Economic Reconstruction of War-Torn Countries: The Role of the International Financial Institutions

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I. INTRODUCTION

With the end of the Cold War, a large number of countries in the developing world emerged from civil conflict or another form of chaos in the early 1990s. While Cold War related conflicts winded down, a number of ethnic conflicts erupted, and several military interventions took place. Interventions were justified either for humanitarian purposes, as in the Balkans and several countries in Africa, or for regime change as in Haiti, Afghanistan, and Iraq.

A few of these countries have succeeded in constructing a fragile peace and embark on what is often a complex and challenging multipronged war-to-peace transition: from conflict and violence to peace and improved security; from one-party totalitarian rule to a participatory political system based on democratic principles, the rule of law, and respect for human rights; from ideological, ethnic, religious, tribal, or class confrontation to national reconciliation so that people can live again with each other; and from war-torn economies, weak macroeconomic policies, and large imbalances to "post-conflict economic reconstruction."

This essay uses the term "reconstruction" in a broad sense to include everything necessary in the transition from war to peace to reactivate employment in the short-term and set the bases for what Nobel Laureate Edmund S. Phelps refers to as the "good economy,"[1] that is, an economy that is both dynamic and inclusive.

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[1] *See* Edmund S. Phelps, *The Good Life and the Good Economy: The Humanist Perspective of Aristotle, the Pragmatists and Vitalists; and the Economic Justice of John Rawls*, *in* 1 ARGUMENTS FOR A BETTER WORLD: ESSAYS IN HONOR OF AMARTYA SEN (forthcoming 2008); *see also* EDMUND S. PHELPS, DESIGNING INCLUSION (2003); EDMUND S. PHELPS, REWARDING WORK (1997).

In Phelps's view, the good economy requires creativity and new ideas that need to be put into commercial uses, financiers who select which entrepreneurs to support through the development stages, and the vibrancy of entrepreneurs and consumers who grasp and act on the new ideas available in the marketplace. In his view, a country's economic institutions and its economic culture—not just the rule of law and private property rights—impact the actors in the innovation process and thus add or detract from an economy's dynamism.

In countries coming out of war, innovation will come mostly from imitation and adaptation. Furthermore, financiers are not easily available, and the government—through effective and transparent aid utilization in the form of direct subsidies and credit facilities—needs to support innovative entrepreneurs and agricultural producers so they can create a dynamic economy and avoid aid dependence.

For government support to have a chance, post-conflict economic reconstruction should include not only the rehabilitation of physical and human infrastructure per se, but also macroeconomic stabilization and structural reform policies. It should also include the microeconomic foundations, including an appropriate legal, institutional, and regulatory system and a friendly business climate, necessary for the promotion of market-based investment, employment creation, and growth. Economic reconstruction is a critical but neglected aspect of peacebuilding and state-building literature, where it is treated as if it were "development as usual."[2]

Early on during the transition to peace, policymakers need to address serious macroeconomic imbalances and monetary and fiscal management issues with weak bureaucracies, insufficient technical capabilities, and serious financing constraints. This is particularly difficult in the midst of the political, social, and institutional vulnerabilities and polarization that are the legacy of conflict. Aid and technical assistance are imperative in the short-term and should be targeted at improving the capacity of the government to create an adequate environment conducive to productive investment and growth.

[2] The term "reconstruction" is often used in a narrow economic sense to refer specifically to the rehabilitation of infrastructure and services. This was the case during the Marshall Plan of the late 1940s. It is also often the case nowadays where the other economic activities that need to take place in the transition to peace are considered "development" activities. The term "reconstruction" is also often used in a political-security sense, where economic reconstruction is only one dimension of the transition to peace (and not the most important one). *See* JAMES DOBBINS ET AL., AMERICA'S ROLE IN NATION BUILDING: FROM GERMANY TO IRAQ (2005); JAMES DOBBINS ET AL., U.N.'S ROLE IN NATION BUILDING: FROM THE CONGO TO IRAQ (2005); ROLAND PARIS, AT WAR'S END: BUILDING PEACE AFTER CIVIL CONFLICT (2004).

With the support of donors, governments need to make an effort early on to reactivate the private sector through the promotion of a good business climate for investment. This includes modernized institutions, an appropriate legal and regulatory framework, an adequate banking system, a lean and effective bureaucracy, and policies for human development. It is particularly important in post-conflict transitions that economic growth create broad-based employment. Unless the population at large perceives a "peace dividend" in the sense of better access to basic services and infrastructure and a noticeable improvement in their standard of living, the transition to peace will not be sustainable.

Adequate job creation is critical for the success of economic reconstruction. However, job creation of viable and licit jobs has proved particularly difficult in the post-conflict context of the last two decades. The failure of economic reconstruction not only has had tragic human consequences for war-torn countries, but it also has had costly consequences in terms of military, security, and peacekeeping expenditures for the donor community.

With the exception of El Salvador[3] and Croatia,[4] economic reconstruction has had a poor record in the post–Cold War period. Many countries have been considered a success because they have not reverted to war. This is clearly the case of Mozambique, Bosnia and Herzegovina, and Uganda, for example. From an economic point of

[3] For an analysis of the transition from war to peace in El Salvador, see KEEPING THE PEACE: MULTIDIMENSIONAL U.N. OPERATIONS IN CAMBODIA AND EL SALVADOR (Michael W. Doyle, Ian Johnstone & Robert C. Orr eds., 1997); Graciana del Castillo, *Auferstehen aus Ruinen: Die besonderen Bedingungen des Wirtschaftlichen Wiederaufbaus nach Konflikten* [Postconflict Economic Reconstruction: A Development-PLUS Challenge], DER ÜBERBLICK, Dec. 2006, at 42; Graciana del Castillo, *Arms-For-Land Deal: Lessons from El Salvador*, *in* KEEPING THE PEACE: MULTIDIMENSIONAL U.N. OPERATIONS IN CAMBODIA AND EL SALVADOR 342 (Michael W. Doyle, Ian Johnstone & Robert C. Orr eds., 1997) [hereinafter *Arms-For-Land Deal*]; Graciana del Castillo, *Post-Conflict Peacebuilding: The Challenge to the U.N.*, 55 CEPAL REVIEW 27 (1995) [hereinafter *The Challenge to the U.N.*]; Graciana del Castillo, *Post-Conflict Reconstruction and the Challenge to the International Organizations: The Case of El Salvador*, 29 WORLD DEV. 1967 (2001); Alvaro de Soto & Graciana del Castillo, *Implementation of Comprehensive Peace Agreements: Staying the Course in El Salvador*, 1 GLOBAL GOVERNANCE 189 (1995); and Alvaro de Soto & Graciana del Castillo, *Obstacles to Peacebuilding*, 94 FOREIGN POL'Y 69 (1994).

[4] The economic reconstruction of Croatia, by contrast to that of El Salvador, has been analyzed more in the context of the transition of Eastern Europe to market-based economies, than as a country coming out of war. More research and analysis would be desirable to draw lessons from this experience for other war-torn countries. It would be particularly interesting to contrast the experience of Croatia, which is clearly on a path of normal development, to that of Bosnia and Herzegovina, which remains highly aid dependent. For a discussion of the differences between the transition in Eastern Europe and that of post-conflict countries see *infra* Part II.

view, however, these economies have become highly aid-dependent and thus provide an unsuitable model for economic reconstruction in the future. Inadequate economic policy frameworks and aid practices in Kosovo, Timor Leste, Afghanistan, Sierra Leone, Iraq, and many other countries, has not only impeded the creation of jobs necessary to improve the wellbeing of the populations but has also failed to facilitate long-lasting peace.

Post-conflict economic reconstruction puts a heavy burden not only on the countries themselves but also on the international community that facilitates and finances the transition to peace. Operationally, reconstruction involves a wide variety of international actors, ranging from the U.N. system as a whole to the international financial institutions (IFIs), the development organizations, bilateral and regional donors, and often a large number of non-governmental organizations (NGOs).

The IFIs, which include the Bretton Woods institutions—the International Monetary Fund (IMF or Fund) and the World Bank—and the regional development banks, play a critical role in establishing the economic and financial framework and the stabilization and structural reform policies which are critical for effective reconstruction. These institutions become involved in post-conflict economic reconstruction in different ways and at different stages. They assist countries at times of peace, and they renew their relationship with the country as soon as conflicts end, security conditions permit, and a credible government is in place. Because a critical aspect of reconstruction is building the institutions and capacity for market-based recovery and employment creation at the government level, the IFIs play a major role in economic reconstruction.

The purpose of this essay is fourfold. In Part II, I compare economic reconstruction at the end of the Cold War with successful reconstruction experiences from the past to analyze why the present day context has proven to be so challenging. In Part III, I discuss why—despite taking place in countries with low levels of development—economic reconstruction is not "normal development" but a "development-plus" challenge. In Part IV, I argue that policymaking under normal development is fundamentally different from policymaking in countries coming out of crises, and that the latter has a different set of priorities as well as constraints. Finally, in Part V, I examine and evaluate the role of the IFIs in supporting reconstruction, both through policy advice, technical assistance, and financing. I argue that the "business as usual approach" of the IFIs to post-conflict countries is inadequate and that recent proposals for reform will not suffice to make a difference. I also argue that to make these institutions more effective in supporting reconstruction, the IFIs should engage their executive boards and management in a broad-based high-level debate with policymakers in post-conflict countries and with academics and practitioners from other organizations.

II. RECONSTRUCTION IN WAR-TORN COUNTRIES: PAST AND PRESENT

As the Cold War ended in the late 1980s, many countries came out of civil war or other internal conflicts that had been fuelled by the Cold War. Because of the internal nature of the conflicts, these countries embarked on a multi-pronged transition. As Table 1 shows, this transition encompasses security, political, social, and economic processes.

Table 1: Multi-Pronged Transition From War to Peace

Transition	From	To
Security	Violence and insecurity	Developing institutions to improve public security
Political	Lawlessness and political exclusion	Developing a participatory government and respect for the rule of law and for human rights
Social	Ideological, ethnic, religious, or class confrontation	Moving towards national reconciliation and the development of an institutional framework to address future differences through peaceful means
Economic	Ruined and corrupt war economies, statist policies, and large macroeconomic imbalances	Embarking on economic reconstruction and the creation of viable economies that would allow people to make a decent and licit living

In contrast to earlier experiences, countries in the transition to peace at the present time are at low levels of development and have attempted to carry out the security, political, social, and economic transitions simultaneously.[5] This has made economic reconstruction quite distinct and more challenging than reconstruction in the past

[5] *See* Graciana del Castillo, *Afghanistan—The Way Forward*, 9 GLOBAL GOVERNANCE 153 (2003); Graciana del Castillo, *Economic Reconstruction in Post-Conflict Transitions: Lessons for the Democratic Republic of Congo*, (OECD Dev. Ctr. Working Paper No. 228, 2003); Graciana del Castillo, *The Rules of Post-Conflict Reconstruction*, PROJECT SYNDICATE, Aug. 2006.

(Table 2). Although it is not always easy to adapt strategies from one country to another or from one period to another when conditions are so diverse, it is nevertheless interesting to compare the present-day challenge with some of the successful experiences with reconstruction in the past, at least to understand why the present has been so overwhelmingly complex and the rate of failure so high. Until we understand what has gone wrong, we will not be able to improve it.

Table 2: Reconstruction in War-Torn Countries: Past and Present

	Germany & Japan (late 1940s)	Other Euro-pean Countries (late 1940s)	South Korea (early 1950s)	Vietnam (1980s & 1990s)	Eastern Europe (early 1990s)	Post–Cold War (1990s)
Conflict	Interstate	Interstate	Intra/ Inter	Intra/ Inter	Some countries	Intrastate
Transition:	Political/ Economic	Political/ Economic	Eco-nomic	Socio-Eco-nomic	Eco-nomic/ Political	Political/ Security/ Social/ Economic
Political	Yes	No	No	No	Yes	Yes
Security	No	No	No	No	No	Yes
Social	No	No	No	Yes	No	Yes
Economic	No	No	No	Yes	Yes	Yes
Level of De-velopment	High	High	Low	Low	Med	Low
Education/ Gender Gap	Good	Good	Bad	Good	Good	Bad
Market-Based Framework	Yes	Yes	Yes	No	No	No
Foreign As-sistance	U.S. (Mar-shall Plan in Germany)	U.S. (Marshall Plan)	U.S.	Interrup-tion USSR/ CME	EU/IFIs	IFIs, UN, Bilateral, NGOs
Output	Collapse	Collapse for some	No collapse	No collapse	Collapse	Boom then bust

It is widely recognized that the Marshall Plan of 1948–52 for the reconstruction of Europe has been the most successful strategy for reconstruction ever. Although there are clear lessons from this experience for the post–Cold War countries attempting reconstruction,[6] Europe (with the exception of Germany) did not go through a political or social transition at the time of economic reconstruction. In fact, these countries had mature political and economic systems that could be used in the process of reconstruction. At the same time, because of the inter-state nature of the conflict, there was no need for national reconciliation as there is in countries coming out of civil war so that former enemies can live with each other in the same community. Nor was there a problem with security after the war ended, because institutions for public security were in place and effective. Furthermore, European nations had rather homogeneous and educated populations and a market-based economic framework in place.

Economic institutions in Europe were strong, human and government capabilities were adequate, and security was no longer a problem after the war ended. This facilitated economic reconstruction and made it very different from reconstruction in the new context. Nowadays, most countries in the transition to peace have to create civilian police forces because they had become militarized societies during the war. They also need to make serious efforts at national reconciliation to ensure that former combatants, refugees, and the internally displaced can return to their communities and live in peace. This imposes serious financial and time constraints on economic reconstruction.

In Vietnam,[7] another case of successful economic reconstruction, the need for reconciliation between the North and the South was large after the U.S. troops left the country in 1975. Thus, economic reconstruction took place amid the social transition. Contrary to the present-day experiences, however, Vietnam did not move to-

[6] For an analysis of the Marshall Plan and lessons for post–Cold War cases, see GRACIANA DEL CASTILLO, REBUILDING WAR-TORN STATES: THE CHALLENGE OF POST-CONFLICT ECONOMIC RECONSTRUCTION 21–26, 78–91 (2008).

[7] Because of the lack of involvement of the international community in Vietnam prior to the early 1990s, it is not easy to find good information about the early period with reconstruction. For an interesting early study see Gabrielle Lipworth & Erich Spitäller, *Viet Nam—Reform and Stabilization: 1986-92* (Int'l Monetary Fund, Working Paper No. 93/46, 1993). *See also* A. Terry Rambo, Nguyen Mann Hung & Neil L. Jamieson, *The Challenges of Vietnam's Reconstruction*, ASIA PACIFIC ISSUES, Apr. 1993, at 5. For more recent analyses, see POST-CONFLICT RECONSTRUCTION IN JAPAN, REPUBLIC OF KOREA, VIETNAM, CAMBODIA, EAST TIMOR AND AFGHANISTAN: PROCEEDINGS OF AN INTERNATIONAL CONFERENCE IN HIROSHIMA (Nassrine Azini, Matt Fuller, & Hiroko Nakayama eds., 2002); and INITIATIVE FOR POL'Y DIALOGUE, VIET NAM COUNTRY DIALOGUE (2004).

ward a more participatory type of government at the same time. By remaining a single-party system, Vietnam avoided the political transition. Vietnam was also different from the more recent experiences in that, due to the U.S. embargo which lasted until 1993, there was no involvement from the IFIs and reconstruction took place with little foreign assistance.

Reconstruction in Vietnam was similar to many post–Cold War experiences in the sense that it involved a country at a very low level of development. Despite this, a mixture of Confucian and Communist influences in Vietnam had resulted in a well educated population in terms of literacy with hardly any gender gap, despite per capita income levels comparable to those of Afghanistan. This was indeed a significant advantage in the reconstruction of Vietnam, particularly in comparison to countries in Africa, Central America, and Asia where low levels of education and the gender gap have been serious constraints to effective reconstruction.

Korea in the 1950s is another example of successful economic reconstruction, under very different conditions from those in Vietnam. Reconstruction in Korea started with very low levels of development, with illiteracy rates among the highest in the world, but with large amounts of U.S. aid.[8] Like Vietnam, Korea did not go through

[8] United States assistance to Korea while the Cold War was ranging was quite different from what it had been in Japan a few years earlier. In Japan, the United States's first objective had been to "demilitarize and democratize" Japan with little economic assistance. Thus, the reactivation of the economy was financed by the Bank of Japan through money creation, with serious inflationary consequences. Only in 1947, with the deepening of the Cold War, did the U.S. policy change in favor of economic reconstruction and building an industrial power in the Pacific. For details, see Koichi Hamada & Munehisa Kasuya, *The Reconstruction and Stabilization of the Postwar Japanese Economy: Possible Lessons for Eastern Europe*, *in* POSTWAR ECONOMIC RECONSTRUCTION AND LESSONS FOR THE EAST TODAY 155–87 (Rudiger Dornbusch, Wilhelm Nölling & Richard Layard eds., 1993). As part of the change in policy and in an effort to reopen private foreign trade, the Cotton Revolving Fund, a credit facility to reactivate the cotton spinning industry, was established in 1947. Nevertheless, efforts at providing aid at a large scale (an Asian "Marshall Plan") were put aside in late 1948 as the U.S. Congress massively cut aid and the National Security Council adopted Resolution 13/2, establishing a stringent stabilization and reconstruction program. This program, known as the Dodge Plan, was not unlike some of the more recent programs under the sponsorship of the IFIs in countries such as the Democratic Republic of Congo, Iraq, Afghanistan, and others, and consisted of tight monetary and fiscal policies and the unification of the exchange rate. For details of the Dodge Plan, see TAKAFUSA NAKAMURA, THE POSTWAR JAPANESE ECONOMY: ITS DEVELOPMENT AND STRUCTURE 21–49 (1981).

a simultaneous political transition, but, unlike Vietnam, it did not need the move from state-led to market-based policies.[9]

In Eastern Europe, several countries, particularly Bosnia and Herzegovina and Croatia, have gone through devastating conflicts, often involving more than one country. Nevertheless, economic reconstruction of these countries after the fall of the Berlin Wall differed from that of countries coming out of war at that time outside Europe because countries in Eastern Europe had stronger political systems. They also lacked the polarization created by years of internal conflict that has made policymaking particularly difficult in other countries. At the same time, they had better human resources and government capabilities that provided them with wider options in their move towards market-based policies.

Another notable difference between Eastern-European Countries and other post–Cold War experiences is that while economic reconstruction and the move from statist policies to market-based policies resulted in a collapse in output in the former, this was not the case in the latter.[10]

The fact that output does not collapse—and in fact often grows rapidly—in countries outside Eastern Europe that have gone through the war-to-peace transition in the last two decades, not only gives them a false sense of success but also allows the IFIs to claim success for their policies. Because in the post–Cold War period the multipronged transition to peace takes place at low levels of development, foreign assistance and the presence of the international community in these countries is large. Such presence—which often includes large peacebuilding missions with military and police forces and civilian staff, as well as a number of other actors including the IFIs, other development agencies, bilateral donors, NGOs, and others—normally creates a boom in the immediate transition to peace.

Growth is not the same as the "dynamism" that Phelps discusses. This type of growth is neither healthy nor sustainable. Because a

[9] For a discussion of the reconstruction of South Korea and lessons for North Korea, see Jenny Town, *Post-War South Korean Economic Reconstruction: A Case Study* (Dec. 2007) (on file with author).

[10] For an analysis of the economic reconstruction of Eastern Europe, see MARIO I. BLEJER & MARKO ŠKREB, FINANCIAL SECTOR TRANSFORMATION: LESSONS FROM ECONOMIES IN TRANSITION (1999); MARIO I. BLEJER & MARKO ŠKREB, CENTRAL BANKING, MONETARY POLICIES, AND THE IMPLICATIONS FOR TRANSITION ECONOMIES (1999); MARIO I. BLEJER & MARKO ŠKREB, MACROECONOMIC STABILIZATION IN TRANSITION ECONOMIES (1997); ROMAN FRYDMAN, ANDRZEJ RAPACZYNSKI, & JOHN S. EARLE, THE PRIVATIZATION PROCESS IN CENTRAL EUROPE (1993); ROMAN FRYDMAN, ANDRZEJ RAPACZYNSKI, & JOHN S. EARLE, THE PRIVATIZATION PROCESS IN RUSSIA, UKRAINE AND THE BALTIC STATES (1993).

large presence of the international community in poor countries creates a large number of distortions in terms of inflation, higher rents, misallocation of human capital and other resources, it is difficult to make this type of growth healthy. To make growth sustainable and avoid the bust that normally follows as the international community's presence withers, the reactivation of the private sector through entrepreneurship and inclusion needs to take priority. In general, countries have not managed this challenge well, and many of them become seriously aid dependent in the transition to peace, a situation that is not sustainable in the long-term.

The absence of a "peace dividend," the heavy reliance on aid, and the slow transition from "humanitarian" to "reconstruction" aid has made recent reconstruction also different from the post–World War period. The peace dividend, which in a fiscal sense includes the reduction in military expenditure following the end of conflict, helped finance the European economies. At the same time, their governments were able to finance their budgets through bond issuing. The situation has been fundamentally different in the post–Cold War context: except for a few resource-rich countries, with Angola the most notorious, most post-conflict countries are now highly dependent on official aid flows—mostly in the form of grants—to finance their reconstruction plans.[11] Because Cold War related conflicts were largely foreign financed, military aid fell as war ended, depriving them of a peace dividend in the fiscal sense. Furthermore, because the transition often takes place in failed states, breakaway provinces, and some of the countries at the bottom of the United Nations Development Programme's (UNDP) *Human Development Index*, the reintegration of a large number of former combatants, returnees, and internally displaced into productive activities has proven particularly challenging.

Since the end of the Cold War, donors have provided large amounts of "humanitarian aid" to countries coming out of war in order to save lives and improve living conditions of the groups most affected by the conflict. Humanitarian aid allows vulnerable populations to increase their consumption of food and basic services. This, however, creates price and other distortions that discourage production and—like welfare programs—also discourages work and entrepreneurship. Only "reconstruction aid," which is directed mainly to-

[11] Despite oil revenue amounting to about $90 billion since 2005, Iraq has used only a small amount in its own reconstruction. See, U.S. GOV'T ACCOUNTABILITY OFFICE, STABILIZING AND REBUILDING IRAQ: IRAQI REVENUES, EXPENDITURES, AND SURPLUS (2008).

wards investments in infrastructure, services, and the reactivation of agriculture, creates short-term employment. If reconstruction aid is well invested and the investment climate improves, this type of aid will also have a positive impact on longer-term job creation as firms reactivate and expand their activities in industry, services, and elsewhere.[12]

The difference between "humanitarian" and "reconstruction" aid—which has been often blurred in the present-day context by having the same actors providing both—was very clear at the time of the reconstruction of Europe following World War II. In his book entitled *The Marshall Plan*, Allen W. Dulles argued that it would be a waste of money for the United States merely to provide humanitarian aid to feed the Europeans for a year or two. He argued that reconstruction aid was necessary to give them the tools without which they would have little chance of righting their own war-torn countries. He stressed that policies adopted in the first year of the Plan would be decisive in determining how reconstruction proceeded. Dulles quoted Henry Hazlitt, a renowned journalist and advocate of free enterprise, who made the case that aid would be of little value unless Europe "discontinues policies which unbalance its trade and discourage or prevent production . . . . Unsound fiscal and economic policies can make any outside help futile."[13]

In comparison with previous experiences, reconstruction in the post–Cold War period has a dismal record. This has to do with the difficulty of carrying out economic reconstruction amid the political, security, and social constraints described above. The financial burden of peace-related programs in these areas and their low level of development has made these countries highly dependent on aid. The focus on humanitarian rather than reconstruction aid, which has made job creation difficult, has been a major problem. In these situations, the political and security objectives often conflict with optimal economic and financial policies.

While policymakers, academics, and practitioners at the highest level debated every possible issue and policy option relating to economic reconstruction following the two World Wars, reconstruction following the Cold War has failed to generate such a debate. In its

[12] For an analysis of the differences between these two types of aid and the distinct impact on reconstruction, see Dimitri G. Demekas, Jimmy McHugh & Dora Kosma, *The Economics of Post-Conflict Aid*, (IMF, Working Paper No. WP/02/198, 2002).

[13] ALLEN W. DULLES, THE MARSHALL PLAN 101–02 (Michael Wala ed., Berg Publishers 1993) (original 1948 manuscript is located in the Allen W. Dulles Papers at Princeton University).

absence, and because post-conflict economic reconstruction since the early 1990s has taken place amid low levels of development, it has been treated as "development as usual." This is how the IFIs approach reconstruction. It is the wrong approach and it needs to be corrected, particularly in light of the serious financial crisis that will lower the prospects for aid.

III. A "DEVELOPMENT-PLUS" CHALLENGE

Post-conflict reconstruction is not "development as usual."[14] Similarities do indeed exist between "normal development" and "post-conflict economic reconstruction." In fact, economies coming out of internal strife or conditions of extreme socio-political upheaval share a number of characteristics with countries under normal development:

- Destroyed and distorted economies, low levels of development, and high levels of poverty;
- Weak institutional, legal, regulatory, and judicial systems;
- Poor governance, inadequate human resources and administrative and managerial capabilities; and
- High indebtedness, large arrears, and dependence on aid.

Furthermore, the same generic principles apply to both. For example, countries undergoing reconstruction—the same as those in the normal process of development—need to do the following:

- Build national capabilities and institutions;
- Promote on-the-job training; and
- Generate employment in a dynamic and relentless way.

Similarities between normal development and post-conflict economic reconstruction, however, should not lead to their conflation. Post-conflict countries have special needs, require specific activities, and have risks that are distinct from those under normal development. These are the reasons:

- Governments in post-conflict countries need to carry out a number of additional activities, including the disarm-

[14] This argument is certainly not new. It was first discussed in *The Challenge to the U.N.*, *supra* note 3. It was developed in Graciana del Castillo, *Economic Reconstruction in Post-Conflict Transitions*, *in* PRAGUE TO PRETORIA: TOWARDS A GLOBAL CONSENSUS ON THE DOCTRINE OF PEACE SUPPORT OPERATIONS (Mark Malan & Christopher Lord eds., 2000). However, in the second half of the 1990s this argument was resisted by the development organizations, particularly the UNDP but also the World Bank that preferred to treat it as business as usual. For details on how these organizations argued at the time and how their thinking evolved over time, see DEL CASTILLO, *supra* note 6, at 31–35.

ing, demobilization, and reintegration (DDR) into society and productive activities of former combatants and other groups that have been involved in the conflict, as well as the demining of their territory;

- Post-conflict economic reconstruction takes place amid the constraints and fiscal burden of the multi-pronged transition to peace; and
- Post-conflict countries have roughly a fifty percent chance of reverting to war or chaos[15] which sets the stakes to succeed high.

Because of these factors, post-conflict reconstruction is a "development-plus challenge": countries emerging from protracted civil wars have to confront the normal challenge of socio-economic development while simultaneously accommodating the additional burden of national reconciliation and peace consolidation. The latter is essential so that former enemies can live with each other and address their grievances through political, institutional, and peaceful means.

The IMF and other IFIs, such as the World Bank and the regional development banks, play a critical role in post-conflict economic reconstruction. Putting aside the human cost of returning to conflict,[16] the high risk that this entails makes reconstruction an investment with a potentially high-rate of return for national governments and the international community. If reconstruction is effective and it succeeds, large spending in military, security and peacekeeping operations will be avoided in the future.[17]

[15] *See* The Secretary-General, *Report of the Secretary-General on the Question of Development, Security, and Human Rights for All*, ¶ 114, *delivered to the General Assembly*, U.N. Doc. A/59/2005 (Mar. 21, 2005). The report notes that "[r]oughly half of all countries that emerge from war lapse back into violence within five years." *Id.*

[16] For example, the human cost of the Iraq war has been tremendous. American military casualties in Iraq since the invasion in 2003 have amounted to 4200. Casualties of coalition troops have been over 300 and of contractors have reached 450. Although figures vary, Iraqi deaths due to the U.S. invasion have been estimated by various organizations at well over one million Iraqis.

[17] AMY BELASCO, CONGRESSIONAL RESEARCH SERVICE, THE COST OF IRAQ, AFGHANISTAN, AND OTHER GLOBAL WAR ON TERROR OPERATIONS SINCE 9/11 (2008), reports cost estimates for Iraq of $653 billion, for Afghanistan of $172 billion, and for enhanced security $28 billion (these figures include bridge financing until next administration takes over). Of these, about ninety-four percent of the funds were for the Department of Defense and only six percent for foreign aid programs and embassy operations and less than one percent for medical care of veterans. This shows how disproportionate the allocations have been. The Report also shows that while foreign aid programs dropped in Iraq from $19.5 billion in fiscal year 2004 to an annual average of less than $3 billion in the next four years, defense expenditure increased from $56 billion to $145 billion in fiscal year 2008. A larger investment in reconstruction early on, together with a good strategy and appropriate policies, could have avoided the large increase in military expenditure over the years. Peace-

The development-plus challenge that post-conflict countries face is particularly arduous because, after years of political polarization and ideological or ethnic confrontations, building consensus on macroeconomic policymaking is hard. At the same time, putting the economy back on a path of stabilization and growth becomes imperative if large numbers of former combatants of both sides, and other conflict-affected groups including returnees, internally displaced persons, and the resident population in former zones of conflict, are to be reintegrated effectively and permanently into the productive life of the country.

IV. ECONOMIC POLICYMAKING IN CRISIS SITUATIONS

Economic policymaking during reconstruction—as well as following other crises such as financial chaos or natural disaster—is clearly distinct from policymaking in the normal process of development (Table 3). While under normal development, economic policies can be established with a medium- and long-term framework, reconstruction most often requires emergency policies that are often distortionary and normally contribute little or nothing at all to medium- and long-term development. This is true, for example, when food aid, that might be necessary to avoid a humanitarian disaster, distorts price mechanisms and work incentives which discourage the reactivation of the agricultural sector. It is also the case when temporary housing or medical centers have to be established to save lives but will not be long-lasting, and thus, will fail to contribute to the long-term development of the housing and health sectors.

keeping costs are also large. The 2008 to 2009 budget for U.N. peacekeeping is over $7 billion, involving 90,000 uniformed personnel as compared to only 5000 expatriate civilians and 15,000 local ones.

Table 3: Differences Between Policymaking in Normal Development and in Crisis Situations	
Normal Development	**Crisis Situations**
Medium and long-term framework	Requires (distortionary) emergency programs
Application of the "equity principle"	Application of the "ethics of reconstruction"
Low and stable foreign assistance	Sharp spikes in foreign assistance
Government establishes rule of law	Foreign troops and police support rule of law
Foreign political involvement considered an interference in national affairs	Intensive and often intrusive political involvement of the international community

Policymaking under normal development is guided by different principles than in countries coming out of crises. While the ethics of normal development determines that all groups with the same need should be treated equally ("equity or development principle"), the ethics of reconstruction determines that groups most affected by the conflict should be given special attention in the short-term ("political principle or ethics of reconstruction"). This is so because of the high probability that these groups will revert to conflict should this not be the case. Development institutions, including the World Bank, have often found it difficult to break the equity principle that guides normal development and give special preferences to some groups over others with similar needs on the grounds that in post-conflict reconstruction the political objective should prevail at all times.

Two other factors that make policymaking different under normal development than during post-conflict reconstruction are the involvement of the international community in the domestic affairs of the countries and the spikes in international technical and financial assistance during reconstruction. Under normal development, the first factor would be considered interference with the internal affairs of the country and its national sovereignty. The second factor creates the challenge in post-crisis countries of effectively and transparently managing large flows of aid in the short-term and avoiding aid dependency in the medium- and long-term.

At the same time, the large physical presence of the international community in post-conflict countries often creates serious distortions as a result of these two factors. Such presence not only distorts prices, wages, and rents, but it also deprives the national civil service and other public offices of the most qualified people in the country. Furthermore, by employing those people in jobs in which they may eventually lose their skills, countries are affecting not only their present but also their future productive capacities. It is not hard to imagine how a civil engineer or an oncologist may lose their expertise after working for the United Nations or an NGO as a driver or translator for many years.

Countries in the normal process of development rely largely on domestic savings (the most important source of development finance in developing countries) to finance investment. Frequently, these countries also have access to inflows of private capital in the form of loans or foreign direct investment. Post-conflict countries, on the other hand, rely heavily on official flows (government aid and loans) for what often proves to be a long and difficult transition. Until governments establish credibility in the post-conflict transition and the issue of property rights is appropriately resolved, private flows (loans and foreign direct investment) will not be available during reconstruction.

V. THE ROLE OF THE IFI

A critical factor in making peace sustainable—as we saw most tragically in Lebanon in the summer of 2006—is the need to disarm, demobilize, and reintegrate into society and into productive activities former combatants and other groups that have been involved in the conflict. This is a long and expensive process that has proved to have important fiscal and financial consequences. The last twenty years of reconstruction provide enough empirical evidence that DDR programs will not succeed unless the economy is rapidly brought onto a path of growth and employment creation. It is because of these factors that the IFIs play such a critical role in post-conflict economic reconstruction.

Given the dismal record of economic reconstruction in the last two decades and the need for a broad-based debate on issues and policy options to improve performance in the future, the role of the different actors—including the United Nations and its agencies, bilateral donors, NGOs and other actors, and the national governments themselves—should be questioned. The purpose here is to focus on the IFIs. In this regard, three questions become relevant:

- Are macroeconomic stabilization policies and market-based reforms "imposed" by the IFIs in post-conflict countries or has there been national "ownership" of these policies?

- Is the macroeconomic and institutional framework designed by the IFIs "appropriate" for these countries?
- Are the IFIs' aid mechanisms "adequate" for effective policymaking in post-conflict countries?

Before these questions are answered, it is important to understand that the IFIs' involvement in post-conflict reconstruction takes place through four basic channels:[18]

- Policy advice under different arrangements—surveillance; staff-monitored programs (SMPs), or an upper-tranche program (UTC);[19]
- Technical assistance and capacity building;
- Financing reconstruction; and
- Catalyzing resources from other institutions and governments.

Although there are overlapping areas in which the different IFIs collaborate, there is a basic division of labor among them. The IMF helps countries to rebuild their capacity in the fiscal, monetary, exchange, and statistical areas. The World Bank and the regional development banks focus on rebuilding the microeconomic foundations for investment, employment, and growth.

Although the IFIs can provide policy advice and technical assistance to all member states, the provisions of aid to post-conflict countries is normally restricted until the country clears debt arrears to the IFIs and normalizes any relations suspended because of those arrears. In addition to providing policy advice on a number of macroeconomic and microeconomic issues, the IFIs also advise post-conflict countries on how to solve the arrears problems and on debt renegotiations because many of them require debt relief.

A. *"Ownership" of Market-Based Reforms*

A much-debated issue is whether the IFIs have "imposed" on post-conflict countries macroeconomic discipline and a market-based

[18] For an analysis of IMF incursion into post-conflict countries see Int'l Monetary Fund [IMF], *Fund Involvement in Post-Conflict Countries*, BUFF/95/98, Sept. 19, 1995; IMF, *Fund Involvement in Post-Conflict Countries*, EBS/95/141, Aug. 16, 1995; World Bank, *Post-Conflict Reconstruction: The Role of the World Bank*, Apr. 1998; World Bank, *The World Bank's Experience with Post-Conflict Reconstruction*, 1998. *See also* IMF & World Bank, *Issues Note on Providing Additional Assistance to Post-Conflict Countries*, EBS/98/155, Sept. 1, 1998. See also, IMF, *Concluding Remarks by the Chairman: Issues Note on Providing Assistance to Post-Conflict Countries*, BUFF/98/102, Sept. 22, 1998.

[19] UTC programs normally refer to Stand-By Arrangements (SBA) or Poverty Reduction and Growth Facilities (PRGF).

framework, or whether there has been "national ownership" for such policies.

It seems that monetary and fiscal disciplines, as well as the market-based institutional frameworks developed by post-conflict countries, have not been "imposed" by the IFIs. In most cases it has been a more pragmatic than ideological move. With disillusion with central planning policies and the increase in globalization, even socialist countries such as Vietnam and China moved towards market-based policies and macroeconomic discipline on their own, without imposition from the IFIs.

At the same time, countries that embark on post-conflict economic reconstruction with weak fiscal and debt situations find it difficult to adopt expansionary Keynesian policies to stimulate aggregate demand through public work or other programs, unless they are able to rely on aid to do so. Because public jobs often become recurrent expenditures of the government and aid soon withers in the transition to peace to more normal and reduced levels, governments realize that the creation of employment requires a rapid reactivation of the private sector. It is in the ability to create such jobs through the promotion of entrepreneurship and through small-scale labor-intensive agricultural production where recent experiences have largely failed.

Of course, countries have differed in the speed, sequence, and comprehensiveness with which they have followed stabilization policies and market-based reforms, and particularly on the role they have kept for the state in their economies. They have also differed with regard to government "ownership" of such policies and reforms.

In Vietnam, for example, after thirty years of war, reunification between the North and South took place in 1975. For the next decade, economic reform was conducted according to central planning in which the government exercised strong control over the economy through regulations and support for the development of heavy industry and infrastructure. Although some market mechanisms were maintained in the South, central planning resulted in a highly distorted and inefficient economy.

By the mid-1980s, with a population of over sixty million, a rapid population growth rate (over two percent), a large percentage of the population below fifteen years of age, sixty percent of it in poverty, and dismal social indicators, job creation became a main concern.[20] For the next three years the government followed a piecemeal ap-

[20] Data on Vietnam are from the IMF. *See* Lipworth & Spitäller, *supra* note 7.

proach to socialist reforms in which efforts were made to reactivate agriculture without eliminating the strong distortions existing in the economy. By the end of the decade, however, high inflation, low growth, and large fiscal and external deficits had become unsustainable and impossible to finance, following the collapse in aid from the former Soviet Union and the breakdown in the preferential agreements with the Council for Mutual Economic Assistance (CMEA) area with which Vietnam was integrated.

It was under these conditions that in 1989—well before relations with the IFIs had resumed in 1993—Vietnam started its "Doi Moi" (Renovation) Program. This included bold and comprehensive reforms in a number of areas, including far-reaching land reform, price liberalization and restructuring of state enterprises, modernization of the financial sector, freer trade, exchange rate unification, and tax reform. These reforms, together with Vietnamese entrepreneurship, led to a better allocation of resources, dynamic growth with stable inflation, low fiscal deficits, extraordinary gains in poverty alleviation, and rapid integration into the world economy through rapid export growth.

Thus, while Vietnam moved pragmatically and gradually into market-based reforms as a result of the failure of central planning, other countries such as Afghanistan have moved into market-based reforms with the support of the IFIs and with a bang—rather than a gradual approach. In Kabul this took place with strong ownership under the leadership of the Minister of Finance, Ashraf Ghani, who was more "royalist than the king" in pushing for comprehensive market-based reform, despite overwhelming opposition from other government officials and without building consensus among the population at large.[21]

The issue of ownership has proved to be a key factor in successful reconstruction. The IFIs and other donors should not impose their vision of reconstruction on national governments. However, neither should key government officials, without the support of others, impose their own vision on the population at large. For reconstruction to be effective and sustainable there should be a participatory process in setting up national priorities.

[21] Although well intended and appropriate for countries at a different stage of development and not coming out of thirty years of conflict, macroeconomic policies adopted in Afghanistan not only lacked widespread "ownership" but were inadequate for such country at such time. *See* Part V.B. *infra*.

B. Adequacy of the Macroeconomic and Institutional Framework

Early in the transition to peace, countries need to establish the macroeconomic framework and its microeconomic foundations (including the institutional, legal, and regulatory systems, as well as an adequate business climate). This is important because good economic management and stability are critical to the success of economic reconstruction.[22]

There is no longer much debate—even among socialist leaders—on the importance of good macroeconomic management and the need for solid micro-foundations to support it and create an environment conducive to private investment and growth. The issue is whether the macroeconomic and institutional framework that post-conflict countries have adopted is adequate to allow governments to play the active role they need to play in reconstruction. Governments need to ensure that the political objective of the transition to peace (or peace objective) prevails over all others to ensure that conflict does not recur.

To be effective, this framework needs to be simple and flexible. A simpler framework requires a lower level of expertise to operate and presents fewer opportunities for mismanagement and corruption. The more flexible the framework, the easier it will be to integrate the political ("peace") and the economic ("development") objectives of post-conflict reconstruction.

In setting up this framework, the IFIs, particularly the IMF, have been playing an expanding role over time. In fact, as Kristen Boon has argued, the IFIs, despite a lack of mandate, have adopted "quasi" legislative functions in many of these countries—including Afghanistan and Iraq—in establishing policies and institutions for economic

[22] The Fund has prepared a number of studies on how to assist countries in building up their macroeconomic framework. For earlier work prepared in collaboration with the United Nations, see IMF, The Design of a Minimal Monetary and Exchange Rate Structure for Countries in Post-Chaos/Post-Conflict Situations (July 1995) (unpublished background paper for the third meeting of the High Level Group on Development Strategy and Management of the Market Economy); IMF, Outlines of the 'Architecture' of a Minimalist Fiscal Framework for Countries in Post-Chaos/Post-Conflict Situations (July 1995) (unpublished background paper for the third meeting of the High Level Group on Development Strategy and Management of the Market Economy). For more recent work, see IMF, *Background Paper for MFD Technical Assistance to Recent Post-Conflict Countries*, (Dec. 13, 2004); IMF, *Background Paper for Rebuilding Fiscal Institutions in Post-Conflict Countries*, (Dec. 10, 2004) [hereinafter *Rebuilding Fiscal Institutions*]; IMF, *MFD Technical Assistance to Recent Post-Conflict Countries*, (Dec. 13, 2004); IMF, *Rebuilding Fiscal Institutions in Post-Conflict Countries*, (Dec. 10, 2004).

reconstruction.[23] Putting aside the issue of mandate, I argue that the main concern from an economic point of view is that policies and the institutional framework adopted in many post-conflict countries is often inadequate and has been a factor in the failure of reconstruction efforts.

Because the objective of peace should always prevail over that of development, if the two ever come into conflict—which they often do—"first best" or optimal economic policies are not often attainable or even desirable.[24] Furthermore, peace-related programs should get priority in budget allocations. Thus, the independence of the central bank and the "no-overdraft" rule for budgeting financing—a desirable policy framework under normal development—proved too restrictive in Afghanistan. This has been a serious problem because it has impeded an active role of the government in creating licit jobs in the economy.[25]

Similarly, in the case of Timor-Leste, the utilization of its rich oil and gas reserves in the Timor Gap as if it were a "development as usual" situation impeded the successful completion of its economic

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[23] *See* Kristen E. Boon, *Open for Business: International Financial Institutions, Post-Conflict Economic Reform and the Rule of Law*, N.Y.U. J. INT'L L. & POL. 513, 513–81 (2007).

[24] In 1995 I first argued that post-conflict countries "have to settle for less than optimal policies in their economic reform efforts." *The Challenge to the U.N.*, *supra* note 3, at 30. At this time the IFIs considered this "heresy." *Id.* A few years later, I argued that assistance to post-conflict countries required the rethinking of analytical and operational issues to frame them in a multi-disciplinary strategy in which "first-best" policies based on purely economic profit-maximizing criteria are often not appropriate or even recommended. *Arms-For-Land Deal*, *supra* note 3, at 1968. It took over a decade of IFIs' involvement in post-conflict reconstruction for them to acknowledge this. In *Rebuilding Fiscal Institutions in Post-Conflict Countries*, the IMF acknowledged that their advice was tailored to the circumstances of post-conflict countries. As an example, the IMF mentions that with respect to tax policy, there was generally more openness to policies that were not first-best from an efficiency point of view (e.g., export taxes), given the urgent need to generate revenue. *Rebuilding Fiscal Institutions*, *supra* note 22, at 5. The IMF notes, however, that from an efficiency standpoint, these taxes leave much to be desired, as they divert resources away from their most productive uses and, by delaying investment in export sectors, these taxes may contribute to balance of payments difficulties. *Id.* at 22; *see also id.* at 31, box 1. In the discussion at the Board on this paper, directors agreed that "first-best" policies may not be immediately appropriate but that policies which are not optimal should be phased out as soon as feasible. *See* IMF, *IMF Executive Board Discusses Staff Papers on Rebuilding Fiscal Institutions in Post-Conflict Countries*, Public Information Notice (PIN) No. 05/45, Mar. 29, 2005; *see also* SANJIEEV GUPTA ET AL., REBUILDING FISCAL INSTITUTIONS IN POST-CONFLICT COUNTRIES, IMF Occasional Paper No. 247 (2005).

[25] The "no-overdraft" rule refers to the need for the central government to cover expenditures with revenue, that is, the rule eliminates the possibility that the government runs a budget deficit. For the details of such reforms and the problems they have created see DEL CASTILLO, *supra* note 6, at 166–90.

reconstruction, with dire security and political consequences. The commercial exploitation of these resources could have facilitated reconstruction and the creation of jobs for thirty percent of the labor force that is unemployed. Instead, with the strong support of the Bretton Woods institutions, Timor-Leste created a Norwegian style petroleum fund to save the money for a rainy day when in fact it is now pouring in the country. This policy, in conjunction with a policy of zero domestic or foreign borrowing, was too restrictive in a country at the bottom of the HDI.

What may be best practice for a developed country such as Norway with an aging population, will certainly not be best practice for a developing country with the largest population growth in the world and a large proportion of which is younger than fifteen years old, one of the lowest per capita income levels, seriously damaged infrastructure, and a lagging reconstruction program. This was acknowledged by the Asian Development Bank—an IFI as well—which noted that "it is unclear that the current policy on drawdowns is the best approach, given the early stage of the economy's development . . . [and the fact that] [n]ew discoveries of energy in the future . . . may well mean that future generations are much better off than the current generation."[26]

On the other hand, the Vietnamese took a different approach. When the IMF recommended that the government save some of its oil windfall in 2006 and 2007, the authorities questioned the appropriateness of saving it. In fact, they argued that a country at Vietnam's level of development would be better off using the windfall upfront to increase investment and deal with huge gaps in public infrastructure.[27] This is the approach that Timor-Leste should have taken because infrastructure deficiencies are a main deterrent to private investment and sustained growth.

In Timor-Leste—as in Afghanistan, Iraq, the Democratic Republic of Congo (DRC), and other post-conflict countries—peace will be ephemeral unless economic reconstruction takes place in the framework of dynamic economic growth, political inclusion, and national reconciliation. Business as usual policies, inflexible institutional arrangements, and best practices in pursuit of purely economic objectives can have tragic consequences. The political objective of peace should prevail at all times. This may not be possible in the context of

[26] *See* ASIAN DEVELOPMENT BANK, ASIAN DEVELOPMENT OUTLOOK 246 (2006).

[27] *See* IMF, *Vietnam: 2006 Article IV Consultations—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Vietnam*, at 9, IMF Country Report No. 06/421 (Nov. 29, 2006).

an over-complex and inflexible macroeconomic and institutional framework.

C. IFIs' Financial Support for Reconstruction[28]

In the immediate post–Cold War period, the IMF and the World Bank used the same mechanisms to finance post-conflict economic reconstruction as they did to finance normal development. Thus, the IMF used Stand-By Arrangements (SBA), normally with high conditionality that was hard on countries coming out of war. Similarly, the World Bank supported these countries with Structural Adjustment Loans (SAL) that were used to support countries under normal development—rather than those in a multipronged transition to peace where the main concern should have been avoiding a relapse into conflict. This was the case (or the option) during post-conflict reconstruction in El Salvador, Mozambique, Cambodia, Guatemala, and others.

In the past, bilateral and other donors preferred to provide "project finance"—that is, funding allocated to specific programs monitored by them—rather than to provide "budgetary support," where countries have more flexibility to use the money as they see fit. Budgetary support through the creation of "trust funds" became more common starting in the mid-1990s. Trust funds are often administered by the World Bank. In addition to the regular performance-based allocations (PBA) of IDA financing at concessional terms,[29] the World Bank started financing post-conflict countries through the Post-Conflict Fund (PCF), the Low-Income Countries Under Stress (LICUS) Implementation Trust Fund, a Multi-Donor Trust Fund, and a number of country-specific trust funds. Through some of these funds the World Bank has channeled grants—as opposed to loans—

[28] For a full discussion of the different financing mechanisms of the Fund and the World Bank, see IMF Home Page, http://www.imf.org (last visited Oct. 10, 2008); World Bank Home Page, http://www.worldbank.org (last visited Oct. 10, 2008). For a broader discussion on issues related to IFIs financing mechanisms, see DEL CASTILLO, *supra* note 6, at 66–93. For a discussion of IMF and World Bank financing mechanisms, see IMF, *Assistance to Post-Conflict Countries and the HIPC Framework*, SM/01/99, (Mar. 30, 2001); IMF, *Concluding Remarks by the Acting Chairman Assistance to Post-Conflict Countries and the HIPC Framework*, BUFF/O1/57, (Apr. 19, 2001); IMF, Assistance to Post-Conflict Countries: Progress Report (1999) (unpublished); IMF, *Update on the Financing of PRGF and HIPC Operations and the Subsidization of Post-Conflict Emergency Assistance*, (2003). *See also* World Bank, *The Role of the World Bank in Conflict and Development: An Evolving Agenda*, (2003).

[29] World Bank financing through IDA is on concessional (preferential) terms (interest-free loans with a fee charge of 0.75% and forty years repayment), but the amount is quite limited.

for short-term budgetary support and emergency projects. Nevertheless, the UNDP and the U.N. agencies, which fund themselves through voluntary contributions, continue to be a more important source of grants to post-conflict countries.

By the mid-1990s, the Fund was also revising its financing mechanisms for post-conflict countries. In 1995, the Fund expanded the scope of its Emergency Assistance Facility to include post-conflict countries, in addition to those recovering from natural disasters. The Emergency Post-Conflict Assistance (EPCA), as the new facility was named, is supported by policy advice and in many cases by technical assistance to rebuild the national capacity for macroeconomic policymaking in eligible countries.

Constraining requirements—including an international concerted effort in support of the country, the absence of arrears to the Fund, and a commitment on the part of the country to move to a SBA or Poverty Reduction and Growth Facility (PRGF) in the future—have limited the eligibility of countries to the EPCA. Although this facility's funding is quickly disbursed with "no conditionality," there is "no concessionality" in it either. This means that countries coming out of war have to pay normal (rather than preferential) rates of interest to the Fund. Because EPCA lending is limited to twenty-five percent of the quota (raised in 2004 to fifty percent) and funding from this facility has often been used to pay arrears to the Bretton Woods institutions, the real impact of this facility, which has been used by only twelve countries, has been quite limited. Moreover, the "repayment period" of three and one-quarter to five years has been much too short for post-conflict countries.

The EPCA and the Highly-Indebted Poor Countries (HIPC) Initiative of the World Bank and the Fund require that the country build up a good "track record" to qualify for "concessionality." Since 2001, donors subsidize EPCA interest but only for countries with a track record which makes them eligible for the PRGF. This is also the case for debt reduction in which countries must establish a track record of good policies before they become eligible for the HIPC Initiative.

LICUS World Bank Initiative adopted after 9/11 shifted the focus of attention toward achievement of the U.N. Millennium Development Goals (MDGs)—a development as usual focus—rather than a post-conflict one. By including post-conflict countries with other countries under stress, the special needs and risks in the former are conflated with the normal development needs of the latter.

The same is true of including post-conflict states with other "fragile states." Fragile states are defined as those least likely to achieve the MDGs, likely to receive inadequate aid for their social and economic needs, and which lag behind other low-income countries in terms of economic performance.[30] In January 2005, a Senior Level Forum (SLF) on Aid Effectiveness in Fragile States, co-sponsored by the World Bank, Organization for Economic Co-operation and Development's Development Assistance Committee, the European Commission (EC), and the UNDP, brought together senior officials, leading development practitioners, government reformers in fragile states, and academics to examine aid issues relating to fragile states, donor coordination, and donor policy coherence. At the annual meetings of the World Bank and IMF in October 2007, the heads of the Bretton Woods institutions and other development banks discussed a strategy for deepening their collaboration and strengthening their engagement in "fragile" situations.

Although the focus on the most vulnerable countries and efforts to make assistance more effective are welcome, the inclusion of post-conflict states with other fragile states—as within the LICUS Initiative—is unfortunate because it leads to a "development as usual" approach. In fact, this was confirmed by the statement of the heads of the IFIs in October 2007, which posited that "addressing fragility is one of the highest priorities of the development community. Fragile situations undermine the development prospects of individual countries and can also affect regional stability and security."[31] They agreed to a set of goals, principles, operational approaches, and working arrangements to deal with fragile states. Because, as discussed earlier, the "peace" objective should prevail over the "development" objective in countries coming out of war, the goals of international assistance to post-conflict countries should be determined at the highest political level—including the U.N. Security Council and the U.N. Secretariat—and not by the development community, including the UNDP, the World Bank, and other development and financial institutions.

At the present time, thirty-five countries have been identified as fragile states. Unless the special needs and risks of post-conflict coun-

[30] "The Fragile States Group is a unique forum that brings together experts on governance, conflict prevention and reconstruction from bilateral and multilateral development co-operation agencies to facilitate co-ordination and share good practice to enhance development effectiveness in 'fragile states.'" Organization for Economic Co-operation and Development, http://www.oecd.org/department/fragile states.

[31] Press Release, Inter-American Development Bank, Development Banks Commit to Closer Collaboration Working in Fragile Situations (Oct. 20, 2007), *available at* http://www.iadb.org/news/detail.cfm?language=EN&id=4092.

tries are addressed with specific strategies and policies, these countries will continue with a fifty-fifty chance of reverting to conflict. Keeping the course with a "development as usual" approach will fail to improve this dismal record.

VI. A MOVE TOWARDS GREATER FLEXIBILITY?

In April 2006, the Fund's Medium-Term Strategy (MTS),[32] which establishes new directions for surveillance, also called for more focused engagement and greater flexibility in program design and lending facilities for fragile states (including post-conflict countries).[33] In April 2008, the IMF Board discussed a paper presented by the staff entitled *The Fund's Engagement in Fragile States and Post-Conflict Countries—A Review of Experiences—Issues and Options*.[34] The Review concluded that the Fund's engagement in these states has been "broadly effective."

In establishing effectiveness, the Fund staff has been using the "wrong yardstick." Given the primacy of the political objective in post-conflict economic reconstruction, a different yardstick should be used to measure success than is the case under conditions of normal development. The effectiveness of the Fund and other IFI policies cannot be measured only by how much the country grew, lowered inflation, improved its fiscal balance, and accumulated reserves. As discussed above, low-income countries coming out of war often grow simply because of the presence of the international community and large volumes of aid, neither of which is sustainable. This growth creates serious distortions. The yardstick should be whether Fund policies are improving the wellbeing of the population which is essential for national reconciliation and peace consolidation in the short-term, and whether it is helping to create a "good economy" in the long-term. For this, the government has to be able to provide basic services and infrastructure to establish its legitimacy, develop the legal, institutional, and regulatory framework, provide a small and effi-

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[32] *See* IMF, *The Managing Director's Report on Implementing the Fund's Medium-Term Strategy*, Apr. 5, 2006; IMF Press Release, A Medium-Term Strategy for the IMF: Meeting the Challenge of Globalization, U.N. Doc. 06/01 (Apr. 18, 2006).

[33] For a discussion of "fragile states" and the activities of the World Bank in them, see World Bank, Fragile and Conflict-Affected Countries, http://www.worldbank.org/conflict (last visited Oct. 16, 2008).

[34] The report is for official use only. *See* IMF (2008b), *IMF Executive Board Discusses the Fund's Engagement in Fragile States and Post-Conflict Countries—A Review of Experience*, Public Information Notice (PIN) No. 08/43 of April 1, 2008 [hereinafter *Review*]; and IMF, *IMF Evaluates Its Involvement With Fragile States*, IMF Survey Online, April 1, 2008 [hereinafter Survey Online].

cient bureaucracy, and ensure adequate credit. Only in such environment will the creativeness of the people and businesses thrive and create much needed licit jobs. The inflexibility of IMF- and World Bank-sponsored policies and institutional frameworks—and the short period over which adjustment is expected to take place—have often impeded rather than facilitate the creation of a good economy.

In a way, the Review acknowledged the problems associated with their assistance to these countries by recognizing that there have been "certain gaps in the Fund's engagement which have significant implications for certain fragile states."[35] Furthermore, the Review accepted that "in some programs, the structural reform agenda may have been overambitious, in view of severe administrative capacity constraints; the coverage and sequencing of measures may have been inappropriate; and insufficient attention may have been paid to public financial management, governance, and generating the political consensus for reform."[36] In light of these and other shortcomings, the Review recognized that "the transition to an upper credit tranche (UCT)-standard arrangement may have been premature."[37] Because of this and other failings, the Review concludes that "a more systematic, graduated approach could improve the coherence of the Fund's engagement."[38] In the staff's view,

> [a] medium-term framework that explicitly adjusts Fund policy advice and monitoring, capacity building, signaling, and financial assistance to a country's evolving capacity to formulate and implement macroeconomic policy, and that builds on the countries' commitment to reform, would allow the Fund to offer fragile states an engagement that is better attuned to their deep-rooted problems.[39]

The Executive Board supported the conclusions of the Review that a more systematic and graduated approach could improve the effectiveness of the Fund's engagement with fragile states. However, the Board was divided on whether the proposal for a new formal

[35] *Review*, *supra* note 34, at 5.
[36] *Id.* at 14.
[37] *Id.* at 5.
[38] *Id.* at 5, 17.
[39] *Id.* at 5.

framework entitled Economic Recovery Assistance Program (ERAP) was necessary or whether present arrangements could be modified.[40]

Because Management has to return to the Executive Board with a follow-up paper on this issue, a debate on the merits of the ERAP proposal should occur. As stated in the Review, rather than proposing a major change in the Fund's policies or instruments, ERAP combines the modes of the Fund's present engagement with fragile states into a consistent medium-term framework.[41] ERAP would include two phases. The first phase would be a non-financing phase, emphasizing capacity building and macroeconomic policy support. Once sufficient implementation capacity has been established, and provided a balance of payments financing need exists, the country could enter the second phase which would provide Fund financial support, the Economic Recovery Financial Assistance (ERFA) to any eligible low-income, fragile state under terms and conditions similar to those under the EPCA. Non low-income post-conflict countries would continue to be eligible for EPCA under the existing policy. Successful implementation of phase two would provide a track record to assess readiness for transition to a UCT-standard program. It is proposed that the financial support to fragile states under the ERFA be on concessional, possibly PRGF terms, and that for HIPC-eligible fragile states, the ERFA would count toward the decision point track record under the enhanced HIPC Initiative.

This proposal is welcomed in one sense and is still lacking in another. On the one hand, by proposing that ERFA financing for low income post-conflict countries be at concessional, possibly PRGF terms, this is certainly an improvement over EPCA which is non-concessional except for countries eligible for PRGF terms, i.e., those that have built up a "track record." On the other hand, by contemplating that countries will move to the second phase only within three years, the ERAP proposal deprives post-conflict countries of the Fund's financial assistance in the immediate transition to peace—a financing that is often critical in avoiding a relapse of conflict.

VII. CONCLUSIONS

Failure at effective post-conflict reconstruction has led to human tragedy, large number of displaced populations and refugees, and a huge burden to taxpayers in donor countries. At the same time,

[40] Survey Online, *supra* note 34.
[41] *Review*, *supra* note 34, at 17–18.

failed states are an incubator for terrorism, drugs, human trafficking, and other illegal activities.

Donors' resources allocated to post-conflict countries have been largely for military, security, and peacekeeping operations rather than for economic reconstruction. Past experience has clearly shown that the less successful reconstruction is in creating jobs and improving the wellbeing of the population at large, the more will be needed to address insecurity. Although a total figure is not available, U.S. data mentioned earlier for total expenditure in Afghanistan and Iraq are nevertheless indicative of the magnitude of resources spent and the burden to taxpayers of dealing with post-conflict countries. Since 9/11, Congress has authorized budgetary expenditures of about $860 billion (of which Afghanistan and Iraq account for $820 billion).[42] Of the total, $810 billion were allocated to the Department of Defense and only less that $50 billion to the Department of State/USAID for reconstruction. With a population of about 300 million, this represents roughly $3,000 per person and $12,000 per family in the United States.

In the first year of the Bush Administration, the budget surplus amounted to $90 billion. Beginning with the war in Afghanistan at the end of 2001 and aggravating with the war in Iraq, the budget turned into a huge deficit. From 2002 to 2008 the average annual budget deficit was $460 billion dollars. Contrary to previous wars, the wars on Afghanistan and Iraq were financed through higher debt rather than higher taxes. By August 2008 (before the banking rescue), the national debt had surpassed $10 trillion, representing seventy-three percent of GDP. Resources spent by the United Nations (also through taxpayers' contributions), the IFIs, other international organizations, other bilateral donors, and NGOs in post-conflict countries are also large.[43] The U.N. peacekeeping budget for 2008–2009 is $7 billion. In addition, the programs and U.N. agencies have their own budgets to deal with post-conflict countries through voluntary contributions.

Despite the large investment that the international community has made in post-conflict countries, the record in rebuilding war-torn states is dismal. A large number of countries either revert to conflict

[42] See *supra* note 17 for data on the U.S. military and civilian expenditure in Afghanistan and Iraq. *See also* United States Government Accountability Office, *Global War on Terrorism: Reported Obligations for the Department of Defense* (2008), *available at* http://www.gao.gov/.

[43] The cost to taxpayers is different in the IFIs where the IMF and the World Bank lend and charge for their lending.

or fail to create a dynamic and inclusive national economy, thus becoming highly aid-dependent on the international community in the process.

If effectively utilized, resources allocated to rebuilding war-torn countries could have a high rate of return. Otherwise, they are a major diversion from much-needed international funding for normal development, the environment and the elimination of transmittable diseases. The United Nations announced in September 2008 that aid has fallen by twelve percent in the last two years. Amid large recessionary pressures and unsatisfied needs for health, education, infrastructure, and energy in donor countries, in conjunction with the worst banking and credit crisis since 1929, less (rather than more) aid is likely in the near future.

There is thus an urgent need to debate the issues and the policy options for post-conflict economic reconstruction. This is necessary in order to find better tools, strategies, and channels through which aid and technical assistance could be more cost-effective in promoting reconstruction. Without a change in course, countries will not be able to create the productive and dynamic investment and the sustainable employment that is necessary to improve their livelihoods, sustain the peace, and avoid aid dependency.

Putting the economies on a path of stabilization and sustainable growth is imperative during post-conflict economic reconstruction. Reintegration of a large number of former combatants, returnees, and other groups affected by the conflict will not be possible in stagnant economies. Furthermore, putting the house in order is also important because donors will be increasingly unwilling to help countries that do not help themselves. This is why the IFIs play such an important role in post-conflict countries.

Despite recent efforts by the IFIs to improve their assistance to these countries, their policy advice remains inappropriate, their financing instruments remain too tough and inflexible, and the adjustment process too short for these countries to be able to successfully rebuild their war-torn economies. One of the lessons from recent failures with post-conflict reconstruction is that market-based reforms and stable macroeconomic policies are necessary but not sufficient to create jobs. In all cases, the government needs to play an active role (including the use of subsidies and price support mechanisms) to promote private investment and economic inclusion. This requires a flexible macroeconomic and institutional framework (unlike the one promoted by the IFIs in Afghanistan, East Timor, and elsewhere) even if macroeconomic stabilization is somewhat delayed in the process. Only such a framework would allow for the active government intervention that is needed to succeed at reintegrating various war-affected groups into the productive and licit economy. Without such intervention, reconstruction may not be sustainable. The market alone will not suffice.[44]

Both the IMF and the World Bank have followed a "selectivity policy" in the sense of targeting resources and providing concessional terms to countries that have established a track record of "good policies." This process follows a perverse logic: rather than helping countries in the immediate transition to peace, which is the most fragile phase, countries are asked to build up "credibility" and "national capacity" first. The latter would indeed facilitate the effective use of aid. In the meantime, roughly half of the countries in the transition to peace revert to war. The international community can continue to ignore this only at its own risk.

[44] For possible effective use of subsidies to create licit and productive employment in post-conflict economies see Edmund S. Phelps & Graciana del Castillo, *A Strategy to Help Afghanistan Kick Its Habit,* FINANCIAL TIMES, Jan. 4, 2008, at 7; and Graciana del Castillo & Edmund S. Phelps, *The Road to Post-War Recovery*, PROJECT SYNDICATE, July 2007, *available at* http://www.project-syndicate.org/commentary/phelps9.