Chapter 2

Risk perceptions and analysis

Chapter 2 addresses three questions: (1) *How are risks dealt with in aid policy?;* (2) *How do donors currently assess risks and report on successes versus failures?; and* (3) *How do perceptions of risk vary and how can differences be bridged? It looks at whether taking risk and reporting results are compatible, and asks how we can break down vague and over-ambitious objectives into more realistic and tangible goals. It also points out that one of the greatest challenges in adopting a whole-of-government approach to fragile states is to bridge differences in organisational cultures. It concludes by describing how the donors who are more willing to take risks can lead the way, later to be followed by more cautious donors. It also emphasises that individuals need the support and backing of senior managers if they are to be encouraged to take appropriate risk.*

In this chapter we look at the ways in which aid actors perceive and analyse the three types of risk (contextual, programmatic, institutional) identified in Chapter 1. We do so by answering the following questions:

1. How are risks dealt with in aid policy?
2. How do donors currently assess risks and report on successes versus failures?
3. How do perceptions of risk vary and how can differences be bridged?

This and the following chapter (which looks at risk management) are based on a review of the literature and policy and procedural documentation, supplemented by the results of interviews of some of the main DAC donors, multilateral donor organisations and UN implementing agencies (see Annex D).

Two important caveats should be noted here. First, these chapters review approaches to risk and risk management primarily as seen through the eyes of donor government staff in headquarters, and through the lens of institutional procedures and policies. This does not necessarily reflect practice throughout an organisation, particularly at the field and programme implementation level. Practice depends in part on the way in which policy is understood and implemented and the amount of discretion given to regional and country offices or implementing partners.

Second, given the limits of the study, we have not been able to explore the perceptions of aid recipient countries, either the government or the population at large. Clearly, this is an essential matter for future consideration. National and international perspectives of contextual risk may be very different; and in the national sphere, differing priorities often lead to different perceptions of risk. For example, one of the most striking examples of the significance of different risk perspectives is the relatively low priority that tends to be given to risks affecting population groups such as destitute rural and urban families, that may be highly vulnerable to natural hazards and economic shocks, but which are politically and economically marginal. Risk is ever-present in the lives of such people, who often inhabit marginal land and depend on precarious livelihoods. Yet the vulnerability of these communities only tends to be a top priority in national and international aid policy when a humanitarian crisis occurs. In spite of the renewed prominence given to this topic by the climate change agenda, preventive action to reduce the risk of disaster remains one of the "orphans" of the aid agenda – as the recent floods in Pakistan remind us. Similarly, social protection mechanisms to help people recover from shocks and build resilience in the medium and longer term tend to be underfunded and grossly inadequate to the task. Besides the risk of conflict, exposure to hazards of this kind is one of the recurring characteristics of fragile states – and may in turn increase the likelihood of insecurity and political instability. Although further analysis of these and

other contextual risks involved in fragile settings is beyond the scope of this study, it forms an essential backdrop to the discussion that follows.

2.1. Risk in development and humanitarian policies

The concept of risk lies at the heart of much of the new thinking on fragile states. As noted in the previous section, many of the donors researched for this report acknowledge the higher risks of engaging in fragile states. The European Commission, the Netherlands and the UK are the most outspoken about this in their formal policies and strategies. For example:

> *The risks involved in working in fragile states are greater than those in other developing countries. Staff who are sent to these countries face significant risks. The political risks are also greater due to the fact that these are weak states with unstable political situations. Management risks are also considerable since the capacity of the government and implementing organisations is often more limited than in other developing countries. There is consequently a higher risk of misspending and corruption. There are also risks of interventions proving ineffective, since the overall situation could worsen rather than improve, thus undoing the intervention's effects. (NL MFA, 2008)*

DFID, in turn, speaks about fragile state engagement as "more complex peacebuilding and statebuilding processes, with greater potential to transform the long-term prospects of these countries, but with much higher levels of risk" (DFID, 2010b). The European Commission explains that "dealing effectively with fragility involves taking risks and requires rapidity and flexibility in adopting political decisions and making them operational in the field, while dealing simultaneously with partner countries´ constraints, often in terms of limited capacities" (European Commission, 2007). Germany makes a distinction between fragile and non-fragile states in its guidelines to using budget support as to provide aid, noting that "[d]ue to the higher risks posed by [fragile states], a policy decision in favour of budget support would only be taken in an exceptional case." (BMZ, 2008)

Other donors – usually those without official fragile states strategies – are less outspoken about the higher risks of intervening in fragile states. Australia, Canada, Denmark and Sweden do not formally distinguish in their development policies between risks linked to interventions in fragile states and those associated with other forms of development co-operation. Sweden, for example, has no separate framework for assessing or managing risks in fragile situations, only general guidelines that apply to all forms of development assistance. Denmark, in turn, has no specific guidelines for managing funds in transition situations. However, on an informal, programming or operational level these donors nevertheless tend to acknowledge the greater risks in fragile

states and the need to treat engagements in these contexts differently. One official with the Danish MFA, for instance, stated that although no specific guidelines exist for engagements in fragile situations, it is widely accepted that general development guidelines will need to be applied differently in these contexts.[1] An official with the Swedish International Development Co-operation Agency (Sida), in turn, stressed that "Sida acknowledges the need to take more risk when intervening in conflict-affected situations, but it is not clear how to take acceptable or calculated risks".[2]

Most donors acknowledge the higher risks of engaging in fragile states, because of the higher levels of insecurity, political instability and lack of partner capacity in these areas, but they also emphasise the urgent need to promote peace, security and development in fragile contexts. The European Commission describes fragile situations as "… a particular challenge as an obstacle to sustainable development, equitable growth and peace, creating regional instability, security risks at global level, uncontrolled migration flows, etc." and the German Federal Ministry for Economic Co-operation and Development (BMZ) stresses that "[f]ar-reaching policy changes and reform processes are necessary in these countries if the Millennium Development Goals are to be achieved" (BMZ, 2007). Similarly, in 2008 the UK's DFID announced that it is "… responding to humanitarian need, the economic costs of insecurity and the need to reduce poverty in insecure environments by increasing its emphasis on conflict prevention and on supporting 'fragile states'" (DFID, 2008).

2.2. How do donors assess and report risk?

Assessment frameworks

While most donors acknowledge that risks in fragile and conflict situations are higher than in traditional development contexts, only a few donors have risk assessment frameworks specially designed for these environments (Box 2.1). In some cases, however, they acknowledge the need to apply general frameworks differently in these contexts. This is the case in Denmark, where one respondent working for the MFA stated that "… of course, in fragile situations the risks are even higher, the timelines are shorter and there is a need to work collectively. The general rules may not apply in these situations."[3]

Some donors have frameworks or guidelines that lay out the risks and benefits of particular forms of engagement in different kinds of context. The EU is currently in the process of developing a framework for analysing the risks associated with providing budget support to fragile states.[4] While still in the draft stages, this framework is interesting because it gives attention to "tendencies of change" rather than just the overall weakness of financial systems in fragile states. In other words, it considers the potential for transition in public financial management rather than assuming a steady state. Among

Box 2.1. **The UK's Programme Risk Assessment Matrix**

Some donors do consider the risks associated with engaging in fragile states separately from the general risks of development co-operation. DFID´s Middle East and North Africa Department (MENAD) has developed a Programme Risk Assessment Matrix (PRAM) that it claims is "… particularly relevant to conflict and fragility" (DFID, 2010b). The PRAM, which is updated at six-monthly intervals, monitors risk and performance across three country programmes (Iraq, the Occupied Palestinian Territories and Yemen) and the regional programme. Its data consist of a summary of portfolio performances and trends, one-page risk summaries for each country and the region, a table with monthly performance scores for all ongoing programmes, and detailed reports for each individual programme. According to DFID, the strength of the PRAM is that the "… regular assessment obliges both country offices and the MENAD to keep levels of risk and impact on operations under constant review. If the same risks and responses are recurring, managers should take remedial action" (DFID, 2010b). Furthermore, the PRAM enables MENAD to keep an eye on both individual country situations and regional trends, and facilitates information sharing across programmes.

other things, it examines the recent evolution of the macroeconomic situation in the country and the region, recent changes in budgetary processes, and whether a national programme exists that is capable of introducing credible and coherent financial reforms. It also outlines (as far as is possible) remedies for particular risk factors. While many donors reject outright the provision of budget support in fragile situations, the EU framework may help to highlight important nuances that exist in different fragile states.

In a report on fragile state engagements, the German Federal Ministry for Economic Co-operation and Development (BMZ) also focuses attention on "tendencies of change". Categorising fragile states according to government performance and development orientation, the BMZ notes that governments that are demonstrably more development oriented make worthier candidates for close collaboration and may even qualify for programme-oriented joint financing (PJF) measures. Budget support, however, will be provided only in exceptional cases (BMZ, 2007). A related document on budget support states: "In principle, PJF can be granted to [fragile states], provided that notwithstanding their low governance levels they show a clear and positive trend in government performance (development orientation, political commitment to reform, readiness to engage in dialogue)" (BMZ, 2008). Such distinctions are a helpful reminder that interventions in fragile states should seek to encourage positive tendencies, not simply reward past achievements.

Many other donors do not have specific frameworks for assessing risks in fragile states, but instead use general risk assessment frameworks for all forms of development co-operation. Sweden, Australia and Canada all have single sets of risk assessment guidelines for general development engagements. The Swedish risk assessment procedure is based on a process of first documenting and valuing risks, then analysing and appraising them in terms of acceptability (Sida, 2009). The Australian Agency for International Development assesses risks in three steps: *(1)* identifying risks; *(2)* analysing their likelihood and consequences; and *(3)* ranking risks against priority criteria (AusAID, 2005). This in turn resembles methods that CIDA uses, where the risk assessment process consists of *(1)* identifying risks; *(2)* evaluating them in terms of likelihood and impact; and *(3)* ranking them based on this evaluation (CIDA, 2010). In many respects, these procedures may also promote effective risk management in fragile contexts – but without the necessary step of balancing competing risks and weighing them against opportunities. As noted above, reducing risk in one area can increase it in another – and too exclusive a focus on risk reduction may have a negative overall effect.

It is interesting to note the different risk categories used by donors. There is clearly no single way of understanding and grouping risks; instead, donors have developed an array of typologies and definitions based on their perceptions of the risks of development co-operation. MENAD's PRAM (Box 2.1) identifies three broad categories of risk: country risks, partner risks and programme/ project risks. Country risks affect "… the broader environment in which DFID is operating, including the internal and external political context, levels of insecurity and violence, and events and processes that may impact DFID's operations at a strategic level." Partner risks are linked to low partner capacity or weak political will in the partner country,[5] but also include fiduciary and corruption risks. Finally, programme and project risks affect the implementation of programmes and projects, including security risks and risks linked to infrastructure and supplies[6] (DFID, 2010b). Sida categorises risk in different terms altogether. Its report *Integrated Risk and Results Management* defines risks in terms of their effects on "output efficiency", "outcome effectiveness", "outcome relevance" and "outcome sustainability" (Sida, 2009). This provides the analytical distinctions that are fed into a risk management framework that is explicitly results oriented.

CIDA uses a different results-based risk assessment framework, where the overall categories include operational risks, financial risks, development risks and reputational risks (CIDA, 2010). Each of these broader sets is then sub-divided into more specific risk types. For example, operational risks include human resources risks, performance management risks and information systems risks; while financial risks consist of funding risks, fiduciary risks and contractual instrument risks. What is interesting about CIDA's risk assessment framework is that it is derived from and subordinated

to an overall risk management system used by the Government of Canada. CIDA follows similar risk standards and procedures to any other government department:

> *The government has a Corporate Risk Profile that identifies the main risks that need to be tackled in any planning profile or strategic planning. The risk analysis is to be conducted by different government bodies, looking into risks in relation to the Corporate Risk Profile and specifically related to the branch. The risk analyses are filled out and reviewed periodically. After that, the Corporate Risk Profile is updated based on the information provided. The objective is to keep the risk analysis as simple as possible and standardised as much as possible so that everybody is using the same methodology.*[7]

The use of a standardised framework covering all state departments may of course be too rigid when applied to specific policy initiatives, and also ill-suited to fragile contexts, where greater flexibility may be necessary. However, as Canadian government officials were careful to stress, the standardised framework is not meant to influence decisions over whether or not to engage in risky situations – these are taken on political grounds – but rather the way in which engagements are to be undertaken. It should also be noted that the Canadian START initiative (see Chapters 1 and 3) expects to be able to employ a tailored risk analysis framework (derived from the risk management framework of Canada's Treasury Board Secretariat).

Although not specifically referred to as risk analysis frameworks, increasingly country offices and/or embassies are regularly analysing the political-economy context. Such analysis in effect serves as a risk analysis and management instrument (*e.g.* the Dutch Strategic Governance and Stability Assessment Framework). It assists in the strategic management of programmes by alerting managers to changes in country conditions that may require adjustments to priorities or delivery methods; it supports operational management by identifying threats to the successful delivery of programmes (Box 2.2); and it enables donors to protect their staff and contractors by identifying threats in the operating environment (Cox and Thornton, 2010).

The Democratic Republic of Congo illustrates the problem of balancing the risks of planning jointly with host governments against the risks of *not* doing so. The international community has had limited influence on the DRC government, which adds to the operational challenges of planning, alignment and co-ordination. This lack of co-ordination has been highlighted by the activity of bilateral actors – like China – whose engagement in the DRC has been driven by political, strategic and economic interests (Jiang, 2009). DAC donors have attempted to address their weak influence on the government and their lack of co-ordination by jointly preparing a Country Assessment Framework[8] and an engagement strategy. However, the strategy,

critically, has not involved Congolese actors in the planning and negotiation phases. The risk that these priorities will not achieve political buy-in from DRC government stakeholders is consequently high – a dangerous precedent to be setting, given that, cumulatively, these donors supply 85% of official development assistance to the DRC (Cox and Thornton, 2010). However, the consensus appears to be that these risks are outweighed by those associated with closer engagement with the government.

Box 2.2. **Sida's risk assessment in the Democratic Republic of the Congo**

In order to monitor the situation in the Democratic Republic of the Congo (DRC), donors have devised a number of different strategies, including the articulation of a joint Country Assessment Framework. The related pooled mechanism is designed in part to transfer the risks of engagement and programming onto the UN, enabling bilateral donors to provide institutional aid without running the danger of all the associated risks of programming in fragile contexts. Where bilateral donors have decided to undertake bilateral programming as well, a number of innovations have been introduced, such as diagnostic systems. Sida, for instance, uses monitoring exercises to determine the drivers of risk for its programming in the DRC so that the agency can address rapidly changing conditions on the ground. To understand risk effectively, Sida examines power dynamics and uses a number of scenario-planning tools to identify the range of possible consequences of co-operation and programming (Sida, 2009).

Risk, results and realism: are they compatible?

With the current financial crisis and increased media attention on government spending, the pressure to show results from aid money has increased dramatically. It is now not uncommon for donor agencies and politicians to be held publicly accountable for any failure to achieve expected results or to spend taxpayers' money effectively and efficiently.

This is leading to more and more donors adopting "results-based risk assessment frameworks". This tendency is reflected in international aid policy frameworks, which have become increasingly focused on identifying results chains (input–output–outcome–impact); results-based management and reporting; and improving monitoring and evaluation systems as an integral part of results frameworks. For example, DFID's Results Action Plan (November 2007) stresses the importance of good results management in fragile states and calls for more quantified information on the impact of programmes (Cox and Thornton, 2010).

This focus on results has major consequences for donors' willingness to take risks: the pressure to show results appears to be making donors more risk-averse. This, in turn, makes implementing agencies also more risk-averse – they do not want to end up as scapegoats for the donor community. Two particular aspects of results-based management might be expected to influence the level of risk-taking in these circumstances. First, there would appear to be a structural incentive to avoid setting ambitious objectives or adopting new or untested approaches to programmes, as this might increase the chances of programme failure and make it harder to demonstrate results. Second, the system implies an ability to demonstrate results on an "outcome" and even "impact" level, but this is notoriously hard to do – particularly in fragile and conflict situations. There is reason to believe that both factors have tended to make for more cautious and risk-avoiding behaviour in the design of programmes, at least at the level of tangible outputs and outcomes. Logical frameworks focus the mind on what it will be possible to demonstrate.

In spite of these factors, there is a tendency to set highly ambitious "strategic" or "meta" objectives alongside more immediate goals, and a corresponding tolerance of failure to achieve such objectives – at least in the settings of highest strategic concern to donors. Indeed, practice shows that realistic objectives, coupled with appropriate timelines and commensurate resourcing, are the exception rather than the norm. As one Sida respondent observed:

> *You have to be able to see where things will go: trial and error. If there is a long-term engagement, then you have more time to right the wrongs. Unfortunately, the focus in transition situations is usually very short term. On the issue of realistic timelines: as it stands now, donors and agencies are playing a game of fiction – donors will not fund agencies that are using realistic timelines. So agencies work to timelines that they know are not realistic, and donors accept that. (Source: Interviews with Sida official)*

By way of example, a 2009 review of the World Food Programme's (WFP) strategy in the DRC noted that the WFP plan "… assumes things about capacities and the pace of government-led reform that now (and perhaps at the time) look highly over-optimistic. Perhaps this is what WFP thought its donors wanted to hear, but it raises serious questions about the kind of consensus that allows such propositions to become the basis for planning." (Darcy and Foliot, 2009).

It seems that the failure to achieve "meta-objectives" such as those related to peacebuilding or statebuilding – over which donors acknowledge they may have relatively little influence – is treated with a high degree of tolerance. Indeed, the risk of programme "failure" in this wider sense is

arguably built into many programmes from the start. While the more tangible and more easily-measured programme elements (such as food distribution or health care) are treated according to more normal rules of accountability, the intangible elements sometimes appear as window dressing. One of the key questions, therefore, is how to break down vague and over-ambitious objectives into more realistic and tangible goals that can be integrated into results management at the country and programme levels.

Related to this is the question of how objectives can be identified so that they acknowledge the risks involved. This requires a sound understanding of the sources and drivers of conflict and fragility. Programme documents need to (Cox and Thornton, 2010):

- Make risk drivers explicit, stating which of them the programme seeks to influence (taking into account the political opportunities that exist and what others are doing) and how the portfolio of interventions has been designed to accomplish this.
- Identify the risks involved.
- Justify why these risks are taken (including a trade-off/cost-benefit analysis).
- Explain how the programme will tackle the risk outcomes if they occur.

In practice, however, logical frameworks in situations of conflict and fragility tend to be over-ambitious and unrealistic. Risk assessment, if present at all, is mostly a "tick-box" exercise.

Monitoring risk

The three categories of contextual, programmatic and institutional risk (Box 1.1) can help donors distinguish the different levels of monitoring that are needed. Risks in the external environment are generally tracked at country level and must be factored into project management, while risks that are internal to the design and management of individual projects (*i.e.* programmatic and institutional risks) tend to be monitored and managed at the intervention level. As external risks are mostly beyond the control of donors, the focus is largely on programmatic and internal risks. In order to manage these, higher levels of operational monitoring are needed in these environments, for several reasons:

1. Implementing partners tend to be activity focused and to lack flexibility.

2. Interventions are harder to deliver in difficult operating environments, and implementing partners may struggle to post experienced managers to insecure environments.
3. Counterparts may be weak, and weak partners tend to be optimistic in their reporting.
4. Donor staff in the field can become used to working in risky environments and may not be attuned to gradual increases in the level of risk.

All of this calls for additional monitoring arrangements to give donors an accurate picture of implementation.

One of most basic challenges to monitoring the progress of a programme and the factors that may cause it to fail is data shortage in fragile or conflict-affected settings. National data systems may have broken down, in some cases for long periods of time, meaning that basic demographic data are not available. In countries with repressive regimes, in particular, government data may be politicised and unreliable. Security constraints may hamper access to many areas for data collection (Box 2.3; Cox and Thornton, 2010). Donors and implementing agencies are increasingly recognising that financial investment in generating information is not only appropriate, but essential.

Box 2.3. **Somalia and the problems of aid monitoring in highly insecure environments**

Somalia epitomises some of the external and internal risks involved in aid work in fragile states. Rampant insecurity, weak state structures and volatile politics add to a situation where aid workers have very little control and are often at great personal risk. Consequently, many international aid organisations have responded by removing most or all foreign personnel from the country and instead running "remote control" operations from Nairobi or other neighbouring countries. Aid organisations often contract out operations to local implementing partners instead of working through their own staff on the ground. However, while this avoids the security risk to their own staff, it also drastically undercuts these organisations′ oversight and control of their operations. For instance, the US government has a policy of no presence on the ground in Somalia, so USAID relies on information from partners, other donors, local officials, news reports and other key sources of information to plan and monitor its programmes (US Accountability Office, 2008).

Box 2.3. **Somalia and the problems of aid monitoring in highly insecure environments** *(continued)*

This kind of operational outsourcing can have serious consequences, as WFP found in Somalia (see Chapter 3). In the absence of proper monitoring mechanisms, aid may be diverted to enrich contractors or even fund armed groups, rather than supporting the needy populations for which it is intended. Even where there is no large-scale graft, local contractors are often able to negotiate extortionate fees for their services as a result of the absence of competition and the pressing need for service delivery. This illustrates some of the most painful dilemmas of working in fragile states. Responding to the security risks of operating in the country by pulling out staff inevitably increases programme and fiduciary risks. Besides the dangers of actually causing harm, organisations risk damage to their reputations in these circumstances.

The issue is not confined to Somalia. For example, a number of major NGOs reported that donors were not prepared to fund them in Iraq in the mid-2000s because the donors had little or no ground presence, were working through intermediaries, and could not provide the requested guarantees on reporting and accountability (ODI, 2008).

2.3. Bridging differences in risk perceptions and tolerance

Over the last couple of years the international community has increasingly recognised that engagement in fragile and conflict-affected situations requires multiple actors to work together in a coherent manner. This is very clearly reflected in the FSP (Box 1.5), which state that "… the particularly complex and severe development challenges that the international community is confronted with in fragile situations require joined up and coherent action by political, economic, security and development actors within and among governments and organisations" (OECD, 2007). These spheres are considered to be interdependent: failure in one risks failure in all others.

By identifying the rationale for coherent working, the OECD believes it will reduce the risk of objectives either being compromised or simply not being met (*i.e.* programme risk; OECD, 2006). However, the fact that so many different actors are involved in a process also *creates* risks, as it makes it difficult to align different approaches and objectives within one strategy. This applies both to the process of developing a risk management strategy and that of developing an overall intervention strategy.

The process of assessing and analysing risks, and then developing a strategy to manage these risks, is currently something of a tacit compact

among all the different stakeholders involved – if it happens at all. Yet in order to be as effective as possible, a joint strategy needs to build on the comparative advantages of all the actors involved (Box 2.4). There is also a need to better align risk perceptions: what is a risk to one is not necessarily a risk to another (and may even be an opportunity). As an example, one respondent pointed to the fact that the World Bank is about to provide substantial funding to the DRC Government for mineral extraction. The risk calculus for this intervention may be very different depending on where you are sitting. Some would perceive the chance of doing harm through such an intervention as being too great, while for others, this intervention is justified by the countervailing risk of *not* investing and thus failing to boost the control of the DRC government over mineral extraction in the country.

We often willingly take risks because we see the *prospect of future gain*. Given our limited ability to predict the future, even where we have some influence over it, any investment in an enterprise carries some degree of risk. That risk increases in fragile states, where the number of variables (and hence the degree of uncertainty) tends to be high, and the degree of control low. But the stakes are commensurately high, whether expressed as contextual risks averted or positive outcomes achieved. By not being willing to take risks, we forego the opportunity for gain. One of the problems considered below is the generic problem of defining "gain" (or success) in both the development context and that of wider foreign policy goals.

Box 2.4. **Shared risk analysis: a US example**

Any intervention in fragile and conflict-affected situations is a process of linking the political reality in-country with donors' domestic political realities. It requires a constant reviewing of the risks involved and the level of exposure. Many donors have developed analytical instruments for this purpose. One example is the US Inter-Agency Conflict Assessment Framework, a tool that brings together experts to develop shared analysis. The tool is generally administered by the State Department and USAID with the participation of other relevant agencies. The shared analysis allows for greater transparency, at least internally, on the rationale for interventions. This is perceived to be very important, as the rationales for engaging in fragile and conflict-affected situations may differ and at times conflict. Actors approach the work from different angles, ranging from counter-terrorism to governance, conflict prevention and peacebuilding, trade promotion, and development co-operation (OECD, 2006). These differences in rationale lead to different assessments of the risks involved.

It is important to understand that risk is a *relative* (not an absolute) concept: we need to understand from whose perspective a risk judgement is being made. In some cases, the same outcome or event may be good for one party and bad for another. For example, if a gambler places a bet on a horse to win a race and it wins, this is good for the gambler and bad for the bookmaker (and *vice versa* if the horse loses, which it usually does). This risk/gain *reciprocity* is a common, but not universal, feature of risk: one party may gain from the very thing that causes harm to another. More often, perhaps, an outcome that is undesirable to one party may be a matter of no particular concern to another – and perhaps even a matter of complete indifference. Either way, incentives to ensure or avoid a particular outcome can be very different, depending on whose perspective is considered.

Understanding risk and the part it plays in people's own decisions and behaviour is an essential part of successful engagement in fragile states. In particular, it is crucial to understand the nature of contextual risk and the different perceptions of it. For example, the greatest risk as perceived by the international community (*e.g.* the political resurgence of the Taliban in Afghanistan) may not be the same for ordinary people (who may be more concerned about ongoing threats to their own security and freedom of action). The questions of how ordinary people's decisions are informed and what motivates their behaviour are important considerations for those planning to intervene on their behalf. In other words, *perceptions* of risk are important here, and we consider this below in relation to both institutions and individuals.

This point is not confined to "contextual" risk as defined above. Institutional risks are likely to be perceived differently by different parts of the same institution and individuals within it. Similarly, programmatic risk – the risk of programme failure – may be seen differently in the field and at headquarters, or by different government departments. It may also be seen differently by donors, implementing agencies and aid recipients. So, for example, while donors may be most concerned with failed investment (wasted money), agencies may be more concerned with the loss of their reputation, either with the donor or with the community or host authorities. For the intended beneficiaries, on the other hand, programmatic failure may be a matter of life and death – or at the very least may have significant implications for their chances of effective recovery.

One important aspect of aid interventions is an asymmetry in risk taking and risk perception that can result from weak local ownership. In such situations, donors may in effect take risks "on behalf of" the recipient country. This can affect both donors' and recipients' perception of risk, and donors may be less risk-averse if risks are shared more equally by recipient countries. Another question of risk balance arises between bilateral donors and the multilateral organisations through which they channel assistance. In the following sections, we consider in particular the issues associated with

multi-donor trust funds and other pooled funding mechanisms, in which programme and institutional risks are both transferred and shared.

When understanding different risk perceptions, it is important to take into account the different levels of *risk tolerance* among different actors. Risk tolerance is made up of two things: *(1)* risk appetite; and *(2)* the capacity to take on risk (*i.e.* to assess and manage it). A large organisation like the WFP, for example, is better able to deal with risk – and so can better cope with a crisis like the current one related to food aid in Somalia – than a small NGO.

Understanding how risk tolerance varies

One of the greatest challenges in adopting a whole-of-government approach is to bridge differences in organisational cultures. This section explores the ways in which risk is perceived by different sectors.

The culture of risk

Organisational culture can be described as "a pattern of basic assumptions that are invented, discovered or developed to help cope with problems of external adaptation and internal integration within an organisation" (Schein, 1991). The pattern of assumptions may include values, norms, rules, myths, stories and rituals. An organisation's culture arises from a number of factors, including the predispositions of members and the circumstances with which the organisation must cope. Rather than one culture, many organisations have several cultures that are often in conflict (Box 2.5).

An organisation with a strong sense of mission may excel at carrying out tasks defined within that culture, but is likely to be poorly adapted to perform tasks that are not defined as part of that culture. This is relevant in fragile and transitional settings, where both donor departments and their partner agencies may be operating outside their "comfort zones" and where organisational culture may make adaptation difficult.

In terms of risk-taking, one can also see cultural differences. Departments for development co-operation are traditionally more process oriented, whereas defence or foreign affairs departments tend to be more output oriented (OECD, 2006). Several respondents referred to the fact that defence and foreign affairs departments are used to taking calculated risks – *e.g.* in deciding whether or not to engage in a military intervention. Development actors, on the other hand, are perceived by some as living in a technocratic bubble, developing technical solutions to highly political problems, setting unrealistic timelines for achieving results due to mounting political pressure, and understating the risks involved in engaging in fragile and conflict-affected situations. Respondents referred to the fact that the relevant literature on intervening

in fragile states suggests that (on average) there is at best a 50% chance that an intervention will be successful. Moreover, what counts as "successful" in aid delivery terms is often narrowly interpreted, so that anything short of a 100% achievement of objectives is considered to be a failure. One respondent described how a donor had provided funds to set up 10 women-only projects in Afghanistan. The programme was scored and listed as "unsuccessful" because it only managed to establish 8 projects instead of 10. As noted above, what constitutes success depends on your point of view, but this example surely points to a problem of perceiving and evaluating "success" in difficult working environments.

Many respondents feel that their respective departments for development co-operation remain too "traditional" in the sense that the focus is on supporting development only in terms of economic growth, health and education.[9] Risk taking and involvement in political processes are not mandated from the top. This partly has to do with the fact that in most countries, development co-operation is the least powerful actor in the 3D package (defence, diplomacy, development).

Risk management systems must not only consider the "hard" aspects of procedures and systems, but also "soft" aspects such as behaviour, organisational culture and incentives (See Box 2.5).

Box 2.5. **System-wide cultures**

Sometimes the culture "problem" goes beyond the bounds of the individual organisation and extends to the way in which a whole government thinks. In a recent paper, Andrew Natsios, former USAID administrator, has written about the dominant "measurement" culture in the US public sector and the way it affects the delivery of international development assistance:

> *One of the little understood, but most powerful and disruptive tensions in established aid agencies lies in the clash between the compliance side of aid programs – the counter-bureaucracy – and the technical, programmatic side. The essential balance between these two in development programs has now been skewed to such a degree in the U.S. aid system (and in the World Bank as well) that the imbalance threatens program integrity. The counter-bureaucracy ignores a central principle of development theory – that those development programs that are most precisely and easily measured are the least transformational, and those programs that are most transformational are the least measurable. Relieving the tension between the counter-bureaucracy and development practice would require implementing new measurement systems, conducting more research on overregulation and its effects, reducing the layers of oversight and regulation, and aligning programmatic goals with organizational incentives. (Natsios, 2010)*

Humanitarian versus development perceptions of risk

It is generally felt that humanitarian actors are less risk-averse than development actors, largely because donors are more tolerant of risk-taking and failure to fully account for the use of funds in humanitarian programmes. Humanitarian assistance is also felt to carry less political risk, particularly when it is delivered through international agencies. Development assistance is felt to be ill-suited to financing transition activities: it is seen as inflexible, bound too closely to the idea of government-led initiatives and requiring responsible governance and the capacity to deliver. These requirements are unwarranted in the immediate aftermath of conflict – the contextual risks are simply too high and the needs too urgent. As a result, donors tend to prefer humanitarian instruments in protracted crises, but do not generally allow recovery-type activities to be carried out with such funding (Beijnum and Kaput, 2009).

Integrated versus independent development co-operation institutions

The research shows there is a difference in assessing and managing risks between those donor governments that have integrated development co-operation within their department of foreign affairs and those that have an independent department for development co-operation. In the cases of Denmark and the Netherlands, for instance, their respective MFAs deal with both political and security issues as well as development co-operation. Here the conduct of risk assessments and analysis is a shared process, and the level of exposure is the same for all elements, because they are all part of the same organisation. As a result, battles are fought internally and not in public. In countries like Sweden, the UK and the US, on the other hand, there have been cases where development co-operation is felt to have been "hung out to dry" after an intervention had gone wrong, while the foreign affairs departments remained out of sight. Specifically, respondents referred to the need for government to have "plausible deniability". The fact that Sida in Sweden, for instance, has a high degree of independence and autonomy means, on the one hand, that it is harder for the Swedish government to "steer" it; but, on the other hand, if something goes wrong, the MFA can say that Sida handled the intervention on its own. As a result, some respondents felt that Sida staff were becoming more risk-averse, as they feel the political cover to take risks is lacking.

Headquarters versus in-country perceptions

Differences exist between risk perceptions at headquarters and in the field. This is especially relevant where donors have decentralised their development aid so that it is embassy staff, and ultimately the ambassador,

who take decisions about taking risks. In general, it is felt that headquarters tend to be more risk-averse than staff in the field. So the fact that most corporate tools used to analyse and assess risk are developed by headquarters means that these tools do not necessarily fit the reality on the ground. Many respondents noted the need for headquarters to double check assessments made at field level: people that have been in the field for a long time start judging risks in a different way – they are more used to threats and risks and therefore tend to grow more tolerant of them.[10] There is also a tendency to validate "sunk costs" by continuing to pursue an approach beyond the point at which it appears to have failed (see Box 2.6).

Box 2.6. **Risk psychology and individuals' risk behaviour**

Risk management systems must not only consider the "hard" aspects of procedures and systems, but also "soft" aspects such as behaviour, organisational culture and incentives.

When faced with complex problems or incomplete information, rather than undertake taxing calculations, people tend to resort to simple educated guesses, "rule-of-thumb" thinking or personal intuition. Psychologists refer to these as "heuristics" (*e.g.* Gilovich *et al.*, 2002) or "biases". These tend to shape individual decision making about risk taking in significant ways.

The "sunk cost" fallacy is one of the most troubling biases, where people fail to cut their losses and continue investing in clearly failing situations. This suggests that people who have invested time and money in something may have a strong tendency to continue to invest despite clear losses. As Teger (1980) suggests, people can find themselves with "too much invested to quit" and are reluctant to waste their effort. More generally, losses "weigh" more heavily with people than gains. "Prospect theory" posits that individuals are much more distressed by prospective losses than they are made happy by equivalent gains. (Kahneman & Tversky, 1979)

Risk processing and response are highly affected by personality traits. One such trait is the individual's "need for achievement" (McClelland, 1967). People who have a strong need for achievement tend to avoid both low-risk and high-risk situations. They avoid low-risk situations because it is easy to be successful in them and so a genuine sense of achievement is lacking. They avoid high-risk situations because they may not be successful and therefore will not gain the positive feedback they desire; or else the outcome could be attributed to chance rather than their own efforts.

Many of the implementing agencies consulted for this study felt that their field actors were under enormous pressure from incentives *not* to take risks. This feeling has been strengthened by the decentralisation of development co-operation: country offices are protecting their budgets and their "business as usual". Meanwhile, at the central level, the focus is very much on preventing reputational damage, with headquarters perceived to be protecting field activities from outside criticism.

Implementors versus auditors' perceptions of risk

There is a clear difference in risk perception between those involved in implementing development activities, and those involved in controlling and accounting for them. Due to an increasing pressure to account for public expenditure and a growing intolerance of corruption, financial and administrative regulations seem to have become the most important parameters against which to assess risk. This emphasis on limiting fiduciary risks has made development actors more risk averse. In the case of Sweden, for instance, Sida has been publicly attacked in some very critical audits in which the auditors found that the paper trail for certain activities was not up to standard. As a result, Sida now has a zero tolerance approach towards corruption. Along the same lines, in Denmark it is now mandatory to report all cases of corruption on the Internet so that the public can see what is happening, how much money was involved, and so on. This is a response to events that took place in the summer of 2008, when the Danish Minister for Development Co-operation was publicly criticised for not telling the auditor-general about certain cases of corruption.

In the US, the management of foreign aid is also very restricted by the influence of risk-averse auditors and controllers. The Office of the Inspector-General, responsible for investigating all foreign assistance using public funds, has no tolerance for anything less than full accountability. The same applies to the US Accountability Office, the investigative office for Congress. The result is that aid agencies spend a lot of time meeting these institutions' requirements rather than focusing on the development issues at stake. Organisations become more risk-averse as a result.

The difference in risk perception between those implementing programmes and those accounting for and controlling them also occurs between donors and implementing organisations like the UN and international NGOs. According to most of the implementing organisations consulted for this study, the regulations imposed by the donors in an effort to reduce fiduciary and programmatic risks restrict their room for manoeuvre, decreasing both the efficiency and effectiveness of their interventions. The same applies to the level of control required by donors in an attempt to avoid programmatic risks (*e.g.* reporting requirements and decision-making processes). Another point is that the

objectives identified by donors, and for which they hold implementing agencies to account, can be unrealistic in most fragile states. A good example is the Millennium Development Goals.

Many respondents stated that donors in effect transfer risks to their implementing partners, sometimes using them as scapegoats if a programme fails. This in itself is not necessarily a bad thing, as these organisations – and specifically UN agencies – are in some respects better suited to intervene in fragile and transitional situations based on their mandate, financial weight, capacity to engage in a direct and neutral dialogue with host governments, and political influence. However, it is essential that bilateral donors realise that the transfer of risks to these organisations does not mean that they have transferred all responsibilities for risk taking. Respondents stressed the need for donors to provide the political backing necessary for the implementing agencies to take risks. A review of multi-donor trust funds conducted by the World Bank shows that although trust funds pool risks for donors and implementing partners, as fund manager, the World Bank is taking substantially more risk than the donors (World Bank, 2010). This has resulted in bank staff becoming more and more risk averse.[11]

Bilateral versus multilateral funding risk perceptions

Respondents pointed out that the tolerance of failure among donors is higher for bilateral funding than for multilateral funding. At the same time, some UN agencies and the World Bank are less accepting of failure than bilateral donors, largely as a result of extensive donor criticism. The UN Development Programme (UNDP), for instance, is still haunted by the Iraq oil-for-food debacle. Our study has highlighted a miscommunication between implementing agencies and donors: each tends to make assumptions about the other. Specifically, implementing agencies think donors have certain limits (in terms of money and procedures), while in reality donors may be more flexible. Open communication is the key here: most often donors say they are willing to make adjustments or exceptions to rules and regulations, provided that this is supported by valid arguments and evidence.

Civil servants' versus politicians' risk perceptions

Increasingly, civil servants are caught in a political struggle as politicians focus more and more on foreign agendas to allow them to claim the credit for good results. Risk management strategies need to take into account to what extent civil servants are being honest in their reporting to political decision makers. Politicians wish to have speedy results and no embarrassment; civil servants need to counterbalance this and be honest about timelines and obstacles to achieving objectives. Experience shows that in order to take a

calculated political risk, strong parliamentary backing is required. For obvious reasons, there is a higher political willingness to take risks when a country's own interests are at stake. For instance, if donor countries have troops involved – *e.g.* Danish soldiers in Afghanistan's Helmand Province – more innovative and high-risk activities are condoned. In such cases, political parties are often tied into the decision-making process. Getting buy-in from parliament is perceived to be a good way of managing risk. The Government of Canada developed public benchmarks and indicators for its engagement in Afghanistan, and provided quarterly reports to parliament on progress and the challenges at play in the operating environment. This form of risk management enabled the government to improve communications with the public and parliamentarians on what it was trying to achieve in Afghanistan, and to clarify why it might not achieve objectives in certain areas due to circumstances on the ground.[12]

Summary: handling differences in risk perceptions

In an ideal world, one should take into account the different risk perceptions of all international actors when formulating strategies, because responding to contextual risk should be a collective agenda. However, the research for this study has revealed that collective risk perception is rare – the focus is very much on individual organisations. That said, there are some positive examples of collective approaches where less risk-averse donors have started a project and more risk-averse donors have been able to step in at a later stage (when some of the perceived risks had been reduced). Denmark, for instance, has piloted projects on SSR in Zimbabwe that have later brought in the UK and other like-minded donors. The same principle may hold true across government departments, or even across departments within donor bodies, depending on their remit.

An organisation's level of risk-taking depends on institutional backing and incentives. One has to take into account not only the institutional risk faced by the organisation, but also the risks involved for the person who decides to take or accept certain risks. What are the consequences for this person's career if things go wrong? Is there institutional backing for him/her? An organisational culture that encourages and rewards appropriate risk-taking is needed, yet few donor bodies or implementing agencies currently offer their staff incentives to take risks. Even though in many cases – like Sweden, Denmark, the Netherlands, Canada, the UK and the World Bank – the official line is that staff are encouraged to take calculated risks, this has not been incorporated into the operational system. If you take a risk and the outcome is successful, there is no problem (although the success may not be recognised). But if the outcome is an obvious failure, there is no institutional support and no policy or explicit *political* cover. Many respondents stated that in these circumstances, staff's level of risk-taking was influenced by the level of experience they have

of the system – the more a staff member knows and understands the rules of the game, the more willing he/she is to take risks. Crucial to this is the lead given by senior managers, and the extent to which they are prepared to support those who take appropriate risks and manage these risks properly, even when the outcome may be adverse.

Establishing an appropriate risk culture – one that encourages appropriate risk taking while having adequate controls in place to avoid over-exposure to risk – is an essential task for managers whose job includes overseeing engagement in fragile and transitional contexts. Because so many organisations and mandates are involved, it is hard to generalise about this. But based on consultations for this study and a review of the literature, building an appropriate risk culture seems to require a number of elements:

- A defined structure/oversight system within which risk can be managed, allowing relevant decisions to be delegated or taken by senior management, as appropriate. This may require the pre-agreement of an organisation's board or a government department's minister that defines limits above which their explicit approval is required. "Bottom lines" can be defined, but should not be so restrictive as to inhibit appropriate action.
- A system of regular institutional risk review, and a culture of open and regular discussion of institutional risks between line managers and their staff.
- Incentives for appropriate risk taking, while removing disincentives. This might include providing political/institutional "cover" for those making risky decisions.

A similar culture needs to be fostered between donors and their implementing partners.

Notes

1. Interview with Danish MFA official, 5 March 2010.
2. Interview with Sida officials, 10 February 2010.
3. Interview with Danish government official, 5 March 2010.
4. Interview with EU official for this study.

5. In the terms used in this study, these would be considered risk *factors* that might contribute to the risk of programme failure.

6. Again, in the terms of this study, these are a combination of risk factors and institutional risks.

7. Interview with Canadian government officials, 19 April 2010.

8. At the time of its completion, 17 partners were involved in the Country Assessment Framework, including the World Bank Group, the UN system, the European Commission, the International Monetary Fund and the African Development Bank, as well as key bilateral donors.

9. As Andrew Natsios (2010) argues in the case of USAID, this is partly because of a tendency to focus on what can be measured – a direct response to public accountability pressures.

10. What Jared Diamond (2005) calls "creeping normalcy"; otherwise known as the "frog-in-the-pot" syndrome.

11. Interview with World Bank representatives, 15 April 2010.

12. Interview with START officials, July 2010.

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