Institution: London School of Economics and Political Science		
Unit of Assessment: 16 - Economics and Econometrics		
Title of case study: State capacity: crafting effective development strategies		
Period when the underpinning research was undertaken: 2007-2018		
Details of staff conducting the underpinning research from the submitting unit:		
Name(s):	**Role(s) (e.g. job title):**	**Period(s) employed by submitting HEI:**
Tim Besley	School Professor of Economics and Political Science	1995 to present
Torsten Persson	Centennial Professor	1999 to present
Period when the claimed impact occurred: 2015-2020		
Is this case study continued from a case study submitted in 2014? No		

1. Summary of the impact (indicative maximum 100 words)

Professor Tim Besley has published extensively on the role and origins of state capacity, envisaged in his work as both the legal and the fiscal capacities of states. His research has underscored the need to place political economy at the centre of policy thinking about these things. It has made a significant contribution to improved understanding of the nature of state development and the causes of state fragility. It has also had an important influence on the work of multi-lateral agencies such as the European Bank for Reconstruction and Development (EBRD), International Monetary Fund (IMF), and World Bank. The research has particularly informed these agencies' engagement with poor and transition countries, as they help them build sustainable growth strategies reflecting the vital importance of building state capacities.

2. Underpinning research (indicative maximum 500 words)

Research conducted at LSE by Professor Tim Besley has documented the role of state capacity as a central pillar of growth and development. It has addressed five key questions:

- What role does state capacity play in building effective government?
- What forces shape incentives to build state capacity?
- How does building state capacity support markets?
- What role does investing in state capacity play in establishing security and reducing conflict?
- How does capacity build resilience to shocks?

The research responding to these questions provides an integrated understanding of the multiple dimensions underpinning the development process, highlighting the roles of both state capacity and institutional change in this. It was published between 2007 and 2011 in a series of papers (**[1]**-**[4]**) and a monograph **[5]**, which developed an overarching narrative and demonstrated wide-ranging applications of the ideas published in **[1]**-**[4]**.

Developing a theory of state capacity: Besley and his co-author Torsten Persson (Centennial Professor at LSE; also Swedish Research Council Distinguished Professor, Stockholm University) started their work on the development of a theory of state capacity by trying to understand differences in countries' experiences of building that capacity **[1]**. This led to an approach that was fully developed in their monograph **[5]**. State capacity is envisaged here as the ability of the state to support markets and enforce contracts (legal capacity) and to raise revenue (fiscal capacity). This theory brings together investment in state institutions, political violence, and economic growth. One key insight is that the existence of common interests among groups in society - based either on preferences for public goods or cohesive political institutions - is conducive to strong incentives to invest in state capacity. Conversely, investment in state capacity is discouraged by long-standing grievances between societal groups, which create social cleavages and oppositional identities between citizens.

The stylised problem studied in the core framework is the division of state revenue between broad-based and narrowly-targeted programmes. In the absence of institutional constraints on the executive, politicians tend to allocate more resource to their own "in-group" (e.g. selective investment in infrastructure in locations populated by their supporters), to the detriment of broad-based programmes benefiting all groups in society (e.g. a national healthcare programme). Less cohesive institutions allow the state to be run more in the interests of a narrow segment of the population; this weakens the motivation to improve the core functions of revenue collection and market support. When institutions are not cohesive, political instability shortens the time horizons of governments and diminishes incentives to invest in state.

There is a sizeable existing literature on state capacity in historical-sociological research, looking at economic development through this lens and linking political economy to comparative development. The novel approach in Besley's research was to identify state capacity as key to institutional differences, both in income and in levels of political violence.

Political instability and political violence: it has long been observed that civil wars tend to arise in low-income countries with weak executive constraints. In **[2]** and **[3]**, Besley and Persson use the framework described in **[1]** (and **[5]**) to consider incentives for political violence and how this can create political stability. States whose institutions are cohesive typically make little use of political violence. Where institutions are not cohesive, political violence is used by governments as a tool to maintain power. This can result in stable repressive states which have some incentives for building state capacity. However, when it leads to contested power and civil war, this is not conducive to state capacity-building. The framework developed here (particularly in **[2]**) to study political violence and state capacity can be used to provide a wider understanding of what makes states effective in maintaining a social order and delivering its core functions.

Development clusters - state fragility as a multidimensional symptom of under-development: the framework described in **[1]** and **[5]** also shows how economic and political factors combine with cohesive political institutions as a common factor in reducing political violence and building state capacity. In **[4]**, the approach in **[1]**-**[3]** is used to shed light specifically on state fragility, characterised here as the clustering of weak state capacity, low income, and political violence. State fragility is a key symptom of under-development that had been insufficiently studied in mainstream development economics.

Also in **[4]**, Besley and Persson drew on work published in **[1]** and **[3]** to propose a framework for analysing fragile states. In an ineffective state, few investments are made in fiscal and legal capacity; in a violent state, the government and opposition invest in violence to maintain or acquire political power. A common interest in providing public goods, fostered either by circumstances or cohesive political institutions, can eliminate both of these problems. However, when institutions are non-cohesive, either pathology may emerge. The model supports analysis of the conditions for their emergence, thereby contributing to understanding of the roots of state fragility. In highlighting the multidimensionality of under-development, the framework set out in **[4]** avoids excessive emphasis on income and brings a focus on state ineffectiveness and political violence as aspects of development. It provides a way of thinking about state fragility as a locally stable equilibrium.

The LSE-Oxford Commission on State Fragility, Growth and Development: the LSE-Oxford Commission on State Fragility, Growth and Development (hereafter "the Commission") was established in 2017 under the academic direction of Besley with Professor Paul Collier (University of Oxford) to inform effective approaches to addressing state fragility. The Commission presents fragility as a multidimensional syndrome, an under-development cluster with mutually reinforcing characteristics that entrap economy and society. Outputs of the Commission underpinning impacts described here include *Escaping the Fragility Trap*, published in 2018 to provide actionable recommendations to address state fragility **[6]**. The report sets out clearly the characteristics of fragility, looks at the wider consequences, and recommends a new approach to state fragility and international aid. As well as being a co-author, Besley's work with Persson on development clusters **[5]** forms the analytical underpinning for *Escaping the Fragility Trap*. A key insight of the Commission's work, reflected in **[6]**, is that state fragility remains because there are vested interests in maintaining the status quo. Without addressing these incentive problems, for which the state capacity framework is useful, it is impossible to understand how progress can be made. The Commission also emphasises the need to recognise a lack of state capacity as one of the reasons for a weak private sector and low levels of private investment.

3. References to the research (indicative maximum of six references)

[1] Besley, T. and Persson, T. (2009). The Origins of State Capacity: Property Rights, Taxation and Politics. *American Economic Review*, 99(4), pp. 1218-44. DOI: 10.1257/aer.99.4.1218.

[2] Besley, T. and Persson, T. (2010). State Capacity, Conflict and Development. *Econometrica*, 78(1), pp. 1-34. DOI: 10.3982/ECTA8073.

[3] Besley, T. and Persson, T. (2011). The Logic of Political Violence. *Quarterly Journal of Economics*, 126(3), pp. 1411-1446. DOI: 10.1093/qje/qjr025.

[4] Besley, T. and Persson, T. (2011). Fragile States and Development Policy. *Journal of the European Economic Association*, 9(3), pp. 371-398. DOI: 10.1111/j.1542-4774.2011.01022.x.

[5] Besley, T. and Persson, T. (2011). *Pillars of Prosperity: The Political Economics of Development Clusters.* The Yrjö Jahnsson Lectures series, Princeton University Press. ISBN: 9780691152684. Translated into Chinese, 2015.

[6] Besley, T., Collier, P, and Khan, A. (2018). *Escaping the Fragility Trap*. LSE-Oxford Commission on State Fragility, Growth and Development. Available at: https://www.theigc.org/wp-content/uploads/2020/10/Escaping-the-fragility-trap_Oct-2020.pdf.

4. Details of the impact (indicative maximum 750 words)

The problem of state fragility is widely viewed as one of most intractable challenges in development, and has become an increasing urgent focus for both multilateral institutions and donors. This reflects (in part) the centrality of state fragility to UN Sustainable Development Goal 16, which calls for peaceful, inclusive, and just societies. Two major impacts of the LSE research are described here. The first is a significant contribution to **improving understanding of and promoting international policy debate on state fragility**, including through the work of the Commission. The second is the use of Besley and Persson's analytical framework for understanding state capacity to support significant **changes in the strategies and operations of major multilateral agencies**, particularly in relation to their engagement with partner countries. Illustrative impacts are presented on the work of the European Bank of Reconstruction and Development.

1. Improving understanding of and promoting international policy debate about state fragility

Some two billion people live in countries affected by fragility and conflict around the world. It has proven difficult to deliver an effective strategic approach to tackling fragility without a framework for understanding what is distinctive about fragile states and why they are a locally stable equilibrium phenomenon, as argued in **[4]**. The LSE research on development clusters **[5]** and subsequent Commission report, *Escaping the Fragility Trap* **[6]**, have helped shape policy discussion by providing this theoretical basis for understanding the factors contributing to state fragility. Chaired by former UK Prime Minister David Cameron, the Commission was established with the aim of using robust research and an approach grounded in political economy to inform policy progress. This thinking underpinned the appointment of Besley (with Collier), whose research on state fragility provided the analytical framework guiding the Commission recommendations, starting with the core guiding idea (from **[4]**) that policy needed to focus on "escaping the fragility trap".

The Commission has sought from the outset to address issues of state fragility through partnerships with practitioners, as well as researchers. To that end, it includes a mix of academics, private sector actors, and individuals with policymaking experience. Key findings of **[6]** were promoted at high-profile events, including a roundtable on state fragility and development hosted by the IMF during its 2018 Spring meetings in Washington DC and attended by Kristalina Georgieva (Managing Director of the IMF, then Chief Executive of the World Bank Group) **[A]**. In January 2020, **[6]** was described by World Vision's Executive Advisor on Fragile States as one of only two major reports "*that attempt to describe roadmaps towards more peaceful and inclusive societies*" (the other is the World Bank and UN's

"Pathways for Peace" report) **[B]**. The report is also credited with having focused renewed attention on the issue of state fragility in the 2019 final report of the "Bellagio Consensus". This initiative, which was co-sponsored by the United State Institute for Peace, The Rockefeller Foundation, and the Overseas Development Institute, aimed to find "a critical path forward on the future of fragile states" **[C**, p. 3**]**. In addition, **[6]** was cited as a "*key report*" in discussion and debate about state fragility by Nancy Lindborg, President of the United States Institute of Peace: a 2018 paper notes that it provides "*a compelling summary of recommendations for how to approach fragility more effectively*" **[D**, p. 2**]**.

Creation of the Development Finance Institution (DFI) Fragility Forum
As well as catalysing and contributing to international debate about fragility more broadly, the Commission has supported the work of specific governments and international organisations helping fragile states to change policy practices. One of the recommendations set out in **[6]** was that: "DFIs and aid agencies should coordinate their financial and technical support for sectors prioritised as strategic". The Commission further advised that "DFIs should cooperate with each other to create standardised support so that investments that succeed can readily be offloaded." In 2019, the DFI Fragility Forum was established in direct response to these recommendations **[E]**. Hosted by the University of Oxford and co-organised by the African Development Bank (AfDB), CDC Group, the International Finance Corporation (IFC), and the International Growth Centre (IGC), the Forum brings together 27 DFIs in action-oriented discussion about how to improve the effectiveness of job-creating private investment in fragile and conflict-affected environments. At its first meeting, attending DFIs agreed to participate in a series of potentially transformational pilot programmes, trialling a collaborative approach to investments in fragile and conflict-affected environments. They also agreed to work together to identify ways to streamline their processes for investments in the private sector of economies affected by fragility and conflict **[E]**.

2. Impacts on the strategy and operations of development aid agencies: redefining transition at the EBRD
The analytical framework developed by Besley and Persson in **[5]** has supported the development of policy recommendations that are both rooted in rigorous research and simultaneously individually and collectively coherent. These have led to changes in the strategies and operations of major development aid agencies, including the European Bank for Reconstruction and Development (EBRD). The EBRD is a multilateral development bank established in 1991 to provide financial support to the former Eastern Bloc countries and support their transition to an open, market-oriented economy. It has since expanded its operations and now invests some EUR10 billion each year in 38 economies in post-communist countries, the Middle East, and North Africa. According to its charter, three criteria guide the EBRD's operations: sound banking, additionality (i.e. complementing rather than substituting private investment), and transition impact. The concept of "transition" - understood here as the movement of economic actors and institutions from central planning to a fully-fledged market economy - is central to the EBRD's mandate.

Revising the transition concept: identifying qualities of a well-functioning market economy
In 2015, the EBRD commissioned an external review of the transition concept. It did so in the belief that an updated understanding of the transition concept was required to reflect a shift in its own understanding of a market economy. This shift was especially in terms of the role of institutions and state capacity in ensuring sustainable, inclusive, well-governed, and resilient markets. Besley was asked to chair the review panel on the basis of "*his track record in applied economics, his understanding of the multilateral development banks, and especially his research record and proven expertise with respect to the topic of state capacity in a market economy*" **[F]**.

The revised transition concept adopted by the EBRD argued that, "*a well-functioning sustainable market economy should be more than just competitive*", but also well-governed, resilient, inclusive, environmentally friendly, and integrated **[H**, p. 10**]**.

The review panel was required to challenge deeply-held views within the EBRD about what constitutes a market economy. To achieve this, and to ensure full understanding and ownership of the new transition concept, it engaged extensively with the EBRD's Board of

Directors through workshops and seminars, an away day with the Board, and a lecture series held at LSE **[F] [I]**. This active engagement was instrumental in effecting a change in thinking regarding the role of the EBRD and in "*[building] a common understanding around the need for state and institutional capacity to support markets*" **[F]**. It supported the formal adoption of the panel's proposals in November 2016. By informing the development of a new transition concept which is central to the EBRD's operations, the panel report underpinned by LSE research "*has effectively shifted the EBRD's identity*" **[F]**.

Subsequent changes in the operations of the EBRD
The EBRD's former Managing Director of Corporate Strategy and Acting Chief Economist describes the impacts of the review panel chaired by Besley. On the basis of its final report, he says: "*the EBRD fundamentally redrew its country and corporate strategies*" to focus more on outcomes, including through the creation of a new project impact assessment framework **[F]**. Specifically, the implementation of the new transition concept led to the creation of "*a formal quantitative system of grading each project's contribution to the six qualities, or Transition Impact, both ex ante and ex post"* **[I]**. The Bank now also routinely assesses the transition gaps for each quality in its countries of operation through its annual Assessment of Transition Qualities (ATQ) **[J]**. This is a key input to all country strategy development processes, which generate country-specific objectives formulated around the transition qualities. EBRD investments must be consistent with these strategic objectives: projects must demonstrate Transition Impact in these key priority areas. As such, the revised transition concept informed by LSE research has had knock-on effects on key aspects of the Bank's operations, evaluations, and strategic approach.

5. Sources to corroborate the impact (indicative maximum of 10 references)

[A] Recording of IMF roundtable on state fragility and development, 18 April 2018. (References **[6]** at 10mins, 22mins, and 30mins.)

[B] "Why we need to rethink our understanding of state legitimacy to address fragility", *Development for Peace* blog, World Bank, 28 January 2020.

[C] Overseas Development Institute, The Rockerfeller Foundation, and the United States Institute of Peace, "The Bellagio Consensus: Final outcome document", June 2019.

[D] "Fragility 2.0: Ideas to Action", President, United States Institute of Peace, prepared for the 2018 Brookings Blum Roundtable.

[E] CDC Group, "Delivering greater impact in fragile and conflict-affected states", 23 February 2019.

[F] Supporting statement from former Managing Director of Corporate Strategy and Acting Chief Economist, European Bank for Reconstruction and Development, 15 October 2020.

[G] [redacted]

[H] European Bank for Reconstruction and Development, "Annual Report 2016", 10 May 2017.

[I] Supporting statement from former Chief Economist, European Bank for Reconstruction and Development, 1 October 2020.

[J] European Bank for Reconstruction and Development, "Transition Report 2019-20".