Security Council is broadly representative, and it gives a veto to the five permanent members so as to promote consensus on contentious issues, even if this sometimes prevents a decision with super-majority support.) MDBs are banks and so their decisions are weighted by creditor country interests, or by the size of the member's economy in the case of the World Bank. Furthermore, MDBs may require the agreement of large shareholders to access their capital markets for the MDB's non-concessional borrowing and for MDB capital increases, which also increases the leverage of large shareholders. The AfDB has balanced the voting power of its funding countries and regional member countries, tending to follow the political agendas of the African Union (AU). Those MDBs with soft credit or grant windows are dependent upon industrialised countries for replenishment of funds every three years, which comes with conditionality linked to operational effectiveness and the development agendas of the donors. These agendas have favoured MDB engagement in FCV, in large part because donors understand that addressing this GPG/RPG is in their own interest.

While MDBs have mandates that exclude political activity, the foregoing indicates that their practice can be more flexible and creative than their mandates suggest. This flexibility has been applied by their boards, which are representatives of shareholder governments with political interests, rather than their managements, which are apolitical (except at the most senior levels, where informal guidance from shareholders takes place). On the other hand, the slow response of MDBs to short-term political events in borrowing countries is due to their dependence on UN resolutions and shareholder consensus, which has the unintended consequence of reducing aid volatility. While MDB mandates have constrained them from operating in political space, there is flexibility in these mandates that could enable them to be more proactive when politics and development intersect in fragile situations, provided that their shareholders are in agreement.

3.2 A limited country-based business model

MDBs are intergovernmental bodies and are designed to engage with national governments, not least because their financing model requires a government guarantee that loans will be repaid. Governance of MDBs is controlled by high-level bodies consisting of ministers, usually of finance or development, who represent the collective interests of shareholder governments. While this model has worked well in providing development finance to central governments, it has been cumbersome in providing finance to sub-national governments or to activities that span two or more countries. Furthermore, the country-based model is limited when a national government is unwilling to recognise that it has an FCV problem, particularly when

⁹ For an example of the literature on how World Bank lending has catered to the political interests of shareholders, see Fleck and Kilby (2006).

it is located in a marginalised or lagging region that has little voice in national politics.

Sub-national fragility can exist in otherwise well-developing countries but not be recognised by the national government (perhaps because the region might be populated by a minority without much political voice), which, if neglected, could create a national problem that turns into a regional or global one. For MDBs to address sub-national fragility, they need to be able to provide funds additional to those which the country would otherwise receive, or finance directly sub-national governments or civil society organisations. However, MDBs can lend to sub-national governments or other public or private organisations in the country, but only with a sovereign counter-guarantee.¹⁰ MDBs have non-sovereign financing instruments through their development finance windows, and these are frequently used to finance private companies that pass creditworthiness tests. However, during the past decade, MDBs have opened grant windows for countries that do not pass the most basic tests of creditworthiness. Such countries have generally been affected by conflict and fragility. These grants are processed administratively using similar procedures to loans and credits.

MDB concessional windows now have special allocations for regional projects that are additional to a country's allocation (or entitlement for funding from the MDB). Mainly, these have been used for regional infrastructure projects and require a group of coordinated single-country loans. Such projects can be complicated and implementation is dependent on the weakest partner – a road to the border is not useful until the other country completes the section that connects to its own transport network. In theory, the regional windows and lending approaches could be used to address regional and cross-border FCV, and some MDBs are currently considering this. Regional organisations are rarely creditworthy, though technically their members or allies could provide repayment guarantees. Under current MDB practices, regional FCV projects are more likely to be implemented as coordinated national projects. This is cumbersome in practice, particularly when one of the national governments has neglected a border area and channelled resources to regions where government support is higher and where results are easier to achieve.

Reducing FCV in border areas requires both incremental funding (on the grounds that shrinking these ungoverned and violent regions is an RPG/GPG) and instruments that can channel support to the region efficiently and effectively. An option for doing this is for MDBs to make greater use of their grant instruments (where there are no repayment obligations or concerns about creditworthiness) to fund both national and regional projects that reduce FCV. Since FCV is a negative RPG/GPG, MDBs could make a strong case to their donors for incremental funding, so as not to compromise the amount of financing available for development activities in other areas, which remain a priority. These resources could be provided through their concessional windows or through trust funds. Trust funds could be single- or multi-country (e.g. to address a regional FCV problem, such as in the Central African Great Lakes region) or added to existing trust funds (such as AfDB's Transition Support Fund and the World Bank's State and Peacebuilding Fund). Such grants could be made available to regional organisations that have the implementation capacity, or to UN special missions. These non-government channels may be preferable when the national government lacks control over the FCV-affected region or only grudgingly consents to support flowing there.

¹⁰ A sovereign guarantee is a legal commitment by a government to repay a debt. A sovereign counter-guarantee is when the government agrees legally to honour the guarantee to repay offered by another entity such as a sub-national government.

3.3 Country allocation models that underfund FCV-affected countries

Recovering from a conflict is costly. Post-conflict countries normally lack the resources to recover, particularly the poorest countries at the beginning of their recovery.¹¹ Yet despite this, global aid allocations do not reflect this need. Aid often goes disproportionately to richer countries, and little allowance is made for whether a country has been affected by conflict. Given that nearly all conflict-affected countries are also low-income countries, this group loses out on both counts.

This misallocation of aid is obscured by the standard Organisation for Economic Co-operation and Development (OECD) aid analysis, which focuses on aid per capita. Considering that the post-2015 SDG challenge is the elimination of extreme poverty, it is helpful to examine aid allocations in terms of aid provided per person living in extreme poverty (at less than \$1.25 a day). Low-income countries receive \$193 a year of long-term development aid per person living in extreme poverty.¹² Middle-income countries, which are typically least affected by conflict, receive on average \$313 per person living in extreme poverty. Moreover, no preference is given to conflict-affected states. The average for the group of countries most in need – high-poverty and conflict-affected countries – is just \$123 per person living in extreme poverty, just over a third of the amount per poor person in a middle-income country (McKechnie and Manuel, 2015).

MDBs allocate their financial support on the basis of a Country Policy and Institutional Assessment (CPIA) and indicators of the efficiency of project implementation.¹³ This basis for allocating aid has the disadvantage of being backward looking, so it understates the potential for change in a country emerging from conflict or after a change in government and does not give sufficient weight to the factors that prevent FCV and the chaos that can destroy past development gains. FCV is an RPG/GPG and the CPIA-based allocation approach does not take account of the benefits of reducing fragility in an individual country to the region in which the country is located or to the wider world.

While some MDBs do provide additional allocations for countries affected by FCV, this is insufficient to offset the funding distortions created by other international partners. In addition, there is further misallocation within countries. Priority sectors for the g7+ group of fragile states, such as infrastructure, are underfunded. Countries emerging from conflict have large deficits in the basic infrastructure that any country needs – at independence, South Sudan did not have a single paved highway and so roads turned to impassable mud during the wet season. Other critical activities are insufficient or ineffective, such as jobs creating private investment (McKechnie and Manuel, 2015). Treating FCV as an RPG/GPG would call for a major reallocation of MDB financing, which could transform the prospects for peace.

11 In Afghanistan and Sierra Leone, the tax-to-GDP ratios in the early 2000s were around 5%. While there was very rapid growth in both countries – partly due to strong support from development partners and from the development of natural resources – it took 10 years for the ratios to rise to the more normal levels of around 15%. In Somalia, the federal government's share of tax revenue is just \$50 million.

12 Aid figures cited refer to the OECD definition of country-programmable aid, which is aid that can be programmed by the government for spending in the country and so excludes debt relief, humanitarian aid and aid spent in the donor country (such as support for students attending university in the donor country). Figures used are for 2011 and cover 91 low- and middle-income countries. Countries with populations of less than half a million are excluded (to avoid the figures being distorted by high per capita allocations in small states). Figures are medians to avoid distortion by outliers.

13 The methodology for the World Bank's IDA is set out at <http://ida.worldbank.org/financing/ida-resource-allocation-index>. The AfDB methodology is very similar and the African Development Fund formula is described at <http://www.afdb.org/en/about-us/corporate-information/african-development-fund-adf/adf-country-resources-allocation/>.

3.4 Gaps between potential and performance

While MDBs have the *potential* comparative advantages set out in Section 2, the *actual* performance in these areas has varied among MDBs and has been inconsistent within particular MDBs. The two MDBs most active in fragile states, the World Bank and AfDB, have been criticised for their cumbersome fiduciary systems (which can be alien to a borrowing country's financial management, audit and procurement systems) and the lack of overall flexibility in their administrative procedures (AfDB, 2012: 39; MOPAN, 2010, 2012). This has been compounded by the reliance on externally recruited staff with limited knowledge of the banks' fiduciary processes to fill positions in MDB offices in FCV-affected countries (which are unattractive to regular staff); in addition, a survey of World Bank staff found that most believed that the Bank's procurement processes were not well adapted to FCV-affected countries (World Bank, 2013).

Nevertheless, both the World Bank and AfDB have made progress in strengthening the quality of their lending operations; the World Bank's project performance in fragile states is at least as good as in non-fragile states, and the indicators for AfDB's fragile states portfolio are close to those elsewhere (World Bank, 2013; AfDB, 2012).

Management of pooled funds has also been mixed. Some (such as in Afghanistan and Liberia) have worked well, while others (such as in Haiti and South Sudan) have been less effective, at least in delivering early results (World Bank, 2013; OECD, 2010b). In addition, MDBs have suffered from a culture of lending, where staff have incentives based on loan approvals rather than development results (see Ravallion, 2015).

The variation in performance of particular MDBs is indicative of management shortcomings and an unwillingness or inability of shareholders to enforce accountability. Both the World Bank and AfDB have had difficulties in staffing offices in FCV-affected countries, although this has improved in the past five years, as well as in delegating decision-making to the field (World Bank, 2013; MOPAN, 2012). The operational performance of MDBs in FCV-affected countries raises issues about: management oversight; staff capacity in the field and incentives to staff; disconnection between regional, country and sector silos; and the structure and competence of executive boards and local aid management arrangements in assuring MDB performance.

While reports by MOPAN (2010, 2012) and DfID (2013) acknowledge that MDB performance in FCV countries is at least adequate and has been improving, fixing MDB operational shortcomings would seem a priority if MDBs are to take a greater role in addressing the FCV GPG/RPG. This is unlikely to happen unless MDB shareholders engage with senior management to obtain commitment to operational reforms and ensure accountability for actions and performance results at both country-operations and corporate levels.

4 MDBs and the FCV

GPG/RPG: a way forward

More effective MDB engagement is needed to reduce regional and global FCV. It will require some actions at the global level, some country-level actions to be taken by MDBs individually and actions that MDBs could take collectively.

4.1 Global actions to strengthen MDBs' engagement to reduce the regional and global impacts of FCV

The international community is committed to preventing major shocks to the international system that can lead to conflict and chaos, like the crises of the 1930s and 1940s. MDBs are part of this international system and their effectiveness will depend on how well other part of this system complement their work. Comprehensive reforms are much needed, to reduce the fragmentation, duplication of effort and lack of accountability to those the international community is trying to help. Indeed, the current international architecture for sustaining peace is a direct outcome of the trauma of the two World Wars. It is widely accepted that sustaining peace requires action among all the policy communities – development, humanitarian, diplomatic and security – and although reforms to the MDBs are necessary, those alone will not be sufficient.

At the global level, the UN is the only organisation with a mandate in all of these policy and delivery areas. Its effectiveness is crucial to an effective response to the global challenge of FCV, not least to the MDBs, which have more constrained mandates and legitimacy. At the regional level, the importance of regional bodies such as the AU, the Organisation of Islamic Cooperation, the Arab League and the EU is, likewise, critical. Change to global and regional organisations is likely to proceed incrementally as problems with the present system become acute, shortages of funding constrain operations, and visible shortfalls in their performance cause a new consensus to emerge among national leaders. Nevertheless, there are actions that can be taken. The following policy actions could reinforce the contributions of the MDBs to reduce the regional and global impacts of FCV:

Strengthen the legitimacy of multilateral organisations by rebalancing their supervisory bodies to reflect current global realities. As well as strengthening accountability to the countries they purport to assist, increasing the legitimacy of multilateral organisations could lead to deeper multilateral engagement by rising powers and emerging economies. Strengthening legitimacy would also involve rebalancing the executive boards of the International Monetary Fund (IMF) and the World Bank. Such rebalancing would involve a convergence of the interests of the funding countries in financial integrity, value for money and results on the ground, and the interests of recipients in responsiveness to their priorities and in streamlined processes that lower transaction costs. Rebalancing executive boards is one way to address the risk aversion of international financiers. In the case of the World Bank, this might involve an equal balance in voting power between shareholders from donor countries and recipient countries on the IDA board, which oversees a capital

base built on grants from its shareholders. The International Bank for Reconstruction and Development (IBRD) board, which has to maintain the confidence of the international bond markets, might continue to have a more conventional banking structure. Regional banks have their own legitimacy issues, such as the dominance of Japan at the Asian Development Bank, Saudi Arabia at the Arab and Islamic banks and funds, and the likely increasing role of Germany in the European banks.

Strengthen international rules on illicit financial flows and tax avoidance.

Fragile states are particularly vulnerable to funds leaving the country illegally. Extractive economic institutions are one of the drivers of fragility and conflict (Acemoglu and Robinson, 2012; Collier, 2011). MDBs have the potential within their existing mandates to promote actions at the country and global levels that could have profound effects on FCV. The risk of illicit flows is higher when the country receives large revenues from natural resource extraction, which is often the case in countries affected by FCV. MDB activities at the country level that reduce capital flight should be strengthened and the impact of their engagement would benefit from a tighter international regime on illicit flows. There are also issues of quasi-legal flows related to tax avoidance by companies with transnational operations and high net worth individual, which may take advantage of weak tax administration in fragile states. Banking systems in emerging markets and industrialised countries are usually complicit in processing funds that may have been obtained through illegal or quasi-legal activities. These countries are receptive to investments, particularly in real estate, and allow easy residence permits for ‘high net-worth individuals’ from fragile and other states. Options for addressing tax evasion and avoidance and for exchange of information among tax authorities have been on the G20 and OECD agendas, and now need to be translated into action. Doing this would magnify the impact of MDBs in reducing FCV.

Continue to build upon existing codes of practice influencing the activities of private investors in fragile states, such as: the Extractive Industries Transparency Initiative; the voluntary code of conduct for responsible international investment in infrastructure promoted by the Food and Agriculture Organization, the United Nations Conference on Trade and Development, the International Fund for Agricultural Development, the OECD and the World Bank; the Equator Principles for financial institutions (public and private) on handling the environmental and social risks attached to their lending; and the assistance for complex contract negotiations announced at the Brussels G4 Summit in 2014. MDBs are instrumental in supporting the introduction of these codes of practice at the country level and, again, strengthening global incentives for participation and compliance would deepen their impact.

Deepen MDB participation in global fora. The MDBs should be expected to participate fully in reforms involving the mobilisation of new funding streams and the strengthening of international rules that currently allow extractive elites to spirit money abroad, and in ensuring foreign investment sustains development, rather than succumbing to the ‘resource curse’. Mechanisms exist to do this, such as the high-level meetings of the heads and senior staff of MDBs and the participation of MDBs in meetings of the OECD and G20. In addition, the International Dialogue on Peacebuilding and Statebuilding is a forum for bringing together the g7+ group of fragile states, OECD donors and MDBs.¹⁴ The weakness in these arrangements is that they exclude countries such as China and Brazil: countries that are major

investors and financiers in countries affected by FCV. This is partly because peacebuilding and state-building may create perceptions of interference in a

¹⁴ See <http://www.pbsdialogue.org/en/> for more information on this forum.

country's internal affairs and constitute a violation of sovereignty, which might be understood to be contrary to these countries' foreign policy agendas. Yet the recent crisis in South Sudan has shown there can be an alignment of interests among investors, financiers, traditional donors and those with an interest in peace in the country. Reformed MDBs with greater international legitimacy have a potential role in bridging these interests.

4.2 Country level actions by MDBs to strengthen their engagement in the FCV GPG/RPG

While reforms to the international financial system at the global level face many obstacles, making changes at the country level is more achievable. There is even greater scope for success if it is the fragile state that calls for change and there are like-minded partners involved. The following reforms are possible:

Reforms to country level and regional coordination

Although coordination may be difficult to achieve at the global level, it may be easier to change coordination arrangements within a particular fragile state. MDBs are major financiers and providers of knowledge in FCV settings, and their active participation is critical to effective coordination. Better coordination should be conceived as a way to increase the total impact of international partners, government and civil society on FCV beyond the sum of what each could do alone. Usual coordination mechanisms work worse in fragile settings than in other countries because of multiple objectives that cut across political settlements, justice, personal security, humanitarian action and development. None of these policy communities is willing to be subordinate to another. Under the most favourable conditions, the government of the fragile state is able to set clear priorities with broad national ownership and coordinate assistance. At the other end of the spectrum are countries where the state's authority is not widely accepted by the population, elites extract economic rents, the government is not oriented towards development, and where violence could cross borders. Across this spectrum, the footprint of the international community should be as light as circumstances permit. In countries where the objectives of the international community and government coincide, the government should clearly be in the lead in coordinating its partners, as would happen in any other country. It may need international support to enable effective coordination, and this should be embedded within the ministry responsible for this coordination.

In countries where the government is unable or unwilling to coordinate, its partners, including MDBs, may need to speak with a single voice and coordinate themselves. In practice, partners may resist being coordinated, particularly by another policy community that may have different objectives over a different time frame. Also, there may be differences in capacity, legitimacy and resources among the key players – the UN representative may have legitimacy and access but lack human and financial resources, whereas the World Bank may lack policy breadth but have stronger resources, especially in the economic and sector policy and institutional development areas. RDBs bring sectoral knowledge and financial resources, especially in sectors such as infrastructure. The objectives of the commander of the peacekeeping forces may be much more short-term than those of the agencies responsible for institutional development. RDBs may feel excluded from the 'top table', and the World Bank may represent its own interests rather than those of the MDBs or development actors generally.

One model for coordination in cases where government coordination is not possible is the Board of Principals arrangement used in Bosnia and Herzegovina. This was chaired by the EU special representative and consisted of the heads of the nine key

multilateral agencies in the country (including the IMF and the World Bank), which took decisions on a collective basis similar to a government cabinet (Ashdown, 2008). This model has risks: it could appear to be a colonial government, insensitive to country conditions and driven by outside interests¹⁵; it might have difficulty deferring to state authority as government capacity grows; and it would be dependent on strong, broad, effective leadership attuned to the country. It would also require capitals and headquarters to delegate authority to their heads of country offices and for board members to represent adequately their constituents. Such arrangements would require international legitimacy (which would most likely come from the UN or a regional organisation with a broad mandate) and active participation by senior MDB staff.

MDB engagement in political space

As described above, when there has been a consensus to do so among their shareholders, MDBs have taken decisions on financing that were influenced by political considerations. Moreover, MDB activities aimed at development can also have positive or negative political impacts. While changing their mandates might open a ‘Pandora’s box’, some clarification is needed of how the political non-interference mandates of MDBs should operate in the modern world where FCV, development and politics inevitably intersect. MDBs should consider incorporating the following important components into such a policy:

- Non-interference in party politics when there is a transparent, fair and competitive electoral processes. This would involve not favouring one party over another, even when one party’s economic policies are aligned with the views of the MDB. MDBs might also decide to suspend new funding decisions during election campaigns, which current policies do not prohibit (although good practice has been to wait until the new government confirms or modifies the MDB country programme).
- Explicitly address the development of the security sector, particularly police, security sector reform, corrections and criminal justice. In a country affected by FCV, problems in these sectors may be the greatest obstacle to development, stability and human rights. It is relatively straightforward to make a development case for MDB engagement in these sectors. An alternative would be to reform other partners with broader mandates, such as the UN and regional organisations (e.g. the AU and the EU), to have fully funded capacity to respond effectively. While these organisations have the mandate currently to do this, they have lacked the funding, internal coherence, capacity and performance record to achieve sustainable results in these areas. Greater clarity is needed on what MDBs can finance in the security sector, the responsibility for risk and the approach to managing the fallout from risk. For example, MDBs could be permitted to include the security sector in public expenditure policy and institutional work, regardless of whether this is a government preference. MDBs could finance police salaries and all aspects of disarmament, demobilisation and reintegration during transitions from conflict, and ensure that the risks of, for example, poor performance and abuse of power of the security sector are the full responsibility of the government and the individuals involved.
- Supporting the capacity development of legislatures is also a priority, particularly for strengthening their oversight of executive accountability. Some of this support is of a technical nature, e.g. public

¹⁵ The Coalition Provisional Authority established in Iraq in 2003 demonstrates the problems of a heavy foreign footprint in achieving development results.

finance oversight that is not necessarily problematic in terms of a development mandate. However, it may conflict with the country-based financing model, where an MDB's country relationship is with the executive (usually the ministry of finance or planning), rather than the other branches of government (e.g. legislature and judiciary). In principle, these function independently of the executive. Debt financing on hard terms may not be a suitable instrument due to constitutional constraints, but MDBs could use their grant and concessional funds more imaginatively to finance the other branches of the state.

- In contrast, the UN does have a mandate to engage in political issues. MDBs have the option of financing the UN to undertake 'political' activities, or to use the UN as an agent. There are existing mechanisms to do this, but these mirror the weak accountability arrangements that generally characterise UN funding. Innovative financing arrangements would enable the UN to manage the risks (such as risks to human rights from financing 'political' sectors) and have contractual arrangements that ensure financial and performance accountability.

Better use of pooled funds to address fragmentation, coordination and risk aversion

Pooled funds, such as MDTFs, can address many of the shortcomings in the international aid system. These shortcomings that MDTFs can overcome include the high transaction costs of a fragmented aid system, poor coordination of donor activities, and the provision of aid on budget that does not meet country priorities. In addition, such funds pool risks and transfer risk management to the organisations best placed to manage them, because of their experience of operating in fragile environments, their ability to implement risk management procedures and their influence with the recipient government. MDTFs have provided stable and predictable finance, particularly for recurrent costs in Afghanistan, Timor-Leste and the Palestinian Authority. However, some MDTFs have been less successful than others, e.g. in South Sudan and Haiti, partly because of unclear governance arrangements involving fund donors. Generally, frustration about cumbersome procedures and implementation delays has been expressed by countries and fund donors, while management oversight of these funds has, on occasion, been inadequate (World Bank, 2013). Attributes for successful pooled funds include embedding management in a government ministry, aligning with government systems, limiting earmarking, use of procedures appropriate to a fragile state, having well-qualified fund management staff in-country and ensuring mutual accountability (Coppin et al., 2011). The overriding issues for pooled fund performance are management, governance and accountability. Fund managers such as the World Bank have not always put their best staff into fund management or integrated them into their normal management systems, or applied procedures suitable for a fragile environment. Donors have lacked confidence in management, interfering in operational matters and not holding fund managers – including at the senior levels of management – accountable for timely results.

Financing instruments to address fragility in middle-income or creditworthy countries

There are very few financing instruments that are suitable for addressing FCV in middle-income countries or those countries that qualify for concessional development finance. Most of the activities of MDBs in FCV-affected countries have been in post-conflict low-income countries, which were not creditworthy for even concessional credits. Financing instruments such as trust funds and grants were the only financing option available. When these countries returned to creditworthiness for concessional credits, the highest priorities for their

governments were typically post-conflict reconstruction, institutional development and investments to secure peace. For functioning states with sub-national conflicts and marginalised communities affected by conflicts on their borders, it has been difficult for the international community to support actions that may be of lower priority to majoritarian governments than activities that benefit their constituencies. Since reduction of FCV is an RPG/GPG, the international partners should consider finance that is incremental to their normal level of support. This could involve access to trust fund grants (see paragraphs above and below), and buying down the terms of incremental debt finance. For example, the World Bank has considered using donor resources to soften the terms of its non-concessional IBRD window for Jordan and Lebanon. In this case, the governments were unwilling to borrow from IBRD to cover costs imposed by Syrian refugees when so many of their national populations were in need (see Metcalfe-Hough et al., 2016).

Better instruments to address the FCV RPG

Avoiding conflict spilling across national borders requires simultaneous action in several countries. Regional projects are particularly difficult to finance and implement through MDBs that have a country-based business model. The difficulty increases when financing shifts from grants to concessional loans and loans on hard terms as the repayment obligation increases and countries are less likely to borrow for activities that may be in marginalised border regions. Several possibilities exist for better financing regional aspects of FCV:

- Greater use of grant and trust fund resources to finance peacebuilding activities of regional organisations that do not have a capacity to borrow.
- Special financing windows that provide additional resources for peacebuilding above the country allocations. This has happened to a limited extent with the AfDB's Transition Support Fund and the World Bank's State and Peacebuilding Fund, and the current moves to consider special windows for regional peacebuilding activities in their concessional loan replenishments deserves support.
- Multi-country financing operations with mutual government cross counter-guarantees. For example, if one country defaults, the other country could cover the default in exchange for an MDB-supported future claim on the defaulter. This would include a reduction in the normal country financing envelope for the defaulter.

Decentralisation to field offices

Decentralisation enables MDB support to be country-driven, flexible and timely, and places MDB staff close to their counterparts, who can receive on the job support as they develop their expertise. In the past decade MDBs have generally moved to locate staff in or close to countries affected by FCV. However, there have been issues with the numbers, level of experience and skills of staff posted to what are typically hardship posts, and the degree to which decision-making is delegated to country offices. While MDBs, like other international partners, have endeavoured to place more staff in country offices in FCV-affected countries, it has been difficult to recruit high-flying staff because in these countries it is more difficult to become associated with the strong development results that advance careers. As a consequence, staffing may depend too much on junior or contract staff and the balance between internationally recruited and cheaper and less-experienced national staff may become skewed. Fundamental changes are needed to the overall incentives for staff to ensure that high-quality teams are in place in FCV-affected countries – financial incentives are necessary but not sufficient. MDBs may need to reform career development incentives that have become biased in favour of staff, in the sense that high-flying staff can choose where they wish to work, rather than be guided to where they would

be of most value to the MDB. The costs of operating in these countries tend to be higher than in other similar countries, partly as a result of the additional costs of security, but also because post-conflict countries typically suffer from inadequate infrastructure, inflated property rentals and higher salaries for professional national staff. Decentralisation and operating in such countries requires MDBs to allocate additional internal budget resources, while also changing staff incentives to recognise the difficulty of facilitating development results in FCV-affected countries and the high risks of failure.

Deepening reforms in operational rules and greater use of country systems

Complex processes that introduce delays in project implementation have been a consistent complaint from governments of FCV-affected countries. Procurement has been the most chronic problem because MDBs' rules have not been well adapted to the market conditions in these countries. For example, the international private sector may lack interest in bidding, and local firms lack capacity or have no access to a financial sector that can provide for leasing arrangements and performance guarantees. MDBs such as the AfDB and the World Bank have adjusted their procurement rules to enable more flexibility and simplicity in fragile situations. However, risk-aversion and resistance to change by staff could lead to these improved arrangements not being used; their implementation therefore needs periodic review and to be benchmarked against the MDBs that have not adjusted their rules. Greater use of country systems is part of the New Deal on Engagement in Fragile States, agreed in Busan, Republic of Korea (g7+, 2011), and has been included in several transition compacts between governments of post-conflict countries and their international partners. However, international partners have tended not to use county systems because of aversion to fiduciary risk, even though well-managed risk cannot be substantially higher than in other countries (see International Dialogue, 2014; McKechnie and Davies, 2013). MDBs have advantages over bilateral donors in pooling and managing risks (see above). They are well placed to take the lead in progressively deepening the use of country systems and extending them beyond public financial management, to areas such as environmental management and the human and financial costs of compulsory land acquisition.

A more hands-on approach to capacity development

Low capacity constrains the achievement of development results in FCV-affected countries and institutional change takes place slowly and incrementally. To be effective, MDBs need to shift from a detached banker's stance to one of hands-on support to governments. This requires in-country staff who work closely with their counterparts to solve problems of programme implementation, assist in compliance with government and MDB policies and facilitate institutional development. The 'doing development differently' movement in which MDBs are participating is an example of a modality problem for working, to facilitate countries making iterative adaptations to development policies and institutions (see Andrews et al., 2012).

Strengthening mutual accountability

The New Deal calls for greater mutual accountability between governments of FCV-affected countries and their international partners. However, this has been implemented to only a limited extent (International Dialogue, 2014). Mutual accountability involves transparency of aid flows, and independent reviews of the activities they finance to ensure results and value for money. MDBs have a better record of accountability than bilateral partners, which are sometimes not transparent, particularly when activities fail to achieve intended results, and can be less than fully cooperative on aid flows, the activities they finance and their outcomes. Transparency sometimes disappears in order to obscure negative information,

because of government and partner concerns that this will undermine a fragile state. However, optimistic statements of progress that are not grounded in reality may undermine society's trust in the state and contribute to fragility.¹⁶ MDBs already evaluate country programmes and activities in FCV-affected countries using their internal evaluation departments, and MDB-managed MDTFs are subjected to periodic external review. However, these reviews take place from a development perspective and do not assess the contribution of the MDB to a broader effort by the country and its international partners to sustain peace.

Independent reviews of all international activity in the country – bilateral and multilateral – are another option for strengthening mutual accountability and MDB performance. They could be carried out jointly, similar to the OECD peer reviews and the African Peer Review Mechanism. These would need to be carried out by a small team of evaluators who understand the conditions in the country, development in a fragile situation, implementation and financing modalities, and effectiveness, efficiency and financial integrity. Independent reviews would build upon the standard evaluation work carried out by the government and its partners at the programme and project levels, and objectively assess the performance of partners and their counterpart agencies. Such evaluations could give significant support to the case for greater multilateral assistance to the country, and strengthen the incentives for MDBs for effective and timely support and value for money.

Facilitating jobs-creating private investment

Jobs-creating private investment is one of the Peacebuilding and Statebuilding Goals of the New Deal, but MDBs have a mixed record on implementing this. Private sector investment in FCV-affected countries is difficult because of the high risks to investors and complex because factor markets and the business climate tend to be weak. MDBs ought to be able to provide the combination of sovereign and non-sovereign finance, advisory services and policy advice needed to facilitate private investment in such countries. However, this tends to be expensive and risky, but with potentially high rewards. In addition, jobs tend to be created by local or regional-based firms, rather than the large capital-intensive foreign investments in sectors such as mining, petroleum and mobile communications that MDBs have gravitated towards in FCV-affected countries. MDB staff who process private sector development projects may have incentives to work in the easier markets. MDBs need to revisit their strategies, business plans and staff incentives for stimulating private investment that creates jobs in FCV-affected countries, which includes working with the local private sector.

¹⁶ World Bank (2011) presents a model of fragility based on citizens trust and confidence in the state.

4.3 Collective actions by MDBs to mutually strengthen their activities to reduce FCV

There are some actions that MDBs can undertake jointly that would strengthen their collective impact on FCV. These include the following:

- **Deeper engagement by the RDBs with the g7+ group of fragile states.** The g7+ is a joint initiative of governments working towards more effective engagement in fragility and the aftermath of conflict. The g7+ provides an important platform for collective engagement between governments and MDBs. Some MDBs, notably AfDB and the World Bank, have participated in discussions and knowledge exchanges with the g7+. There is scope for representing other MDBs, where fragility and conflict is a less prominent issue. For example, while the Inter-American Development Bank (IADB) might not wish to participate in all g7+ meetings (as Haiti is the only g7+ member from the Latin America and Caribbean region), it might wish to be included if the g7+ agenda includes crime and drug trafficking.
- **Engagement in high-level platforms,** such as the UN Security Council and General Assembly, the G7 and the G20 at the global level, or the AU at the regional level. FCV matters are often on the agenda at these meetings, giving MDBs an opportunity to agree common approaches and representation.
- **Knowledge exchange** among MDBs enables each to tailor its approach to addressing FCV in its area of interest, and to transfer comparative expertise to the other banks. Such comparative knowledge might be in areas such as private sector development, security budgeting, addressing organised crime and participation of FCV-affected countries in regional infrastructure networks.
- **Harmonisation of MDB processes,** particularly procurement, financial management and social and environmental safeguards. This already takes place to some extent, but given that these processes have been difficult for FCV-affected countries, accelerating harmonisation and standardisation of documents would be beneficial to more timely implementation. Given the flexibility allowed in World Bank and AfDB procurement rules, harmonisation and greater sharing of experiences among MDBs could improve risk management and allow fuller realisation of the benefits from the new policies.
- **Co-financing and risk pooling,** where regional mandates overlap, would concentrate MDB resources on projects that could transform development and sustain peace, such as large infrastructure projects. Such projects also enable the risks to be shared and the overall exposure of each MDB to be lowered. Another possibility is to address the regional dimension of FCV, so that MDBs could coordinate their financial support in participating countries in the FCV-affected region.

5 Conclusions

MDBs can make a real impact on GPGs and RPGs through their analytical support to operational strategies and in providing substantial financing. Some MDBs are already taking a fresh look at their mandates, areas of intervention and comparative advantages. For example, the World Bank has previously contributed to GPGs in the areas of climate change, communicable diseases, the international financial architecture, global trading systems and knowledge creation. More recently, the World Bank's fast response to the Ebola crisis and the creation of a new fund to facilitate the fight against the disease has also shown its ability to engage in GPGs. The World Bank and others are also experimenting with insurance-based facilities for weather and disaster risk reduction and with pandemic early response systems, which could enable better responses to future crises.

As this report has outlined, MDBs are already operationally configured to the advantage of tackling FCV. However, their operational configuration does create some barriers, but there is built-in scope for MDBs to resolve these. Therefore, MDBs could make a better impact in reducing FCV if they could address the following:

Clarification of political non-interference mandates, and a review of how MDBs should operate in the modern world where FCV, development and politics inevitably intersect.

Limitations of their country-based operational model, particularly to provide funding for activities that cut across national borders or where support is needed for organisations that are independent of government. One option is to make more creative use of MDBs' grant instruments, where there are no repayment obligations or concerns about creditworthiness, to fund both national and regional projects that reduce FCV.

A major reallocation of MDB financing to countries affected by FCV that addresses the distortion in aid allocation.

There are several themes which emerge from Section 4 that will help MDBs offer more robust support to FCV-affected countries:

Strengthen the legitimacy of global and regional organisations that have a mandate to deliver both policy and action in the development, humanitarian, diplomatic and security arenas. MDBs can play a big role in shoring up banking systems and the international rules on illicit financial flows and tax avoidance. MDBs are already invited to high-level meetings of the OECD and G20; they need to continue on this path of participation in global fora to build their international legitimacy and bridging the interests between parties.

Utilise MDBs' finance and banking expertise to develop more innovative financing coordination and financing instruments for tackling FCV. MDBs can use their grants, concessional funds and trust funds more creatively in certain country-based financing models. MDTFs can also address many of the shortcomings of the international aid system – accountability is key, particularly to the recipients

of international assistance. MDBs can fill a gap in financial instruments that specifically address FCV in countries that are middle-income. MDBs also need to strengthen their operational engagement in FCV-affected countries, especially through decentralising highly qualified, empowered staff to country offices, using country systems wherever possible and providing hands-on support to counterparts in low-capacity countries.

Deeper engagement and collective action between MDBs is needed to maximise their impact on FCV. MDBs will have varying degrees of engagement with FCV, but there is scope for better representation between banks. Moreover, MDBs can transfer much-needed knowledge and expertise to other banks, potentially share in the risk and overall exposure of each bank and harmonise MDB processes to increase their effectiveness in tackling FCV.

This paper has shown that FCV is a regional and global negative public good that merits continued and enhanced attention from the international community, not least because ‘to save succeeding generations from the scourge of war’¹⁷ is in the national interests of international partners. As major financiers and repositories of international expertise on how to reduce FCV, MDBs have a key role to play. While they have taken significant steps to develop relevant capacity, they need to do more to increase the impact of their activities to prevent and reduce armed violence, one of the key issues of the early 21st century.

¹⁷ Quotation from the Preamble to the UN Charter.

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Appendix

Table 2: Providers of ODA to Fragile States, 2012

Provider	Development finance (\$ million)	
	ODA	Non-ODA*
MDBs		
EBRD*		178
EIB*		1,042
IBRD*		1,273
IDA	4,364	
AfDB	1,100	
IFAD	288	
AFESD	217	
IADB	155	
AsDB	65	
OFID	64	
IsDB	47	
EADB	45	
CDB	10	
NDF	7	
Total	6,362	2,493
Other multilaterals		
EU institutions	5,599	

Global Fund	1,791	
UN System	1,427	
GAVI	689	
IMF	472	
GEF	75	
OSCE	41	
Total	10,094	
<hr/>		
Bilaterals	38,048	
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Total	54,504	2,493

Source: ODA data from OECD (2015), non-ODA data from EBRD, EIB and World Bank Annual Reports.

** Non-ODA data is for loan approvals (commitments), not funds disbursed, which are not published by country.*



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