

# Failed States, Vicious Cycles, and a Proposal

**Raghuram G. Rajan**

## Abstract

Rajan examines the problems of failed states, including the repeated return to power of former warlords, which he argues causes institutions to become weaker and people to get poorer. He notes that economic power through property holdings or human capital gives people the means to hold their leaders accountable. In the absence of such distributed power, dictators reign. Rajan argues that in failed states, economic growth leading to empowered citizenry is more likely if a neutral party presides. He proposes a unique solution to allow the electorate to choose a foreigner, who would govern for a fixed term. Candidates could be proposed by the UN or retired leaders from other countries; they would campaign on a platform to build the basic foundations of government and create a sustainable distribution of power. Rajan emphasizes that this is not a return to the colonial model—the external candidate (like all the others) would be on a ballot and the electorate would choose whether he or she was their best chance to escape fragility.

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## Foreword

I am delighted to sponsor this paper by Raghuram G. Rajan, Eric J. Gleacher Distinguished Service Professor of Finance at the University of Chicago's Booth School of Business, and an economic advisor to the prime minister of India. Rajan's work provides insight into the vicious cycles of leadership in failed states and offers a unique proposal to jumpstart a country which has emerged from conflict or natural disaster.

Rajan examines the problems of failed states, including the repeated return to power of former warlords, which he argues causes institutions to become weaker and people to get poorer. He notes that economic power through property holdings or human capital gives people the means to hold their leaders accountable. In the absence of such distributed power, dictators reign. Rajan argues that in failed states, economic growth leading to empowered citizenry is more likely if a neutral party presides. He proposes a unique solution to allow the electorate to choose a foreigner, who would govern for a fixed term. Candidates could be proposed by the UN or retired leaders from other countries; they would campaign on a platform to build the basic foundations of government and create a sustainable distribution of power. Rajan emphasizes that this is not a return to the colonial model—the external candidate (like all the others) would be on a ballot and the electorate would choose whether he or she was their best chance to escape fragility.

This paper provides a novel solution to the problem of failed states; one that is worthy of serious consideration by policymakers. Rajan does not condemn states to failure, rather he proposes that the people can govern themselves if they are provided with conditions that would create stable institutions. Past international interventions and traditional dialogue have yielded few results. This proposal by Rajan provides much-needed innovative thinking and a radical solution for states stuck in the cycle of failed leadership and extreme poverty.

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The scenario is depressingly familiar in some parts of the world. A civil war ends. The battling warlords, having exhausted their resources, agree to elections. The people, having endured years of rape and pillage, go wild with joy. But their choice in the United Nations-monitored election is really between parties set up by former warlords, because no one else has the money, the muscle power, or national recognition to compete with the two. One wins, and then proceeds to destroy the few state institutions that curb his power even while he uses the instruments of the state to pick off his opponent. Once that is done, he proceeds to loot the country under one-party rule until an opposition eventually organizes. Since elections have now become a farce, the opposition has to resort to force to overthrow him, and the whole cycle resumes. The people get poorer and poorer, kept from starving only by handouts of international aid. The lucky leave while the unlucky endure.

The world rightly believes it should do something. But what can it do, some ask, if people are incapable of governing themselves?

The premise of this question, I will argue, is wrong. It presumes there is something wrong with the people. Yet studies indicate that there is little in a people's ethnicity or religion that makes their countries succumb to conflict. The problem has far more to do with economics. A comprehensive World Bank study finds that "if a country is in economic decline, is dependent on primary commodities, and has a low per capita income and that income is unequally distributed, it is at high risk of civil war".<sup>1</sup>

Why might there be a link between these economic conditions and the failure of governance? And how can the outside world break the vicious cycle where countries are trapped in conflict – where a country that ends a civil war has a 44 percent chance of returning to conflict within five years?<sup>2</sup>

## **The role of the economic environment**

Recent research in economics indicates that more than culture or ethnicity, a good institutional environment, which protects the contractual rights, opportunities, and the property of the individual against the powerful is key to explaining how countries attain a path of long run sustainable economic growth. Since the absence of constraints on the powerful also characterizes failed states, it should not be surprising that poverty and the failure of states have common roots.

But then where does a good environment come from? One answer is that it is simply a matter of design: there are certain systems of government that bring out the best in the rulers and the ruled, while there are others that are poorly designed.

For example, a number of studies have shown that former colonies that inherited an English Common Law tradition from their colonial masters seem to have better

institutions of governance today than countries that inherited a French Civil Law tradition. Though there is much controversy about the inferences drawn from these studies, the notion is that Common Law somehow does a better job protecting the rights of the ruled.

A different but not unrelated view is that it is not so much the colonial origins of a country's laws that matter but the attitude of the original colonizers: if a colony's hospitable environment attracted a large number of Western settlers, they adopted rules of governance that treated everyone equally. But when they settled only in small numbers because of the inhospitable unhealthy environment or a large pre-existing native population, the colonizers adopted an exploitative form of government. According to this view, the nature of government initially adopted has carried over to today – typically democratic and nurturing in the temperate parts of the world while authoritarian and exploitative in the tropical, disease prone, areas of the world.

One way of interpreting these studies is that certain “blueprints” adopted in the past – whether they be laws or wider institutions of governance -- are better than others and influence the quality of government today. Perhaps then, all failed states need is to adopt the right blueprints – the best constitution and institutional forms -- much as firms adopt best practices from their competitors.

Yet the history of Liberia suggests blueprints are not enough. The 1847 Constitution of Liberia was based on the ideals of the American Constitution of popular sovereignty, separation of powers, and limited government. In some ways, it was more progressive in that it protected women's rights and abolished slavery. Yet a League of Nations report in the 1930s found that Liberia “represents the paradox of being a Republic of 12000 citizens with 1,000,000 subjects”. It deplored the unsanitary conditions under which much of the tribal African population lived, termed its financial situation “tragic” and its monetary system “confusing”. Despite some improvement in the middle decades of the twentieth century and massive infusions of foreign aid, Liberia has not been a model state to put it mildly.

This suggests that we need something more than the right blueprints. There is something overlaid on the blueprints that gives them the force to constrain rulers in some situations and makes the blueprints completely irrelevant in others. One candidate is tradition. Perhaps the original blueprints, seasoned with age, become much more binding. Yet after World War II, Germany and Japan overcame their authoritarianism and became market democracies. Japan is particularly interesting because it stayed that way after the post war occupation even though it was not enveloped through various pacts with democratic neighbors, unlike Germany.

Something more changeable than historical antecedents, yet with some degree of persistence, is needed to explain why institutions constraining the government had force in post-war Germany and Japan but not in Liberia. A natural candidate is the distribution of economic power.

While not undisputed, there is a historical line of thought suggesting that an environment capable of constraining the powerful emerges only when a significant share of the population has economic power through their property holdings or their human capital. When economic power is widespread, the people who individually need the protection afforded by institutions such as an effective police force and an impartial judicial system collectively have the political power to give them teeth. This then suggests one reason why states that fail tend to continue to stay failed – they simply do not have the distribution of economic power that will sustain the environment needed for growth. In turn, because they do not produce economic growth, they do not allow an appropriate distribution to emerge – in other words, a vicious cycle emerges.

Put differently, institutions such as the judiciary, without an appropriate distribution of power backing them, are useless. Take, for example, the protection of property. Warlords have their own private armies to protect their property. They don't need enabling institutions like fair courts or helpful policemen. By contrast, middle class professionals or small entrepreneurs cannot individually buy their own protection – they have to appeal to courts or rely on policemen if their livelihood or property is threatened. Collectively, however, if they are sufficiently numerous and well organized, they have the political and economic might to make sure the institutions work. Whether it is through political parties or the press in more civilized environments, through strikes and tax boycotts in less civilized ones, to funding their own militia in anarchic environments, an organized gentry has the power to check arbitrary rule.

This means, for example, that too much ownership concentration is inimical to the broader protection of property, because large powerful owners can protect their interests without a fair and objective judicial system, and so they have no interest in developing one. Indeed, they often have an interest in preventing its development so they can continue their privileged violations unimpeded. But an overly dispersed ownership structure is not conducive to the protection of property either, because each owner is extremely weak and coordination is very difficult.

England achieved a delicate balance in the 16th century following the expropriation of large landowners and the widespread sale of land that took place under Henry VII and Henry VIII. This created a powerful gentry, who were neither too powerful individually to dispense with the law nor too weak collectively to demand its enforcement and to withstand the monarch's depredations. Not only did the United States

import this economic structure from England, it actively promoted it. Americans like William Penn and Thomas Jefferson were deeply influenced by the British philosopher James Harrington, who in his 1656 book, *Oceana*, argued in favor of a more equal distribution of land ownership, which he saw as the key to England's success.

In these modern times where human capital is increasing in importance, broadening access to education and skill acquisition offers another route to spreading economic power. Since human capital is hard for a government to expropriate, it is more secure than physical property. And when it is appropriately combined with physical property, as in the case of farmers who know how to exploit their land better than anyone else or entrepreneurs who know how to produce more value with their machinery than others, human capital can enhance the value and security of the physical property: when physical property is managed well, even predatory governments have a far greater incentive to tax it lightly rather than expropriate it and kill the proverbial goose. More important, the latent political power embodied in the citizenry serves to check the growth of arbitrariness.

### **Why failed states have the wrong distribution of economic power**

Whatever the original reasons for why a state descends into anarchy, the natural tendency is for it to emerge from conflict with a very skewed distribution of economic power. Prolonged conflict tends to result in the complete expropriation of the entrepreneurial class. The professional classes who can flee the country do so, while the skills of those left behind deteriorate through disuse. The young do not acquire a proper education, which leaves them ill-equipped to contribute economically. Violence is the predominant currency, and the ability to inflict it is the sole skill of many.

In this environment, traditional sources of economic power collapse, leaving natural resources as the primary sources of wealth. Since these will be controlled by the strongest thug, who typically also runs the government, there tends to be little countervailing power outside of it. Hence the vicious cycle of war, exhaustion, peace, elections, dictatorship, and finally war again persists in the failed state.

If this is a correct diagnosis, the outside world cannot endow a failed state with blueprints or skeletal institutions – a constitution, laws, a newly-hired police force – hold elections and then leave it to its own devices. This is not to say that the people of the state cannot make reasonable choices when asked to vote. The problem is that the only powers left in the state are warlords and knowing the institutions of the state are weak, they have to destroy the others or be destroyed. Anyone in power has no incentive to foster institutions that would constrain themselves. So the state will always be stalked by dictatorship or conflict.



To have some semblance of a chance then, the state needs both institutional blueprints and the right distribution of economic power. Japan's post-World War II success in moving to a market democracy was not just due to the constitutional reforms imposed by Douglas MacArthur, but also due to his sweeping economic reforms. Before his reforms, land holdings in Japan were concentrated and economic power was held by a few large industrial and financial combines called the Zaibatsus. MacArthur saw these agrarian and industrial elites gave backbone to the Japanese Nationalist Government, which had taken Japan to war. For this reason, he tried to undermine their power. The post-war land reforms did expand and widen the land-owning class, in the process fostering an agricultural revival, and making Japanese democracy more stable. But even though MacArthur started to break up the Zaibatsus, he did not have the necessary time to carry it out. The need for reliable suppliers during the Korean War forced the government to compromise with the Zaibatsus.

Nevertheless, MacArthur accomplished a lot. In part, he was helped by the complete collapse of Japan and the utter exhaustion of its people. There was virtually no armed resistance to the occupying authority. The Japanese held their domestic elites responsible for initiating and prolonging the disastrous war, and attempts to cut them down to size were not resisted, and even welcomed by the citizenry. In some ways, these initial conditions reflect those of failed states.

## **A possible solution**

How does one break out of vicious cycles? Clearly, by temporarily altering conditions so that the chain of causality can be interrupted. In failed states, one clear point of intervention is when peace breaks out, however temporarily.

These states need a period of peaceful economic growth, growth that will provide incentives for predators to turn to productive activities, growth that will increase the ranks and the power of those with a stake in a good institutional environment, growth that will attract back those who have emigrated in search of safety and opportunity. While it is believed that a good institutional environment is needed to facilitate growth, growth itself can create a domestic constituency powerful enough to demand and sustain the good institutional environment.

How does one restart growth? The problem with electing the warlord politician is that because the constraints on naked exercise of power are so weak, he has far more to gain by attempting to decimate his rivals before the next election than by doing good for the people. As a result, he is not trusted by his rivals, so they do not disarm. The election is simply an interlude before the next outbreak of war.

Would it not make more sense then to give the people of a “post-conflict” state a real choice when they are asked to participate in elections? Instead of having to choose between equally thuggish homegrown politicians, what if they could also choose a more neutral group that has a proven record of providing good governance?

One possibility is for the outside world to support some good domestic or expatriate politician with funds and security. If this politician and her supporters could provide good governance for a while so that an alternative distribution of power could emerge, then the country could have a real chance of breaking the cycle.

The problem is that power corrupts. In an atmosphere of limited countervailing power, how will the “good” politician resist the temptations that even Caesar was not immune to – that of becoming dictator for life after a few years of good work? If the incumbent politician decides to ignore the outside world and abolish elections, the outside world may have little ability to intervene. Homegrown dictators cannot be deposed without accusations of intervening in the sovereignty of the country.

Even if the outside world can guarantee not just the first election but also the second (and maybe the third) it may not be enough. There are other ways the incumbent can ensure permanence – for instance by getting rid of rivals. Anticipating this, rivals will keep their powder dry, and there will be little hope for peace again.

One alternative, which would create the right incentives, is for foreigners to govern initially. The virtue of outsiders is not that they are intrinsically any better but that they can be easily pushed out by the outside world if they overstay their welcome. In many ways, MacArthur’s success in Japan was because he could not stay as pro-consul for life, and had little incentive to create power structures that would ensure that. Moreover, knowing that the outsider is neutral and will not strive for permanence, the rival warlords have more of an incentive to lay down arms and lead their bands into more productive activities.

The manner in which these foreigners come to govern is key to their legitimacy and success. They should be voted in by the people (and this is critical in distinguishing my proposal from recent events in Iraq and from older colonial notions of trusteeship). It recognizes that the problem is not with the people or their ability to choose but with the incentives of those they are typically forced to choose amongst in the anarchic environment that characterizes a failed state. By expanding that choice set, perhaps the vicious cycle can be broken.

This idea is not as controversial as it might first seem. In many failed states, outsiders in the form of the United Nations, official aid agencies, and non-governmental organizations (NGOs) already run much of the infrastructure. We now even see the UN draw on private security forces to perform the role that belonged in the past to military

forces supplied by member nations. Unfortunately, these outsiders have little control over the instruments of the state (and thus little responsibility for outcomes), which prolongs the country's dependence indefinitely.

Would it not be better to recognize the problem as the lack of good incentives and tackle it directly? The devil, as always, is in the details. What states would be candidates, who would choose the outsiders, who would determine their scope of action and the length of their stay, and what would ensure they would leave?

## **Some details**

One should not minimize the legitimate concern that unless precisely defined, the mechanism would be a way for powerful nations to get rid of inconvenient or unconventional regimes. To narrow the scope for intervention, perhaps the focus could be on small countries where there is little chance of making things worse, countries where the United Nations has to intervene to quell a prolonged and widespread state of conflict. Ultimately, however, while one can think of checks and balances to prevent abuse of the process (see below), the primary guarantor of legitimate intervention is the court of international public opinion.

The official representative of this court is the United Nations, so the process should obtain legitimacy by operating under its aegis. Perhaps all one needs to do is to offer the country a choice on the ballot of rejecting all domestic candidates and opting for rule by a United Nations administrator. However, bureaucrats need not govern well, however good they may be at carrying out instructions. On the other hand, because good governance is a public good, it will not easily be provided by private entities. This suggests some intermediate solution: the United Nations could pick a leader (or better still, two, to ensure competition) and channel funding to him or her. It could do worse than choose among the energetic, successful, but perforce retired politicians of countries that have term limits.

Politicians are particularly appropriate because their role will not be just to set up the blueprints but also convince the citizens of the merit of their proposals – in effect, secure their legitimacy. The leader would select his team, choose a reasonable platform, and campaign.

Clearly, it would be sensible to choose a leader who knows the country and its problems well. At the same time, there are good reasons why the leader and his main associates should not be from the country itself, and preferably not from a neighbor. Distance minimizes prior bias, making the leader more acceptable to the warlords. It also minimizes the leader's ability to stay on past his term, as suggested earlier. A foreigner will be clearly identifiable, and his legitimacy far more easily questioned by the outside

world than an overstaying citizen. At the same time, given sensibilities about colonialism, the foreigner may be more acceptable if from a developing country than a developed country.

The electorate will vet the leader's initial platform. Much of it could be based on a common minimum program that all such external parties would be bound to. This means, for example, that he should create an effective judicial system to enforce property rights and the rule of law, build the basic organs of government like public services and taxation, ensure access to primary and secondary education and basic healthcare, and build the infrastructure for decent transportation and financial systems. It also means that he should be discouraged in attempts to dramatically alter the distribution of property by force, other than to reverse clearly illegal expropriations of the recent past. The intent of his administration should be to alter the distribution of economic power to a more sustainable one, not by power grabs as in the past but by improving incentives for effort and expanding access to opportunities and resources.

But elected officials do depart from their manifestos. Given the nature of the outside leader's mandate, however, it makes sense to limit his program to one that is enabling and moderate rather than one that is revolutionary. To check any excesses, an international court or an international parliament (potentially with some domestic representation) could have oversight. Furthermore, decisions of national importance like the enactment of a constitution or membership of a free trade region should be put to a public referendum.

It may not take long for change to take place provided the program has credibility: such an environment could attract back émigrés, thus creating strong foundations for distributed economic power. At the same time, one should give the process enough time to gain deep roots. Somewhat arbitrarily, a seven year mandate might be appropriate. While the initial leader should have only one term, the people could be asked to vote in a referendum at the end of this period whether they want the process to continue with a fresh set of outside choices at the next election.

Finally, while we have already alluded to conflicts of interest if locals are involved in the highest ranks of government, their involvement everywhere else should be encouraged. In particular, while retaining control over the broad framework of governance, the outside leader should also encourage decentralization and local self-government so that people gain experience in self-rule. Thus the institutions necessary for democratic functioning would be built bottom up.

## **Obvious concerns**

There are, of course, a number of concerns that come to mind. Is this a new form of colonialism? Clearly not! The new rulers will be voted in by the people and unlike colonizers of old, will have a clear mandate to foster institutions and a clear expiry date for their government.

Will the people not reject outside rule out of hand? After all, don't people want to be ruled by their own kind? This may well be true if one associates outside rule solely with the sorry record of colonialism. Yet in modern times a significant portion of the world's population have accepted rule by outsiders in preference to rule by their own – we call this voluntary choice immigration. Instead of people voting with their feet to where governance is enabling, I am advocating a process of moving governance to where the people are. If the cost of better opportunities is a period of rule by outsiders, people have shown they can tolerate it. After all, self-determination is the freedom to choose one's government, not rule by one's own kind.

Would the warlords accept rule by outsiders and disarm? Perhaps! They may understand disarmament under a neutral party offers them the best protection against other enemies. Nevertheless, some coercion and external monitoring may be needed, both to get the initial plan accepted, to ensure elections are free, and to disarm the warlords in the event of an outsider electoral victory. This is why international backing is so important.

Finally, am I missing the root problem with failed states – is the true problem that there is too little government capacity rather than bad incentives for those governing? I think the two are linked. Poor governance has chased away capable people and destroyed the human capital of those that remain. But a credible assurance of good governance could bring back those who have fled, improve incentives of those that remain, and with that, the capacity to govern. That said, I do not want to underplay the time and the external resources needed to put these states back on the right track. Failed states are not rebuilt in a day, or even a year, and the outside world must find the necessary patience and commitment to help the people of these countries.

There are no good precedents for what I have proposed. The United Nations Transitional Authority in Cambodia (UNTAC) effectively ruled the country till its first post-Khmer Rouge elections, but the intent of UNTAC was to depart as soon as possible. Thus it does not offer an appropriate template. Neither do most of the “mandates” under the League of Nations, where mandates were either virtually self-governing (e.g., Iraq) or virtually colonies of the mandatory powers (German South-West Africa). But there is certainly increasing involvement of outsiders in domestic governance in this

interconnected world. If foreign management can be hired to run firms, if foreign consultants can be hired to revitalize police forces, if naturalized immigrants can run governments, with the appropriate checks and balances is it unthinkable that some day we would look to the best talent in the widest possible pool for the most important job of all?

## Conclusion

The idea proposed in this article may bear a resemblance to ones that have been floated before.<sup>3</sup> But there are key differences. Instead of attributing the failure of states to the inability of certain people to govern themselves – a notion that is both offensive and untrue – failure is more appropriately attributed to the absence of institutions and the conditions that would naturally lead them to be developed. This means that any solution can rightly rely on citizens voting and offering guidance periodically on important issues while at the same time ensuring that powerful interests do not hijack the government. When coupled with the ability of citizens to appeal to international authority if the experiment sours, a proposal such as the one outlined may well give citizens a chance to turn around their country.

There are no panaceas for the problem of failed states. There will, of course, be better ways of attempting what I have proposed. But the outside world has to try new solutions. In this era of growing world integration, the frustrated young man in a failed state affects the comfortable citizen in a developed country in a variety of ways, ranging from the benign, immigration, to the malign, terrorism. Just one statistic should be enough to make the point: approximately 95 percent of the world's production of hard drugs occurs in countries with civil wars. Instead of erecting fortresses against these young men, would it not be more cost-effective to attempt to ameliorate their lot? Even if we do not see the moral imperative of rescuing those still living in a Hobbesian world, we should see our self-interest in doing so. Future generations will not forgive us if we do otherwise.

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<sup>1</sup> p 4, *Breaking the Conflict Trap: Civil War and Development Policy* World Bank Policy Research Report by Paul Collier et al. 2003. Also see "Postmodern Imperialism" by James Fearon and David Laitin, Working paper, Stanford University.

<sup>2</sup> P82, Collier et al.

<sup>3</sup> See, for example, "Saving Failed States" by Gerald Helman and Steven Ratner, *Foreign Policy* 89, Winter 1992, 3-18, who argue for a UN conservatorship, and "Failed States and Shared Sovereignty" by Stephen Krasner, working paper, Stanford University, who argues for a form of shared governance in certain areas.