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Abstract

Most small fragile states have their own unique circumstances that predispose them to social conflict or frequent economic disruptions. These disruptions end up imposing a large cost on regional neighbours and on the international community more broadly. Therefore the development community is in search of ways to reduce the risk of conflict but this search has proved elusive thus far.

This paper explores the potential for migration to serve as a safety valve as well as a medium term strategy for employment creation in conflict-prone states. It draws together the analytical and empirical arguments needed to make the case for enhancing the labour mobility options for these vulnerable populations.

Keywords: Fragile states, export diversification, small states, migration, remittances.

Why fragile states need more international attention

It is estimated that out of the world's six billion people, 26% live in fragile states. A fragile state is described as one that is particularly vulnerable to internal and external shocks and domestic and international conflicts. In 2007, per capita GDP grew at 2 per cent in fragile states compared to 4 percent in other low-income countries. Projections are that fragile states will constitute an even larger share of low-income countries in the future given that many better performing low-income countries graduate to middle-income status. The increasing proportion of fragile states will, without a strengthened model for dealing with them, make international engagement and development assistance less effective. (DFID 2005)[1]

This is of concern to the international community because fragile states impose large financial costs on themselves and on their neighbours. It is estimated that the average cost in net present value terms of just one single country falling into the fragile states status is US $ 80 billion. This is a staggering figure and larger than the world's annual aid budget to all countries. Most of this cost incidentally accrues to neighbours rather than the country itself even when the fragile state is entirely peaceful. Finally, evidence also shows that fragile states generate substantial and complex social costs including conflict, displacement of people environmental destruction and disease. Also, once a country has entered the fragile states status it usually takes 56 years for it to shed this status.

While there is no agreed list of fragile states, the World Bank classifies 34 countries in this category and refers to them as LICUS countries. Of these, six countries are landlocked and nine are island economies with a population of around 1 million or less. For the latter group, both size and geography seem to be associated with economic fragility and in at least six of them violence has brought economic activity to a halt in the last decade or continues to cause low-level disruptions on a daily basis.

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[1] "*Why we Need to Work more Effectively in Fragile States?"* Department For International Development, 2005

It is this nexus of smallnesss and fragility that this note tries to explore and in doing so suggests consideration for migration policies within the broad suite of development policies being pursued. (It is important to bear in mind that it is extremely difficult as well as dangerous to make any generalisations for fragile states – after all "While all happy families are happy for the same reason all unhappy families are unhappy for their own special reasons") But first, what do we know about conflict-prone countries and are there factors that predict conflict in a way that might offer some hope in shaping policies to prevent it in the first place.

What predisposes some states to conflict and violence?

While the popular discourse on rebellion and conflict tends to see rebellion as a protest motivated by genuine and extreme grievance, economists who have studied rebellion tend to think of them not as the ultimate protest movements but as large scale predation of productive economic activities. In the economist's view then the risk of conflict is determined by the *feasibility of predation*. To test this view Collier and Heoffler (2000)[2] analyse a data base on civil wars during 1965-99 in 161 countries and model it to predict the occurrence of war. In doing so, they reveal the following high-risk factors that predispose a country to conflict.

The most powerful risk factor comes from having a substantial share of income coming from export of primary commodities. The most dangerous level of primary commodity dependence is 26% of GDP. By contract, if a country had no primary commodity exports but was otherwise the same, it's risk falls to only one half of one percent. Why are primary commodity exports such a risk? Because they are the most lootable of all economic activities – either by governments to tax or by rebels to loot - because their production relies heavily on assets which are long lasting and immobile. Mines and plantations are location-specific, for e.g. once cocoa trees have been planted it is worth harvesting them even if much of the cocoa would have to be surrendered. Thus rebel activity does not eliminate the activity or shift if elsewhere as would happen if a manufacturing activity were the target.

[2] Collier P., and Heoffler A. and Rohner, D. " *Beyond Greed and Grievance : Feasibility and Civil War"*, University of Oxford, August 2006.

Both geography and history increase risk – if the population is highly dispersed the risk of conflict increases. History matters because once a country has had conflict it's risk of recurring conflict remains very high. Immediately after hostilities there is a 40% chance of falling back into conflict, after that the risk falls by one percentage point for each year of peace.

Conflict is – as popularly expected - also found to be concentrated in countries with fast population growth and economic decline. So countries with large youth bulges, poor education enrolments and low economic growth rates are at high risk. Countries with youth bulges making up 35 percent or more of the adult population run a risk of internal armed conflict that is 150 percent higher compared with the most developed countries if all other factors are the same. This factor usually offers itself most readily to framing the public discourse of rebellion as a protest against bleak futures for the young and restless. Collier's analysis shows however that while this factor makes predation easy by lowering the cost of recruitment by rebels, on its own it would significantly over-predict the occurrence of conflict, so it is a necessary but not entirely sufficient condition for conflict.

The prescription that emerges out of this analysis is that the most important policy would be one that encourages diversification away from primary commodities and is able to find alternate forms of income and export revenues. In particular, encouraging diversification away from immobile assets to mobile activities would make the activity less lootable and hence increase overall resilience to conflict and crisis. In the presence of well known Dutch-disease like characteristics as well as rent-seeking behaviour with resource-based income such diversification can be extremely difficult to accomplish. Reducing population growth rates, keeping youth in school and promoting economic growth obviously help a lot but the former two are as much a result of the latter as a cause of it.

So what does this mean for small states? What are realistic prospects of small fragile states being able to develop other economic activities and diversify away from primary commodities?

Income/export diversification in small fragile states

The thinking about the economic prospects of small states has gone through some pendulum swings recently. Some 20 years ago small states were considered to be bestowed with special advantages such as endowments of natural resources and small homogenous populations that allowed for political consensus to be reached easily and for adaptation to change to be more manageable.[3] Even the presence of higher risk premiums for private investment was not considered a problem, as it was compensated for by higher aid flows. Their openness to trade was also considered an asset that positioned them for higher growth. Overall the message was that the lessons from the growth experience of other developing countries could be easily applied to small states[4] and examples such as Hong Kong, Singapore, Luxembourg, Switzerland and Qatar were cited to support these views.[5]

With time and experience, our understanding of these issues has progressed and in the process has overturned some of these views. We know now that greater openness to trade is also accompanied by greater volatility in small, undiversified economies that are price takers. Natural resources unfortunately can be more of a curse than a blessing and small populations may have a more difficult time avoiding capture by special interests since interest groups can be more prominent. We also know now that aid and private investment are not interchangeable and that aid may crowd out investment and possibly undermine the incentive framework.

Recent empirical evidence has shed light on the problems faced by small states by showing that there is a significant 'price' of smallness. This price manifests itself in the form of higher costs for transporting exports and imports, higher utility costs, and higher (30–40%) wages and rents.[6] Given the price-taker status of small countries in world markets, these cost premiums are hard to pass on to customers, which implies that the only way these economies can export at world prices is if some factor of production accepts lower returns than it would get in larger economies. Winters and Martin (2004)[6] have calculated such 'income penalties' and found that capital would

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3 T.N. Srinivasan, "*The costs and benefits of being a small, remote, island, landlocked, or ministate economy* ", World Bank, Washington, DC, 1986.

4 W Easterly and A Kraay, "*Small states, small problems? Income, growth, and volatility in small states*" , *World Development*, vol. 28, no. 11, pp. 2013–27.

5 These countries are not the micro-states that characterise the Pacific or even small states more generally.

6 A Winters and P Martin, "*When comparative advantage is not enough: business costs in small remote economies"*, *World Trade Review*, vol. 3, no. 3, 2004, pp. 347–83.

earn negative returns if it were invested in small economies[7] and had to bear the cost of local inefficiencies itself (see Table 1). Similarly, even if wages were zero in a small economy, total costs would still exceed world prices. This is true for manufacturing as well as a service industry such as tourism.

TABLE 1 CENTRAL CASE COST INFLATION FACTORS AND INCOME PENALTIES

	Electronic assembly				**Clothing**				**Hotels and Tourism**			
	Micro	**V. small**	**Thres.**	**Small**	**Micro**	**V. small**	**Thres.**	**Small**	**Micro**	**V. small**	**Thres.**	**Small**
Cost inflation factor	36.4	14.3	5.0	2.7	36.3	14.3	5.1	2.7	57.5	28.5	11.9	6.2
Income penalty (% of median-country's income flow												
1. all domestic supplies	-38.8	-11.6	-3.0	-1.2	-40.1	-12.0	-3.1	-1.3	-36.2	-17.4	-7.1	-3.3
2. factors and services	-42.6	-13.3	-3.6	-1.5	-44.7	-14.0	-3.8	-1.6	-46.3	-22.3	-9.1	-4.3
3. value added	-88.0	-29.2	-8.6	-3.8	-86.0	-28.6	-8.4	-3.7	-71.9	-34.0	-13.7	-6.5
4. capital	-245.1	-91.8	-30.9	-14.1	-263.9	-99.9	-34.0	-15.6	-202.1	-98.4	-40.5	-19.2
5. labour	-175.5	-62.5	-20.1	11.2	-161.0	-57.3	-18.4	-10.2	-116.5	-56.6	-23.4	-12.4

Source: *Winters and Martin*

Why are the costs of smallness so substantial? Possibly due to market size and location[8].

[7] Micro refers to nations with a population of less than 1 million.

[8] The CPIA rankings of the World Bank do not seem to be point towards any systematic deficiencies in the policy settings of small states.

Market size

Market size is defined as the scale of economic activity over which agents can contract. Usually national borders define the scope of this contractual space. The larger this space the greater the potential for reaping economies of scale and the greater the scope for specialisation. Reaping economies of scale and scope requires specific investments in physical and human capital, as well as marketing channels, which are constrained when the scale of economic activity is small. This is true not only when producing and exporting goods, but also when providing government services – be they public utilities or general government administrative functions where indivisibilities in certain services can increase the overall size of the public sector.

Of course, the moot question is how much does market size matter if the country has open trade policies – which small countries do generally follow. It appears to matter quite a lot, as international fragmentation seems to affect trade and capital flows, and hence price equalisation. McCallum found that trade between Canadian provinces was 20 times larger than with an equidistant US state (despite the fact that the US–Canada border is perhaps the easiest to cross, given similarities in economic development as well as broad cultural characteristics).[9] Similar evidence from Engel and Rogers found that crossing a border is the economic equivalent of adding thousands of miles to the distance between cities.[10] Parsley and Wei estimate that crossing the US–Japan border adds 43 000 trillion miles to the process of price convergence between cities.[11]

These 'border effects' could also translate into a negative impact on output levels – and hence possibly growth rates to transition into higher income levels, as trade has significant effects on income. An increase in trade of 1 per cent raises income by 0.33 per cent over 20 years. As new small states emerge, so do new transaction costs, which seem to limit both foreign and domestic trade and hence income in the long run.

[9] J McCallum, "*National borders matter: regional trade patterns in North America*", American Economic Review, vol. 85, no. 3, 1995, pp. 615–23.

[10] C Engel and J Rogers, "*How wide is the border*?", American Economic Review, vol. 86, no. 5, 1996, pp. 1112–25.

[11] D Parsley and S-J Wei, "*Explaining the border effect: the role of exchange rate variability, shipping costs and geography*", Journal of International Economics, vol. 55, 2001, pp. 87–105.

Location

In addition to size, distance from markets or the main centres of economic activity plays a role in inflating the cost disadvantages faced by small countries. Remoteness or isolation from trading partners as well as main economic hubs exacerbates the disadvantages of small market size that prevents specialisation. Most countries that are small, particularly in the Pacific region, are also remotely located.

In empirical studies, it therefore becomes hard to disentangle the size effect from the isolation effect. But Winters and Martin have put a distance variable into their regression equations for estimating costs. For sea freight costs as well as the cost of passenger travel, distance turns out to have a significant effect. Given the large percentage of imports in the consumption basket and the need to export products to larger and far away markets (particularly for the Pacific, where inter-island trade is negligible), the higher cost of sea freight poses a major disadvantage to Pacific islanders. The high cost of passenger travel to distant locations also limits the ability of small islands to sell tourism services to the rest of the world.

Gibson (2006)[12] has also calculated GDP and population-weighted rankings for remoteness of countries and found that the Pacific region ranks around 207th (out of a possible 218 on remoteness). The most frequently used comparator region, the Caribbean ranks only 97th which again underscores the importance of location. Using such remoteness variables in empirical modelling of growth rates shows that perhaps there lies an upper bound to the growth rates that are achievable in the Pacific and that upper bound seems to be around three percent. Hence arbitrarily chosen comparator countries that offer superior policy environments may be of less use to the fragile remote nations in the Pacific since there is a "natural' upper limit to their economic prospects.

All this then brings us to an unknown and somewhat scary place. If concentration in primary commodities makes economies highly conflict prone and if the prospects of small fragile

[12] Gibson, J., D. McKenzie, and H. Rohura. "*How cost-elastic are remittances? Estimates from Tongan migrants in New Zealand"*. University of Waikato, New Zealand. 2006

economies diversifying away from primary commodities are bleak then the probability of conflict and violence in these countries is permanently high. This implies that the cost to the international community is likely to be substantial, nearly certain, prolonged and disproportionately felt by neighbours. This gives urgency to the need for conflict prevention and it is in this context that migration – particularly for the poor – needs to be approached.

How can migration help attain development and stability in fragile states?

Urdal (2004)[13] shows that while the combination of youth bulges and poor economic performance can be explosive, a key factor that mutes the violent potential of youth bulges is the access to emigration. Emigration works as a safety valve and may mute the negative effects of large youth cohorts. Moller (1968)[14] argues that the large scale migration from Europe to the US in the 19th century helped to prevent youth-generated violence in Europe in this period. While few if any countries experience emigration rates similar to the 19th century Europe, migration opportunities are likely to have prevented youth discontent and this reduced the risk of political violence in many developing countries.

Within the Pacific – where youth make up over 40 percent of the population - it is little surprise that the most conflict-prone countries are the Melanesian countries (PNG, Solomon Islands, parts of Fiji, and Vanuatu) which have had absolutely no migration outlets, in contrast to Polynesia which has had historic ties to NZ and the North Pacific countries like Micronesia which has open borders with the United States. So how should we begin to advance the agenda for enhanced migration opportunities for the citizens of small fragile states? Here are ten issues to consider in framing the case.

1. Recognise that the elites are moving out of small fragile states anyway leaving vast masses of non-elites trapped in fragile or deteriorating economic environments. This is

[13] Urdal, H, *"The devil in the demographics: The effect of youth bulges on domestic armed conflict, 1950 – 2000"*. Social development Papers, Conflict Prevention and Reconstruction. World Bank, Washington DC. 2004

[14] Moller, H., "*Youth as a Force in the Modern World",* Comparative Studies in Society and History, Vol. 10, No. 3 (Apr., 1968), pp. 237-260, Cambridge University Press

simply so because they can. Emigration policies of receiving countries favour the "best-and brightest" overtly and very little can be done to curtail this brain drain which is a now a nearly global phenomena. The adverse results of these skewed policies on small fragile states cannot be underscored enough where the slice of the population that is educated and skilled is by definition thin and fast eroding. It is estimated that for every skilled person that leaves nearly 10 local semi or unskilled jobs are sacrificed (Duncan 1997)[15]. The possibility of skilled emigration of course raises the economic return on skill-acquisition which in turn induces greater investment in skills and is a positive outcome. However, while the investment in skills increases, employment opportunities are unable to keep pace in most fragile economies and since only a subset of new graduates can emigrate the rest are left under- or unemployed creating room for social instability

2. Nor can we really expect employment opportunities within small states to expand on the basis of domestic business activity. The empirical analysis presented earlier shows that the smaller the country the greater the income penalties for both manufacturing and services. In small economies there is neither absolute nor comparative advantage in most activities where world prices prevail. Therefore it may become necessary to accept that while some countries will diversify in the export of goods, others can diversify their range of services, and some fragile small states will have to export labour to deliver services outside their borders.

3. The good news here is that demographic projections for advanced countries point in the direction of growing demand for labour to deliver services. As populations age the demand for labour-intensive services that can't be mechanised such as child and aged care, some agricultural jobs, and hospitality industries will mandate importing labour in unprecedented amounts. Sending countries would do well to prepare themselves to deliver these services.

[15] Duncan R., and Lawson T. "*Cost structures in Papua New Guinea.*" Discussion Paper no. 69 Institute of National Affairs, Port Moresby, 1997

4. We may also have to recognise that the international labour market is not set up for the poor to move. If the bottom billion is our concern then migration needs to be more pro-poor than it is now. However, the social costs whether real or perceived associated with the movement of the poor are seen as too high to be politically feasible. New mechanisms will have to be found to make temporary movements of persons both profitable to individuals and manageable by governments.

5. And we know that migration - even in its limited and skewed form as it exists now – already generates remittances that are roughly three times all ODA. The propensity and ability for people to help themselves seems to be far greater than the ability of the international community to make resources available for development.

6. Household level surveys show that these remittances have had a positive impact on reducing poverty, inequality, improve education and health outcomes and even spur business activity (GEP 2005)[16]. In addition remittances into small economies tend to be counter-cyclical which is handy given the crisis-prone nature of these economies. Furthermore, remittances don't have the same rent-seeking impacts as aid or natural resource rents can which are large, concentrated and associated with capital intensive activities. Remittances on the other hand are usually small amounts of money spread across the population quite thinly.

7. And it's not just the money that flows back – new ideas and knowledge does too. Workers from Vanuatu who have worked in NZ for 5-7 months have returned home with new irrigation techniques, agricultural productivity enhancing know-how as well as computer literacy and a higher sensitivity to the cost of connectivity in their home countries creating a demand for better service delivery at home (based on interviews of returning workers). Samoa, a country which has perhaps had the most labour market access amongst small island states in the region (30 years of labour market access due to the treaty of friendship with NZ) has been able to make advances on public sector reform, trade and privatisation in the 1980s. Having been exposed to good governance through

[16] Global Economic Prospects 2005: Trade, Regionalism and Development 2005, World Bank, Washington D.C.

migration, both the demand and capacity for good governance at home has visibly increased to a level that stands out quite perceptibly in the Pacific region. At a time with institutional quality is becoming central to discussions on spurring and maintaining economic growth, creating powerful vectors of norm diffusion through "social remittances" can have long term consequences for socio-economic stability (Kapur and McHale 2005)[17].

8. Some critics have not bought into the migration-governance link and instead take the view that migration sets governments off the hook and retards good governance. Undoubtedly there are some economic and social costs to migration and even the Diaspora can support and fund secessionist activities back home. The counterfactual however of leaving the "hostage citizens" of fragile states at home to develop employment opportunities in environments where size and remoteness remove all comparative advantage, or to demand good governance which they have not ever experienced, seems too risky and in the Pacific has only served to intensify the risk of conflict.

9. And neighbours will ultimately pay the price of conflict which we know is substantial and protracted. Repairing societies where conflict has broken out involves generational shifts and we know that once conflict has broken out a country 40% more prone to it again. Instead taking a proactive approach which entails offering preferential labour market access to citizens of fragile countries would seem to offer a win-win from both a security as well as development view.

10. Finally, place is the most important correlate of a person's welfare (WDR 2009)[18]. Agglomeration economies dictate that economic activity is and will continue to be highly concentrated, therefore instead of attempting to spread it out, the more effective policy for raising the welfare of citizens of economies on the periphery (due to physical or economic distance) is to find ways to link them to the hubs of economic activity. Labour

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[17] Kapur D., and McHale J. "*Give us your best and brightest: The global hunt for talent and its impact on the developing world.* " Washington D.C., Centre for Global development, 2005.

[18] World Development Report 2009: Reshaping Economic Geography, World Bank, Washington D.C.

links - even in a limited, temporary or managed way - provide an opportunity to enhance those channels of integration with economic hubs. Such proactive policies in fragile states may be the ounce of prevention that saves taking a pound of bitter medicine later.