



Citizen-Centered Approaches
to State and Market



Stability, State-Building and Development Assistance: An Outside Perspective

THE PRINCETON PROJECT ON NATIONAL SECURITY

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**Stability, State-Building and Development Assistance: an outside perspective
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September 11 and the terrorist attacks on Madrid and London have changed the prospects and challenges of global development. During the 1990s, those in the wealthy and democratic world could seriously entertain the illusion of the end of history, witnessing the end of the specter of communism, the implosion of the Soviet Union, the unification of Germany, and the quick defeat of Iraq. The historical ruse, however, manifested itself right after the celebration of the new millennium, in the form of networks of violence directed against the icons of power and wealth, and against the citizens of developed countries. From their breeding grounds in the territories of failing or fragile states, these networks of violence utilize the assets of globalization to undermine the confidence that citizens of developed countries have in their governments' ability to protect their cherished freedoms and daily routines.

The irony is that the people in whose name the terrorists attempt to speak and act often dream of gaining access to the lifestyle enjoyed by citizens in developed countries. It is not their rejection of economic globalization and democratic forms of government, but their exclusion from these benefits that fuels the resentment of the subjects of unrepresentative regimes. Overcoming its legacy as the instrument for repressing the many by the few, the state has acquired the capacity, in developed countries, to become the preferred instrument for delivery of public value. Fragile states, by contrast, have not only failed to acquire the range of functions now routinely associated with state-capacity, but have failed to perform the one function defined as the criterion of statehood: the legitimate monopoly of means of violence. We are not talking here about their failure to use violence against their subjects – witness the brutal practices of regimes across the world ranging from Pol Pot's Cambodia, to the Sudan, to the killing squads of Central America. Rather, we are referring to their failure to acquire the legitimacy to deny other actors access to means of destruction and, thereby, make the state monopolize violence.

If our globalized world is to be secure, we need to establish the conditions for all its citizens to believe that they can lead secure lives. Since a capable state is the most effective form of organization for establishing security, confronting the problem of global security requires a clear acknowledgement that state-building in the developing countries is the critical task of the moment. Mobilization for carrying out this task requires the same level of imagination, energy, resources, and time-horizons that statesmen and alliances of countries devoted to overcoming the challenges of fascism and the Great Depression.

Initially, this paper examines the implications of making state-building our central goal. It then provides a mapping of the processes used in practice to implement aid, by examining the record of development agencies in some recent cases. We do this firstly from the perspective of the US Government Accountability Office, and then secondly from the perspective of the client – the Ministry of Finance – on the ground in Afghanistan. The example of US assistance is used because of their role as the largest donor in Afghanistan; but examples of other nations’ development agencies could also have been similarly studied. (The issue is not isolated to US assistance, but can be found across the aid system.) Lastly, the paper summarizes some proposals for how the aid system could support the goal of state-building. The assistance of the international community is needed more than ever, but the mechanisms and processes for providing support need urgent attention and revision.

State-building as the goal

If the goal of state-building is to be realized, the first step is to agree on the functions that a state must perform in today’s interdependent world. We argue that states must perform a constellation of interrelated functions, in marked contrast to their one-dimensional function of providing security in the 19th century. We have identified ten functions that a modern state should maintain (see box). The characteristics of these functions, together with a proposal for a state effectiveness index which could continuously track movements in the sovereignty gap over time and across countries, are further delineated in a separate report¹.

Ten Key Functions for the Contemporary Sovereign State	
<p>1. A legitimate monopoly on the means of violence</p> <p>2. Administrative control</p> <p>3. Sound management of public finances</p> <p>4. Investment in human capital</p> <p>5. The creation of citizenship rights and duties</p>	<p>6. Provision of infrastructure</p> <p>7. Regulation of the market formation</p> <p>8. Management of the assets of the state</p> <p>9. Effective public borrowing and management of international relations</p> <p>10. Maintenance of rule of law</p>

The weak link

Acknowledging the goal of state-building, however, is only the first step in fashioning the means necessary to accomplish it. Ministers of Development from OECD countries have reached consensus that the challenge of weak and failing states should be

¹ Ghani, Lockhart, Carnahan, Closing the Sovereignty Gap: USIP August 2005

addressed in certain contexts by a shared goal of state-building². But the ability of donor countries to advance this goal requires a major revision of the way aid is delivered in practice. While such rethinking applies to a range of donor agencies from developed countries, it is instructive to examine some recent reviews relevant to US assistance. A brief examination of some of the findings of the Government Accountability Office – the organization mandated by US Congress to monitor the expenditure of public money – underlines the difficulty of implementing goals through conventional approaches to development.

The report on Southeast Asia asserts that “the State has not produced a coherent national security assistance strategy that meets the objectives that Congress encouraged State to include in this strategy... Among other shortfalls, the plan does not identify the allocation of resources to accomplish objectives, the ways in which programs would be combined at the country level to achieve objectives, or the coordination of these programs with other US government agencies” (2005). Not surprisingly, only two of the nine objectives specified by the Congress have moved to implementation.

Summing up its findings on the commitment of \$587 million by USAID in Afghanistan until September 2004, the same office concluded that “longer-term reconstruction efforts achieved limited results in creating a stable Afghan society. Delayed US funding, small staff size, inadequate working conditions, and a lack of comprehensive strategy impeded progress; at the same time security deteriorated and opium production increased” (2005:7). More specifically, the report states that “complete and accurate (financial) information was still not readily available; consequently, US efforts to plan, assess progress, and make informed resource allocations were impaired. As in 2002-2003, USAID lacked a comprehensive operational strategy in Afghanistan in the year 2004” (2005:10).

On the critical issue of accountability, the report concludes that “contract management problems affected most reconstruction sectors, making it difficult to hold contractors accountable. Oversight of the USAID assistance contracts for Afghanistan was essential owing to the inherent risks associated with the use of cost-plus fixed-fee contracts; the awarding of contracts through bidding procedures that were not fully open and competitive; the large initial dollar value and scope of the contracts and large increases in the dollar values and scopes over time; USAID did not provide adequate contract oversight, including holding contractors to stipulated requirements and conducting annual reviews of contractor performance” (2005:10;48-49). How did the promises compare with the results on the ground? Out of 286 schools to be built by the end of 2004, only eight structures had been completed by September; and out of the promised 253 health clinics, only 15 new structures had been completed over the same period.

² The Principles of Good International Engagement in Fragile States were endorsed by Ministers from OECD countries in March 2005 at the Paris OECD High Level Meeting

If this is the condition on Afghanistan, where President Bush was personally following the progress on a critical highway,³ what is the assessment on the expenditure of \$18.5 billion in 2004 in Iraq? In an independent evaluation, CSIS concludes that only 27% of the committed funds were actually available for direct services or investments. The use of the bulk of the funds was estimated to be as follows: security, 30%; corruption, fraud and mismanagement, 15%; insurance, international salaries, and other costs, 12%; overheads, up to 10%; profits, 6% (2005).

Afghanistan and Iraq were the Bush administration's two main foreign policies. The stated goal in both countries, with repeated assertions that failure was not an option, was to create stability through winning the hearts and minds of the people. Although the context in the two countries was radically different – since the Afghans genuinely welcomed the Coalition forces as friends, while Iraqis generally saw them as invaders – both situations saw the US, and a range of other countries, pledging vast sums of money towards reconstruction. However, it is clear from both contexts that the existing modalities of aid implementation are not currently configured to deliver the desired results.

In Afghanistan, we interacted with the international aid system both as customers and analysts. Drawing from this experience, we present a customer perspective, then an analytic perspective, on the functions of the state in the 21st century. We then move on to formulate a possible strategy for establishing an aid system aligned to the objective of state-building as the critical task of our times.

A Customer Perspective

The aid system is among the exceptions in the financial sector in that it does not seek regular feedback from its customers in recipient countries. This section looks at the system from the perspective of a country context: Afghanistan during the period 2002-4. During Dr Ghani's two-and-a-half-year tenure as Afghanistan's Minister of Finance, for instance, he was never asked to provide feedback on the performance of USAID's country director – or indeed that of the director of any bi-lateral or multi-lateral institution, or UN agency. The dominant vocabulary reflects the assumption of inequality on which aid has been premised: the country is a client (as in patron-client), or recipient (where the giver is supposedly superior to the recipient). The organization or the visiting team from the headquarters or capital is called a mission: as though it is bringing the truth to the unenlightened. Language is constitutive, for without mastery of the arcane terms and the orthodoxy of the moment, often not fully assimilated by those preaching it, a representative of a country cannot truly represent the wishes and aspirations of her or his people.

USAID prepared an operational strategy for Afghanistan only by mid-2005. The government of Afghanistan, however, presented a national development framework by

³ The highway from Kabul to Kandahar was considered to be a flagship project for the US Government. President Bush regularly enquired about the progress of the road, and was apprised of which mile the road had reached on an ongoing basis.

April of 2002, when it chaired and held its first development forum meeting in Kabul. This framework outlined a donor tracking system, a financing channel administered by an international accountancy firm, an aid coordination mechanism, and a national budget. Between 2002 and December 2004, the government carried a series of reforms in currency, banking, budgeting, customs, and the treasury. From March 31-April 1, 2004, it also presented a comprehensive seven-year plan in a conference in Berlin. Finance and Foreign Ministers from 64 countries welcomed the government's painstakingly detailed vision in the "Securing Afghanistan's Future" report, pledging \$8.2 billion for the next three years, and acknowledging that it was right in calling for a total commitment of \$27.5 billion for a seven-year public investment program. In the political domain, the Afghan Interim Administration and Transitional Government strictly followed the benchmarks of the Bonn Agreement mediated and monitored by the UN to empower the people. Two grand conventions were held, electing the head of the state and passing the constitution, as well as the first direct presidential elections in the history of the country.

Committed to a state-building project that would result in the creation of credible institutions embodying the rule of law and the generation of a sustainable domestic basis of public finances, the Afghan economic team considered the budget to be the central instrument and arena of policy-making and implementation. The Minister of Finance reported back to the cabinet on a weekly basis about the country's finances. This, in turn, required systematic reporting from the line ministries and provinces back to the ministry. By December 2004, the country had met all the benchmarks of a plan monitored by IMF staff; it had met revenue targets, brought military expenditure under control, created a single treasury account, and was receiving reports on revenue and expenditure from 65% of the provinces of the country in the first ten days of every month. International financial organizations repeatedly stated that the country was in the driver's seat and had established an impressive track record in the pursuit of its vision and strategy of reform.

A series of donors pledged money to the government's budget to implement this vision, channeling their money through a Trust Fund administered by the World Bank, and managed by an international financial management agent. These funds were channeled either to pay the ongoing operational costs of the Government, such as the wages of the approximately 200,000 civil servants (mainly policemen, doctors, teachers, managers and engineers) in place across the country, or to implement national programs such as a labor-intensive public works scheme. One program, for instance, delivered a block grant to a village on the basis that its accounts were displayed, projects were jointly decided on by the village, and a management council for the project was elected through secret ballot.

Despite this track record, and clear ownership of the agenda for reform, the Afghan economic team was unable to establish a strategic partnership with USAID. The disconnect flowed from differences in perceptions of threats and opportunities, as well as from disagreements over mechanisms for decision-rights and accountabilities. In June 2002, the Afghan economic team argued that the country was at a rare, historically open moment. With the consensus of the people and the support of the international community, it could write its own future, breaking out of the vicious circle of violence,

economic isolation, and poverty of the past, to embark on a virtuous circle of stability, democracy, and prosperity.

The threats, however, were equally real. Conversely, the country could become a narco-mafia state, with its people trapped in illegal networks which benefited a small number of Afghan and international criminal gangs. State-building, therefore, was a crucial goal. Moreover, the window of opportunity needed to be expanded through credible actions which enhanced the legitimacy of the government, by demonstrating the clear benefits of reform to the people. For this to happen, it was essential that the government – rather than any donor organization or NGO – had to be seen to be delivering to its people.

Without having formulated a clear objective, and without having prepared an operational strategy or system of measurement, USAID proceeded on a project by project basis, creating unintended facts on the ground. Based on its agreement with USAID, the Afghan government informed the delegates of the Constitutional Convention that 1100 km of secondary roads would be built during 2004. Having miscalculated the costs, USAID backtracked; and some of the roads inaugurated by President Karzai prior to the presidential elections in October 2004 had not made any progress by August 2005. As documented by the Congressional Office of Accountability, USAID contractors USAID's failed to deliver on promises in sectors ranging from education to infrastructure

The wider the gap between promises and delivery, the more expensive service delivery became. Sometimes a contract was reported as passing through five nested layers of American contracting firms – each of whom charged a substantial fee – before reaching an Afghan sub-contractor who actually built a structure. A school costing USAID \$250,000, for instance, would be built by an Afghan sub-contractor at a cost of \$35,000-50,000. As complaints about lack of progress and poor quality increased, USAID reportedly hired even more organizations to oversee those organizations already hired to monitor and report to it. The net result: replacement of trust by skepticism, if not outright cynicism, among segments of the Afghan population regarding the intentions of the United States towards Afghanistan. At the time, Dr Ghani argued that every \$1 in cash from a program loan (either from the World Bank or Asian Development Bank, which are both heavily funded by the US) was equivalent to \$5 in USAID financing. Now he believes that the equivalence might be closer to \$8. Meanwhile, it is worth noting that a national community development program by the Afghan government, providing block grants directly to rural communities, has constructed 591 schools in the last two years through a participatory system.

The difference in perspective was not confined to efficiency or credibility. USAID reserved the choice of contractors entirely to itself. In the absence of a shared strategy between the Afghan government and USAID – or even a USAID strategy – these contractors became independent agents, attempting to write the rules of the game for different sectors as they pleased. When paid by their level of effort, these firms repeatedly brought consultants for whose services they charged as much as \$1500 per day: regardless of need, the readiness of their counterparts, or the definition of outputs.

As several reviews carried out at the request of Afghanistan's Ministry of Finance and shared with USAID demonstrated, the quality assurance of the firm contracted by USAID to provide advice on economic governance was not adequate. Managing sub-standard consultants often diverted the national managers of departments from critical reform tasks. Judging a number of such consultants' performance to have been substandard, the Ministry of Finance asked for and obtained their departure. As the Office of Accountability stated, the contractor hired to assist with economic governance "failed to produce contractually required work plans and schedules" (2005:49). Despite this poor record, the firm was not only awarded fresh contracts in other countries, but also another large contract in Afghanistan in 2005.

As the largest developmental actor in the country, USAID's actions and inactions both had cascading effects on the government's ability to coordinate foreign aid and manage domestic affairs, as well as on the plans of other donors. Typically, USAID made larger claims than it could deliver upon, secure the funds for, or implement. Decisions on reprogramming were often made within the orbit of USAID or the US embassy, without any, or adequate consultation with the Afghan government or other donors. Effectively, this created a parallel stem to the government's budget and processes, substantively undermining its own ability to consolidate the management of the reconstruction process. It is true that many of the Afghan government's rules and processes needed to be changed; and there was a desperate need to enhance its capacity. But since USAID had neither an operational strategy, nor a performance-based management system, it could hardly be a model of accountability, effectiveness, and transparency to emulate. Whereas the Afghan government's goal of state-building was aligned with the security interests of the United States, USAID's haphazard approach to development, in an open moment of history, was fundamentally out of kilter with the security interests of the US and the other developed countries in Afghanistan.

Individuals are not the issue, as the small team of USAID personnel worked incredibly hard under very difficult conditions to serve the interests of their country and Afghanistan as they perceived it. There were cases where their projects were well-designed and delivered, and produced value in immensely difficult circumstances. The issue is the aid system, as shaped by explicit and implicit rules of the game that make it contribute to the weakening of the state in developing countries rather than to enhancing state capacity. If state-building is to serve the interests of developed and developing countries as well as the security concerns of the US, as we have argued, then the atavistic practices and mental models of the aid system must not be permitted to undermine these common interests of our interdependent world. Since the problem is one of aligning an old mechanism to a new objective and context, the relation of the mechanism to this objective has to be examined.

USAID was not the only development agency to be inadequately aligned towards effective delivery of the reconstruction agenda through state-building. The Ministry of Finance – which, like the Office of Management and Budget, and the US Treasury, is tasked with the coordination of funding programs – had to work with approximately 45

different donor organizations and agencies. These came from many different countries, and each came with their own strategies, rules, procedures, programs and projects for Afghanistan. Many of them proposed competing strategies and plans for the same road, power station, or school. Whenever the donor organization reserved the right to take decisions and manage separate projects, the coordinating role of the government was bypassed. Sometimes as many as five or six teams from different countries would arrive in town simultaneously to implement the same project. A vast amount of humanitarian aid was channeled by donors directly to NGOs or other implementers who were not willing or able to share information with the government as to where and when schools, clinics, hospitals and universities were being built. Despite being bypassed in this way, the government still had to provide staff and supplies for such projects if they were to become operational and sustainable. The government still had to master the rules and procedures of each donor, agency and contractor in order to be able to fulfill their requirements. Accordingly, a large proportion of the time of the government staff was devoted to deciphering and learning these myriad rules, rather than on domestic reform.

The central misalignment stemmed from a simple fact: if it is necessary for the state to perform key functions for its citizens, then credible institutions and a public finance system are at the heart of its ability to perform⁴. These in turn require financing to be channeled through a domestic budget and expenditure system. Domestic revenue must be mobilized, and domestic line managers must be responsible for decisions. However, many of the organizations and practices of the aid system are, instead, configured to bypass and undermine these domestic systems. This is not to argue that aid in general, and organizations such as USAID, DfID (the UK's Department for International Development), and the other development agencies cannot play a useful role. Conversely, it is vital that they are realigned so that they can assist in catalyzing reform processes. Indeed, some of the donor organizations proved to be more aligned to the domestic systems than others, in that they financed the government's budget through the Afghanistan Reconstruction Trust Fund, and pledged to support President Karzai, along with his government's vision and strategy (the National Development Framework), instead of trying to write their own, competing one.

Realigning procedures, practices and mental models in the aid system to the goal

We now turn from the particular case study to the general. For aid to become an instrument of state-building there is a need for a comprehensive review of the existing procedures, practices and mental models formed during the Cold War era. Proposals for realigning the goal of state-building as the mechanism for ensuring US security are

⁴ There are many indicators that in the eyes of the Afghan population, liberation from war and the establishment of peace, as well as the establishment of an accountable civil service, were their key desires. Focus groups conducted with the population in February 2002 evidenced preferences for the \$4bn pledged at Tokyo to be spent over 20 years to build a reliable and predictable administrative and security system for the country, and frustration at the amount of money spent on expensive NGOs. Delegates at the 2004 Loya Jirga expressed enthusiasm for customs reform, accountability and large infrastructure projects, and frustration with their perceptions of the waste inherent in the aid system.

equally needed. As an initial contribution to such a review, we here offer some suggestions.

The first task to be addressed is **inter-agency coordination** in the US government itself. The creation of the Office of Reconstruction and Stabilization headed by Ambassador Pascual⁵ is the first step in this process. Successful coordination, however, requires clear guidelines on the relation between objectives and mechanism. It cannot succeed without the power of veto over proposed strategies and programs by any of the agencies. It also requires greater clarity around the lines of responsibility between the different agencies, including the reporting relationship between staff from the head offices and field offices of each agency involved in the country.

At the country level, the **strategic criterion of success** must be the contribution of the aid system to building the accountability, efficiency, and transparency of the state in performing the ten functions of the state outlined above. As an exit strategy by the aid system is dependent on enhancing the capacity of the state, it makes logical sense that the success of the aid system should be measured by its contribution to building the state rather than substituting for it.

Adoption of an exit strategy by the aid system requires the clear formulation of a **time horizon**, during which the state can successfully perform its required functions. Working backwards from this goal leads to the conclusion that the annual cycle of allocation, commitment, and disbursement of aid needs to be changed. If accountability, efficiency and transparency are to be the criteria for measuring aid, then the mechanism for allocating funds must be tailored to the goal. Currently, the goal is subordinated to the mechanism, resulting in a cascading series of problems that the Congressional Accountability office keeps documenting. The US Congress has taken a significant step towards multiyear funding for the Millennium Challenge Account. Adoption of a similar procedure for all foreign aid would give the aid system the necessary flexibility to develop a performance-based organizational culture and ethos.

State-building strategies require gaining the **skills and mental models** to partner with government officials in countries with serious governance problems. The analysis of these problems, along with the formulation of strategies for improving governance, the establishment of mutual accountabilities through division of labor, and the delineation of monitoring and reporting mechanisms to the public, must all be at the heart of the aid system in these countries.

If the exit strategy is to be taken seriously, then the (domestic) **government budget must become the central instrument of policy** and the key mechanism of decision-making. The aid system must cease operating as an off-budget system, as experience has demonstrated that all off-budget mechanisms lead to failure of accountability and transparency.

⁵ Krasner and Pascual: Addressing State Failure: Foreign Affairs July/August 2005

Despite its sixty-year history, the global aid system has a poor understanding of the roles and functions of ministries of finance and line ministries. Propelled by the tyranny of the annual cycle of allocation, the aid system has been dealing with the symptoms of poor governance through the adoption of massive technical assistance. As there is an emerging consensus that technical assistance is a very expensive, and yet ineffective instrument for addressing the problem of governance, the issue of **capacity-building** must be examined afresh.

To begin with, all the so-called “beltway bandits” that have received huge contracts for governance should be evaluated by a blue ribbon panel of global practitioners. Those that have been ineffective should be blacklisted from future contracts. As the rates for paying consultants are determined by administrative decisions rather than by the market, new ceilings for these rates must be adopted. All consulting firms and individual consultants should be evaluated on the basis of clearly delineated criteria, based on the development of their counterpart’s capacity. This approach to providing consultants was used to great effect in South Korea. Any firm that fails to be diligent in regard to the quality of its consultants could be fined, and be blacklisted from future contracts for a specified period of time.

Secondly, technical assistance providers and their consultants should be made explicitly accountable to the host government. Currently consulting firms report to the development agency in the donor country that fund them, and the development agency – often with little expertise in the area where assistance is being provided assess the performance of the consultants. This reporting line inhibits the building of a responsive and effective relationship with counterparts in the host government. The alternative approach would be to make the consultants directly accountable to their counterparts in the host government. Coupled with this contracts could be rewritten from their current cost-plus basis to be more heavily performance weighted, based on measurable indicators such as numbers of staff who can meet certain externally assessed standards.⁶

The key to promoting good governance is the local ownership of a state-building agenda. This cannot be promoted without investing in the creation of first-rate institutions of **tertiary education** in those countries considered vital to the security interests of the US. Governance programs, in contrast to fields like medicine, are not actually capital-intensive in the medium and long term, as investments change the relation between supply and demand, creating a sustainable local basis for the production of skilled men and women who can perform whatever tasks are required. Certain skills such as computer programming, or standards in accounting and auditing, can be adopted all the more easily in a country such as Afghanistan. There is no prior history of investment in these fields, and therefore, no opposition from entrenched interests wedded to the old ways of doing things. A \$100 million investment in a well-prepared human capital

⁶ A remarkable irony in the public finance technical assistance industry is the proliferation of consultants and consulting firms who lecture developing country governments on the importance of performance based budgeting in an output and outcomes framework, while themselves operating on an input based cost plus contract!

program can save billions of dollars of expensive or obsolete technical assistance; as well as winning the good will of men and women destined to lead their countries in the future.

Finally, it is important to distinguish between development agencies working within a system of rules and incentives and the rules and incentives themselves. A simplistic assessment of the report of the Government Accountability Office could lead to a proposal to reallocate US Government funding away from USAID and into a different agency. Yet if that new agency or collection of agencies operates under the same system of rules and incentives, then the ‘beltway bandits’ will simply queue up at a different door. The allocation of funding, the ways of doing business and many of the failings identified by the Government Accountability Office are likely to be repeated.

A new partnership with the corporate world for the creation of domestic private sectors

Security depends on making the future predictable. OECD countries have succeeded in creating clearly demarcated pathways to **upward social and economic mobility**, thereby endowing their economic, political, and social systems with legitimacy. Acting on lessons learned from the history of OECD countries, developing countries must be assisted in embracing the creation of large middle classes as their developmental goal. The visible upward mobility of children from poor and excluded groups will do more to win hearts and minds than dozens of quick impact projects.

A middle class cannot be produced without a developmental strategy aimed at the **generation of wealth**, through the removal of constraints imposed by criminal, informal, and illegal economies. Destroying an economy’s relation to criminality and illegality is an admittedly challenging task. But an early focus on the transformation of informal economies – where billions of dollars in the assets of the poor are frozen in the form of “dead capital”⁷ – can generate systemic wins, and pave the way for the inclusion of the poor, and other excluded individuals and groups.

Creating the enabling environment for this type of change requires changes in the **procurement rules and procedures** of the aid system. As currently formulated, the primary objective of the aid system is to benefit American companies. If US security in the post-9/11 world depends on state-building in countries with weak governance institutions, then the promotion of legal, competitive economies in these countries should be the objective of the aid system’s procurement rules.

The first step towards promoting competitive economies is the emergence of a strong **domestic contracting sector**. Systematic early focus on key constraints in the formation and expansion of the contracting industry can give domestic policy-makers, and their international partners, a clear road map to creating an enabling environment for a competitive legal private sector. Critical path analysis and other techniques can also show the sequence and interrelation of actions essential for achieving this objective. At

⁷ De Soto, *The Mystery of Capital*, 2000

the level of human capital, some central deficits are likely to be skills in book-keeping, contract preparation, cost estimation, project management, time management, cash flows, and reporting.

A root cause analysis of the difficulties contractors face in estimating costs is likely to reveal that they work in a very volatile and unpredictable price environment. Far from being a competitive market, critical supplies are usually obtained through real, though informal, networks of people from neighboring countries who manipulate the prices to make huge windfall profits. The remedy in such an environment is investment in **supply chain management**, on the one hand, and incentives to global firms that could produce the needed supplies, on the other. Supply chain management is a developed field in business administration; but the aid system has generally ignored it as a technique for promoting economic development. Depending on the context, the establishment of relative predictability in the supply of five to ten critical commodities essential for reconstruction would have multiplier effects in the effectiveness of utilization of aid, the creation of a competitive private sector, and the goodwill of the population. It would help enable poor people to find employment, and to build shelter for themselves.

A revitalized aid system needs to forge a strategic partnership with global firms. Instead of awarding dream contractors to paper corporations around the beltway that continuously fail to build any sustainable capacity, the aid system should court the best global firms, with superb records in the creation of prosperity. Persuading such corporations to carry out analysis of risks and opportunities for investment in countries deemed vital to the security interests of the US, and then developing risk management strategies with them which make their investment in these countries seem an attractive option, can be critical to ensuring these countries' stability.

In the post-9/11 world, corporate citizenship must come to terms with a new global context. Making the world secure for flows of financial capital and free interchanges of human capital requires thinking on a world-scale. Global corporations can bring critical advantages to the challenge of state-building in developing countries. They have immense experience in dealing with large-scale corporate failures, and in honing leadership and management skills for the formulation and implementation of strategies tailored to rapidly changing contexts. Unlike the aid system, the global corporate sector has internalized the culture of performance-based evaluation and measurement.

Supply-chain management is one illustration of the type of problem for which corporate and non-profit organizations offer a range of solutions, where the aid system has none. The larger challenge, however, is the poverty of development theory in general – and economic development in particular – to offer innovative solutions to the challenges of transformation in countries with weak institutions.

Enfranchising the youth: from disaffection to becoming tomorrow's leaders and managers

Dealing with this critical task requires a strategic partnership between the institutions of learning in the developed and middle income countries – from universities and foundations to major civil society organizations – with the IFIs, bi-lateral aid agencies, and UN agencies. This partnership could develop realistic programs for investment in human capital, and for the promotion of legal competitive economies. Afghanistan and Iraq are among those countries with the youngest populations in the world. Unless the young men and women in these countries see demonstrable evidence of programs for their inclusion in their economies, politics, and societies, there will be no stability. Upward social mobility on the basis of merit and fair criteria are critical to the establishment of trust in the system and ownership of their development agendas.

The case for investment in primary education in general, and that of girls in particular, is well made and does not restating. The aid system, however, has acquired a misplaced bias against tertiary education. Research by the World Bank in Latin America revealed that investment in tertiary education mainly benefited the elite. The context in countries experiencing persistent conflict or suffering from weak institutions is, however, radically different. In countries suffering from persistent conflict, there is not only the problem that skilled people trained during periods of peace have been forced into exile, but also that the institutions of higher learning have been neglected and weakened. Technical assistance, as we have seen, is an unsustainable and very expensive instrument for promoting the good governance and economic dynamism that are the precondition for security in these countries. Consequently, investment in tertiary education must be examined from a dual perspective. As well as assisting human capital formation – the form of capital that is increasingly emerging as the most important component of competitiveness – it also enables the formation of elites that would have the mental models and skills to become stakeholders and shareholders in the security of our globalizing world.

A clear focus on the investment of human capital can enable the aid system to enter into long-term partnerships with innovative institutions of learning in the United States and in mid-income level countries, to create first-rate institutions of higher learning in countries judged critical to the security interests of the US and other developed countries. Investment of every \$100 million in this manner will have much larger returns than far greater sums spent in technical assistance.

Substitution – within clear timeframes and frameworks

The current practices of the aid system often undermine the objective of good governance through the creation of dual bureaucracies, substitution, and parallel systems to those of government.

Dual bureaucracy is the name we have given to the phenomenon where civil servants working for the government of a developing country are paid wages at or just

above the poverty level, while the skilled nationals of those countries end up working for the aid system at wages that are ten to 100 times higher. Inevitably, there is a brain drain from the government to the aid system. In Afghanistan, for instance, doctors or university lecturers left their poorly paid but essential government jobs to assume much better-paid positions as drivers, translators, office managers, or other subservient positions in the aid bureaucracy. When the government budget is significantly underwritten by the international community, as was the case in Afghanistan, the donors end up funding both bureaucracies.

Substitution occurs when the aid system contracts out the functions of government to the usual suspects: “beltway bandits”, UN agencies, NGOs, etc. If these arrangements are part of a coherent state-building strategy – where clear timelines for the transfer of functions to the government exist, along with contractually specified benchmarks on accountability, efficiency, and transparency; and on the transfer of these functions – then the practice can be accepted as part of a short-term solution. But the aid system now resorts to substitution as a first resort, without linking it to an exit strategy. In Afghanistan, for instance, the international aid system provided \$1.6 billion in 2002 to the agencies of the United Nations, but initially only \$20 million to the Interim Afghan Administration. This forced cabinet ministers to seek support for essentials such as office furniture or vehicles from the UN agencies and other aid providers – reinforcing the power asymmetries and hierarchies which are part of the language of the aid system. It is ironic that the aid system keeps preaching the need for dismantling state-owned enterprises on the justifiable grounds that the private sector is better suited to performing economic functions than the state. Yet the aid system fails to apply the same principle to its own operations, for it is largely composed of government or international bureaucracies secluded from competition or public evaluation.

Double compacts and the national budget as the focus of the aid system

Neglect of the budget as the central instrument of policy is at the heart of the problems of dual bureaucracy, substitution, and parallel organizations. The creation of a sustainable basis for public finance is critical to state-building; and this essential task requires that the public in these countries clearly knows how public revenue is being generated and spent. Parallel budgets undermine the development of trust between the government and the people, as citizens see evidence on a daily basis that their government is not the key locus of decision-making regarding their well-being. When the government becomes one of many loci of authority for the citizens, belief in the legitimacy of the system of governance is undermined.

Like corporations failing to produce value for their shareholders, governments failing to produce value for their citizens need to formulate strategies that restore the trusts of their stakeholders and shareholders. The aid system can play a vital catalytic role in this process, through the formulation and implementation of double compacts: on the one hand, between the governments and citizens of these countries; on the other, between these governments and those of the developed countries, as well as the national and international aid organizations. Such compacts could be structured around the

performance of ten core functions, and the commitment to a public process of evaluation and monitoring by specially-created national and international bodies. An agreement on yearly targets of domestic revenue generation – to demonstrate the possibility of exit from the aid system to the citizens and legislatures of developed countries – could be an important component of such compacts.

Conclusion

The security of the United States has become inextricably linked to global security in post-9/11 world. Given the unique consensus in the developed countries over capitalism as the organizational form of the economy, and democracy as the organizational form of the polity, the United States is in a position to contain and eliminate the threat posed by networks of violence against global prosperity, security and peace. The aid system can be an important catalytic mechanism in serving the security interests of our interdependent world, if it reorganizes around the goal of state-building in countries with failing or fragile states.