



EMEA WEBINAR

FRAGILE STATES POST COVID-19: WHAT STABILIZATION POLICIES?

Thursday 25 March 2021, starting at 3:00 pm CET

The panel was moderated by **Professor Rym Ayadi**, President of the Euro-Mediterranean Economists Association (EMEA). The panellists were: **Ralph Chami**, Assistant Director, International Monetary Fund and member of EMEA Advisory Board and Author of “Macro economic challenges in fragile states during and post COVID19”; **Raphael Espinoza**, Deputy Division Chief, International Monetary Fund, USA Co-editor of “Macro economic challenges in fragile states during and post COVID19”; **Prof. Robert Klitgaard**, Professor, Claremont Graduate University, USA “Political economy and corruption: Main issues and how to tackle”; **Prof. Thomas Risse**, Professor, Otto Suhr Institute of Political Science, Freie Universität Berlin, Germany”; **Mario Mansour**, Director, Middle East Regional Technical Assistance Centre, International Monetary Fund, USA; **Daouda Sembene**, Distinguished Fellow, Centre for Global Development, USA “What role of trust in a stabilisation and recovery process?”.

Rapporteur: Sara Ronco, EMEA Researcher

INTRODUCTION

The COVID-19 pandemic, lockdowns, travel restrictions and confinement measures have exacerbated inequality, poverty, health and food insecurity in fragile countries and territories. A recent [OECD Report \(2020\)](#) finds that the progress achieved on several UN Sustainable Development Goals (SDGs) have stagnated and/or declined in fragile locations in recent years. The health crisis has impacted income security, health and education. As defined in the report, fragility is “the combination of exposure to risk in five areas – economic, environmental, political, social and security – and the insufficient capacity of the state or system to manage, absorb or mitigate those risks”. The OECD estimates that 23% of the world’s population and 77% of those classified before COVID-19 as extremely poor, live in “fragile” contexts. One year after the global eruption of COVID-19, several countries in the Middle East and Africa are battling with increasing poverty, inequality, job losses particularly women, political and social instability, weaker States and poorer infrastructure. Fragility is a growing plague that materialises in the continuing loss of legitimacy of governments and the near break-up of the social contract, governments’ incapacity to perform essential functions (such as tax collection, public health services and combatting corruption and crime), increased societal divisions, conflicts and discontent and endemic lack of accountability. Understanding issues facing Fragile and Conflict Affected States (FCS) such as political economy, governance frameworks, fiscal, monetary and exchange rate policies, as well as modalities of International Financial Institutions’ engagement with FCSs, is essential to provide the adequate policy answers in a context of shock, such as the COVID-19 pandemic, and to design adequate stabilisation policies. There are policy actions that can help mitigate States’ fragility trends and steer these in a context of shock towards greater transparency via digitalisation, in order to achieve more efficiency in public services, better tax administration and adequately monitored budget spending, more accountability and responsibility – these are the pillars of resilience. However, are these policies workable in the fragile MENA States and in Africa? How can they be implemented to produce the expected results? Is there a role for global coordination to combat the sources of fragility?

[A book on](#) “*Macroeconomic Policy in Fragile States,*” co-edited by Ralph Chami, Member of EMEA Advisory Board and others, covered the challenges of developing and implementing macroeconomic policy in (FCS). This book provides the backbone for understanding multi-faceted fragility and how to mitigate against it via analytical frameworks and case studies. Against this backdrop, the EMEA webinar discussed the increased fragility in the Middle East and Africa, particularly in the context of COVID-19, whilst addressing the political economy issues and corruption, and provides avenues for stabilization policies anchored in fiscal policy, trust, governance and private sector involvement. The webinar questioned the role of international partners, coordination and solidarity to tackle fragility.

Panellist Presentations



Rym Ayadi introduced the webinar by stressing the difficulties that fragile states are having to bear more than others in the aftermath of COVID-19. She underlined that, since the pandemic, fragile states are demonstrating a high risk of failure. In a context of fragility, governments are more exposed to corruption and are less capable of collecting taxes and providing public goods and social protection. Professor Ayadi said that fragility had been enhanced due to the uncertainty related to the pandemic but that the international community could play a key role. She ended by mentioning the book “Macroeconomic Policy in Fragile States”, as the inspiration for this webinar, before introducing the panellists.

Raphael Espinoza started by giving an overview of the book “Macroeconomic Policy in Fragile States” which he co-authored. He said that the book comprised several contributions from different outstanding authors. Mr. Espinoza provided an overview of the main lessons for macroeconomists, learnt from the research provided by the book on fragility and how to deal with it. He started by providing some fragile states characteristics. They are diverse both geographically (African, Middle Eastern, Asian, Caribbean countries) and economically (low income, lower middle income, upper middle-income countries). He said that there are a range of possible different definitions of fragile states. The one used by the IMF is based on the WB classification defining a fragile state as a state having one of two main characteristics, as follow: experiencing a conflict (presence of a peace-keeping or peace-building operation) or having low state capacity, measured by the World Bank Country Policy and Institutional Assessment as below 3.2. Therefore, the list of fragile states they present in the book also considers countries which are not in the midst of a conflict. A peculiar aspect of fragility is being persistent (he highlighted that one of the most powerful predictors for future conflict is having had a conflict in recent years and that state capacity is something which is very difficult to build up). The framework usually taken by macroeconomists to analyse these countries is the poverty trap, which applies not only to poor countries but also to middle income ones (middle-income trap). The overall idea is that it is difficult to move away from a certain level of income. Many theories have been developed around the poverty trap during the last forty years, originating from the earliest development economists. All the theories around poverty

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trap are strongly based on the vicious cycle emanating from a low level of income: low level of investment, high fixed costs, limited resilience, commodity dependence. In analysing fragile states, there is another set of theories that can be called “fragility trap”. Instead of originating from the low level of income as with the poverty trap theories, fragility trap theories originate from the low level of state capacity, implying a poor private sector, ineffective delivery of public goods (including health), weak civic culture, weak accountability mechanisms. In fragile states, the poverty trap and the fragility trap interact and can reinforce each other. He provided the example of three key factors which worsen both poverty traps and their interrelation: fragility worsens the poverty trap because of the cost of violence; economic weakness magnifies the likelihood and cost of state failure (poverty increases risk-taking); weakness of state makes growth more difficult and reduces and resilience to shocks. Mr. Espinoza highlighted that COVID-19 worsened both traps. He then stressed that fragile states face large fiscal and external challenges.

Ralph Chami: As co-author of the book "Macroeconomic Policy in Fragile States", he continued presenting the book's main findings started by his colleague Mr Espinoza. He highlighted the five key lessons coming out of the book. The first lesson is that every fragile situation is peculiar. He stressed the importance of understanding the context as a prerequisite to effectively provide policy advice, tailoring policy design to a country's circumstances (one-size-fits-all approach doesn't work).

The second lesson he raised is the importance of understanding the political and social context, including the possibility of failure (if not, advice could result in pushing countries into failure). Furthermore, he said that the book provides evidence on the importance of finding the pivotal moment for providing advice to fragile states; advice works better in states where there is a kind of "social learning", meaning that society and the government recognise the fragility of the country. The third lesson he provided is the need to sustain patient engagement; the situation on the ground changes frequently and each fragile country has its own timescales which may not accord with others on the outside. The fourth lesson is to avoid searching for an optimum solution but to work with what is on the ground, using the existing institution's expertise in the field as well as local intelligence. The fifth lesson he mentioned is that transition from fragility to a normal state is complex and complicated, involving work within and outside the country. Therefore, the last lesson is that, in fragile states, it is important to provide a concerted effort, to forge a coalition that makes credible agreements to ensure that potential losers do not become roadblock coalitions.

Prof. Robert Klitgaard started by saying that the big message about fragility and COVID-19 is that, as the literature explained, it is not easy since fragility itself is not easy to prevent or overcome. In the IMF book, some average effects, such as aid, are less effective in a context of fragility where corruption is more prevalent and IMF programmes are less effective. He also mentioned other studies that, when it comes to fragility, recall the importance of further research to understand what kind of programme and financing works in these contexts. Therefore, he stressed that a key element is that context matters, and each country has its own context which needs to be understood, representing a big challenge for operators in fragile states. He stressed some principles that always have to be taken into account when operating in fragile states. The first principle is simplicity, meaning designing programmes with only a few key points. He stressed the other principle is "quick win", meaning planning something that works within a concise term (i.e., six months to three years). He mentioned the other important principle is "signalling", meaning to show the programme's link with civil society being involved as local actors, the government, commitment mechanisms with stakeholders (to not reverse policy reform), and emphasise spending in the social sector.

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Lastly, he stressed the importance of showing engagement in the fight against corruption. He continued talking about being context-sensitive, which is a crucial problem in economics when cultural, social and environmental factors are considered to be fixed effects, explained by the model's error term. He stressed the importance of training economists on what worked and what didn't work in each different, specific context. He said several examples of critical situations getting better and of a significant reduction in corruption and perceived corruption (i.e., Colombia 1998, the Philippines 2010). He said the key elements for exiting fragility could be: looking at data, the capacity to look at similar situations improving around the world, and some sort of analytical framework for the analysis of local and international conditions. He concluded with some key messages: stabilisation in post-COVID-19 fragile situations is essential; to understand that there are other similar situations (you are not alone) and successful examples of exiting from fragility are possible); to reframe the problem by focussing on a small bunch of issues to concentrate on first.

Prof. Thomas Risse started by recalling some of the factors already mentioned by the previous speakers (fragility trap and the need to understand the local context). He said that, in his speech, he wanted to focus on the aspect of state capacity to effectively implement, enforce decisions, and provide services. He stressed that it is not easy to understand how to exit from the fragility trap. Also, looking at countries with weak capacities, an enormous variation in service delivery is observable. Fragile states are not ungoverned or ungovernable. Somebody always governs, even if it is not the state but some other actors. Having that level of variation could explain what works and what doesn't, by looking at the different situations and highlighting factors that explain why some fragile states are well-governed whilst others are not. He said that, interestingly, this variation also applies to the case of COVID-19: looking at data for MENA and Sub Saharan Africa fragile states, there is an enormous variation both in the incident rates of COVID-19 per 100,000 people and the case-fatality rates per person. He then explained three key factors explaining differences in governance and delivery of public services from their recent study (pre-covid). The first element impacting enormously is social trust. If people trust each other, they can develop resilience even under adverse conditions and develop a capacity for action even without a functioning state (i.e., Somaliland seems to work better than Central Somalia because of different levels of social integration). The second element he raised is that those delivering services (either government, local authorities, international organisations, rebel groups etc.) have to be accepted by the local population; there cannot be effective governance otherwise. The last point coming out from the research is that governance institutions must be "fit for purpose", adequate for the task itself. But what is not easy is matching the logistics with the need. He mentioned that looking at some indicators for COVID-19, the research reveals that countries with a less individualistic culture responded better to the pandemic. Furthermore, he said that social inclusion increases social trust (if people feel that the institution or whoever provides services is behaving fairly and transparently, social trust itself improves increasing effective governance and a more resilient society, creating a virtuous cycle). He said that the current vaccination campaign against COVID-19 egoistic interests prevailed international efforts to coordinate fair and equal distribution. He stressed that this egoistic/nationalistic attitude is counterproductive and irrational. Africa needs vaccination quickly; otherwise, the mutations will continue to augment, possibly compromising the current vaccination campaign.

Mario Mansour began by illustrating a few indicators focussing on revenues, since he thought they have a significant role in building states and fund government spending. In 2017, about 7.3% of the global population living in fragile states, produced less than 1.5% of the GDP, denoting a noticeable disparity between shares and portions of the population. Fragile

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states raise 14% of tax in GDP compared to other low-income countries that are not fragile. In the MENA region, fragility is generally highly correlated to oil production, putting the tax in the GDP of the region at less than 10% of GDP in most cases and, in some cases, as low as 2% of GDP. The major correlation between oil and fragility means that fragile states are much more exposed to volatility in oil prices, in terms of fiscal policy adjustment/stabilisation and even in terms of long-term projects. They observed that countries exiting from fragility during recent decades had a tax over GDP ratio of at least 15% (i.e., higher than most MENA countries and corresponding to the IMF definition of the "tipping point ratio", the ratio below which you are unlikely to grow at a decent rate and unlikely to be able to build strong institutions). He thought those indicators should always be kept in mind for people working with fragile states. He then moved on to talk about the state's capacity, referring to the IMF book presented during the webinar which he co-authored. One of the key messages he wanted to stress is that building the speed of fiscal institutions has to be consistent with the speed of political change and commitment. He added that, whether fragility is often considered endogenous, he thought that it is not at least in the early stages (i.e., in conflict countries or countries devastated by natural disasters). He believes that, in these cases, fragility should be taken as given and to advise the government on what to do with fiscal policies and fiscal institutions. He, therefore, presented a two-step approach, as reported in the book. The first one is for conflict/natural disaster countries. The second one is for countries exiting from phase one, still fragile but relatively stable in terms of the political system. At the first stage, Mr Mansour and other co-authors suggest concentrating on the softly-softly collection of taxes. Policies should be consistent with the situation and possibly with the government. They suggest a very small number of taxes with very few tax rates: tax bases that are easy to access (no sophisticated taxation schemes that institutions cannot value). They suggest trying not to have exceptions because it would be the basis for increasing corruption. In most fragile states, particularly at the end of the first stage, mining and oil companies, telecommunications, and the banking sector will tend to approach the market. All these sectors tend to have high economic rents that deserve more attention in taxation design. On spending, they observed that establishing budget credibility by controlling budget preparation and execution on a cash basis, reporting inflows outflows, is highly efficient in providing credibility. At this first stage, he said it is better to avoid large and expensive institutional reforms (i.e., buying expensive IT systems). He said it's important to protect wages (the biggest door to government corruption in fragile states) in the composition of expenditure. He then said it is also important to review all public investment, making a complete list of the government's assets. In the second stage, the medium-term perspective become important. Again, he repeated that plans should not be complicated, proposing something like a 2-3 year indicative budget. Policymaking at this stage should be based on efficiency, equity, transparency and design. During this second stage, they propose thinking about a broad base of taxation (i.e., as has happened in North Africa, the reform should be gradual and slow, from retail sales taxes on goods to value-added taxes on goods and services). Fiscal institutions need to adopt more significant reforms during this stage and be ready to take on policy design and implementation, investing heavily in IT and risk management approaches. On the spending side, they would suggest going for a global PFM law to oversee everything that the budget does, regulate how the budget is done, implement a supplementary budget during the year, etc. Lastly, he highlighted some key final lessons: design a simple set of priorities and pay attention to the speed of reform (take your time and keep it simple); keep a medium-term perspective as soon as the country is ready to move to it; avoid relying on taxes coming from natural resources; more attention should be given to customs collection.

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Daouda Sembene started by analysing the role of trust in the exit phase from fragility. He wanted to stress that fragility is a big issue, particularly in Africa. Raphael mentioned that there are 40 countries considered to be fragile globally, 18 of those are African countries, representing around one out of every three African countries. COVID-19 has aggravated the situation in these countries and he said that trust could play a key role in recovering from the pandemic and stabilising these countries. In fragile situations, adequate government access to the vaccine is vital and, so far, this is a failure we are witnessing worldwide. He said that less than 2% of the African population had been vaccinated, according to mid-March CDC Africa data. He underlined that vaccinations had been distributed to countries in Africa that are not fragile. The lack of vaccination in fragile states means that stabilisation and recovery will be slow. The priority of ending the spreading of COVID-19 in fragile states is also, in most cases, accompanied by the importance of ending conflicts and empowering government capacity. He moved to analyse the role of trust in building recovery in a fragile state. Trust is vital to have good pandemic management – especially if citizens don't trust government, don't respect containment measures or take the vaccine when available. He mentioned the chapter of the IMF book that he contributed. It analyses how trust matters for revenue collection because, if taxpayers do not trust tax authorities, taxpayers will not comply with tax legislation. The same applies to fiscal and monetary policies, therefore general stabilisation and recovery policy. He stressed that trust is a crucial pillar for any social contract; consequently, it is key for building political stability, which is the necessary basis for creating economic stabilisation. To build trust, he said, the literature suggests addressing the sources of political illegitimacy, addressing corruption, increasing social and financial inclusion and political economy issues. He concluded by underlining some key factors for building trust and helping fragile states exit from the fragility: promoting political legitimacy and good governance, addressing inequality and social exclusion, showing some strong results in addressing corruption, strengthening transparency and accountability, and enforcing the rule of law.

Discussion

Cinzia Alcidi stressed the importance of the points raised during the discussion, mainly referring to the international community intervention recommendations for fragile states. She emphasised that policy interventions in fragile states are likely to fail when first implemented and understanding the critical weaknesses of specific countries is key. Furthermore, she stressed the importance of understanding how the political environment works; another fundamental point raised during the webinar, a game-changer for any programme's success or failure. She then emphasised that culture is very relevant and changing cultural mindset is tough (i.e., providing incentives to pay taxes in a context where no one is used to paying them). Non-economic factors are determinant for successful or unsuccessful changes in a country. She concluded by putting three questions on the table:

- 1) On the role of international communities: who, how, when and for how long should international communities intervene, in which context and with which tools? Should it be more traditional technical assistance or financial assistance? And when should financial assistance go towards debt relief?
- 2) On commodities: Why is it a problem that an important endowment of commodities usually characterises fragile states?

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- 3) On political regimes: To what extent could there be a correlation between the kind of political regime and management of natural resources and how can this be improved?

Ralph Chami wanted to recall something stressed during the panel session and in the book which was presented: the importance of understanding (when you are an institution in a fragile country willing to give advice) the pivotal moment for intervention and providing suggestions to stakeholders in the countries. People in the country of interest should be ready to listen; otherwise, it wastes time and resources and could even be counteractive (he stressed that aid in certain circumstances could worsen things). Another point he wanted to recall was the importance of IFIs to coordinate their efforts in order to make an impact, avoiding overburdening institutions in the fragile state in which they are operating. He then highlighted that the COVID-19 impact is a very different situation from a macro perspective; with COVID-19, many fragile states have seen their exchange rates depreciate, or they have had to devalue - different to what used to happen with other crisis. With COVID-19, these states haven't been able to absorb the shock in the medium term.

Prof. Thomas Risse wanted to highlight that a handicap of International Financial Institutions (IFIs) and international organisations is having to work through the state. When working with fragile states, they are likely to find corrupt people there. The rule of law is often weak and political culture prevails. He added that, in his opinion, the interventions from the international communities should not be long-term ones. He stressed that he thinks it would be essential to move away from the state-centric view, both for external actors and internal ones. He concluded by highlighting the importance of social trust.

Mario Mansour wanted to recall the heterogeneity of fragility, highlighting that there is also a significant heterogeneity across institutions in fragile states, and leadership is critical.

Daouda Sembene stressed the need for international communities to help fragile states recover from the pandemic and exit from fragility through fair distribution of vaccines and help in conflict resolution. He said that the international community should engage in more institutional building. Lastly, he wanted to underline that culture matters but, in many cases, like with paying taxes as raised during the panel session, what trust is there in institutions and enforcement measures.

Rym Ayadi raised the question of the role of the private sector in exiting from the fragility trap.

Ralph Chami answered Professor Ayadi by saying that the private sector has a role in helping fragile states and there is a chapter on this in the book. Typically, the private sector in fragile states is not empowered and usually can't ease the state out of fragility. Furthermore, he stressed that in most cases, the private sector in fragile states is connected to the institutions in power and is profiting from the fragility. Hence, the private sector in fragile states needs to be connected to the external world through the trade sector.

Ralph Chami wanted to add that most of the private capital comes in the form of FDI for specific projects in the private sector capacity, so the way they interact with local authorities is critical. He wanted to highlight different ways of overcoming culture impediments to change: the leaders' capacity to communicate and think about specific areas in which to operate.

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Rym Ayadi highlighted the importance of furthering research on the topic discussed during the webinar. She then launched a poll to the audience, from which the following resulted:

- the most important elements for state fragility in the Middle East and Africa are political instability and corruption
- the factors of state resilience in the Middle East and Africa are accountability, transparency and trust.

She thanked all the participants, inviting them all to the next EMEA webinar on debt transparency and PPP in the Middle East and Africa.