POLICY DIRECTIONS

Crisis States Research Centre

ECONOMIC RESOURCE MOBILISATION AND STATE STABILITY

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HIGHLIGHTS:

- The mobilisation of economic resources and their transformation into wealth is critical for political stability.
- In fragile and stagnant countries, the state has to play an important role to help mobilise these resources. This will strengthen its foundation, the business community and ultimately the state's ability to provide public goods.
- Elite bargains sustain both the formal and the informal economy. It is crucial that the elite in the informal sector are integrated into the overall bargain.
- International intervention – political, financial or military- has the potential to either drive forward a national elite bargain or to slow it down. The particular way in which intervention happens influences the elite bargain that can be achieved nationally.

There are certain core tenets that underpin CSRC research. States vary in their relative strengths, and in that of their subsystems. The entire state, and some or all of its subsystems, can be characterised as somewhere along the line of being collapsed, fragile, resilient, stable or developmental. This trajectory of state-formation is not predetermined or inevitable. States in crisis can either slide back into even more instability, or transform fragility into an opportunity for development. Key headlines emerging from the research programme find case specific policy lessons on the importance of the monopoly over large scale violence, which is the most important public good a state has to achieve; the quality and outreach of an administration, which enables the state to set the rules of the game and trump rivalling sets of rules and law enforcement; the political organisation that connects elites and masses; taxation; and international intervention. Understanding these political issues is essential if state builders are to move from fragility through resilience to development. This is well recognised by the majority of donor governments. Yet what is not sufficiently recognised is that to do so without simultaneously strengthening a state's economic foundations will hinder political stability.

No donor or military intervention can substitute for a state's own mobilisation of resources. It is this message that is summarised here, drawing upon extensive findings across CSRC's three research streams but focusing on a series of country case studies. These are states that are relatively poor and still far from the capital formation, resource accumulation, and technological or human resource capacity of industrialised countries. These are countries that rely upon agriculture and, if they are endowed with natural resources, on mining or oil. Their economic foundation is made even more fragile by the limitations to their export markets: their products are usually exported unprocessed, and value is thus usually added beyond their borders. In order to strengthen economic resource mobilisation for political stability, thus, what is being or can be done? All too often, as we here demonstrate, answering this question requires asking the opposite also: what is being done to keep resources outside of the purview of the state?

The role elites play is at the theoretical heart of CSRC research. In the global North, people think of military power as being separate from economic power and political or religious power. This distinction, however, does not hold within states at the more fragile end of the spectrum, where actors can hold these powers simultaneously. We call people with military, economic and political power (these powers combined or separate) the elite. Elites often fight each other but, we argue, can cooperate within a context of credible commitment and threats. They are the dominant decision makers, but this is not to say that the general population does not matter. On the contrary, the elites must mobilise the general population for their respective purposes and provide for them in order to keep them loyal. We call the way that elites interact with each other the 'elite bargain'. This is not usually documented, and can significantly differ from, for example, the constitution. Inspired by the insights of Douglass North, we argue that the way this elite bargain is struck underpins the stability of the state (North et al 2009). In countries like the Democratic Republic of Congo (DRC), different factions of the elite are still engaged in violent fighting and 'taxing', while in the areas without war everyone tries to access whatever resources are in their reach (Hesselbein 2007). No elite bargain holds across the entire country. Even in middle income countries like Colombia or the Philippines the state is contested by members of the elite who want to change the bargain and - violently and illegally - control parts of their country over which the state cannot effectively exercise

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authority (see Gutiérrez 2009). The important lesson here is that each of the countries we discuss has its own bargain with its own intrinsic logic, and with its own societal logic that people perceive as natural. This internal logic is very important when it comes to external interventions, as will be discussed later. Given the centrality of the accumulation of resources for wealth creation, what then do elites do in order to mobilise resources? What do they do in order to create wealth? To what extent have they reached an agreement with the state to be taxed on the one hand, and able to access rents on the other hand? Across the mining and agriculture sectors in our case studies, we find important lessons in three areas: the elite bargain in the informal sector, the elite bargain in the formal sector, and the role of international intervention.

THE INFORMAL AND THE ILLEGAL

The informal sector by definition is not taxed by the state, and therefore cannot be seen as revenue for the state as long as it is not formalised. However, in developing countries a vast amount of economic activity occurs here, not only providing livelihoods for millions of people but substantial rents for those who are able to exercise control over the sector. While this is not necessarily applicable in contexts of subsistence farming, it is the case when products are marketed or smuggled. Informal trade amounts to 90% of the economy in some of our case studies. In such cases, the economy is dominated by farmers who are not connected to the market, as in Tanzania or Zambia, artisanal miners who sell gold, diamonds or coltan to warlords before minerals enter the international market, as in the DRC, or poppy farmers and drug cartels, as in Afghanistan and Colombia. Other, smaller scale but important sources of wealth creation include kidnap and ransom, such as in Mindanao in the Philippines (Lara 2010 forthcoming).

In order to build a resilient state, the economic elites in informal sectors, who often command significant means of violence, must be brought into a bargain with the state (or the formal elite). When elite bargains are not inclusive and flexible enough to accommodate new elites, or backed by enough force to prevent them from collecting rents in the informal or illicit sectors of the economy, then the state cannot yet impose its rules throughout the territory and is constantly threatened from inside. There are options for the state to try to force these elites into cooperation: some of the rents achieved in the informal or illegal sector eventually enter the formal economy, be it through bank accounts, real estate or the import of expensive consumer goods. These might be entry points for the state to strike bargains with this elite – unless the state is captured by elites operating in the illicit trade, like in Afghanistan.

BOX 1: AFGHANISTAN'S POPPY ECONOMY AND THE ELITE

After the US-led invasion of Afghanistan in 2000/01 there was a massive increase in the volume and the geographical spread of poppy cultivation. Those who farmed poppies had to search for state protection or outside protection, and started to shift towards provinces where anti-narcotic programmes were less forceful. The vast bulk of value added is generated outside the country (76%) and only 24% goes to farmers and traders inside. This is a vast incentive to engage in poppy production and shift from subsistence to a market economy.

The elite bargains behind these tendencies are not easily observed: while the shift to opium growing is often supposed to finance the insurgency, proceeds from this trade also serve various political interests other than the Taliban to finance buying votes or to access central positions within the government or provinces. Opium fuelled politics have shortened the life-cycles of political alliances (Giustozzi and Orsini 2009).

The transformation during the war years has formed a new class of politico-military structures and warlord politics, which integrated provincial Afghan cities more into neighbouring economies, rather than linking different parts of the country. International intervention, and in particular the Bonn agreement, has not ended certain power struggles in Afghanistan, but has been decisive about who is considered to be on the 'right side' of the war on terror. (Goodhand and Mansfield 2010).

THE FORMAL ECONOMY, THE STATE AND ITS ECONOMIC FOUNDATIONS

The formal economy in a country is the basis on which a state can sustain itself. This can be through direct or indirect taxes, through import or export duties or through fees for services, and it can be done with different approaches towards the business community. The purpose of taxation is to build the funds for railways, ports, streets etc. and everything that creates internal linkages within a country. However, as Wallerstein noted, this is not only true for economic development, but for strengthening the political bond, or, as he puts it, 'to hold the unit together' (Wallerstein 1961). This part has been overlooked not only in recent policy interventions, but since the paradigm shift in international financial institutions towards economic liberalisation during the 1980s (see Putzel 2005 and below). As a consequence, whatever support countries had put in place to reach out to particular sectors, most notably agriculture, has largely been abolished in favour of market forces, which in the dominating doctrine are supposed to be superior to the state. Sub-Saharan countries gave up their marketing boards, decentralised the responsibility for outreach to farmers to largely unfinanced local authorities and hoped that the markets would educate the farmers. This was, for example, the case in Tanzania and Zambia (Hesselbein 2010). However, as elsewhere, the constraints for farmers proved significant: there are huge transaction costs due to the poor state of infrastructure, under-investment in productivity-enhancing-technologies, 60-75% of the households have no contact with research or extension services, and access to finance is difficult (Tanzania 2006; Zambia 2006). In fact, many farmers do not have even access to markets, and thus even if there is a surplus, it cannot be transported to places where demand for sale exists. This often means that farmers do not know what might be in demand elsewhere, at what prices, at what level of quality and so on. For many crops, storage facilities could help buffer price volatility, but they also have been abolished.

This situation has been overcome in successful development experiences, either by the state, or by entrepreneurs, or by a combination of both. In order to increase productivity, farmers need inputs – and these need capital or credit – in order to overcome subsistence and produce more and at better standards. (see Box 2).

A different type of partnership between states and entrepreneurs also has to be struck in the case of mining, the other raw material that poor states can use to create wealth. In a country where the state is almost non-existent, companies and warlords can profit from numerous opportunities and the state is not even able to collect the relevant taxes, as is the case in the DRC (Hesselbein and Garrett 2010). Furthermore, there is no state institution that has come up with a general plan of how mining *should* contribute to re-building the country. While some donors are working on a strategy, even in the areas not affected by war no such thing has yet been implemented.

However, in spite of a different trajectory, Zambia has basically handed its mining sector - the backbone of the economy as in the DRC – to foreign firms. While the Zambian elite had hoped that there would be a sufficient middle class to run the mining companies privately in the early 1990s, this hope evaporated shortly after, and it took quite some time before international capital was ready to invest. The Zambian elite were not in a good position to bargain with international companies. The new owners were exempt from pension payments, taxes or environmental requirements. Companies lobbied to pay the smallest levies in the world (0.6% of gross turnover for mineral royalties), and when it emerged that the Zambian parliament was lobbying for a 'windfall tax' to increase revenue, copper prices fell again, and parliament scrapped the windfall tax. However, by now the royalties are at 3%, and further renegotiation is going on as a result of a better bargaining position for Zambia.

In order to create wealth and stabilise the state, the formal sector of the economy has to be pushed to increase value, to create linkages and to diversify. Governments have to play a role in this: they must participate in shaping the elite-bargain, or development will not occur.

INTERNATIONAL INTERVENTION AND THE ELITE BARGAIN

Elite bargains are in the first place matters of cooperation between national elites. Without these elites introducing order, property rights and law enforcement the 'state of the state' will remain lawless, where force and violence set the rules of the game. However, national elites cannot do as they please, as international actors are intervening in a way that actually shapes the elite bargain. International financial institutions, international companies, donors and NGOs and in the worst case fully-fledged military interventions massively shape the internal elite bargain that might be nationally achievable.

Interventions do not always achieve what they are intended to achieve, because things can really go wrong (**Gutiérrez and González 2009**). Apart from the 'usual' reasons why things go wrong, two should be highlighted here:

- The economic and political approach of the past - that states are wasteful and markets are efficient - has been proven wrong in most developing countries. Along with budget deficits

BOX 2: AGRICULTURAL DEVELOPMENT IN RWANDA AND COLOMBIA

A good example of how development can be supported can be found in Rwanda, where agriculture accounts for more than 90% of the labour force. As long as subsistence is prevailing, the public sector plays a vital role, as it tries to organise farmers in cooperatives, provides inputs, teaching and quality control as well as fertilizers, certified seeds, storage facilities etc. Of pivotal importance is that the government provides credit to farmers, as neither the financial sector nor donors are doing that. Furthermore, incentives like sending children to school, providing electricity and water for households and health centres in villages created the drive for agricultural improvement.

In some areas commercial farmers contract several hundreds or thousands of farmers. This means that the company provides inputs and controls quality standards, because farmers deliver what is processed within the company, like fruit juice, banana beer, or chilli oils. Again, the government helps the company by providing teachers and by organising a one-stop-shop for all the state-regulations, import licences and tax-payments the company has to deal with.

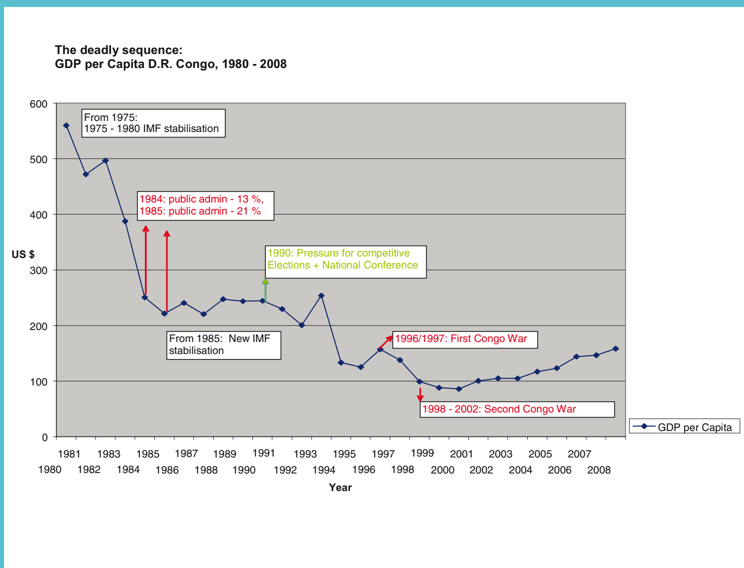
Another good example for the cooperation of the state and private business is the coffee sector in Colombia. It has been successful by organising farmers in the Coffee Farmers Federation, which made sure that coffee revenue was re-invested into the sector for about 80 years. Both of the main Colombian parties were closely linked with the coffee-producers, ie, the backbone of the economy.

However, the example of nurturing a particular sector was not translated into other sectors of the Colombian economy. The challenge of diversification was never tackled by the state- and coffee elites. In consequence, both the breakdown of the coffee agreement and the establishment of a drug economy in areas less controlled by the state changed the economic picture of Colombia – and its security challenges. The massive 'war on drugs' does not seem to help in establishing a new elite bargain that brings security to the state and wealth creation in new areas.

Sources: Hesselbein (2010) and Ramos (2010)

BOX 3: THE DEADLY SEQUENCE

The graph shows the constant and massive decline of GDP in the DRC since the 1980s. A number of international interventions are marked. Neither IMF-pressure for stabilisation (including the reduction of the state) nor pressure for democracy has resulted in stabilising the elite bargain. On the contrary, after decades of economic erosion, war broke out. The DRC is still far from being a resilient state, and its economic foundations are extremely shaky.



and political conditionality donors pressed states to reduce themselves and abandon bureaucrats, doctors, teachers and in the end the military. This view lacks the fundamental understanding of the bare necessities of states, and the result is that national elites seek their fortunes and futures outside the state. A drastic example for this is the case of the DRC (**Hesselbein 2007**). (Box 3)

- Secondly, the internal logic of societies with limited access to resources does not always allow those institutions that have been developed for liberal markets and liberal democracies to function well. While it is possible to imitate these institutions, they will be at the very least partly dysfunctional and may well be used to create new rents, rather than acting as a check on them. Instead, states need to achieve the ability to govern the markets.

CONCLUSION

The big challenge of strengthening states in order not only to rescue them from fragility but to allow them to move from stability towards development, requires some fundamental insights. Our research argues that economic resource mobilisation is critical and can offer important lessons, particularly from within the mining and the agriculture sectors.

- Firstly, without the cooperation of national holders of power (military, economic and political), which we call an elite bargain, a state will not be built, nor is there the possibility of development. This is contrary to conventional wisdom that competition between these elites ends war, and thus is encouraged. This is also contrary to the practice that market forces are promoted and the role of the state diminished. We argue that for the strengthening of the state it is rather the cooperation of the elites that institutes the rules of the game, leading to agreements on property rights, contracts, and their enforcement in law.
- Secondly, without special attention to the economic foundations of the state a legal entity called the state might find itself bankrupt and un-governable. Since poor states have only very few resources and low productivity, special attention has to be paid to how to transform these potentials into actual wealth, which is the basis on which the state rests, and with it the ability to provide public goods.
- Thirdly, international interventions – financial or otherwise – should not only observe the first two fundamentals, but also the fact that the societies in question hold their intrinsic logic, which does not necessarily go well with donors' intentions.
- Therefore, donors should carefully assess in how far they can contribute towards more stable elite bargains, and to growth and wealth-creating policies that underpin a stable state.

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