

Ending violent conflict and building a social compact

A. Introduction

Many poor people must make their lives in Chronically Deprived Countries (CDCs). In the random lottery of life, being born into a chronically poor family in one of the world's 32 CDCs is among the worst things that can happen to you. There will be very little healthcare for you or your mother, little, if any, education (if you make it out of infancy), and not much prospect of a good livelihood either. Of the 32 CDCs, some 22 are classified as 'fragile states' (see Annex K).¹ And of the 45 Partially Chronically Deprived Countries, ten are defined as being 'fragile'. This is the somewhat ambiguous term the international community applies to countries that have bad relationships with other states; export insecurity or conflict; or which struggle to provide any kind of worthwhile public provision for their citizens.² In all, 19 of the 32 countries classed as CDCs have experienced major conflicts since 1970 (a higher proportion than for other categories of country).³ We must therefore add pervasive violent conflict (frequently state violence) and civil war (and the fatal diseases associated with war) to the myriad of risks faced by the chronically poor in CDCs. In short, violent conflict matters hugely for chronic poverty, mainly through the insecurity trap.

Violence is a problem for the poor in all societies, but especially so in CDCs. Poverty can be a cause of violence – from crime to civil war. Injustice can start wars, but, as they progress, commercial motives can start to drive them. Commerce can also be the initiator of civil wars, especially when rich mineral resources are the prize. Ending wars therefore involves dealing with those who use violence to become powerful and wealthy. But their removal (or containment) is no guarantee of peace. To bring about lasting peace, societies must build a viable social compact – a set of mutual obligations between the citizen and their state. A social compact is the driver behind efforts to create broad-based prosperity, and helps to overcome the trap of limited citizenship. If this is not achieved, then new warlords can readily find new recruits (especially among the poor) and war could return when peacekeepers are withdrawn.

Pervasive violent conflict and civil war are among the myriad of risks faced by the chronically poor in Chronically Deprived Countries.

Historically, there are different models for achieving a viable social compact. Common to all is an effective system of public finance, including revenue generation, without which the promises of politicians will prove hollow when they go undelivered. This is especially important in fragile states: new leaders must gain credibility rapidly, utilising any opportunities for new and better government. They need 'quick wins', to convince people that this time things can be different. New leaders must therefore look to the fundamental obligation of all states, which is to reduce individual risk. This means working to protect people against the risks that neither their communities nor the market can effectively deal with.

We therefore redefine the fragile state as a state that either does nothing to reduce individual risk, or actually increases individual risk through predatory behaviour. In both cases, non-state organisations, including rebel movements, can

provide an alternative social compact. This increases the chances of conflict, which would undermine the state further, perhaps turning it into a failed state (one that is unable to exercise much, if any, authority across its territory).

Overall, this chapter argues that a viable social compact is one in which the state acts to reduce people's risks – through law and order, services and infrastructure – in return for their commitment to the state (including a willingness to finance it through taxation). Hence, the social compact is integral to people's perception of justice and to their realisation of citizenship.

B. Violent conflict and impoverishment

It is widely held that poverty can be a factor in the outbreak of violent conflict.⁴ Persistent poverty increases social discontent, but does not automatically lead to violent conflict. Open confrontation with elites carries high risks for people with few material assets or powerful sociopolitical connections, and a large-scale challenge demands resources that they may not have. Furthermore, different groups of poor people may not

perceive themselves as sharing a common cause. But, where their discontent is politicised, and where there is little prospect of non-violent political change, violent conflict becomes more likely.⁵ Both economic hardship, and also the social experience of powerlessness associated with chronic poverty, may be important factors.⁶

Of course, mobilisation need not be based on class solidarity, nor explicitly have the general reduction of poverty as a goal.⁷ Where poverty and inequality coincide with cultural or regional identities – group inequalities – the potential for conflict also appears to increase (and these identities make it easier to mobilise a group for action).⁸ This makes tackling grievances to restore social stability more difficult, because while an aggrieved group will care about its absolute standard of living (and hence about chronic poverty) it usually also cares about its position relative to other groups. Closing the gap sufficiently to prevent (or end) violence is more difficult to achieve. It is particularly challenging when it reflects years of structural disadvantage (especially if some groups have benefited from others' poverty, lack of assets and lack of representation in the political process). A desperate lack of economic opportunity also makes violence a more attractive livelihood.

Grievance-based discontent can easily be exploited by ambitious politicians and entrepreneurs more interested in personal gain than righting injustice. In the worst cases, warlords drive violence forward as a commercial venture – as happened in Sierra Leone's initially grievance-based conflict. As conflict persists, sheer survival ('need') drives recruitment (some young fighters with the rebel Revolutionary United Front in Sierra Leone said that the promise of a pair of shoes had been enough to sway their decision to join up).⁹ Forced conscription also plays a role, and chronically poor people have the least material and social resources with which to buy or bargain their way out of militias. In Liberia, Sierra Leone and Uganda, child soldiers have been involved in horrific violence.

It therefore becomes difficult to separate out the 'greed', 'grievance' and 'need' dimensions of civil war, especially when it is prolonged.

In summary, when conflicts persist and endure, personal gain becomes a more important factor in maintaining them. Lucrative opportunities to loot, sell valuable minerals and trade in drugs become available, and are developed to finance purchases of weapons and mercenaries. This can happen even in conflicts that began in order to redress a sense of injustice. War can become organised crime on a large scale. This can offer able-bodied poor people opportunities that they never had in peace – young uneducated men and women may be recruited as fighters – while many more vulnerable people become further impoverished.

Measures to stop a large-scale conflict occurring (or to reduce its likelihood) will therefore be much less effective once conflict has begun. They weaken as the conflict persists and as more people have a stake, both economic and social, in the conflict continuing. This can apply as much to government forces ordered to put down a large-scale rebellion as to the rebels themselves – with both pursuing lucrative livelihoods (sometimes in tacit cooperation).

Injustice and ending war

Injustice may help start a war, but strategies to restore justice may not be sufficient to stop it. This has consequences for how far it is possible to ensure the adoption of poverty reduction as a political priority in any moves towards a settlement. In some cases, peace settlements offer opportunities to rewrite national myths and expand the political agenda to include tackling poverty. One example is Bangladesh in the early 1970s, when the suffering of women in the war of independence created popular sympathy for a national nutrition programme targeting poor rural women.¹⁰ On a broader scale, conflict

Policies to help poor people gain assets can lessen the risk of social conflict turning violent.

Box 53: Violence and pro-poor policy in Bihar and West Bengal

The North Indian states of Bihar and West Bengal inherited similarly unequal and exploitative agricultural economies on India's independence, with some of the highest poverty rates in India. In the late 1960s they saw a series of rural rebellions, culminating in the Maoist Naxalbari uprising. But since the 1970s, leftist governments in West Bengal have enacted a programme of land reforms, involving nearly two million beneficiary households. This has included increasing the security of tenancies, and distributing land to the landless. Political violence has declined markedly, and the rural poverty rate has fallen to around the all-India average. Meanwhile, in Bihar, Congress and other parties held on to power, and land reform on the Bengal scale did not happen. By 2000, over 75% of landholdings were judged marginal or sub-marginal. Political violence, pitting various caste or class militias against each other, is widespread, inequality has increased, and the rural poverty rate remains high. This comparison suggests that policies to help poor people gain assets (such as land) can lessen the risk of social conflict turning violent. Clearly, the history of both these states is complex and there is more to their politics than land reform. But a wider survey of policy and conflict at state level in India offers some support to this thesis. It concludes that public expenditure on social services, and higher rates of education enrolments, were associated with reductions in civil unrest and violent conflict.

Sources: Justino (2006b), Kumar (2004), Thapa (2004)

sometimes results in the formation of groups that include poverty reduction amongst their aims – examples include the Sandinista-led overthrow of Somoza in Nicaragua, or the military victory of the National Resistance Movement (NRM) in Uganda. The extent to which such groups achieve poverty reduction varies considerably – largely failure in the Sandinista case, but considerable, if patchy, progress in Uganda over the last 20 years.

In other cases, particularly where criminal-type organisations have become prominent, the domestic policy agenda may instead be dominated by placating the powerful potential ‘spoilers’ to peace. Liberia during Charles Taylor’s presidency is one example – Taylor’s campaign slogan, ‘He killed my ma, he killed my pa, but I will vote for him’, grimly illustrated how appeasement can triumph over other priorities.¹¹ Afghanistan today is arguably another – with a weak central government, whose continued existence depends on placating warlords, offering them enough to ensure cooperation (handing out political and administrative appointments, for example) – but which has little in the way of mechanisms to achieve fundamental change. Even when poverty is on the policy agenda, it may be seen through a ‘security’ lens, which focuses on those social groups seen as constituting a security threat – often poor young men.¹² This may divert attention from meeting the needs of others, who are perceived as less likely to be combatants (for example, women or older people).

In summary, the possibilities for poverty reduction in the context of large-scale violence cannot be seen in isolation from the question of how political power is exercised, including the balance of power between competing groups. Potential political power is often the goal for competing political and commercial elites, recruiting the poor as voters or fighters when necessary.

From this situation, two problems follow for the international community. First, can powerful spoilers be taken out or neutralised by incorporation into an effective peace settlement? Second, if the present spoilers are dealt with, how can new spoilers be prevented from emerging, given the weak socioeconomic conditions of CDCs?

Regarding the first problem, the situation can be summarised as ‘one-and-a-half steps forward, and one step back’. First, we look at the steps forward. Since the end of the Cold War, which locked countries into spheres of influence which it was difficult to move beyond, the international community, in various combinations (the UN, NATO, regional bodies such as the African Union, and, more controversially, US-led coalitions), has increasingly intervened in violent conflict, ranging from Africa’s civil wars (Democratic Republic of Congo (DRC), Liberia, Sierra Leone), to genocide (Sudan), to overthrowing Afghanistan’s Taliban regime and its Al-Qaeda associates. Military action and peacekeeping removed the spoilers in Liberia and Sierra Leone – countries impoverished

by years of war. Warlords such as Charles Taylor are now facing international justice. But liberal interventionism has only treated the symptoms and not the causes. More vigorous and effective action against bribery, money laundering and the international trade in weapons and mercenaries, would make it harder for the wealthy and powerful to engage in violence to achieve their ends. There has been (modest) progress in each of these areas. For example, in 2005 Swiss banks were forced by the country’s Supreme Court to return US\$505 million, looted by the late General Sani Abacha, and place it in a special poverty fund run by the Nigerian government. However, much more remains to be done.

The step back is that the high hopes of the early 1990s, for the creation of an international system to deal with conflict, have been stymied by the competing interests of the permanent members of the UN security council, and by the US-led war in Iraq. Mobilising enough peacekeepers has proved next to impossible – hence, the long-running humanitarian disaster of Darfur in Sudan, that threatens to destabilise neighbouring Chad (both CDCs).

The primary purpose of the state is to reduce individual risk.

Regarding the second problem, removing individual spoilers is not enough. Removing one Charles Taylor leaves many potential Taylors to take the stage, if the socioeconomic conditions provide them with the opportunity, and if the poverty that supplies their recruits, persists. If war can be ended, and post-conflict recovery begun, it is vital for societies to start to construct what we term a social compact – a set of mutual obligations between the state and its people. That social compact drives the process of political, social and economic change that hopefully propels societies towards a better and more prosperous future. This removes the context in which the Charles Taylors of this world thrive.

C. Redefining the fragile state

What does all this mean for the individual (and their community)? Another way of posing this question is to ask: from the perspective of the individual, what is the state for? Many answers are offered to this question in political philosophy, but we suggest that the primary purpose of the state is to reduce individual risk. This is the first obligation of a well-functioning state.

Chronic poverty is, by definition, a state of multiple risks (see Chapter 1). The state can absorb those risks that the individual and their community cannot (although there are limits, such as climate change). People benefit not only from actual help (drought relief, for instance), but also from the knowledge that assistance will come if needed. For chronically poor people this is vital, because the fear that goes with poverty is in itself highly debilitating, and limits the possibility of high-risk, high-return livelihood strategies (see Chapter 3). Informal mechanisms of risk reduction exist at the family and community level in all



A child standing near a washing line outside a corrugated iron house in the slums of Sincelejo. Many Colombians are now living in slum areas after fleeing their homes due to political violence. This migration is part of the cycle of violence and forced internal displacement that affects large numbers of people (Sincelejo, Sucre, Colombia). Photo © Stephan Vanfleteren/Panos Pictures (2006).

societies, and formal insurance markets develop alongside economies, but many risks cannot be significantly reduced. These are risks that either affect most people in a community (for example, a natural hazard, a highly infectious disease, or economic recession), or that cannot be insured against, because formal insurance markets do not exist.¹³

We argue that, to have a useful meaning, the term ‘fragile state’ must be based on an understanding of the individual’s relationship to the state. In this respect, we argue that a fragile state is one that does nothing to reduce individual risk. Individuals may be entirely ignored (receiving no help, but paying no taxes either), or they may pay tax but receive little in the way of risk reduction in return (leaving them with fewer resources of their own to cope with shocks). In the worst cases, the state is violently predatory, dramatically increasing people’s risks, and impoverishing them. Myanmar and Sudan are two examples of this latter type, the former using forced labour, the latter turning to violence to ensure a hold over oil wealth.¹⁴ A further example is Zimbabwe, as the life story of Angel demonstrates (see Box 54).

Fundamentally, fragile states are those that never managed to create a social compact post-independence, or where the social compact has disintegrated, or countries in which the social compact is under great stress – usually from economic pressure. The result is often violent conflict.

At this point, a strong word of caution is in order, for we must avoid mechanistic explanations. While there is a broad statistical relationship between a low and declining per capita income and a country’s vulnerability to conflict, there are politically stable countries that have nevertheless gone through precipitous economic decline. Thus, Zambia’s economy stagnated dramatically from the 1980s to the 1990s, yet it has never suffered the turmoil that economically more successful Kenya and Côte d’Ivoire have gone through. Zambia has seen no major violent conflict and has moved peacefully from one-party to multiparty politics (although Zambia has never created the conditions for a developmental

Box 54: Angel and the state in Zimbabwe

Angel lives alone with her 19-month-old baby, in a tiny tin shack close to a town in the Midlands Province, Zimbabwe. After leaving home when she was 14, and working for a short time in a town (where she was exploited by her employer), in 2002 she moved to a nearby informal settlement.

Fifty or so households live in Plot Shumba, in small, fragile, temporary structures which are scattered over three acres of a 66-acre piece of rain-fed agricultural land. Plot Shumba developed gradually as a settlement from the early 1970s. Residents moved to the Plot because they had nowhere else to go – they had lost their commercial farming or mining jobs and therefore their homes: they were unemployed, had lost contact with their rural homes, or they could not afford urban rent. In February 2003 the army demolished Plot Shumba, as part of the state’s drive against squatter settlements and informality (called Operation Mariawanda). Angel was severely beaten and spent a month sleeping in the open at the long-distance bus shelter (along with others from the Plot). The landowner obtained a court order enabling them to move back and the residents rebuilt their homes.

In February 2004, Angel’s cousin helped her to get a job at a local small-scale goldmine, selling beer. While she was there she met a gold panner and fell in love. The mine owner went bankrupt in August 2004 and she lost her job and her home, and was forced to return to Plot Shumba with her boyfriend. For a while things looked up: Angel made a living selling and vending vegetables. She became pregnant in 2004 and gave birth to their first son in March 2005. However, that same month her boyfriend was killed, when the mine he was working in collapsed, killing him and three other men. Angel stayed at Plot Shumba, until it was demolished during Operation Murambatsvina. Afterwards she had to rebuild her shack again. Now unable to care effectively for herself or her son, Angel relies on local networks and an NGO for her own survival and that of her son. In all likelihood, such support has not been sufficient for either of them.

Source: Bird (2006b)

state – see Box 32). Nigeria has staggered from one economic crisis to another, and from democracy to military rule and back again, but, the grievances (and local insurrection) of the Delta region notwithstanding, there has been no conflict on the scale of the 1967-70 Biafra war.¹⁵ The social compact in Nigeria and Zambia, while stressed and partial in many respects and some locales, has proven resilient. Institutions, both formal and informal, channel most grievances into mechanisms for their expression and (perhaps) resolution, that are non-violent in character.

We must also be clear that whilst dictatorships are found among fragile states, dictatorships are not necessarily fragile states. A dictatorship may, if it retains its monopoly of violence, effectively repress any opposition. Some long-lasting dictatorships have, however, sustained themselves by offering a large segment of the population some tangible risk reduction – at least security of the person and protection of property rights (provided one does not challenge the state, or belong to an ethnic group or hold a religion that the dictator finds ‘distasteful’). If the dictatorial state manages the economy well (and/or it has extensive revenues from natural resources to distribute), dictatorships can provide some measure of prosperity, thereby reducing economic risks as well. Some dictatorships can do better at poverty reduction than some democracies. This is not a defence of dictatorship – individual liberty and freedom are rightly goals in themselves – but is a statement of historical fact. That said, many dictatorships fail to reduce poverty, and increase the risks that their population are subject to.

Our definition of a fragile state – one that does nothing to reduce individual risk – offers a better conceptualisation of state fragility for development policy than many in the development discourse. These definitions tend to focus on one of three areas:

- first, bad relationships with other states and development actors;
- second, negative outputs, where the state in question fosters and propagates insecurity and conflict; and
- third, state functionality, which is often viewed as a composite of political will and institutional capacity.¹⁶

Our definition improves upon the third of these categories,¹⁷ in two ways. First, instead of focusing on a government’s political will to reduce poverty, it focuses on the outcomes of these policies – the risks that citizens face. Second, many definitions place too much emphasis on state capacity (including its military capacity to impose its will on the people). You can strengthen the state (i.e. improve its ability to implement the decisions of its government), but then it may simply become a more efficient predator (i.e. better able to extract resources from individuals, and therefore become more of a fragile

state under our definition, since it raises their risks). Thus, the Government of Myanmar has periodically strengthened itself, making it better able to extract forced labour from its populace and suppress regional secession. Our conceptualisation, however, is also congruent with the ‘right to protect’ – the principle that the international community has an obligation to intervene in cases of gross human rights abuses when the state turns predator, and that this requires interference in the internal affairs of the state (previously ‘off-limits’ for much of the UN’s history). This is vital for internally displaced persons (IDPs) and refugees, who are disproportionately found among the chronically poor. We now turn to the impact of state fragility on the poor.

Consequences of state fragility for poverty

Of the 32 CDCs, some 22 are defined as fragile states under the standard Department for International Development (DFID) definition (see Annex K). What does this mean for the lives of the people in them, especially the chronically poor? There are four main channels through which state fragility intersects with poverty, three of which relate to violent conflict.

First, the poor may turn to non-state actors for their risk reduction, when these are perceived to be more available and

Death in war is matched, and in many cases exceeded, by the deaths resulting from the accompanying hunger and disease.

more effective than the state. Non-state actors may be legitimate (e.g. Bangladesh’s NGOs) but some may operate as a quasi-state alongside the (internationally) recognised state – terrorist groups seek legitimacy in this way. For example, Hezbollah in Lebanon operates an effective welfare state for Lebanese Shi’ites, keeping many out of

poverty. As states weaken, new groups create social compacts of their own. The populace then relies upon them, rather than the internationally recognised state, to reduce risk and keep them above the poverty line. DRC and Nepal are two examples. A given geographical territory that is nominally controlled by a state may contain many such groups, each building their own social compact. Sometimes these extend across national borders as well, so that the people in this territory owe no effective allegiance to the state in whose territory they reside. Thus, the areas of Pakistan bordering Afghanistan have long created their own form of social compact, managed their risks, and have no predisposition to call on central government to help – instead they resist it fiercely. Similar situations are found in the DRC and Somalia.

Second, fragile states are often at war. Recall that 19 of the 32 countries classed as CDCs have experienced major conflicts since 1970. The horrible death and mutilation inflicted upon people in war is matched, and in many cases exceeded by, the deaths caused by the accompanying hunger and disease. One estimate is that adult and infant mortality increases by 13% during conflict, and remains 11% higher for at least five years.¹⁸ International sanctions to bring belligerents to peace talks may

have the unintended effect of worsening the lot of the poor. There is some evidence of sanctions worsening nutritional status in Burundi, and sanctions against the Saddam Hussein regime in Iraq were much criticised for their impact on child health and nutrition. Paradoxically, the nutritional status of some of the chronically poor may improve during conflict if they reach the safety of well-run refugee camps, where they receive food and medical assistance (and perhaps some education as well). They may also face fewer (non-conflict) risks in such camps, when previously they made their livelihood in environmentally fragile conditions.

Education also suffers during wartime. This is not only through the physical destruction of schools (which were a deliberate target during Mozambique's civil war), but also due to heightened insecurity, and therefore fears about sending children out to school. Further collapses in household income reduce people's ability to afford to send children to school. One study calculated that an increase of 10% in the proportion of households affected by civil conflict in Uganda reduces investment in schooling by about one year.¹⁹ The impacts can be very different for different groups: the 1992-98 civil war in Tajikistan saw a sharp drop in school enrolments of girls, but not boys, and in urban areas rather than rural areas. Households allocated their reduced resources to educating boys, and were also afraid of girls being harassed by the military. Urban incomes fell more sharply than rural incomes, and rural households had some subsistence income to fall back on.²⁰ Reduced educational opportunities matter less for the chronically poor, who may never have had much access to education to begin with, or sufficient income to afford to send their children to school.

Third, conflict rips apart the social capital of societies, as flight and displacement (often for many years) damages family and social bonds. In the worst cases, young children are conscripted into armies and forced to commit atrocities against their own people, as a way of severing their social bonds and hardening them to violence (the atrocities committed in Sierra Leone and in Northern Uganda, are just two examples). Market exchange is undermined, as people's trust in each other falls, with the consequence that traditional mechanisms for coping with shocks, such as selling assets, become more difficult. During the genocide in Rwanda, people were too afraid to take their cattle to market and when they were able to do so, the prices were low.²¹ As people try to protect themselves, new forms of social capital emerge, including the mutual-support groups formed by street children around the world. Sometimes these cooperative groups form the basis for new livelihoods, keeping people above the poverty line or helping them to cross it.²²

Fourth, during wartime, overall economic activity and employment are reduced, as people become reluctant to create new businesses or to invest in their farms. The total level of

investment by large, small and micro enterprises falls. It also becomes very distorted – towards activities that deliver a quick profit (especially trading in scarce commodities) and away from investing in activities that have a longer-term (but now more uncertain) payoff. The opportunities for unskilled labour thus created tend to be characterised by insecure and exploitative terms of employment, with little attention to labour rights.²³ The exception, in terms of levels of investment at least, is the mineral sector, which is often a protected enclave providing revenue for governments and/or rebels. Unless the country is mineral-rich, the revenue base almost always declines during violent conflict, endangering already weak safety nets and social sector provisions for poor people.²⁴ In mineral-rich countries undergoing conflict, there may be ample revenues available for poverty reduction (Republic of Congo and Angola are examples), but these are often not used to this end, disappearing instead into a non-transparent fiscal system for elite use. Progress in this area has been patchy at best, and while measures such as the Extractive Industries Transparency Initiative may improve accountability, this is not evident in many countries.

In the same way that fear can debilitate those living in poverty and conflict, hope for the future characterises those living in successful, peaceful societies. Hope goes along with economic and social mobility, and therefore is itself a product of successful economic and social development. Many of the success stories, historical and contemporary, cited in the next section are examples of each generation doing better than the last, implying a reduction in the intergenerational transmission of poverty. Building a viable social compact thereby supports, and is in turn renewed by, the many successful individuals who lead healthier, more secure lives than their parents.

Education suffers during wartime, through the physical destruction of schools, heightened insecurity, and collapses in household income.

D. Towards a social compact

To repeat, a social compact is a set of obligations, based on a core set of agreed values, between the state and its people. It is not written down (although it is often reflected in a country's constitutional documents). Citizens and the state fulfil their mutual expectations and obligations through political and social institutions. A social compact exists when the majority of citizens agree (or at least acquiesce) to accept restraints on their individual actions, in exchange for tangible benefits. Typically, the state acts to reduce people's risks – through law and order, services and infrastructure – in return for their commitment to the state (including a willingness to finance it through taxation).

A social compact also affects how citizens behave towards each other. It can create norms and expectations around how individuals interact with each other (politically, morally and economically). Importantly, these norms and expectations

increase mutual benefits and reduce costs. When these 'rules of the game' are largely adhered to, the social compact fosters high levels of trust, reducing the chances of being exploited by others, increasing investments in long-run activities (stimulating growth) and reducing the chances of conflict. Conversely, a weak social compact, and a lack of institutions through which to settle disagreements, increases the chances of exploitation, increases individuals' uncertainty about the future (making investments more short term, thereby hindering growth), and increases the chances of confrontation and violence.²⁵

For reasons to be discussed below, the social compact need not only evolve in a democracy (no matter how desirable democracy is in itself). Authoritarian states have achieved viable social compacts, in which large numbers of people acquiesce (and are not just coerced) to limited political competition, in return for tangible benefits – the protection of person and property (provided you do not fall foul of the authoritarian rulers) and rising material prosperity.

How are social compacts built?

How do viable social compacts get built? The short answer is that there are many paths. History holds important (and sometimes uncomfortable) lessons for present policies and practices, as the following review of styles of social compact in Europe, the USA, Latin America, East Asia, South Asia and Africa attests.

Historically, social movements have not only organised the poor, they have also put pressure on the state and its institutions to address the needs of the poor. As such, they changed the nature of the state itself. This is part of the story of how Europe built effective social compacts during its development. The history of the state in 19th and 20th century Europe involved the construction of social welfare systems in response to the rising power (both political and in the market) of labour movements. Traditional elites increasingly sought to accommodate these social forces – via unemployment insurance, public pensions and healthcare systems – as they built and reinforced nation states (and instilled a sense of nationalism, which was not always for the good, as the wars of 20th century Europe attest). Interacting with, and reinforcing, this process was the extension of the political franchise to parties directly representing the interests of the previously powerless, and their entry into legislatures. This process was, in part, driven by broad-based economic growth. As growth fuelled a rise in demand for skilled, and eventually unskilled, labour, the market power of workers was strengthened (giving them the income to finance their trade unions and political parties). Growth also reduced the adverse incorporation of rural workers and peasants in feudal systems, by providing them with new work opportunities – although this did not always lead to more favourable terms of

History has shown that there are many paths to building a viable social compact.

employment (as Dickens' and de Toqueville's descriptions of horrific working conditions in dark mills illustrate). With the dilution of the power of the traditional landlord class, the rise of the manufacturing class, and, eventually, the working class, the politics of modern Europe was born. Europe thereby built a social compact, in which people expected something of their state (law and order and, eventually, social protection), and the state made demands of its people (taxes, in return for public provision, as well as military service to defend the nation state). In this respect, the social compact took the form of an agreed and adhered to set of duties and rights that became embedded in public institutions.

The US social compact was somewhat different, as broad social protection was not a priority. It was equally strong, however, being based on the generation of fast employment growth, through a vigorous capitalism that absorbed new immigrants.²⁶ Easy labour mobility (rather than social protection) provided both the mechanism to ameliorate periodic market crises, and some escape for African-Americans from their extremely adverse incorporation in the economy of the southern states, which 'reconstruction' after the civil war did little to change. Crises challenged the rules underpinning each type of social compact – notably, two World Wars and the inter-war depression. These required, in Europe's case, the restoration of democracy, and in the USA a grudging acceptance of a bigger role for the state.

Both Europe and the USA constructed a different mix of market and state institutions (and there are also many variations of the European 'model'), but each variety of capitalism worked well enough to give many people – though not all – a better life (or at least the hope of one). For the last 60 years the majority have remained committed to these 'rules of the game' (in particular to non-violent political competition), and flexible institutions and rigorous public debate have so far ensured their resilience. Importantly, the different varieties of capitalism delivered rising revenue bases that, with successful tax institutions, enabled politicians to deliver on at least some of their promises under the social compact. Different mixtures of revenue mobilisation were used, with a greater progressivity characterising the income tax system of European states, in comparison with the USA.

By the start of the 20th century, Latin America, with its rapidly rising population of European immigrants, looked like it might follow the European path towards a viable social compact. But the predatory colonial legacy undermined this possibility. High initial inequality (especially in land ownership) delivered a pattern of growth with very narrow benefits, reinforcing a landed elite adept at controlling legislatures, and limiting the political (and economic) space of an impoverished rural population. Many indigenous people were either left behind or adversely incorporated into exploitative agricultural-export economies. Periods of rapid industrial development

created a working class and urbanisation. From time to time populist governments emerged with redistributive agendas (in Argentina, notably), but these experiments often broke down under macroeconomic instability. With an inadequate revenue base (leading governments to resort to inflationary finance) the creation of social compacts based on European welfare state models stalled. Periodic reversions to authoritarian rule largely failed to deliver economic growth or increase societal cohesion. Hence, these states were unable to build a social compact based on providing the populace with rising living standards in return for accepting an absence of democratic rights (as in the East Asian model).

The painful adjustments of the 1980s, together with a better global economic environment (in particular booming commodity prices), have provided today's democratic governments with a chance to build a new social compact. Tax revenues are rising with growth, and the commodity price boom is providing scope for countries to negotiate better

deals with mining companies (thereby dodging the need to engage in extensive fiscal reform, which has been periodically attempted, but often abandoned in Latin America). This raises the prospects of increased pro-poor social provision, such as the creation of conditional cash transfer programmes in Brazil, Chile, Colombia, Ecuador and Mexico. If successful, such schemes will further consolidate democracy in the region and could make a substantial contribution to consolidating existing social compacts. But progressive state provision remains vulnerable to macroeconomic weakness (economies are still very much dependent upon primary commodities) and the public finances of Latin America are not on a stable footing.

East Asia, starting with South Korea, Singapore and Taiwan, and later followed by China and Vietnam (after their experiments with central planning), built viable social compacts with limited (or non-existent) political competition. Populations largely acquiesced to limitations on political freedom in return for very fast (and historically unprecedented) increases

Box 55: Tackling chronic poverty and spatial disparity in Indonesia

Over 100 million people live on less than US\$2/day in Indonesia, with many clustered around the national-level poverty line of around US\$1.55 purchasing power parity (PPP). Health and education indicators overlap considerably with consumption-based poverty, as do land/asset holdings. Considering the huge size of the country, it is not surprising that there are huge disparities between regions. For example, the mean distance to a health clinic is 4km in Java, whilst in Papua it is over 32km; and while 66% of households in Java and Bali have access to improved drinking water, only 9% do so in Papua. Such disparities are also reflected in the incidence of chronic poverty. Before the 1998 economic crisis, most provinces in Indonesia had relatively low levels of chronic poverty. This was especially the case in Western Indonesia – such as in the provinces of Jakarta, West Sumatra and Java. In Eastern Indonesia the rates of chronic poverty were much higher. Chronic poverty in Indonesia changed considerably after the 1998 economic crisis. All provinces experienced a much higher incidence of chronic poverty (see Figure 4). However, by 2005 chronic poverty appears to have fallen back to pre-crisis levels.²⁷ The strengthening of the social compact through the provision of social protection measures, and political and fiscal decentralisation, have played an important role here.

The government took a multipronged approach to social protection after the economic crisis, and introduced three main measures. First, the Jaringan Pengamanan Sosial, a social safety net, provided subsidised rice and health cards for the poor, a public works programme, and scholarships to keep children in school. These measures worked reasonably well, with the exception of the subsidised food distribution system, which suffered from large targeting and leakage problems.

Second, from 2001 the government introduced a fuel subsidy. This highly regressive measure benefited the richest decile five times more than the poorest decile. As government expenditure on the subsidy escalated rapidly, the scheme was scaled back and complemented by an unconditional cash transfer programme (Bantuan Tunai Langsung) in 2005 (in addition to investments in health clinics, secondary school scholarships and rural infrastructure). The scale of this transfer was immense. Over 15 million households received over US\$2.4 billion in four instalments during the year starting October 2005. A government evaluation reported that over 97% of the money reached targeted households (which included non-poor beneficiaries). The following year Bantuan Tunai Langsung was replaced with a conditional cash transfer programme.

The fall of the Suharto regime in 1998 also precipitated a period of rapid and far-reaching political and fiscal decentralisation. From this time, regional governments received a much greater proportion of central government revenue (40% of total public spending), and also gained greater powers to generate their own revenue, and develop and implement service delivery. To access these funds, regional governments have had to produce the regional equivalent of Poverty Reduction Strategy Papers to provide a framework for pro-poor service delivery. These and other initiatives have increased regional government's pro-poor expenditures. This is not to say that the decentralisation process has not been without its problems. Regional governments suffer from limited institutional capacity, a lack of coordination between levels of government, and weak prioritisation. It appears that remote regions of Indonesia have benefited disproportionately from the manner in which the social compact has been strengthened. For example, both Papua and East Nusa Tenggara showed large falls in chronic poverty between 1996 and 2005. Such falls have been sufficient to contain (if not reduce) regional disparities across the country.

Source: Wells (2008)

in living standards. Large-scale asset redistribution (principally of land) accompanied or followed radical political change (the largest, and most brutal, in communist China in the 1950s, created a rural social safety net with lasting effect). This secured the support of rural populations against external aggression, and limited the possibility of domestic insurgency (important in both South Korea and Taiwan). Rapid poverty reduction followed from fast economic growth. The containment of extreme asset inequality, together with substantial human capital investment, ensured that the benefits of growth were broadly distributed. Social inclusion therefore characterised these authoritarian models and reinforced (or built, in Taiwan's case) strong national identities. Growth, especially through exports, delivered the revenues necessary for state-building in East Asia. In China, state control of the economy enabled direct extraction of revenue (and redistribution) by the Communist Party before (and long after) economic reform began in the 1970s. Recently, China's tax revenues have grown alongside the economic boom. This has given the regime room for manoeuvre in meeting its biggest current challenge: spreading the benefits of growth to interior provinces and poorer, remote and mountainous regions. The number of chronically poor people in China remains high.

Securing the state against internal insurgency was a motive for Indonesia's Suharto after the 1966 coup. The regime delivered 30 years of growth, with rural poverty reduction and some reduction in this large country's spatial inequalities, financed by reinvesting oil rents (widely praised at the time by donors, who ignored Indonesia's takeover of East Timor). Since Suharto's downfall, successive governments have struggled to contain secession (with Timor-Leste breaking away) and

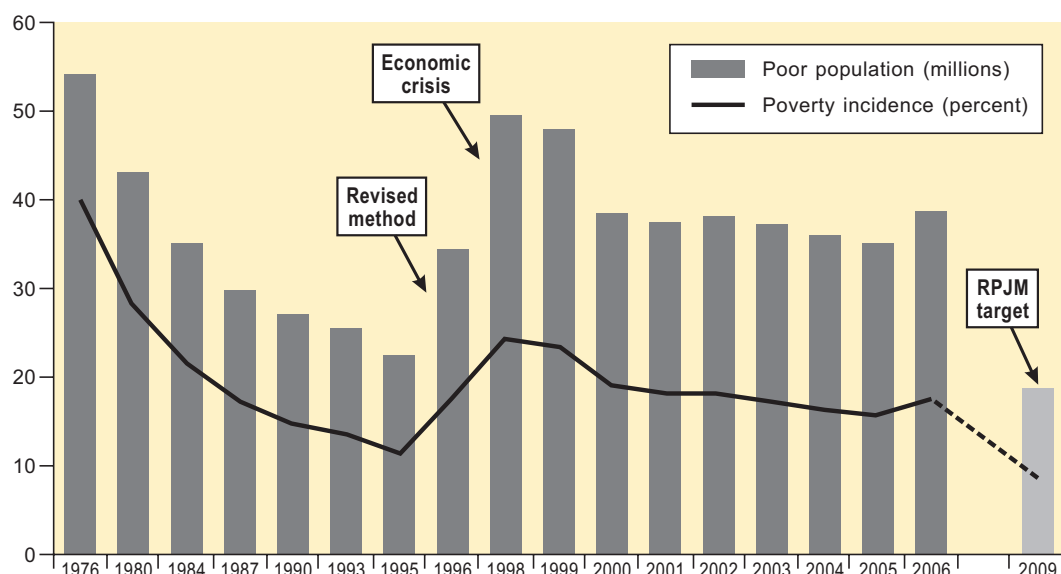
to create a new social compact. The containment of spatial disparity is paramount, and some success has been achieved in containing the effects of the 1998 economic crisis (notably in West Papua). Public finance has been of utmost importance in shifting revenue (especially that from natural resource rents) across the regions.

The Philippines has also been characterised by secessionist movements – in the disadvantaged Muslim areas, rebels have mobilised the local populace by promising a social compact of their own. Whilst the Marcos dictatorship in the Philippines was long-running, it was ineffective in delivering growth that benefited the poor (the export economy was controlled by the landed elite, who adversely incorporated the poor into their plantations). It also failed to contain grand corruption (whereas the venality of Suharto's regime was contained until its last few years).

A more extreme example of the difficulties of state formation in a dispersed territory comes from the CDCs in the Pacific. In Papua New Guinea (PNG) economic management is weak, revenues low (despite the natural resource rents) and the country remains aid-dependent. As our earlier review of Poverty Reduction Strategies showed (see Box 18), PNG has not been able to articulate a satisfactory poverty reduction strategy. Disenchanted young people, without much hope of employment, expect little of the centre, which appears to care little for them (health services are woefully inadequate, and easily defeated malaria is rife in the lowlands, for example).

Papua New Guinea has not built much sense of nationhood since independence, and its politics is as fragmented as the society. Whereas in PNG a mountainous terrain divides people into competing social (language) groups, in the Solomon

Figure 4: Poverty in Indonesia, 1976-2006



Source: Wells (2008)

Box 56: The natural resource curse in Papua New Guinea

Papua New Guinea (PNG) has substantial natural resources – minerals, hardwood and oil/gas – but very few of the revenues generated from these resources improve public facilities or services. Instead, poverty in PNG is widespread and deep. Poverty is worst in the more remote areas of the country, such as the Highlands and the Momase/North coast region. For example, the poverty headcount and incidence in PNG doubles when households take longer than one hour to access basic health facilities and community schools (and the relationship is stronger when using poverty depth and severity measures). The poor take over three times as long as the non-poor to reach the nearest road.

Instead of investing in collective assets and basic public services, the revenues generated from natural resources have been frittered away by politicians, whose immediate obligations are not to the state, but to clan and ethnic loyalties. PNG's six million people are divided into more than 850 language groups (clans or wontoks), with strong cultural identities and traditions. Clan and ethnic differences weaken the sense of nationhood and coherent national politics (also see Box 18 on decentralisation in PNG).

Violent conflict in PNG is widespread, especially in urban areas. Gangs and clan rivalries contribute to PNG's capital – Port Moresby – having a very violent reputation. The elderly and infirm are often victims, and gender-based violence is widespread. Gun crime is commonplace, with members of the urban elite involved. Corruption is endemic. Companies extracting natural resources are frequently alleged to use bribes to obtain contracts, and it is well known that civil servants and politicians abuse their positions of power for personal, family or clan gain. With few signs of change, and a fragmented civil society, many are resigned to the lack of state services and accountability.

Source: Cammack (2007)



Local villagers and clanspeople congregate at the remote Kiburu polling station to cast their votes in the 2007 general election (Mendi, Southern Highlands, Papua New Guinea). Photo © Jocelyn Carlin/Panos Pictures (2007).

Islands it is the vast distances that have hindered construction of a social compact. People in outlying islands perceive that the centre has done little for their lives, while rapacious politicians and entrepreneurs have contributed to extracting the nation's natural resource base.

India has maintained its democracy for most of its 60+ years of independence, despite a low per capita income. Despite religious tensions and outbreaks of communal violence, neither these, nor the Naxalite rebel movements (Maoist-inspired insurgencies recruiting from the rural poor), have seriously threatened the state's integrity. The political system yields social compacts at state level – of varying levels of effectiveness, ranging from Bihar (worst) to Kerala (best). These are underpinned by fiscal federalism, in which part of the state budget is financed from the centre. Organisations of the poor are an increasingly important driver of national

politics, attempting to refashion the national social compact through efforts such as the 'right to food' movement (which invokes the constitution and the state's responsibilities to its people). Strong growth is raising revenues, but India's tax system is highly inefficient, full of *ad hoc* exemptions (to the benefit of the wealthy). Revenues are therefore not rising as fast as growth – to the detriment of pro-poor public spending. India has a broad array of social protection measures in place, but with highly variable implementation and performance. For example, India's new National Rural Employment Guarantee Act (NREGA) is a key arm of the social compact, but suffers from dishonest and corrupt practices, especially in particular states, which reduces its effectiveness. However, the high-level political debates around the major schemes – such as the Public Distribution System, pensions, and NREGA – suggest that India will continue to strengthen its social compact.

In Bangladesh, at a minimum, the state must provide disaster relief to secure its social compact. But the corruption and ineffectiveness of the most recent governments – before the caretaker government took over – and the strength and capacity of the country's large NGOs, imply that many people, particularly the chronically poor, would see their relationship (compact) with these non-state actors as being far more important. Moreover, structures of patron–client relations, and the slow development of a strong concept of citizenship, indicate that many Bangladeshis insulate themselves against insecurity through often exploitative social networks.²⁸ The government's revenue base is weak – and Bangladesh's vulnerability to climate change threatens to slow the growth on which this is based – and the country continues to receive large aid volumes. This will throw even more onus onto NGOs, and further embed individuals in damaging patron–client relationships.

In contrast to India, Pakistan's democratic politics has been unable to deliver a viable social compact, and the country's periodic military dictatorships have not attracted mass support. Pakistan is characterised by very poor human development indicators (especially for women), and the adverse incorporation of the peasantry into what in many ways is still a feudal rural economy. In Nepal, a weak social compact (with very ineffective service delivery) has traditionally been shored up by the religious reverence in which the monarchy was held. This declined as the greed of the royal family became more evident in the 1990s, and the country's extreme rural poverty has enabled Maoist insurgents to build a robust political base, taxing the peasantry to provide the fiscal base for the insurgency.

Turning to Africa, the social compact offered by newly independent states was not so different from that in East Asia. Promises were made of a rapid rise in living standards, in return for loyalty to one-party states. (Political competition was ostensibly limited in order to contain interethnic rivalry, a constant theme in the politics of 1960s Africa.) Aid donors acquiesced, concerned about the stability (and loyalty) of their former colonies, and about their own commercial interests in the mines and plantations of 'independent' states. Thus, Malawi was for long hailed (and financed) as an African 'success story' by major donors, as Hastings Banda delivered growth (but very limited poverty reduction) through a system of highly personalised rule (profiting from the ownership of large export-orientated estates).²⁹ Similarly, Félix Houphouët-Boigny of Côte d'Ivoire was able to contain the strong centrifugal forces of spatial disparity (between North and South in this case) by redistributing the income provided by a vibrant export economy through the fiscal system. For a while this was thought to be a highly effective social compact along East Asia lines: a strong export economy delivering the revenues for state-building (magnified by generous bilateral and multilateral aid flows). Poverty fell, and the state itself absorbed large numbers of young people into a generous system of public employment (eventually this cracked open in the mid-1980s, as the economy went into decline.)

Many other African countries tried the same formula – generous public employment, together with minimal political competition. Due to a combination of bad policy (overtaxation of agriculture) and bad luck (external shocks), however, they failed to create the growth necessary to sustain expansion. Falling output (and rising poverty) took the state's revenue base with it, thereby magnifying an inability to deliver even basic services. This destroyed nascent nationalism and opened the way for (increasingly violent) competition along ethnic lines. In Sierra Leone and Zaire (now the DRC), the hollowness of the state's intent to create any kind of social compact with the populace became particularly apparent in the 1980s, as the economic collapse that accompanied predatory rule

was exposed. The capture (or promise) of valuable natural resources enabled increasingly powerful warlords to offer the prospect of their own pact to the young and disenchanted.

Much of Africa is, at last, on the up again. Whether this is the final fruit of the difficult economic reforms conducted from the 1980s onwards, or the bounty from an expanding global economy (driven by China's insatiable demand for minerals) need not detain us here. What is clear is that growth in much of Africa is once again strong. The few states that built and consolidated effective social compacts from independence onwards are now reaping the gains of high commodity prices. In Botswana's case, the country has the fiscal means to redistribute mineral rents to the population (thereby ensuring that what is otherwise a very narrow growth trajectory, after the fiscal incidence is accounted for, is remarkably progressive).

In contrast to Botswana's relative democracy, Ethiopia, Uganda and Rwanda have limited political competition (although politics is becoming a little more open in Uganda of late). Donors, whatever their statements about the benefits of multiparty democracy, have been happy to fund these states generously, given their effectiveness (at least in Rwanda and Uganda) in achieving post-conflict reconstruction and a large measure of political stability (notwithstanding conflict in Northern Uganda, and both Rwanda and Uganda's engagement, and competition with each other, in the DRC's civil war). But a commodity price boom is not always beneficial

for the majority. For example, generous and rising mineral revenues have allowed elites in states such as Angola and Equatorial Guinea to consolidate their rule. With little need to swap representation for taxation, they have mostly ignored the needs of large sections of the populace, which consequently remain impoverished.

This rapid tour of regions brings us to a fundamental point: states have a variety of political stripes (from true multiparty politics, to competition within a single-party system, to outright dictatorship), but democracy is not necessarily associated with an effective social compact. Irrespective of whether the population desires political liberty in itself, remarkably successful social compacts can be maintained by authoritarian states – if they are able to deliver economic growth and thereby improve living standards (and not all dictatorships, perhaps only the minority, achieve this). If living standards do not rise, then political liberty is unlikely to be sufficient to maintain political stability (low-income democracies have a high failure rate, reverting back to authoritarianism after eight years, on average).³⁰ Moreover, the chances of violent political competition rise, on average, as per capita incomes fall. Growth provides the revenue to buy off potential opposition, ensure the loyalty (if not the love) of the majority of the populace, and defend the state against external aggressors. But growth that is not accompanied by structural economic change (investment of the revenue rents in new sectors to broaden the economy's

If living standards do not rise, then political liberty is unlikely to be sufficient to maintain political stability.

base, particularly in exports) leaves the state vulnerable to an external or internal shock that hits the main export sector, and therefore its revenue sources. Moreover, social compacts come in different shades. They may include public policies that reduce individuals' risks in some areas, through providing law and order, land redistribution, or famine prevention; but not in others, such as not tackling malnutrition and maternal mortality, or not providing sufficient health services.

In summary, there are many pathways to a social compact. Historically, each successful pathway created a set of reciprocal obligations: from the state to the citizen and from the citizen to the state. Many actors are involved: social movements; democrats; 'enlightened despots' and technocrats. Many motives drive the process, including a sense of injustice by those fighting to get out of poverty, fear among elites about losing power, and nationalism. Elite self-interest can be central to implementing, sustaining or renegotiating a social compact. Not all the effects of a social compact are positive, however. Welfare states were sometimes built, and supported, by militarism and external aggression, as in Tilly's memorable phrase: 'wars make states, and states make wars'.³¹ Whatever path that was followed, each successful social compact was characterised by building an effective state, and an efficient system of public finance, that mobilised domestic resources and allocated them effectively to development and nation-building priorities.

E. Financing the social compact

Throughout our discussion of the social compact and the fragile state we have emphasised the importance of revenue and expenditure: nothing gets done unless it is financed. Once financed, it has to be implemented, through an effective public expenditure system. In this section we say more about revenue than about expenditure. There is now much consensus on what needs to be done to improve public expenditure management (a debate intimately bound up with Poverty Reduction Strategies (PRSs), Medium Term Expenditure Frameworks and the whole question of scaling up aid). Moreover, building a social compact is not just about financing states; it is also about getting money and help directly into the hands of poor people themselves. We therefore also discuss external finance, including aid, in this section.

Consider first domestic revenue, which must take centre stage for state-building. A country's tax base rises with the increase in national income, market activity and trade (both domestic and international) that accompanies growth. This provides greater scope for collecting more public revenue, through indirect and direct taxes as well as customs duties. Greater revenues can finance more pro-poor public spending, such as cash transfers to poor families (often encouraging greater school participation); greater provision of basic healthcare, as well as sanitation and water infrastructure; and roads and communication systems that enhance existing

livelihoods and generate new ones. Many more items can be added to this list, but without higher public revenues, funding pro-poor spending will remain dependent on the vagaries, and possible conditions, of foreign aid (if it is available). Moreover, higher domestic revenues are essential to building the state itself, both at the centre and at regional and local levels, and therefore to the prospects of effective (and democratically accountable) service delivery. Rising revenues also reduce the need to focus poverty reduction on narrowly targeted measures, allowing perhaps faster movement towards the construction of inclusive welfare regimes, covering both the poor as well as the 'anxious middle'. This, in turn, can increase the political prospects for effective action, when most people are worried about the impact of global changes on their families and descendants.³²

The fiscal link between growth and poverty is especially important when the main drivers of growth benefit few people directly. This is the case in economies where only a few families own the best land, for example – as in the histories of Central America and southern Africa. This is especially so in mineral-rich economies, where the direct and indirect poverty effects of growth in the mineral enclave are very limited (the poor participate in growth neither as producers nor as employees). Indeed, it is potentially possible for an economy to have a very narrow growth process, but one that yields such a large revenue stream that rapid poverty reduction becomes feasible within a generation.

Taxation is now at the forefront of the fiscal policy debate, whereas previously more attention was given to the expenditure side of public finances.³³ Many countries in sub-Saharan Africa, but also some in South Asia, taxed agriculture heavily until reform began in the mid-1980s. This taxation was 'implicit' (in the structure of policy) rather than 'explicit' (since agricultural income is difficult to tax, for example). In many cases, implicit taxation of this kind exacerbated the plight of the poor by undermining growth. The reform agenda has therefore consisted of four main strands:

- reducing the implicit taxation of agriculture through sector and macroeconomic reforms;
- reforming customs and excise services – so that the revenue actually reaches the government – but also reducing dependence on trade taxes by reforming sales taxes (and introducing the more efficient Value Added Tax (VAT));
- reforming income and capital gains taxes, including taxes collected by local governments; and
- generally broadening the tax base and making the administration of tax institutions more efficient (and honest).

In addition, there is also a reform agenda on urban taxation, to secure some of the resources from urban property and business growth to finance service delivery and infrastructure.

These reforms have had mixed results so far. Most developing countries hope to raise tax revenues of 15-20% of GDP. In practice, however, very similar tax structures and tax rates appear to generate very different revenues across different countries, and many countries have still not reached the 15-20% target.³⁴ Tanzania and Uganda, for example, have both struggled to raise revenues, despite successful macroeconomic stabilisation programmes. The revenue base in many low-income countries remains highly volatile (reflecting the high variance in output when economies are relatively undiversified). Donors can play an important role here, through providing stable and consistent aid flows for key social protection measures and social sector expenditures. Moreover, broadening the tax base is desirable to reduce overall revenue volatility. Broadening the VAT base, however, cannot be achieved without raising the tax burden on the poor. Broadening can therefore only really be justified when the net fiscal incidence (taking account of the incidence of expenditures as well as taxes) is pro-poor – and this is not the case in many countries. Lack of political progress on the expenditure side of fiscal reform holds up desirable progress on the revenue side.

There is also a balance to be struck in mobilising more revenue, in ways that do not discourage growth or investment by the poor themselves. (Punitive tax rates, for example, undermine investment incentives or encourage low-return investments.) Evidence is accumulating that local government taxes have very adverse impacts on poorer households in many countries. They are often arbitrary, harshly enforced, and yield little in the way of actual improvements in local services, thereby increasing the public's reluctance to pay taxes.³⁵ Periodic budget crises intensify enforcement, but this is simply squeezing more revenue from a badly designed system – and from the poor. Ultimately this undermines the legitimacy of local government. If raising taxation becomes an election issue, then revenue collection may become even tougher.

In summary, there are substantial problems with raising tax revenue-GDP ratios. In low-income countries, which are predominantly rural, much economic activity is informal, and incomes are therefore difficult to tax.³⁶ On the institutional side, tax administrations are often archaic, with limited ability to assess tax liabilities properly, and taxpayers are adept at evasion – helped by corruption in many tax authorities. Moreover, many governments subvert the independence of the tax authorities, which are also underfunded – thereby providing little in the way of incentives for staff. Improvements are generally patchy, and corruption has proven resistant to successive institutional reforms in many sub-Saharan African countries (e.g. Tanzania and Uganda). In Kenya, only 30% of those who should pay income taxes, do so. This implies that an increase in compliance would allow a reduction in the burden on current taxpayers, without reducing total revenues.³⁷ There is thus

Donors can play an important role by providing stable and consistent aid flows for key social protection measures and social sector expenditures.



A hairdresser cuts a customer's hair in a makeshift barbershop that he has set up in the abandoned tax department of the derelict National Bank of Liberia (Monrovia, Liberia). Photo © Tim A. Hetherington/Panos Pictures (2005).

a wide divergence between effective and statutory tax rates, particularly in sub-Saharan Africa. This offers considerable scope to raise revenues without increasing tax rates.

Progress is possible. Simplifying the tax regime to make it institutionally compatible is important, although this may come at the cost of less progressivity (e.g. if a flat tax rate is introduced). Many countries have complex tax codes and systems of exemptions, originally intended to support forms of import-substituting industrialisation that are now out of favour. Generous exemptions are also granted to those successful in

lobbying, and their elimination would make the system more progressive. Property and income taxes have positive effects on distribution, whereas indirect taxes are sometimes seen as having adverse distributional effects.³⁸ In Ghana, the increased role of direct taxation has been a pro-poor strategy.³⁹ Excise duties have received less attention in the reform

agenda than other instruments, but they can be used to dampen some of the regressivity of VAT on the overall indirect tax structure. Excise duties can raise substantial revenue and at the same time still be distributionally progressive.

Much has been made of the difficulties of collecting income taxes. A single rate of income tax with a high exemption level will, however, be administratively feasible. This can achieve even greater redistribution than an income tax system with sharply increasing marginal rates.⁴⁰ The income tax threshold should be high in order to protect poor households; in Kenya, the personal income tax threshold is four times the per capita income and has been consistently raised relative to per capita

income to avoid overtaxing low-income earners.⁴¹ Ultimately, countries must create comprehensive income tax systems if they are to fund inclusive welfare regimes – this will also enable them to use tax credits and other mechanisms to target poor households.

How to set about this technocratic agenda is reasonably well known. Questions remain about whether this is politically achievable, and what strategies can be deployed to break out of the institutional stagnation now apparent in many countries. There are success stories: Rwanda has successfully boosted its revenue-to-GDP ratio, for example. We need to know more about the political economy of such cases. But one observation can be made now, regarding inequality.

High inequality means not only that the direct benefits of growth tend to go to the non-poor, especially the wealthy, but also that the wealthy have the power to influence the political process to block tax reforms (and public expenditure reforms more generally) that run against their interests. They can do this by generously financing political parties that oppose progressive taxation, as well as mass media that are against progressive tax reform, and which can influence voters (an important reason why tax reform has been slow at best in Latin America).

Legislators themselves are often disproportionately drawn from higher income groups, especially large landowners, who oppose property and land taxes. The political power of the wealthy and the impact of this on tax policy, pose a major problem for policymakers attempting to finance Poverty Reduction Strategies, notably in countries with large land inequalities, such as Nicaragua.⁴² In the case of Nicaragua, some propose taxing land, and setting a threshold to simplify administration and exempt the poor. This would help raise more revenue and encourage large landowners to sell their land – which can then be purchased on behalf of the poor, which also would raise agricultural growth, since much land is underused.⁴³ This is unlikely to occur, however, given the political influence of Nicaragua's land-owning class.⁴⁴ The same story is repeated, in much the same form, in many other countries with high inequality.

Resolving this political impasse is part and parcel of creating a social compact. The importance of social movements in that process is clear (as shown in our earlier discussion). Revenue is a good issue around which social movements can mobilise: it is tractable (the policy issues are clear); it involves democratic accountability (and therefore provides lines of 'attack' for a social movement – demanding accountability in the use of public money etc); and there are technocratic issues, in which donors can help (institutional design etc.).

The political power of the wealthy, and the impact of this on tax policy, pose a major problem for policymakers attempting to finance poverty reduction strategies.

What role should donors play?

What role should the donor community play in all this? Full CDCs, though constituting only 10% of total population and 17% of US\$1/day poverty, account for 30% of infant mortality and 36% of child mortality (as shown in Table 3).⁴⁵ Yet they received just 29% of total aid (in 2002). This implies that the proportion of aid received by CDCs is less than the share of chronic poverty they endure. Moreover, the CDC share of mortality and poverty has been rising through time. These statistics become even more worrying when one considers that the number of CDCs is also increasing.

One reason for this is, of course, the very weakness in state capacities that we have highlighted in this chapter. These make aid difficult to disburse in large volumes. Moving from project aid to budget aid (which is central to scaling up) is a distant prospect in many CDCs. But donors can still play an important role, and support revenue generation, through improving the predictability and stability of aid flows. Aid flows are at least as volatile as domestic revenues, and this volatility appears to be increasing.⁴⁶ Commitments by donors are frequently not matched by disbursements. For example, pledges are often not implemented in full or on time. Such volatility has numerous

effects. It can jeopardise macroeconomic stability, through increasing domestic borrowing or reducing investment expenditures; it can divert attention from improvements in financial management systems; and it can reduce the likelihood of long-term social sector investments.⁴⁷ Stable and consistent aid flows should smooth the high volatility of the revenue base in many low-income countries.

In addition to conventional aid flows, there are numerous innovative sources of funding for poverty reduction, as illustrated in Box 57.

F. Conclusion

Through discussing the role of conflict and violence in contributing to the insecurity trap, and examining the key issue of revenue mobilisation, this chapter has covered a set of complex issues, to which there are no easy answers. Indeed, the rush by donors to find easy answers to the 'problem' of fragile states, while understandable, is a problem in itself, especially in the many CDCs that are fragile states. It is not that we encourage donors to disengage – they cannot, and indeed should not. But they need to reflect on their own histories in building social compacts. These demonstrate that many paths are possible, that the interface between democratisation and state-building is a complex one, and that the role of social movements has been crucial in making progress.

The international community has a valuable role to play in removing those who use violence to become powerful and wealthy. This must be done within the full framework of

Box 57: Innovative finance for poverty reduction

'Innovative' sources of development finance are attracting increasing attention, given the large sums needed to achieve the MDGs (such as social protection programmes) and the shortfall in Official Development Assistance (ODA), which, while it has risen in recent years, is still far below its target level. New sources of development finance can also fund more global public goods, especially in peacekeeping (reflecting the intense pressure on the peacekeeping resources of the UN and regional bodies such as the African Union); health (in the light of new pandemics, such as severe acute respiratory syndrome (SARS) and avian influenza, as well as the continuing HIV/AIDS crisis); and global climate change. Innovation can take the form of new modalities and new forms of private and public cooperation. Global environmental taxes (specifically a carbon-use tax) are gaining support. According to one estimate, taxing hydrocarbon fuels could generate US\$50 billion, and may have a 'double dividend': reducing adverse global climate change, as well as raising revenue.⁴⁸ Certainly, the revenue could be used well to help Bangladesh and other low-lying countries adapt to climate change: recent floods in South Asia did enormous damage, and the chronically poor on the chars (river islands) of Bangladesh are especially blighted by flooding. A tax on airline fuel, which has become a cornerstone of French action on innovative finance, could go some way to slowing down the carbon emissions associated with the global airline industry.⁴⁹

Health is another urgent area in which innovative finance can be mobilised. The UK's International Finance Facility (IFF) proposal aims to leverage and frontload ODA by borrowing from the international capital markets, the bonds being guaranteed by donor governments. For the moment, the IFF remains at the planning stage, but the International Finance Facility for Immunisation (IFFIm) is now in place, and, aside from its inherent desirability (in reducing child mortality, especially), it also constitutes a pilot for an eventual IFF. Innovation in service delivery is central to the new philanthropy, as is public and private partnership. A good example is the current effort to supply cheap Coartem (a highly effective malaria drug) to Africa. Novartis, which makes Coartem, has waived the patent restriction and supplies it at cost price to public health authorities in Africa, the Global Fund to Fight Aids, TB and Malaria, and other donors. The Bill & Melinda Gates Foundation is working with the Global Fund and the World Bank to cut the cost further, by subsidising the supply chain by some US\$300 million per year. This, together with Novartis' production subsidy, constitutes a major external resource transfer, straight into an area of key priority – since at least one million Africans die of malaria every year (many of them under five years old). Global philanthropy (both large and small scale) – often exploiting the enormous leverage available from global financial markets – could take the centre stage of development finance in the next decade. Development philanthropy by individuals and corporations can be increased by tax incentives, and by matching private donations with public funds.

The market for ethical financial products is also growing, as more individuals and companies seek to incorporate ethical investments into their portfolios (again a trend that can be encouraged by more tax incentives). Ideas for hybrid products – those which appeal to both self-interest and altruism – are also around. Some propose a global premium (prize) bond to fund development and global public goods, modelled on the UK's successful premium bond; each bond is entered in a regular prize draw and the return depends on luck, with no loss of the initial stake.⁵⁰ Microfinance is now increasingly internationalised, through the work of NGOs such as the Microloan Foundation and Five Talents, building on the much deserved success of the Grameen Bank. And while remittances are a very old flow (now amounting to US\$80 billion per annum, matching annual aid flows), there are new ideas (including the use of mobile telephones to make financial transfers) to reduce transaction costs for poorer households, by creating new financial services to improve on the present, high-cost money-transfer services.⁵¹ In summary, innovative finance is growing, through a blend of public and private money. It can deal with global public 'ills', aside from raising revenues, and it has become a basis for political cooperation between North and South (such as the 'Action Against Hunger and Poverty' initiative of the governments of Brazil, Chile, France and Spain).

Sources: See Endnotes

international law: the way that Charles Taylor was brought to justice is the template. Once such spoilers are gone, peace is not certain – building a social compact must take over as the driver. If this does not happen, then new spoilers will enter the stage, encountering favourable conditions for recruiting followers – deep poverty, few livelihoods, and non-transparent (and ineffective) government. Historically, there are many ways to build a social compact, but common to all is a sound system of public expenditure management and, as we have emphasised, revenue. Otherwise, little (or nothing) that politicians promise will be delivered, and no meaningful social compact will be built. This will undermine the trajectory to democracy (if it is in place). Non-state actors, who might deliver a social compact, will then become more attractive to the populace, and may

mobilise rebellion on this basis. Some of these non-state actors will be deeply unattractive to the international community.

The revenue dimension of growth is especially important in resource-rich countries, where resource extraction is often an enclave activity (oil and natural gas in West Africa, for example), so that growth does not directly generate much in the way of increased employment. In these countries, the main way that growth can reduce poverty is through the transmission of resource revenues into greater pro-poor public spending. For the most part, this is not happening. Instead, the poor are missing out on the revenue boom provided by higher commodity prices (especially oil), as revenues flow into spending for elites (or directly into their pockets).

Similarly, in societies characterised by high levels of inequality in access to land and other productive assets, the best means for redistribution may lie not in redistributing these assets themselves – desirable though that may be – but in incorporating redistribution into the fiscal system. This can be through progressive taxation (of capital gains from land sales, for example) to finance public spending that creates better livelihoods and human capital for the poor. In summary, growth can contribute to poverty reduction, even in societies with very high levels of asset inequality, but only if fiscal institutions are built to generate revenue, and focus on the poor and their needs. Otherwise the promises of politicians will prove hollow when they go undelivered.

This is especially important in fragile states: new leaders need to get off to a good start, delivering on quick wins. Many of those quick wins will be in areas directly engaging with chronic poverty – basic health services, and infrastructure to remote (often rebellious) regions. Reducing people's risk, via law and order, services and infrastructure, is the way forward. This sets up mutual obligations between the state and the individual, and provides the basis for individuals to commit their money, through paying taxes, to build the state. The state thus becomes an institution that enters meaningfully into the lives of poor people, rather than an abstract entity (or even worse, something that they do everything to avoid). This is the true basis of citizenship.

Notes

1. DFID (2005)
2. Cammack *et al.* (2006)
3. Anderson (2007)
4. E.g. Timmerman *et al.* (2006)
5. Wood (2003)
6. At the end of El Salvador's civil war, one participant in the insurgency commented: 'Higher incomes? Who knows? But that we not be seen as slaves, this we've won'.
7. Indeed, even in El Salvador, outside the richest sector of the elite (who were overwhelmingly pro-government), participation in the insurgency varied widely across social classes.
8. Stewart (2003)
9. Peters and Richards (1998). Another survey reported that satisfying basic needs – food, education and security – were enough motivation for the largely poor combatants (Justino 2006a: 12).
10. The Vulnerable Groups Feeding programme. See Hossain (2006).
11. However, some years later there are grounds for cautious optimism that, with Taylor in custody and a new government, political space for anti-poverty measures is growing. Taylor's staggering campaign slogan, sometimes given even more starkly as 'He killed my ma. He killed my pa. If he's President, he won't kill me!', is reported by many sources, e.g. Tran (2007).
12. See, for example, Collier (2007: 16) although here it is merely the proportion of young men in the population that is measured, without reference to poverty or inequalities.
13. Gough and Wood (2004) Welfare regimes.
14. The southern Sudan peace deal agrees to share the region's oil wealth. However, at the moment, it seems likely to fall apart, because most southern Sudanese do not feel that they are exchanging their region's oil income for any kind of tangible benefits from Khartoum. The government is perceived as engaging in behaviour that raises their risks, keeping them in poverty: hence their likely vote for secession in the eventual referendum.
15. Described so movingly in Adiche's (2006) *Half of a Yellow Sun*.
16. Cammack *et al.* (2006). See also Torres and Anderson (2004), DFID (2005).
17. Our definition shares some characteristics with that of Warrener and Loehr (2005), where a fragile state cannot or will not offer basic services and functions to the majority of the population. However, instead of focusing on the services and functions, we focus on the effect on the individual.
18. Justino (2006a): 8
19. Justino (2006a): 6
20. Justino (2006a): 6-7
21. Verpoorten (2006)
22. For example, the success of Mozambique's women in growing and supplying food to wartime Maputo.
23. Cramer (2006)
24. The result of the decline in the tax base, which falls as incomes and trade contract and as tax institutions degrade and collapse.
25. Addison and Murshed (2004)

26. Contrary to popular belief, the USA did implement some social welfare programmes – such as civil war pensions and widows' pensions – before the New Deal implemented by Roosevelt in the 1930s. These early social welfare policies were in fact greater than European programmes at a similar time, but were marked by one important difference: they were not based on economic-demographic categories, as in Europe, which discriminated in favour of Union soldiers (see Skocpol 1992). There are some parallels here with how war veteran pensions in South Africa and Lesotho were initiated, and later expanded.
27. See Wells (2008)
28. Gough and Wood (2004)
29. See Pryor (1990); Harrigan (2001); Van Donge (2002a, 2002b)
30. Przeworski and Limongi (1997)
31. Tilly (1975)
32. Revenue reform is now central to the whole climate change agenda, since carbon (and other environmental) taxes offer good prospects for correcting environmental externalities (Stern, 2006) and an additional 'dividend' of revenue for pro-poor spending, including protection from the effects of climate change (Sandmo, 2004).
33. Addison and Roe (2004); Gupta *et al.* (2004)
34. Heady (2004)
35. For example, see Ehrhart and Mwaipopo (2003); Ellis and Freeman (2004)
36. Heady (2004)
37. Karingi and Wanjala (2005)
38. Tanzi and Zee (2000)
39. Colatei and Round (2000); Younger (1996)
40. Heady (2004)
41. Addison and Levin (forthcoming)
42. Wiggins (2006)
43. Deininger *et al.* (2003)
44. Wiggins (2006)
45. Moreover, CDCs continue to lag behind all other non-OECD countries, by as much as 5-7% per annum in terms of reducing child mortality.
46. Nick Highton, personal communication
47. Nick Highton, personal communication
48. See Sandmo (2004); Stern (2006)
49. Landau (2004)
50. Addison and Chowdhury (2004)
51. Solimano (2004)