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Industry Study

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Reconstruction and Nation Building Industry

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RECONSTRUCTION AND NATION BUILDING 2012

ABSTRACT: The Reconstruction and Nation Building (RNB) industry is an "industry of industries" not neatly categorized or analyzed. Yet, approximately $703 billion[1] was transferred from developed countries to underdeveloped or developing countries, many of which are highlighted in the U.S. *National Security Strategy*. In a period of declining budgets, the United States will be faced with the challenge of balancing national security concerns with RNB opportunity costs in the apportionment of funding. The 2012 RNB Industry Study recommends using this period of declining budgets to force efficiencies into the U.S. disaster relief, stability, and development calculus. Continuing to spend billions in aid without unified long-term objectives and a strategy to achieve those objectives not only cripples the U.S. ability to synergistically set and achieve security priorities, but actually hinders host countries in their efforts to build and sustain government services and economic capacity. A paradigm shift must take place in U.S. disaster relief, stability, and development policy where resourcing is targeted towards strengthening host country governance first and foremost. This host country governance-first approach significantly improves a battered nation's probability of achieving long-term sustainability by focusing each dollar of assistance on the objective of making the aid recipient nation into an aid providing nation over the course of a few generations.

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"Successful engagement will depend upon the effective use and integration of different elements of American power. Our diplomacy and development capabilities must help prevent conflict, spur economic growth, strengthen weak and failing states, lift people out of poverty, combat climate change and epidemic disease, and strengthen institutions of democratic governance."

~*National Security Strategy, White House, May 2010*[2]

INTRODUCTION

The United States *National Security Strategy* addresses fragile and conflict-affected states as a threat to American interests and values. For the Reconstruction and Nation Building (RNB) industry to achieve the greatest impact, the United States Government (USG) must place a priority on strengthening the institutions of governance. "Stable, effective governance provides a foundation on which rule of law and economic activity can thrive and become drivers of security and stability."[3] If stable and effective governance is not in place, other forms of assistance, such as health care, economic assistance, education, or agricultural programs will often prove unsustainable. Simply put, if foundational governance is not addressed, development assistance merely treats the symptoms and not the disease. Although the industry is healthy, the USG could get a better return on its investment by focusing its efforts on good governance as the primary enabler of successful RNB.

As USG budgets shrink, U.S. policy makers are forced to simultaneously balance the strategic need to strengthen faltering states abroad with the equally compelling requirement to reverse the downturn of the U.S. economy. Investing abroad is difficult and unpopular, all the more so during strained economic times; however, it is generally less expensive to invest in diplomacy and development efforts than to risk paying for protracted conflict.

This paper defines the RNB industry; analyzes the health of the RNB industry; identifies challenges; presents essays on related issues; and closes with policy recommendations that support the U.S. national security strategy.

THE INDUSTRY DEFINED

The RNB industry is a multi-billion dollar enterprise comprised of an "industry-of-industries," focusing on the national security priorities of preventing conflict, stimulating economic growth, strengthening weak and failing states, lifting people out of poverty, combating climate change and epidemic disease, and strengthening institutions of democratic governance.[4] Participating firms range from architectural and engineering companies that engage in infrastructure construction to more traditional development companies engaged in activities supporting the United States Agency for International Development (USAID) in six foreign assistance program objectives: Peace and Security, Governing Justly and Democratically, Investing in People, Economic Growth, Humanitarian Assistance, and Program Support.[5] In addition, the industry writ large includes multilateral organizations and institutions such as the World Bank, the United Nations, and regional development banks.

Identifiable USG spending in this industry is approximately 1.5% of the overall U.S. budget. USAID is the primary USG disbursing agent for this money. USAID contracts with a multitude of for-profit firms, non-profits, non-governmental organizations (NGOs), and private voluntary organizations. In FY2010, the U.S. Department of State (hereinafter referred to as "State") and USAID spent approximately $3.3 billion, which was roughly 10% of the total foreign assistance budget, on programs related to governance.[6] The remaining 90% of the foreign assistance budget was directed to other aspects of development that are often perceived as bringing more immediate, measurable, and tangible results, such as health and agriculture.

Good governance is an abstract concept that defies easy definition or budget categorization, let alone quantitative analysis. It is, nevertheless, foundational to the health and well being of any development and stabilization effort. Most development experts agree that the essence of good governance is accountability of a government to its people. Accountable governments provide basic services for the benefit of a society and its citizens. When a government functions with minimal corruption, provides basic services, and is accountable to its citizens, other forms of development assistance and aid work more effectively and are sustainable in the long run. Direct foreign investment, which provides jobs and long-term economic growth, will become more attractive and effective, contributing to a more prosperous society. Therefore, investments in governance programs become a catalyst for shifting from foreign aid and assistance as a means of economic growth to more sustainable internal infrastructure and industrial capacity building. Figure 1 illustrates this concept.

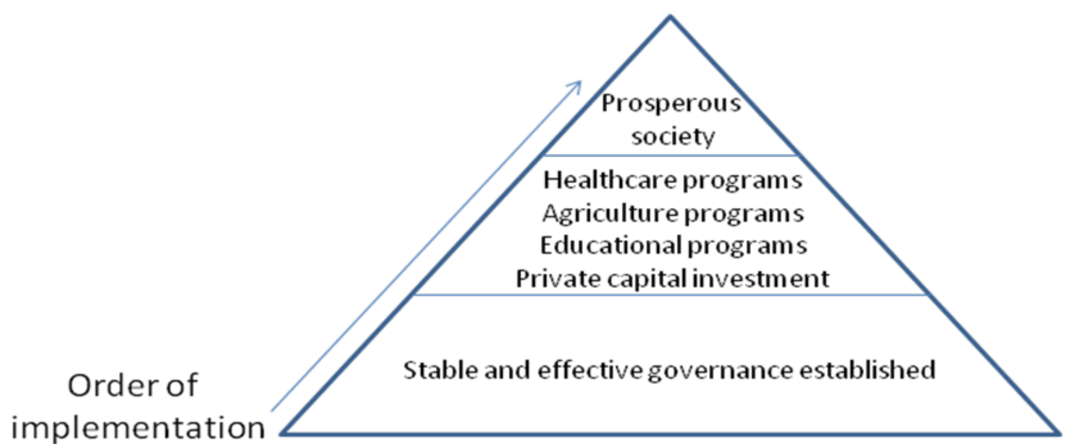


Figure 1. Effective Governance Supports Developing a Prosperous Society

CURRENT CONDITION

The RNB industry is multidimensional with participating firms engaged intermittently in RNB while primarily operating in one of several other identified industries (i.e., construction, engineering, aerospace and defense, environmental services, security, business support services, consulting). Although there is no North American Industry Classification System (NAICS) defining this industry, firms that operate in other industries are often willing to respond to demand for RNB services that will, in the end, contribute to their bottom line. To view the industry in context, it is helpful to understand the scope of the global financial flows from the developed world to developing nations where RNB occurs. In 2010 these financial flows were estimated at $703 billion; of which USG Official Development Assistance (ODA) comprised only $30.4 billion (5.3% of global total).[7] ODA in this context is defined as foreign assistance monies managed by USAID and State. Figure 2 provides a breakdown of global financial flows from developed countries to developing nations.

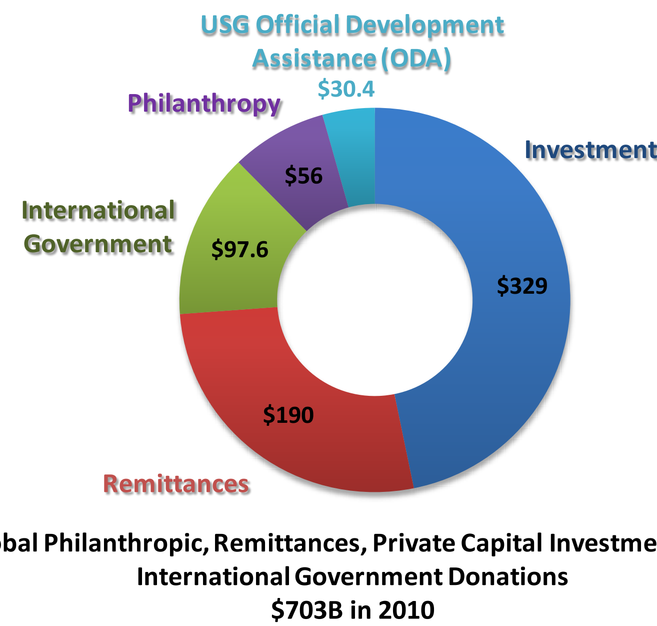


Figure 2. Global Financial Flows from Developed to Developing Countries

Although 21 different USG agencies manage foreign assistance activities, five agencies (USAID, Departments of Agriculture, Defense, and State, and the Millennium Challenge Corporation) control 86% of the foreign assistance.[8] While USAID, State, and MCC foreign assistance funds comprise less than 1% of the overall federal budget, Defense has additional funds above and beyond the aforementioned ODA (such as Commander's Emergency Response Program - $1.4 billion,[9] Overseas Humanitarian Disaster and Civic Aid - $585 million,[10] and Section 1206 funding for counterterrorism - $341 million in FY2010) that contribute to USG RNB efforts. The Department of Treasury provided an additional $2 billion to the multilateral development banks and the

USG contributed $7.7 billion to the United Nations system in FY2010, institutions that support RNB efforts globally[11]. Funding for USAID's category "Governing Justly and Democratically" remained relatively constant over the past four years and comprises 8.4% of the overall foreign assistance request for FY2013.[12]

The RNB industry demonstrates monopolistic competition, with the governance sector tending more towards oligopoly with fewer firms controlling a greater proportion of the market share. Smaller firms tend to function as subcontractors to larger firms, because USG contracting regulations provide preferences to small, disadvantaged, women, and minority-owned firms. RNB-related business units in larger firms expand and contract in response to USG demand signals. Many projects are multi-dimensional, crossing multiple sectors incorporating governance as one phase, making it difficult to determine exactly how much money is being devoted solely to governance.

Three groups of firms within the RNB industry were analyzed to better understand the current condition of the industry: publicly traded, privately held, and non-profit. All ten firms were selected from the Directory of Democracy and Governance (DG) Office Implementing Partners list in the November 2010 *User's Guide to DG Programming*. Eight of the ten firms (or their subsidiaries) were listed among USAID's Top 40 Vendors for FY 2011.

RNB firms have developed differing strategies to effectively maneuver within the industry and remain profitable. Publically traded firms have gained an advantage by purchasing smaller firms with RNB expertise. Private firms benefit from established relationships with USAID that give them a competitive advantage through Indefinite Quantity Contracts (IQCs) that provide business insight that they leverage to their advantage. The non-profits tend to be more focused on a limited number of issues or sectors and are highly dependent on USG financing and charitable contributions.

All of these firms have sought access to new markets in developing nations with the intent of establishing favorable reputations, accumulating profits from USG contracts, and positioning themselves for future business opportunities in both the public and private sectors. RNB activities facilitate market access via any one of the six program areas and then provide a springboard to expand business in other company divisions through private opportunities.

Tetra Tech illustrates the successful implementation of this strategy. It acquired three subsidiary companies active in RNB, grouping them into the Technical Service Business Segment. Each of the subsidiaries provided a base to support the expansion of established contacts to facilitate work for other business segments of the firm internationally. Over the past three years, there has been significant corresponding growth in the Engineering and Consulting Services business segment of the company and the percentage of revenue by client sector has shifted away from the federal government to international clients.[13]

Coffey International Development's attempt to implement this strategy, while allowing the firm to profit in the short-term, has not been consistently profitable over the long run. Revenues from the International Development sector of the company (of which the U.S.-based Management Systems International [MSI] is a part) contributed 42% of fee revenues to Australian-based Coffey in 2009, but the contribution decreased to 21% in FY2011.[14] The decline was due in large part to the completion of the $340 million four-year Tatweer Project designed to create and sustain a civil service cadre in the Government of Iraq. In fact, many of the RNB industry firms heavily invested in work in Iraq have experienced significant reductions in revenues from international development business units corresponding to the USG drawdown which involved concurrent contract closeouts. As demonstrated by Coffey's experience, the process of diversifying into unfamiliar markets in search of profitability holds considerable risk for firms. Restructuring to be responsive to a changed demand signal requires substantial investment which often requires taking on long-term debt. Nonetheless, Coffey has been awarded a follow-on USAID contract in Iraq totaling $151.3 million (which began in June 2011).[15] The company also has expanded its profit base opportunities by seeking new contracts with the Australian and the United Kingdom governments, which MSI is now eligible to compete for as part of the international conglomerate.

L3 Communications, which historically operated in the aerospace defense sector, acquired International Resources Group that currently holds several multi-year USAID IQCs through 2013 including SWIFT III (a five-year $1.5 billion contract in support of political transitions and stabilization needs) in support of USAID's Office of Transition Initiatives. The partnership with L3 and the USG has expanded, adding to L3's credibility and reputation and broadening its record of successful past performance. The firm is building an economy of scope by providing goods and services to the USG across multiple agencies in support of operations; a strategy that has proven successful for the firm.

Analysis of financial ratios reveals that all three companies are operating relatively efficiently when compared with the industrial sector current ratio average (See Chart #1 in Appendix A). While short term liabilities do not pose a problem, both Coffey International and L3 Communications are heavily leveraged with long-term debt. Coffey undertook a major restructuring that involved divestments and acquisitions that refocused the firm towards geosciences. Tetra Tech is by far the best performer among the three companies with an annual return on investment surpassing the sector average and meeting the historical cost of capital.[16]

Privately-held companies do not publish annual reports, and financial data is difficult to obtain. Data reported by USAID for contract award and revenue information provides insight into the overall growth and performance of privately-held firms.[17] While revenue is not necessarily the best indicator of overall performance, in the absence of other indicators it does provide insight into trends among privately held companies (See Chart #2 in Appendix A). Chemonics, a near monopsony with USAID as their major client, increased their contracts' dollar value 65% between 2007 and 2011.[18]

Chemonics' total federal government revenue has grown 43% from 2009 to 2011.[19] Meanwhile, revenue for Development Alternatives, Inc. (DAI) increased 18% from 2008 to 2011 even though the value of USAID contract awards decreased 34% between 2007 and 2011.[20] DAI estimates that 40% of the firm's work is in stabilization programs funded by USAID. Louis Berger was not included on the *Washington Technology* Top 100 largest USG contractor list in 2009, but it made the list in 2010. However, the dollar value of its USAID contract awards decreased by 8% between 2010 and 2011 at a time when the firm's federal government revenue also went down by 43%[21] (See Chart #3 in Appendix A). This downturn in government revenue came on the heels of a $69.3 million fraud settlement prosecuted under the false claims act.

DAI has expanded their client base beyond USAID. The DAI website lists private sector clients, non-profit foundations, national and local governments, bilateral and multilateral donors, and philanthropies. Chemonics appears to be crowding out its competitors, making it difficult for new entrants to compete for USAID contract awards. Since reputation, successful past performance, and an established relationship with customers are key competitive advantages, Chemonics has demonstrated an effective strategy to succeed in the RNB industry. In fact, Chemonics is the top private sector USAID vendor in terms of overall dollar value obligated in FY2011.

Non-profit firms calculate revenue by adding contributions, grants, investment income, and realized gains. Non-profits can still generate a profit from operations; however, the income must be reinvested in their organization. Within the NAICS-defined industry of "Donations, Grants & Endowments (NAICS 81321)," the Bill & Melinda Gates Foundation has a controlling market share (8.8%), which allows the foundation to exercise leadership among foundations and to influence government policy formulation and decisions.[22] The remaining non-profits provide a fraction of donations by comparison to this foundation. A review of the financial statements of the non-profits engaged in governance work indicates that overall the non-profit firms are healthy.

Non-profits break down into two distinct groups: "entrepreneurials" that generate revenue by charging for services and "non-entrepreneurials" that rely on grants and contributions to fund operations. Both Family Health International (FHI) and Research Triangle International (RTI) fall into the entrepreneurial category. More than 66% of RTI's revenue and 82% of FHI's revenue is generated by providing services on behalf of the USG. Both firms continue to carry over assets and annually report millions of dollars in revenue (See Chart #4 in Appendix A). Both compensate senior executives in excess of $200,000 per annum.

In contrast to FHI and RTI, the Solidarity Center and the International Center for Not-for-Profit Law have no program service revenue and rely exclusively on government grants, contributions, and interest income for revenue. The staff for both of these non-profits is considerably smaller and less well compensated than FHI and RTI.

In the end, the RNB industry is healthy. However, the USG is at a disadvantage due to a failure of competitive conditions in this market. Producers have captured much of the consumer surplus for RNB services which are non-excludable, nonrival public goods. It is difficult for the USG to acquire the appropriate quantity and quality of RNB services within the required time period in response to the demand signal at an appropriate price. Firms providing RNB services have therefore benefited by charging a premium for fast response under negative externalities (i.e., non-permissive security environments).

CHALLENGES

Three primary challenges for the RNB industry - policy, structure, and budget - are systemic, long standing, and related to the USG nexus to the industry. The industry operates within the context of these challenges and adapts business models accordingly. However, if the USG were to effectively address these challenges, the industry would be more productive, likely resulting in greater USG funding in the future. The intended end state is to allocate funding in a manner that maximizes positive results rather than merely increasing profits for industry or saving the USG money.

LACK OF COUNTRY-SPECIFIC POLICIES

While USAID implements a country-specific strategy through a *Country Development Cooperation Strategy (CDCS)*, there is little evidence that the CDCS is synchronized with defense or diplomacy strategies. This presents challenges to the implementation of a coordinated and credible development strategy that adequately services U.S. national security interests.

LACK OF LEADERSHIP STRUCTURE

For any enterprise to succeed, good leadership is crucial. Currently there is no clearly identified interagency leadership in the USG international development structure. Lack of leadership hinders progress and coordination among USG agencies.

INCONSISTENT BUDGET

Currently, the development budget for RNB is programmed in one-year increments, even though projects typically involve long-term implementation. This budgetary uncertainty undermines success and discourages industry participation.

OUTLOOK

The future of the RNB industry is characterized by uncertainty. Significantly reduced USG spending is expected in FY2013 and beyond, restricting available funding for governance improvement programs. In anticipation, many firms providing these services have already started diversifying their business plans to seek other global donors and to expand their expertise across other sectors of development. In addition to MSI's 2008 merger with Coffey, the Australian development management company GRM International and global consulting firm Futures Group merged in 2011. More mergers can be expected as companies reposition themselves for the expected market contraction. Larger, more efficient multinational firms may have a competitive advantage by sharing personnel and expertise, covering wider geographical areas and new markets, and offering a more diverse range of services.

SHORT-TERM OUTLOOK (1-5 YEARS)

Although traditional donors (i.e., the United States, Canada, Western Europe, Japan, and Australia) may be cutting foreign aid during this period of extended economic recession, the "aidscape" has changed dramatically many times since USAID was created in 1961. Currently, official development assistance is channeled through 263 multilateral agencies, 197 bilateral agencies, and 42 donor countries, including emerging countries, such as China, India, Brazil, South Africa, and the Gulf states.[23] Development includes the traditional model of wealthy Northern donors and poor Southern recipients as well as a South-South partnership framework with still developing countries providing assistance to less developed countries. Aid from developing countries topped $10 billion annually the past two years, up from $5 billion in 2005, and is expected to continue growing.[24] In addition, thousands of NGOs, private companies, and charities play a major role in development.[25] Implementing companies, especially those that rely on USAID funding for the majority of their business (such as DAI and Chemonics) must be flexible to find alternative funding sources.

In today's economic climate, many non-profits are struggling to support their missions, particularly those relying on private contributions. In a recent survey, 71% of foundations stated that giving would be flat or would drop in 2012.[26] That is largely because their assets slipped in 2011 by 3% to 5% and are still far from returning to pre-recession levels.[27] "In perhaps a more telling sign of how much grant makers are still smarting from the 2008 crisis, the assets of the 10 richest foundations dropped by more than $25 billion from 2007 to 2011 after inflation, or about $1 in $4 of their holdings that has yet to be recovered."[28]

LONG-TERM OUTLOOK (5 – 15 YEARS)

As was the case in Iraq and Afghanistan, the military provides security for early humanitarian relief and reconstruction activities along with health care, food, water, and emergency repairs of infrastructure. Mission creep and inadequate resources will affect how long the U.S. military can continue to provide services above that of security. When the U.S. military fills this gap, those typically called upon to do the work (e.g., multilateral and non-governmental institutions and organizations) will experience a decrease in work and, if not gainfully employed, will retreat to other countries where their work and funding can best be utilized. Protracted delivery of services by the U.S. military impacts the host countries' progress towards becoming self-sustaining and independent. The weak projections of the global economy including the European debt crisis and unrest in the Middle East will impact the USG's ability to continue long-term involvement in RNB. Multilaterals and NGOs will continue to provide services, but at a reduced effort tied to what funding is available through the traditional avenues of aid.

POLITICAL AND SOCIAL FACTORS

Ongoing USAID implementation and procurement reforms will impact the future of the industry. The new "USAID Forward" policy states a goal of "channeling more resources directly to host country institutions—both to civil society organizations and to the government, where possible."[29] USAID Administrator Rajiv Shah explained the strategy to the Senate Foreign Relations Committee in April 2011: "Instead of continuing to sign large contracts with large contractors, we are accelerating our funding to local partners and entrepreneurs, change agents who have the cultural knowledge and in-country expertise to deliver lasting, durable growth."[30] Although this policy may build capacity in new democracies through direct delivery of services to citizens, funding would bypass U.S. development companies in favor of host nation implementers. Many U.S. development companies consulted during this research cautioned that aid channeled through host government institutions could be lost to corruption if the process is not monitored carefully. Corruption scandals could undermine the already weak domestic constituency for international aid.

Lack of a strong constituency in Congress and the American public to support foreign aid programs impacts the industry's short and long-term outlook. During periods of financial difficulty, especially in an election year, negative public and political opinions concerning the use of taxpayer's money to fund foreign aid increase. To counter negative perceptions, development companies have joined forces in professional organizations to advocate for favorable foreign assistance budgets and policies. These organizations include Inter-Action, the Society for International Development, the Coalition of International Development Companies, and the International Stability Operations Association. More effective outreach through the media could help build a constituency for foreign aid among the American people.

STRATEGY

Organizations pursuing RNB initiatives must be adaptable and flexible in order to maintain a preeminent position in the global marketplace. Those depending upon private donations and philanthropy may need to reduce their missions during the economic downturn.[31] To receive development funding from foreign governments, U.S. firms may need to partner with local implementers from the funding nation since many donor governments restrict grants and contracts to their own citizens. In a more highly-competitive market, firms will be more selective about the projects they pursue. Creating a proposal can cost tens of thousands of dollars, so firms will bid only on contracts where they have a distinct competitive advantage or best value added. This will result in fewer bids and less competition for individual contracts, which may cause higher costs for donors.

Successful firms must anticipate changes in U.S. foreign policy trends and adapt their capacity and expertise for expected changes in funding. For example, the president's FY2012 budget request proposes a new Middle East and North Africa incentive fund and eliminates assistance to Europe, Eurasia, and Central Asia.[32]

Partnering with private corporations is another strategy. For example, Procter & Gamble worked with local governments and NGOs to distribute free water purifying products in developing countries. The projects did not earn profits but created long-term relationships and good will in the target nations for the corporation.

GOVERNMENT GOALS AND ROLE

A significant criticism of U.S. RNB efforts is the lack of unified effort within the USG. The U.S. has engaged seven times in RNB in the past two decades and faltered each time. Believing that the prior RNB effort would be the last, no lessons were learned from one engagement to the next.[33] In a time of declining budgets, and after two major RNB efforts following the wars in Afghanistan and Iraq, the U.S. cannot afford to continue this practice. History shows the U.S. continues to engage in RNB, even if political and public sentiment wanes.

Deploying military forces can bring about the opportunity for change, but it is not the military that brings about long-term change – a civil force is needed.[34] Former UN Secretary General Kofi Annan warned in 1999 to not forget about the need for a RNB force:

> "When fighting stops, the international commitment to peace must be just as strong as was the commitment to war. In this situation, too, consistency is essential. Just as our commitment to humanitarian action must be universal if it is to be legitimate, so our commitment to peace cannot end as soon as there is a ceasefire. The aftermath of war requires no less skill, no less sacrifice, no fewer resources than the war itself, if lasting peace is to be secured."[35]

As the experience in Iraq and Afghanistan demonstrated, the USG abdicated its ability to lead RNB efforts on the ground, relying instead on a large and disparate group of NGOs and private corporate actors to execute the government's RNB efforts. The U.S. must recognize that RNB is not on its way out. It must apply continued commitment and resources to RNB. As President Obama noted in January 2012, "We have the opportunity -- and the responsibility -- to look ahead to the force that we are going to need in the future."[36]

ESSAYS ON RELATED MAJOR ISSUES

CORRUPTION IN KYRGYZSTAN: ANTITHESIS OF GOOD GOVERNANCE

Lack of transparency, trust, and integrity is a threat to the legitimacy of any government. Corruption has a direct impact on this legitimacy as it impacts economic growth and undermines free and open markets. Transparency International's Corruption Perceptions Index defines corruption as "the misuse of public power for private benefit."[37] Corruption evolves when there is a perception that government is not performing its duties on behalf of the people at large and officials are operating for personal gain. When governments are not advocates of transparency, and corruption amongst officials is endemic, investors are often presented with the dilemma of constant uncertainty on what rules to follow. As industries seek to increase profit margins and enter new markets they are hindered by uncertainty, corruption, and lack of standardized business rules. Therefore, it is critical that good governance and transparency are at the pinnacle of every elected and appointed official's requirements in government. Good governance builds trust and confidence and facilitates policies to eradicate corruption and cultivate sustained economic growth.

One of the most challenging aspects of improving governance in a fragile or conflict-afflicted state is overcoming corruptive influences such as patronage (sometimes called "cronyism"). Patronage often happens in countries with "resource curses," where the main source of revenue is a commodity or commodities, such as oil, that is controlled by a few select powerful individuals. These individuals enrich themselves at the expense of providing basic services to the people, and use their wealth to stay in power. Since the source of revenue is readily available, the government does not expect anything from the citizens in the way of taxes; in turn, the citizens do not expect much from their government and are distrustful and even fearful of their government. The challenge of reforming a corrupt government is convincing the citizens that they must demand accountability and transparency. Kyrgyzstan faces this challenge now.

When the Soviet Union collapsed, the new states of the Central Asian region had very little in place for good governance, and corruption quickly took hold. The revenue from natural resources such as oil and minerals lined the pockets of corrupt individuals in the previous government organizations, who abused their offices to quickly become rich and form ruling families and groups.

The two poorest countries in Central Asia, Kyrgyzstan and Tajikistan, have very little oil reserves or natural gas, and are landlocked. Furthermore, Uzbekistan, the provider of natural gas to Tajikistan and Kyrgyzstan, controls the price of this commodity at will, making it a "bad neighbor." Lacking natural resources to produce electrical energy, Kyrgyzstan depends on hydro-electrical power plants fueled by the mountain glaciers that are the origin of the rivers in this region. However, the 4,000 or so rivers flow through the poorly marked borders of the Central Asian countries. The control over these rivers is fraught with corruption. Kyrgyzstan is in several of Paul Collier's traps outlined in his book The Bottom Billion.[38]

Kyrgyzstan's autocratic ruler stamped out democracy and free press, and rising illiteracy rates contribute to the widespread increase in corruption. Law enforcement agencies and authorities are in place through patronage, and there is little recourse for the citizens to overcome injustices. Having no support from the government, citizens are left to fend for themselves, and often follow religious extremists who promise to bring justice to them. Corruption is seen as almost being acceptable in the everyday life of a citizen in Kyrgyzstan.

DIASPORA'S ROLE IN FRAGILE STATES

"Diaspora communities have the potential to be the most powerful people-to-people asset we can bring to the world's table."

~ U.S. Secretary of State Hillary Clinton, May 2011[39]

The participation of diaspora communities in humanitarian relief and economic development is already significant, with more than $351 billion in remittances sent to developing countries in 2011 alone.[40] These global remittances total three times the amount of official foreign aid.[41] The USG should consider strategies to expand the power of diasporas beyond financial contributions to human contributions to strengthen governance in fragile states.

Continuing links between diaspora members and their homelands motivate individuals to return temporarily, permanently, or periodically to improve fragile states. They may still have family and friends in their home country and want to visit or move back to raise their children. People from the diaspora usually speak the local languages and understand the culture, religion, and social and ethnic divisions within a country, making the transfer of skills and knowledge easier. They may have professional relationships in country that will help them in their work. Local people may view them as compatriots and more legitimate service providers than foreign aid staff. The diaspora, with previous experience living in a country, may be more suited to working in isolated or difficult places where the need may be greatest for building governance from the bottom up. The returnees often have better education and experience than local citizens. Some may even have civil service experience from working in the governments of the countries where they have been resident.

Challenges to the diaspora's role in governance building are substantial. The fragile states may fall back into conflict, preventing diaspora members from returning. They may have pressing family and financial obligations in their new countries of residence that delay them from returning, even temporarily. Homeland wages are generally much lower, so they may not be able to meet their financial needs. Fragile governments may fear opposition or competition from the returning diaspora community and withhold visas or entry permits required to return. There may be no comprehensive source to learn about special programs or employment opportunities in the homeland. Diaspora groups may be weak, lacking coordination to help mobilize the skills of members. Groups from one country may be splintered into opposing political factions, further restricting cooperation.

For those diaspora members who do return, many factors may obstruct their effectiveness in helping to build governance. Some locals who did not flee the country may resent the return of the diaspora and view members as "carpetbaggers" who are enriching themselves by taking jobs away from those who stayed during the worst of times. Resentment may also arise if nepotism or tribal identity gave preference to the diaspora member over a local citizen. In addition, programs to attract diaspora often include higher salary payments, which may further increase resentment. In turn, even with supplements, the wages may not be adequate to support diaspora employees. After living away from their homeland, diaspora members may experience reverse culture shock and may not re-adapt easily upon return. Institutions in the fragile states may be too weak to utilize the skills of the returnees. Likewise, local employees may lack the basic education and experience for an effective transfer of knowledge to occur. Weak infrastructure, continued conflict, corruption, and bloated bureaucracies in fragile states may frustrate progress. Women from the diaspora, after living abroad in countries where women have equal rights, may become discouraged when faced with discrimination in paternalistic homelands. Finally, building governance is a long-term process in fragile states. Some diaspora professionals may not have the dedication or resources to remain in their homeland for long periods; however, even a short stay may influence the direction of the country. All of these factors may limit effectiveness and retention of diaspora members who return to their homelands to participate in governance strengthening activities.

The U.S. *National Security Strategy* specifically includes the diaspora as an American strength:

> "Facilitating increased international engagement outside of government will help prepare our country to thrive in a global economy, while building the goodwill and relationships that are invaluable to sustaining American leadership. It also helps leverage strengths that are unique to America—our diversity and diaspora populations, our openness and creativity, and the values that our people embody in their own lives."[42]

With the right type of encouragement from USG policies to overcome the myriad challenges detailed above, the diaspora has the potential to act as an effective instrument of national power to build governance in fragile homelands while at the same time representing the U.S. and contributing to America's national security.

COUNTRY SELECTION CRITERIA

In the 1990s, stabilization and humanitarian missions were outsourced to the United Nations, NATO, or the military's own National Guard or reserve component.[43] Negative experiences in Somalia, Haiti, and the former Yugoslavia moderated the desire on the part of the USG, particularly the military, to engage in humanitarian interventions. Participating in these missions had a national security benefit – it created good will that became a defense against anti-Americanism and extremism.[44] Pursuing both combat and humanitarian tasks created challenges for the USG. Today, in a time of constrained fiscal budgets, the United States must optimize the use of development and capacity building resources to only those countries that specifically meet our national interests.

The Department of Defense is now taking notice of countries previously considered too small and too weak (e.g., Djibouti, Mali, and Yemen) because terrorists could possibly seek out these small and weak states as safe havens. The territories also act as conduits through which arms, drugs, money, and people can be trafficked without notice, in turn creating problems for governments far outside their borders. In addition, threats to human security like ecological degradation, refugee flows, contagious disease, and famine may burden foreign governments because fragile states cannot manage humanitarian crises. Furthermore, internal disorder can become a cancer on entire regions, spreading chaos and violence to neighbors ill-equipped to handle any troubles beyond their own.[45]

Not everyone agrees with using military forces for non-traditional missions. Some argue that if policymakers have immense military might at their disposal they will constantly be tempted to overreach, and to redefine ever more broadly the "national interest." In addition, instead of preserving American security – the core national interest – the maintenance and use of an enormous and expensive military is corrosive to contemporary American Democracy.[46]

The lack of a comprehensive concept for humanitarian relief and political reconstruction was a result of a strategy formulation process that failed to integrate the efforts of the United Nations, relief organizations, and various USG agencies.[47] Effective interagency management and the use of special mechanisms are needed to coordinate agency efforts and provide greater unity to the humanitarian relief and security operations.[48] Integrated planning and effective management of agency operations early on in an operation can avoid delays, reduce pressure on the military to expand its involvement in unplanned ways and create unity of effort within an operation that is essential for success of the mission.

Potential coalition partners for conducting RNB interventions include the governments, NGOs, civilian, and military organizations. Each organization and discipline has a unique culture, perspective, purpose, and language, but much can be gained from their cooperation.[49]

Assessing a country's eligibility based on a descriptive ranking within "failed state" criteria is currently being used by several organizations involved in improving development capacity and nation building. Four such rankings include the Failed States Index (Fund for Peace), the Index of State Weakness in the Developing World (Brookings Institute), and the Country Policy and Institutional Assessment and the Post-Conflict Indicators Framework (World Bank).

Our allies and clients, or those who aspire to be, will cajole and connive us into taking risks on their behalf, while they remain content to dedicate resources to their own domestic pursuits.[50] Large multinational corporations often pursue "a foreign policy" that is compatible with that of the leading national government, but their search for profitability and unencumbered access to as large a marketing zone as possible may very well conflict with a national emphasis on full employment and maximum economic autonomy in critical industries.[51] This could result in higher costs to the USG and to the local citizens. This is one of many reasons why we must holistically and critically make every effort to spend our resources wisely.

The 2005 *National Security Presidential Directive 44* (NSPD-44),[52]combined with the initial funding to begin implementing the directive, started the ball rolling on getting resources to accomplish the mission. Unfortunately, State has inadequate institutional capacity to undertake such a task.[53] The newly established Bureau of Conflict and Stabilization Operations, that replaced the bureaucratically stifled Office of the Coordinator for Reconstruction and Stabilization originally formed to implement NSPD-44, is so new that reportable metrics to assess its impact on program success are not available.

The time is now for State to carry out the reconstruction and stabilization operations responsibilities outlined in NSPD-44. This can only be accomplished with necessary resources and collaborative assistance from the executive departments and agencies whose programs and personnel support the stabilization and reconstruction problems of the 21st century, including but not limited to Treasury, Justice, Defense, Homeland Security, and Agriculture.

SOUTH SUDAN: MAKE IMPROVEMENT OF GOVERNANCE A PRIORITY

To achieve the U.S. interest of a stable, prosperous, and democratic South Sudan at peace with her neighbors, the USG and its partners must assist South Sudan in almost every area of development, but especially in the area of improved governance. South Sudan is a prime example of a nation where improved governance must be at the heart of a successful and holistic development effort. USG assistance to improve governance could leverage the far greater resources of other actors in the private sector and in the philanthropic sector, creating a virtuous cycle of improved employment prospects, agricultural independence, and multi-sector development.

Private capital flows into South Sudan are already impressive, primarily in the oil extraction industry. Due to South Sudan's vast economic potential, many more investors would enter if only good governance would reduce risk to more acceptable levels. After independence and before the oil shut-off, South Sudan produced about 350,000 barrels of oil a day which provided 98% of government revenues. South Sudan accounts for about three-quarters of pre-independence Sudan's estimated 6.6 billion barrels of oil reserves.[54] The biggest investor, Greater Nile Petroleum Operating Company, is a consortium of Chinese, Indian, and Malaysian investors with a 5% South Sudanese stake.[55] It is currently in talks with the South Sudanese government on construction of an oil pipeline to Africa's east coast. South Sudan claims it can pay for such a project and that it has enough financial reserves to operate for a full year without additional oil revenue (if true, a credit to the Finance Ministry).

Oil revenues (existing and potential) guarantee capital interest, but South Sudan also has vast agricultural potential, with plentiful fertile soil and abundant water. At independence, there were 10-20 million head of cattle in South Sudan and over 80% of South Sudanese survived on subsistence agriculture.[56] Vast tracks of fertile land are still untilled and there is strong foreign interest in commercial farming (especially cotton, various grains, and rice). Large wildlife herds could eventually attract eco-tourists and the White Nile has enough flow for hydro-electric power. In short, South Sudan is unusually blessed with resources which could attract large capital investments to create a growing and dynamic economy, employing millions, raising living standards, and advancing development across all sectors.

Improved governance could also enable international aid efforts in health, education, and agricultural development to be far more effective. Since 2005, South Sudan has received more than $4 billion in international aid,[57] one of the highest per capita levels in the world, and the spigot likely will remain open for the foreseeable future. For several reasons South Sudan is clearly defined on the radar of donor governments, NGOs, and the giving public. First, to the extent that aid follows the news cycle, South Sudan has benefited from extensive attention. After the long civil war, atrocities in neighboring Darfur, recent independence, and celebrity advocacy (i.e., by George Clooney, Mia Farrow, and others), South Sudan, by a bloody price, has earned the world's attention and sympathy. Second, northern aggression and atrocities have attracted a large humanitarian response in general, and a Christian response in particular.

Unfortunately, much of that aid is under-utilized. A representative of Serving in Mission stated that the NGO has the funds and personnel to build and staff a hospital but has been unsuccessful in obtaining uncontested land title. Two other buyers were given title to the same plot of land by corrupt government officials. Building cannot commence until land title is settled. The representative said that this instance of corruption is not unusual and that poor governance is one of the greatest barriers to NGO development work in Africa generally, and in South Sudan in particular.[58]

Not every under-developed country is like South Sudan, blessed with abundant natural resources and relatively large foreign aid flows. But in almost every country, improved governance would leverage whatever economic potential exists and improve the performance of development dollars. In almost every country the improvement of governance is a responsibility that will only be assumed by government donors. Development of governance is an inherently governmental task, if not necessarily in implementation, then in funding.

An informal survey of NGOs and development organizations involved in South Sudan (about a dozen interviews and websites), revealed very little involvement in the governance sector (unless funded by a donor government or international organization). Why? First, host nation officials tend to listen to donor governments or their contracted agents on matters of governance. Second, improvements in governance are hard to measure and consequently difficult to market to the giving philanthropic public. Representatives from non-profit NGOs World Vision and Serving in Mission confirmed that they do not/not address issues of governance because they do not have the tools, the training, the credibility, or the access to host governments required to address governance issues.

Because the task of governance improvement is so critical to long-term development goals and because other actors are poorly equipped to address the issues related to governance, the USG should direct more of its aid resources toward improvements in governance. South Sudan is a helpful example of why the USG should change its mix of aid dollars, to favor improved governance, but South Sudan is an example with wide relevance to many other under-developed countries.

POLICY RECOMMENDATIONS

The USG should adopt five critical policy recommendations in order to ensure the solvency and effectiveness of the RNB industry.

Establish a National Diplomacy and Development Strategy: State should create a *National Diplomacy and Development Strategy (NDDS)* drawn from the *National Security Strategy*. The NDDS would serve as a companion to the Department of Defense's *National Defense Strategy*, and any RNB strategies would be drawn from the NDDS.

Develop Country-Specific Policy and Planning: The Secretary of State should lead a whole of government approach to develop and implement country-specific policy that clearly defines desired objectives with respect to U.S. national security goals. Country-specific policy that prioritizes governance programs would provide a clear starting point for the coordination of State Mission Resource Requests, DoD Theater Cooperation Strategies, and USAID's Country Development Cooperation Strategies. This synergy would create greater opportunities for industry participants to succeed in development goals. Clear policy, unique to each country, will allow RNB industry companies to anticipate trends and properly structure themselves to meet USG objectives. Greater program success might in turn lead to increased future revenue opportunities as country-specific policies feed into regionally interconnected goals.

Change the Funding Paradigm: Congress should authorize and appropriate no-year funding for USAID's six foreign assistance program objectives as is done for the Millennium Challenge Corporation. Shift prioritization of USG funding within these program objectives to Governing Justly and Democratically. Current budget inconsistency hinders companies in the RNB field who must promise multi-year work on an annual budget. Adding predictability to the market will increase efficiency and output for the RNB industry. In addition, where possible and with great caution, channel development funds through host government institutions to build governance capacity.

Build RNB Human Capital Strategy Across the USG: State should take the lead to fully staff, equip, and train an expeditionary corps of international development professionals who are able to conduct nation building on the ground, often in austere locations. Interagency cross-training and rotational developmental assignments should be included. They would conduct duties similar to those currently employed by both USAID and the Peace Corps; however, some personnel would possess hard skills in areas such as engineering, medicine, and law to advise host nation ministries. Establish a career progression model to develop personnel through hands-on experience overseas, programmed tracks of duty positions, and progressive training. This will require a substantial increase in State and USAID funding.

Mobilize the Diaspora: As a complement to the expeditionary corps of international development professionals articulated above, the USG should provide incentives to foreign diaspora members to return to their countries of origin to conduct international development duties and increase host government capacity with human capital.

CONCLUSION

RNB is not a traditional industry and therefore not easily defined or analyzed using the traditional methods of industry analytics because the industry is amorphous. It is an "industry of industries," which through a variety of strategies, has become very healthy despite declining USG budgets. In order to get maximum results for every USG dollar spent, this paper recommends a paradigm shift from doing "aid for aid's sake" to targeting host nation governance as a way to build capacity for the country to be self-sufficient and more prosperous and less dependent on external aid. The concept of "good governance" does not easily lend to comparative analysis, nor is it easily quantifiable for the purpose of measurable results to justify legislative changes or additional resourcing. It is for these reasons that USG funding should be high for governance, as NGOs can fill requirements for more metrixed aid. RNB projects such as clean water and education lend well to short-term demonstrable results, but are simply not sustainable if governance is poor. Although there is widespread consensus that governance is the key to successful RNB, there seems to be lack of political will to accept a paradigm shift – especially during a time of recession – and the constituency for this is outweighed by constituencies for earmarked projects. The five policy recommendations outlined in this paper are not only supportable, but their execution is imperative if the United States is to continue RNB efforts in support of our national security interests.

Appendix A

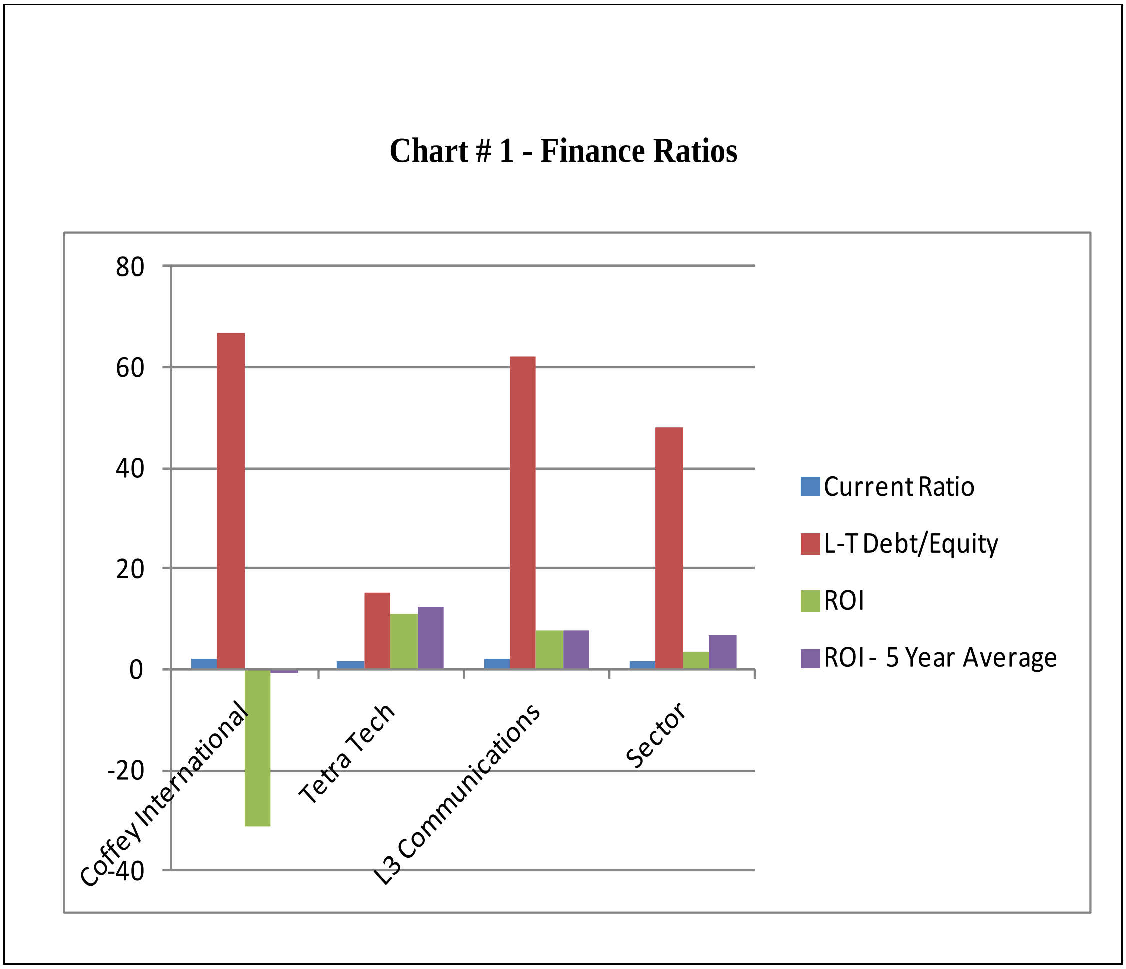


Chart # 1 - Finance Ratios
80
60
40
20
0
-20
-40
Coffey International
Tetra Tech
L3 Communications
Sector
Current Ratio
L-T Debt/Equity
ROI
ROI - 5 Year Average

Chart #2 - Dollar Value of USAID Contracts ($M)

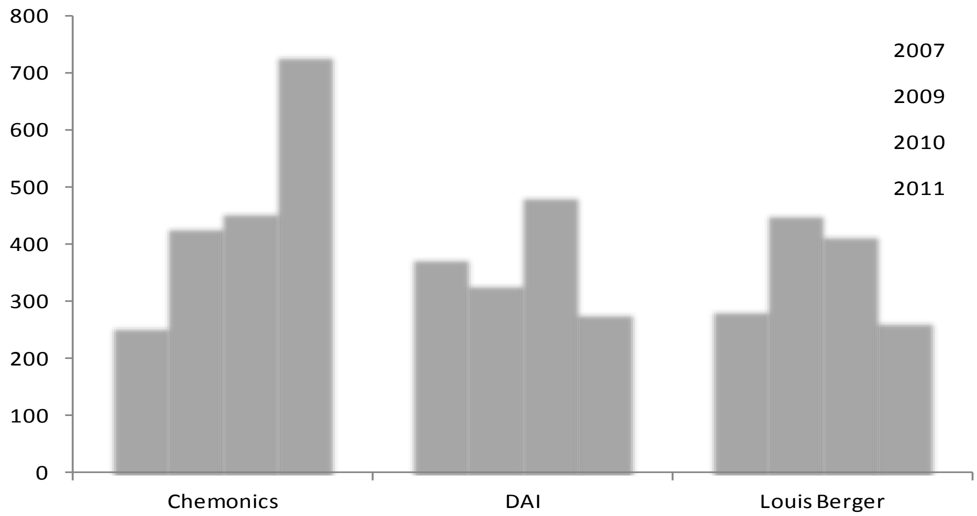


Chart # 3 - Revenue Comparisons from *Washington Technology* Top 100 for Federal Prime Contracts ($M)

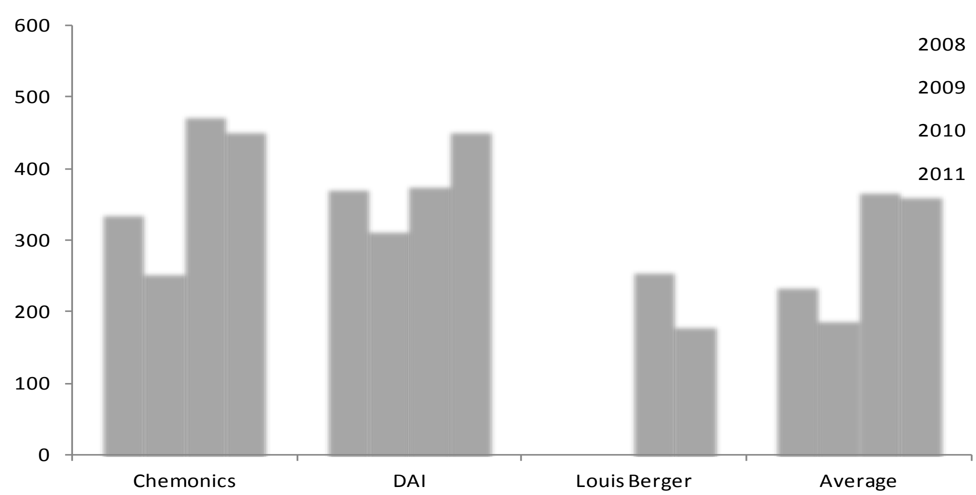
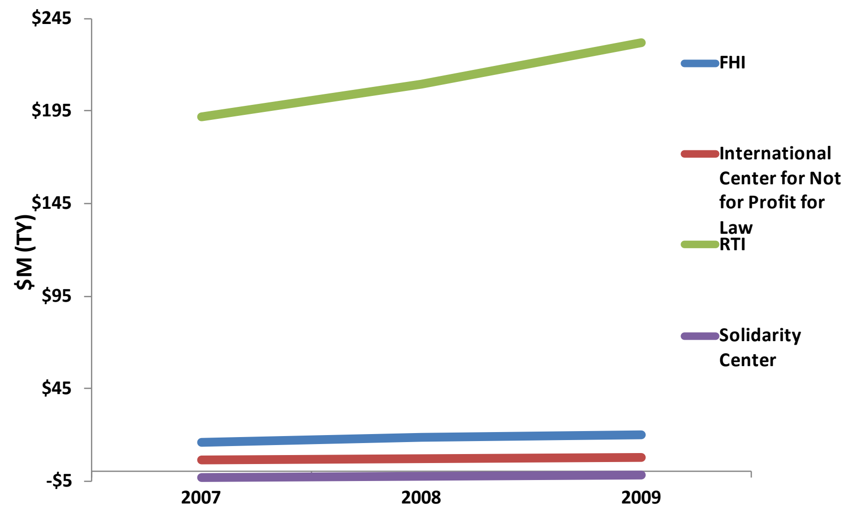


Chart #4- RNB Non-Profit Organizations' Net Assets



Net assets provide an indication of the level of resources the organization has to help support its activities in the future. An organization with a large amount of net assets at the end of the year would be better able to endure a time of income shortfalls and still continue its activities. Three of the four organizations cited have growing net assets, reflecting healthy operations.

GLOSSARY OF ACRONYMS

CDCS	Country Development Cooperation Strategy
CERP	Commander's Emergency Response Program
CSO	[Department of State] Bureau of Conflict and Stabilization Operations
DAI	Development Alternatives, Inc.
DoD	Department of Defense
DoS	Department of State
EU	European Union
FHI	Family Health International
FY	Fiscal Year
IQCs	Indefinite Quantity Contracts
MCC	Millennium Challenge Corporation
MSI	Management Systems International
NAICS	North American Industry Classification System
NATO	North Atlantic Treaty Organization
NDDS	National Diplomacy and Development Strategy
NGO	Non-Governmental Organization
NSPD	National Security Presidential Directive
NSS	National Security Strategy
ODA	Official Development Assistance
RNB	Reconstruction and Nation Building
ROI	Return on Investment
RTI	Research Triangle International
TY	Then Year
UN	United Nations
USAID	United States Agency for International Development
USG	United States Government

PLACES VISITED

DOMESTIC
Government:

Department of Defense:
- Combined Joint Task Force – Horn of Africa
- Joint & Coalition Warfighting Center, Suffolk, VA

Department of Homeland Security:
- Eighth Coast Guard District, New Orleans, LA
- Gulf Coast Incident Management Team for Deepwater Incident

Department of State:
- Bureau of Conflict and Stabilization Operations (CSO), Washington D.C.
- Millennium Challenge Corporation (MCC), Washington, D.C.
- United States Agency for International Development (USAID), Washington D.C.
- United States Mission to the United Nations, New York, NY

NATO Civil Military Fusion Centre, Norfolk VA

Office of the Governor of Louisiana / Coastal Activities, Baton Rouge, LA

The World Bank, Operational Communications/External Affairs, Washington D.C.

United Nation's Peace Building Support Office

United States Institute of Peace (USIP), Washington, D.C.

United States Senate Committee on Foreign Relations, Washington D.C.

For Profit/Non-Profit Firms:

AEGIS Defense Services, LLC, Arlington, VA
Chemonics, Washington, D.C.
Council on Foreign Relations, New York, NY
Development Alternatives International, Bethesda, MD.
InterAction, Washington, D.C.
KBR, Arlington, VA
L-3 MPRI
Louis Berger Group, Washington, D.C.
Management Systems International (MSI), Washington, D.C.
New York University Center on International Cooperation, New York, NY
Rand Corporation, Arlington, VA

Research Triangle Institute (RTI), International, Washington, D.C.

INTERNATIONAL:

Amayo Wind Power S. A. Project, Rivas, Nicaragua
Ejercito de Nicaragua - J3, Managua, Nicaragua
Ministry of Defense, Managua, Nicaragua
Haitian Diaspora Working in Haiti (HDWIH)
Instituto de Estudios Estrategicos y Politicas Publicas (IEEPP), Managua, Nicaragua.
Mayor Alfonso Garcia, Chief, San Juan del Sur Fire Department
Mercy Corps, Port-au-Prince, Haïti
Ministère del Intérieur, Port-au-Prince, Haïti
Ministry of Health, Port-au-Prince, Haiti
Nicaraguan Emerging Democratic Leaders/USAID, emerging democracies meeting.
Office of Transition Initiatives, USAID, U.S. Embassy, Port-au-Prince, Haiti
Padron Cigar Factory, Estelí, Nicaragua
Ram Power/Polaris Thermal Energy Plant, Leon, Nicaragua
Sebaco Bean Production Facilities, Sebaco, Nicaragua
United Nations Stabilization Mission in Haiti (MINUSTAH), Port-au-Prince, Haiti
United States Embassy, Managua, Nicaragua
United States Embassy, Port-au-Prince, Haiti
Universidad Americana (UAM), Managua, Nicaragua
VegyFrut/USAID, Managua, Nicaragua

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