INTERNATIONAL MONETARY FUND

MFD Technical Assistance to Recent Post-Conflict Countries

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List of Acronyms

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BPA	Banking and Payments Authority
CPO	Central Payments Office
DAB	Da Afghanistan Bank, the Central Bank of Afghanistan
DFID	U.K. Department for International Development
DM	Deutsche mark
DRC	Democratic Republic of the Congo
FAD	Fiscal Affairs Department of the IMF
LEG	Legal Department of the IMF
MFD	Monetary and Financial Systems Department of the IMF
MoF	Ministry of Finance
TA	Technical assistance
UN	United Nations

Executive Summary

1. **This paper reviews the recent experience with technical assistance (TA) to post-conflict economies in the monetary and financial areas with a view to providing lessons for ongoing and future work**. This paper reviews the IMF's Monetary and Financial Systems Department's (MFD) experience with eight post-conflict cases since 1999. The broad objective of TA to post-conflict economies is to develop or rebuild monetary and financial systems with the aim of supporting recovery and growth.

2. **The absence or severe insufficiency of the most basic monetary and financial services creates an urgent need for substantial TA in post-conflict economies**. Recovery and growth require the basic financial services of means of payments; the execution of the government's budget; and financial intermediation. However, for post-conflict cases these services are severely impeded by emergency social conditions, physical destruction, security challenges, destroyed or disrupted central administrative functions, a nonexistent or impaired legal and regulatory framework, macroeconomic instability, and often corruption and theft.

3. **The unique circumstances of post-conflict cases pose challenges to the delivery of TA that are among the most severe faced by the staff in its work**: security issues delay or preclude the on-site delivery of TA; damaged or destroyed buildings and infrastructure and weak or nonexistent communication impede TA delivery in the field; periods of conflict and disruption wear down government employees who serve as counterparts to Fund staff; and ambiguity of the legal status of the government sometimes complicates TA by making it difficult to develop a consensus for reforms and garner support from local personnel.

4. **The choice of a currency and exchange rate regime to establish monetary control and facilitate payments is one of the first basic decisions that must be made and that requires assistance from the Fund**. Cash currency can take the form of national banknotes from existing stocks, banknotes of another country, or multiple currencies for a transitional period. Countries that decide to issue a national currency will need to design and arrange its production, introduction and use. If an autonomous national currency is chosen then an exchange rate regime must be decided upon.

5. **The restoration of payment services is a core area of post-conflict TA**. Initially, an emergency payment system has to be set up to make possible non-cash transactions as well as external payments associated with external assistance. New supporting legislation may be needed. As the situation stabilizes payment reforms aim to have transactions carried out by banks.

6. **The Fund also assists in the restoration of basic central bank services**. In the absence of an existing central bank key tasks can be organized in a Central Payments Office (CPO). Initially, the central bank or CPO should pay particular attention to accounting and correspondent banking relationship issues. The central bank/CPO can also help ensure public sector transaction and payments. The central bank/CPO should agree with the ministry of Finance (MoF) on what services it could provide and the reimbursement it should receive for doing so.

7. **Simplified approaches are generally required in monetary policy and operations owing to limited information and infrastructure**. Typically, a foreign exchange auction is the main instrument early on, and the strongest policy transmission is through the exchange rate. In a post-conflict environment changes in reserve requirements and lending facilities can be used to soften the impact of unexpected fluctuations in base money. A short-term information system for monetary management should be established. A formal foreign exchange market should be established or restored.

8. **Commercial banks have to be assessed as soon as possible and efforts made at establishing a market-based and properly supervised banking system**. An early step should be to modernize the banking law, or, if not appropriate, to enact a decree. The Fund often provides TA to strengthen the bank supervisory authority, generally located in the central bank, usually with the help of foreign expertise. No bank should be allowed to operate without a license, and the central bank should have powers to determine whether a license should be issued to a particular institution.

9. **An important lesson from the experience with post-conflict TA is that security must be well in place before effective TA can be delivered**. Further, suitable premises must be identified by the authorities at the earliest possible opportunity.

10. **The impracticality of long-term planning means that judgment and flexibility are especially important**. Often the second and third best solutions must be chosen in the context of shifting and highly country-specific circumstances.

11. **A particular sequencing of key policy decisions has been adopted in most cases**. Usually currency reform comes first, followed by the establishment of payments, the restoration of basic central bank services, improved monetary operations, and reforms in bank supervision and bank restructuring.

12. **Another set of lessons concerns coordination between TA providers and the selection and operation of expatriate staff**. Conflicts can arise between local entities if they receive contradictory advice from particular external donors or agencies. These conflicts can be avoided by full cooperation among the external donors and between them and the local entities. Often it is necessary to hire expatriate staff in key management positions, but recruitment can be difficult. Foreign staff must be open-minded and flexible. These staff must be willing to train local staff to ultimately take over their positions.

13. **The experience of post-conflict TA in the monetary and financial systems areas offers lessons for future work in nonpost-conflict countries with limited institutional capacity**. Many low-income countries have limited institutional capacity and thus for TA purposes are closer to post-conflict countries than to other TA recipients. Looking ahead, there are also member and non-member countries that will sooner or later emerge from long periods of isolation and require extensive assistance for institution building. TA for these countries will be able to draw important lessons from the TA experience with post-conflict countries.

I. Introduction

14. **This paper reviews the recent experience with the Fund's extensive provision of TA in the monetary and financial areas to post-conflict economies with a view to providing lessons for ongoing and future work**. The broad objective of this TA is to develop or rebuild monetary and financial systems to support economic recovery and growth.

15. **The paper is based on eight post-conflict cases**: Afghanistan, Cambodia, the Democratic Republic of the Congo (DRC), Iraq, Kosovo, Serbia, Sierra Leone, and Timor-Leste. In response to interest in covering recent cases, the period FY1999–2004 is discussed.

16. **The paper is organized as follows**: Section II discusses the special challenges posed by post-conflict cases. Section III focuses on TA delivery at different stages and in different core areas. Section IV includes the modalities of MFD TA. Section V presents the lessons and implications for future work. Section VI contains proposed issues for discussion. A supplement contains brief case studies of the eight post-conflict countries.

II. Special Challenges Posed by Post-Conflict Cases

17. **Fund policy on emergency assistance was expanded in 1995 to cover countries in post-conflict situations**. This paper uses the definition of EBS/95/141 on Fund Involvement in Post-Conflict Cases which addresses those countries that as a consequence of profound domestic or international unrest have: (i) severely impaired administrative capability limiting the ability to develop and implement a comprehensive macroeconomic and structural adjustment program; and (ii) a need for concerted and rapid international assistance to address the aftermath of the crisis. The primary role of the Fund in these circumstances is to help reestablish economic stability as an essential foundation for recovery and sustainable growth. Fund staff have prepared papers on the early work in some post-conflict countries.[1] Fund support is often part of a broader country-wide rehabilitation plan.

18. **The special circumstances of post-conflict countries not only create an urgent need for the restoration of the most basic monetary and financial services but also impede the delivery of supporting TA**. Recovery and growth require the resumption of the basic monetary and financial services of a means of payments, the execution of the government's budget, and financial intermediation. However, the following circumstances impede financial services as well as TA in support of their restoration:

- **Safety and security**. Official and private financial institutions often are not operating after the cessation of conflict reflecting social and military conflicts (Afghanistan, Kosovo, Timor-Leste and the DRC). For Fund staff post-conflict situations are rarely

[1] Valdivieso and others (2000); Corker and others (2001); Bennett and others (2003); Laurens and Fonteyne (2004).

safe and secure, especially in the early stages.[2] The decision to send Fund staff to the country is one of the most wrenching faced by the Fund and is based on careful security monitoring by experts and Fund staff. However, a rapidly changing situation can quickly put Fund staff at risk. Security concerns can limit Fund staff to the capital or even selected safe neighborhoods of the capital (Iraq and Afghanistan).

- **Physical destruction**. In some cases damage or destruction of key buildings impedes functioning of the government and the delivery of TA (Iraq and Timor-Leste). Destruction of data and loss of statistics also create serious problems and obfuscates assessment of the situation.[3] Further, weak or nonexistent communication infrastructure complicates the planning of missions and diverts time and resources from the delivery of TA per se to making logistical arrangements.

- **Limited local administrative functions and human capital**. Local capacity and capabilities are often fundamentally impaired (Cambodia and Timor-Leste). Prolonged periods of conflict and disruption can act to wear down government staff that serve as counterparts to Fund staff delivering TA (Cambodia). Effective local counterparts are crucial for TA to attain its goals. At the same time the dedication and determination of local staff can greatly facilitate the effectiveness of TA (Sierra Leone).

- **Poor governance**. Often, unbridled government expenditures have been monetized, leading to price instability, and arrears on domestic and international debt have cut off governments from financial markets (the DRC). The delivery of TA is especially complicated in situations marked by ambiguity of the legal status of the government. In these situations it can be difficult to develop a consensus for reforms as well as garner support from local personnel (Iraq).

- **Nonexistent or impaired legal and regulatory framework**. During the period of conflict, the lack of an undisputed central authority makes the law of the land unclear. Laws are no longer seen as enforceable, and corruption thrives. A lack of good governance discourages formal economic activity (the DRC and Sierra Leone). For new countries or territories emerging from post-conflict situations, there may be

[2] For example, the first visit to Kosovo took place in armored cars under UN military escort. In Timor-Leste, the first Fund mission's sleeping quarters were guarded by soldiers. In Afghanistan, two unexploded bombs were found on the grounds of the guest house in Kabul that was used by the first two missions. In Iraq, the first two missions with MFD staff were marked by shooting and dangerous convoys to the central bank and Fund staff were injured during the subsequent visit by an MCD mission in August 2003.

[3] For example, in Kosovo the situation was complicated by the sudden and total abandonment of the old payment bureau sites by Yugoslav authorities with loss of vault keys and combinations, whatever cash had been on hand, and all official records. In the case of Timor-Leste, the issue was the disagreement between the Fund and the World Bank on the future use of the former Bank Indonesia branch building with a restorable vault.

uncertainty as to which laws and regulations are still in force, calling into question ownership of key facilities (Kosovo and Timor-Leste).

- **Corruption and theft**. In some cases commercial bank financial assets have been hollowed out by corrupt managers and physical assets taken. Central bank assets may have disappeared and funds held abroad may have been sequestered or blocked (Afghanistan and Iraq).

- **Multiple donors and TA providers**. A typical trait of post-conflict situations is that many donors and TA providers rush in as early as the security considerations permit to assist with the obvious and acute needs. At that time, the country is often poorly prepared to receive multiple and conflicting offers. Everybody wants to see key local officials, thereby creating a real constraint in the decision making process. These can be dealt with through coordination of TA by the United Nations (UN) or a major party. The Fund has often been asked to provide such coordination within its areas of competence (Afghanistan, Kosovo, and Timor-Leste).

19. **While the above features are typical of post-conflict situations, there are also important differences between the cases**. Four cases require setting up institutions from scratch, while in other situations the focus is on rebuilding existing institutions. For Kosovo and Timor-Leste the challenge was to build brand new institutions, while in both Afghanistan and Iraq, functioning central banks existed but needed to be modernized. The circumstances in Sierra Leone and Serbia were less serious than the other countries and thus TA for them had elements of normal TA as well as post-conflict rebuilding. Still, all post-conflict countries require extensive capacity building in the context of difficult circumstances.

III. DELIVERY OF TECHNICAL ASSISTANCE

20. **The broad objective of financial sector TA is to re-establish properly functioning monetary and financial systems in support of recovery and sustainable growth**. The experience of the Fund with former Soviet Union republics[4] and with post-conflict countries[5] suggests that the following is required to establish a minimum infrastructure for functional monetary and financial systems:

- determine the appropriate currency and exchange rate arrangements;

- ensure the operation of a domestic payment system and the minimum capacity for carrying out external payments;

- establish monetary control in support of price stability;

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[4] Sundararajan and others (1995).

[5] Lönnberg (2003) and Lönnberg (2004).

- provide financial services to assist in the execution of the government's budget; and
- restore financial intermediation and other basic banking services.

21. **MFD post-conflict TA is planned and delivered in close cooperation with area departments and other Fund departments as well as other international entities**. Much TA involves not just financial institutions but also the MoF and other government agencies and thus MFD is closely coordinating with the Fiscal Affairs Department of the IMF (FAD). Further, much of the critical work involves legal issues which are closely coordinated with the Legal Department of the IMF (LEG). Early coordination with the Statistics Department of the IMF is essential to establish and maintain a data reporting system for monitoring developments and policy formulation. Close coordination is also needed with the World Bank, regional development banks, and other multilateral or bilateral donors.

22. **Experience has shown that reestablishing a functioning monetary authority and a financial system require a graduated approach that can be presented in terms of five stages**. The timeframe for these phases varies depending on information available and local circumstances such as the physical infrastructure and the security situation. However, owing to the linkages and sequencing requirements, the need to preserve the momentum of the reform process is imperative.

A. Stage I—Diagnostic Phase

23. **The first stage involves engagement in the country to collect information**. Fund departments review the information on the country at hand as well as the relevant cross-country experiences. One or more missions including the area department, MFD, other TA departments and often the World Bank, visit a country (Afghanistan, Iraq, Kosovo, and Timor-Leste) to carry out exploratory assignments and apprise Fund management and the Board of the situation and recommendations for future action.

24. **This information is used for diagnosis and the planning of policy decisions**. Early decisions include choice of currency and exchange rate regime and payment system reform. An open and market-oriented approach should underpin the efforts to restore the financial system, while prioritizing the needs for TA.

25. **Early channels of contact must be opened with key donors and other major TA providers**. In addition to the World Bank and relevant regional development banks such institutions normally include major donors as well as neighboring countries and others with which the post-conflict country may share a common language or cultural heritage.

B. Stage II—Emergency Phase

26. **The restoration of financial functions in support of humanitarian services (food, health care, clothing, and shelter) is the main concerns during the emergency phase**. This phase often lasts around six months. In addition, efforts focus on recreating or restoring the minimal essential payment and banking functions and rejuvenating commercial activity.

Currency and exchange rate regime

27. **Early decisions must be made with respect to the choice of a national currency to establish monetary control and facilitate payments**. The country requires a supply of cash currency—either shipments of foreign currency, foreign or domestic printing and shipment of currency, or existing stocks in the central bank and/or commercial bank vaults. Cash currency can take the form of national banknotes from existing stocks, banknotes of another country, or multiple currencies for a transitional period. When there are competing convertible currencies it is better to provide incentives to encourage the use of the national legal tender rather than restrict their use.

28. **Countries must decide whether to issue a national currency**. On the one hand, the desire of a country to have a currency of its own as a national symbol is quite understandable. On the other hand, there may be considerable risks in trying to pursue an independent monetary policy in the context of weaknesses in staffing and political difficulties. A new currency or a new set of banknotes may need to be designed and arrangements made for its production, introduction and use. In Afghanistan and Iraq, political decisions were made to retain the current legal tender and to replace it within a year with a new series of banknotes to unify the currency. The initial success of currency reform in the DRC in 1998 was reversed by continuing hyperinflation. Sierra Leone did not need to change its cash currency management, but suffered some problems with theft and with the destruction of unfit banknotes. In the DRC, much effort has been focused on de-dollarizing the economy, while in Cambodia little was done in this area. In the cases of Kosovo and Timor-Leste, the use of a new currency was, on balance, considered to be the most appropriate. In Kosovo, the UN decided to make the deutsche mark (DM), as the physical representation of the euro, the de facto currency of choice in 1999. Timor-Leste followed in 2000 by making the U.S. dollar legal tender but initially allowing the free private use of any currency. In Serbia, the Fund advised the authorities on how to convert large cash holdings of physical DMs into euros.

29. **If an autonomous national currency is chosen, an exchange rate regime must be decided upon**. The early discussions with the authorities on this matter are conducted with the area department in conjunction with the Policy Development and Review of the IMF and MFD. All alternatives are considered, including a currency board arrangement; another fixed exchange rate system; or a floating exchange rate regime. The choice depends in part on the degree of confidence in supporting monetary and fiscal policies, as well as the level of administrative capacity.

Payment systems

30. **An emergency payment system has to be set up in the absence of a functioning central bank and banking system**. Such a payment system makes transfers of funds possible to and within the country to help ensure that the necessary humanitarian assistance reaches those in need. Storage, security, and transportation to distant distribution points must be restored with a strong focus on security considerations. Banknote quality must also be maintained, and systems of inventory control strengthened and enforced. Reestablishing formal payments outside the capital was an important issue in Kosovo, Afghanistan and

Timor-Leste. Depending on the circumstances, payments were handled with ambulating vehicles, via regional “hubs,” or through the informal payment system. In the case of Sierra Leone, the issue was less a question of the formal payment system having collapsed, but rather the fact that the country had for a long time been fundamentally a cash economy.

31. **New legislation may be needed**. Payment legislation is reviewed and amended when appropriate. If no acceptable legislation exists, a new payment decree should be enacted. Fund staff has assisted in the preparation of such legislation in many post-conflict countries.

Key central bank functions

32. **If a central bank already exists, its resources must be assessed and it operations restarted as soon as possible**. If necessary, new staff is recruited and trained and management and departments may need to be reorganized to match the skills of staff and meet critical needs. Accounting records and reports are not only important for proper management but are also vital for implementation of monetary policy. Existing records and accounting systems must be inventoried. A balance sheet based on the existing chart-of-accounts is produced even if some entries must be estimated.

33. **In the absence of an existing central bank in Kosovo and Timor-Leste, key tasks can be organized in a CPO**. Initially, the CPO pays particular attention to establishing correspondent accounts, reconciling earlier accounting records of funds held abroad, and setting up a system for receiving and channeling foreign funds. The central bank/CPO can act as a depository and cashier, accept and channel emergency assistance, ensure that payments related to essential public services are made, transfer payments to major places nationally, and handle payment of public salaries and social benefits. The central bank/CPO agrees with the MoF on what services it can provide and the reimbursement it receives for doing so. The central bank/CPO must also accept deposits from public authorities and from foreign banks, international financial institutions, and donors. If no functioning MoF exists, a transitional institution on the fiscal side is established. Until functioning banks are re-established, the central bank/CPO may need to accept demand deposits on behalf of individuals and legal entities; receive and disburse money; and provide other payment services. The central bank/CPO may also monitor the activities of organized foreign exchange bureaus and money-changers, preparatory to setting up a supervisory function for financial institutions in Stage III. Identifying existing cash reserves is an important early task in the context of the destruction of central bank records, looting of the vaults, and frozen offshore assets.

34. **A key difference from regular TA work is that TA to post-conflict economies occasionally includes providing resident experts for line positions at central banks**. Decision-making in post-conflict countries is often severely constrained by shortfalls in human capital and administrative capacity. Identifying and selecting resident or peripatetic experts to alleviate these constraints will involve different interested institutions. In some cases, the Fund has placed experts in key line positions in the central bank or quasi-central bank: Kosovo (since 1999), Timor-Leste (2000–04), and Serbia (2001–03). These positions were financed by a variety of external sources arranged by the Fund.

Banking sector issues

35. **Commercial banks and other financial institutions are assessed and early decisions made regarding their reform and rehabilitation**. Entities that do not meet appropriate supervisory criteria need to be recapitalized, reorganized or closed and others are relicensed. In Serbia and in Cambodia, such issues in the context of bank restructuring have been a major area for TA. The need to quickly deal with issues relating to diminishing bank assets underscores the importance of TA combined with capacity building in problem bank identification and resolution. TA in these areas is usually provided by the World Bank with the Fund having a supportive role. Some banks undertake some of the fiscal agent responsibilities that normally rest with the central bank. In Iraq, two large state-owned banks, having extensive branch networks, continue to carry out some tasks of the central bank.

Financial sector legislation

36. **Key financial legislation often needs to be revised or completely redrafted in accordance with international best practices**. If not already done, a new, or revised, central bank law may need to be prepared with Fund assistance. LEG is responsible for the actual drafting of legislation and MFD for addressing policy issues that arise in the preparation of the legislation. This work must be tailored to the local legal system and circumstances and is often complicated by language and unfamiliar legal system issues. In some cases, new legislation have taken an extended time to put in place reflecting domestic circumstances.

37. **Other commercial legislation such as the company law, collateral, and bankruptcy legislation is reviewed and possibly strengthened**. It is essential for the resumption of economic activity to reestablish timely and orderly transfers of ownership titles. The World Bank typically conducts an overall review of the legal system to enable legal reform to be prioritized and carried out in a coordinated manner.

Monetary control

38. **Simplified approaches are often required to establish monetary control owing to limited information and infrastructure**. Support to strengthen monetary policy and monetary operations dominated the MFD TA provided to Cambodia from FY 1999 through FY 2001 as well as in the DRC during FY 2003–FY 2004. Early on, a foreign exchange auction is typically the main instrument and the strongest policy transmission is through the exchange rate. In Afghanistan and Iraq, this instrument was the first used since the exchange rate had been selected as the day-to-day operating target. In the DRC, the situation was much more complicated since the country had experienced hyperinflation during more than a decade and severe currency depreciation, increasing dollarization, and a lack of international reserves, requiring general macroeconomic stabilization. Besides foreign exchange intervention, changes in reserve requirements and lending facilities can be used to soften the impact of unexpected fluctuations in base money.

39. **A short-term information system for monetary management is established**. Consumer prices and exchange rates are key inputs for policymaking, and these are the focus of early statistics efforts. Basic research and policy analysis capabilities must also be set up.

Foreign exchange market

40. **A formal market in foreign currencies must be restored**.[6] The foreign exchange operations of the central bank/CPO is organized with a clear structural separation between dealing (agreeing on transactions) and settlement (execution of payments). Any foreign exchange sold by the central bank/CPO goes to the highest bidder at market rates. The re-establishment of foreign exchange markets (for both cash and deposits) is more easily achieved in the private sector, if allowed. Commercial banks are usually the main source of and intermediaries of foreign exchange between individuals and enterprises. In Afghanistan, this function was initially fulfilled by the money changers in the *hawala* system.[7] Foreign exchange dealers are licensed and prudential, accounting and reporting standards re-established. In some cases, minimal, more easily enforced standards need to be developed. The standards for licensing exchange bureaus must be liberal. In the transition, it may be efficient to allow informal transmission mechanisms, such as the *hawala*, to remain unregulated as their informality may have allowed them to survive the conflict largely intact.

C. Stage III—Institution-Building Phase

41. **During the institution-building phase the emphasis of TA shifts to establishing lasting institutions in support of financial services**. This often begins within the first 18 months. Any government needs an institution that can serve as its fiscal agent and its banker, to provide storage and safekeeping services, and to manage financial assets and reserves at home and abroad. As the demands on a CPO increase, it is transformed into a new institution with wider responsibilities, a Banking and Payments Authority (BPA) as a step toward the reestablishment of a central bank. BPAs were created by the UN administrations in Kosovo and Timor-Leste based on Fund advice and with Fund support.

Commercial banking system

42. **By this stage, conditions will generally allow for the establishment of a standard commercial banking system**. In some countries, a functioning two-tier structure has remained intact (Iraq). However, in other cases the commercial banking sector has been severely weakened, resulting in the central banking function taking over services which are normally provided by the commercial banking sector. An early step is to modernize the banking law or to enact a new decree. In Cambodia, MFD TA supported rationalizing a two-tier banking structure by helping to separate commercial banking functions from the central

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[6] A recent MFD paper discusses operational aspects for moving towards exchange rate flexibility *SM/04/396.*

[7] El Qorchi and others (2003).

bank for subsequent privatization. MFD and LEG, in cooperation with the World Bank, have often taken the lead in this task, for example, in Afghanistan, Cambodia, Iraq, and Serbia. In cases where the UN is the transitional administrator (Kosovo and Timor-Leste), staff drafted UN decrees were used as banking laws. In Kosovo and Timor-Leste, foreign-owned institutions were the first banks to be licensed in the post-conflict era and they played an important role in restoring confidence in the banking system and bringing critical financial and human resources to quickly start operations.

Supervision

43. **The bank supervisory authority, generally located in the central bank, often needs to be strengthened**. The central bank must establish and enforce minimal reporting and regulatory standards. Foreign expertise may be needed to assist in the restarting of the banking system and to provide a minimum of supervision. The emphasis has often initially been on off-site monitoring but, as soon as possible, should shift to on-site inspections, at least to verify the accuracy of reports. The reporting format should be kept simple but has to provide basic data for prudential and monetary management purposes. In addition, prudential limits on open foreign exchange positions should be introduced as part of the development of banking supervision. Usually the World Bank takes the lead on advising on which banks should be relicensed, rehabilitated, or closed. Of the eight cases covered in this study, only the one on Serbia included TA on the restructuring and resolution of weak banks.

44. **Licensing is particularly important**. No bank is allowed to operate without a license, and the central bank has powers to determine whether a license is issued to a particular institution. Ideally, all banks are relicensed as soon as is feasible. Depending on the extent of the destruction, the central bank need, in exceptional cases, to relicense banks with negative net worth. If so, it will need to decide on (with the government) and announce policies regarding the restructuring of these banks. In Cambodia and Serbia, TA to strengthen banking supervision was a complement to other support provided to resolve restructuring problems in the banking sector. The use of long-term resident advisors in supervision was particularly intense in Cambodia and Timor-Leste.

Nonbank financial intermediaries

45. **Nonbank financial intermediaries can attract savings and channel financial resources to rural or deprived groups and areas**. The central bank/BPA should be in charge of licensing microfinance institutions and empowering them to accept deposits from members, and possibly to a limited extent from the general public. However, it should normally not be in charge of regulating and supervising microfinance institutions.

Payment systems

46. **In the institution building stage, payment systems move closer to a conventional system whereby transactions are carried out by banks and between banks on behalf of their customers**. Banks, usually in major urban areas, replace any emergency-oriented payment bureau operations. The central bank/BPA must encourage this through its pricing of

payment services. The central bank/BPA does not stop providing emergency-oriented payment services in any area unless at least two banks are competing in that area in order to avoid replacing one monopoly with another. The central bank/BPA should provide deposit, payments, and credit services in areas without bank branches. The central bank/BPA, in cooperation with the financial community, takes the initiative of establishing an interbank clearing house and provide rules for the settlement of payment transactions.

Foreign exchange asset management

47. **In addition to managing the foreign reserves of the country the central bank/BPA must be ready to manage financial assets of public agencies**. This should be carried out in accordance with best international practices as defined by guidelines organized by the Fund and with the assistance of MFD. Reserves management requires appropriate structures for efficiency, internal control and risk management.[8] The central bank/BPA typically also needs to review its correspondent banking relationships.

D. Stage IV—Reform Consolidation Phase

48. **In this phase—approximately in the first two-and-a-half years—the objective is to consolidate reforms with a view to restoring normal conditions**. On the political side, this typically implies that any previous UN transitional administration has given way to a national government. On the economic front, commercial activity is being revived.

Noncash payments

49. **Once banks are in operation previously existing noncash payment instruments must be reestablished and improved**. The central bank must be prepared to provide leadership to establish a planning framework. If telecommunications and/or data processing facilities are unavailable, available paper-based payment instruments can be used. Arrangements will be needed for clearing and settling payment instructions. Simple netting arrangements through local clearing houses will be useful. Each clearing house serves a particular region where the payment documents can be delivered on the same day.

Financial integrity

50. **At every stage, it is important to strengthen the integrity of financial systems and deter financial abuse in post-conflict situations**. The Fund is often the first international institution making the post-conflict country aware of the importance of issues relating to anti-money laundering and combating the financing of terrorism (AML/CFT). The provision of TA in the areas of legislative drafting, the development of effective supervisory regimes, and the establishment of financial intelligence units are important components of a program.

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[8] International Monetary Fund (2001).

Market-based monetary operations

51. **Over time, efforts are directed to developing a wider range of market-based instruments**. In parallel with the phasing-in of bank restructuring or rehabilitation measures, some market-based instruments are introduced and collateralized interbank credit markets encouraged. These measures set the stage for progressively greater reliance on market-based instruments. Treasury bill auctions were developed with the assistance of the Fund in Serbia and Iraq. In addition, plans should be made to develop secondary markets.[9]

Central bank—treasury coordination

52. **Strong coordination between the central bank and the treasury is needed for monetary and treasury liquidity management**. The relationship between the central bank and the treasury is resolved with respect to debt issue, debt-servicing, and management of government deposits following the Fund's and the Bank's public debt guidelines.[10] Primary issues of government debt, particularly treasury bills, can be used initially to implement monetary policy as well as cover budget deficits.

E. Stage V—Exit Phase

53. **During the exit phase the exceptional post-conflict TA provided by the Fund is phased out**. The time for this varies but often occurs after about five years. Progress in restoring normal conditions have reached far enough so that the issue of ownership lies squarely in national hands. Serbia is an example of a country in the exit phase where total assistance has fallen by about half of the level of initial TA in the monetary and financial areas provided in FY 2002. Good reasons could, however, remain for continuing to provide advice and assistance, now part of traditional Fund interaction with member states.

54. **The development of local counterpart skills is critical**. A shortage of adequately trained local staff for policy management as well as hands-on skills in banking operations constitutes a severe handicap. TA in all areas contains training components aimed at strengthening core activities in central banking operations. In matters outside (but still important to) the Fund's core area, attempts are made to mobilize alternative providers in coordination with other international financial institutions and major donors. Training programs are formulated and implemented in Stages II, III and IV, covering the central bank to build critical capacities in the payment, banking operations, and supervisory tasks. Such training has been provided in all the eight post-conflict case study countries.

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[9] For a discussion on monetary policy implementation in countries with nascent or shallow markets, including those in the post-conflict and financial intermediation development stages, see *Monetary Policy Implementation at Different Stages of Market Development*, SM/04/364.

[10] International Monetary Fund and the World Bank (2001).

55. **Training local staff for senior- and middle-ranking positions is especially important**. Local staff having the appropriate macroeconomic qualifications and work experience can benefit from direct mentoring as well as taking part in seminars outside the country. Any selection process must ensure that equal opportunity is given to the participation of appropriately qualified women and any national minorities. The Fund has encouraged each department in the central banks to develop training programs. Such programs can be supported by TA provided by other international financial institutions or donors by setting up specific courses or regional workshops.

56. **Some donors may be better-suited than the Fund to provide trainers able to communicate with local staff**. Language is often of critical importance. In the case of Timor-Leste, training in Portuguese is being promoted through the Portuguese government and private organizations. Also, on-the-job training must take place within the framework of a particular ongoing activity and should be provided by outside donors. Such training could be expanded to the operational work at hand. Over time, the development of skills should include exposure to other aspects that typically are part of the institutions' responsibility.

IV. Modalities of Technical Assistance

57. **All TA departments in the Fund provide assistance to post-conflict economies**. In addition to that provided in the monetary and financial areas, important TA has also been supplied to member countries with respect to legal, fiscal, and statistical issues. Given the interdependencies of post-conflict problems, the integration of assistance between these areas is critical to making early progress. The modalities of TA delivery vary over the five stages previously described.

58. **MFD's work on post-conflict countries at headquarters and in the field has increased significantly during the last several years**. As shown in Figure 1, MFD personnel resources devoted to post-conflict countries discussed in this paper have increased from 1 percent in FY 1999 to about 14 percent of all MFD's personnel resources devoted to TA in FY 2004.[11] In FY 1999, TA was provided only to Cambodia; five years later, eight countries were receiving TA. Assistance to Timor-Leste and Kosovo has been substantial for several years but has started to decline as these cases are approaching the exit phase. TA to Afghanistan and Iraq can be expected to increase and a new set of post-conflict countries may emerge from Africa. The duration of the Fund's post-conflict involvement varies but often reaches a span of five years.

[11] It should be noted that the data for FY 1999 onwards do not include other post-conflict countries to which MFD had commitments to provide TA to, for example, Bosnia and Herzegovina, Croatia, and Liberia.

Figure 1. Eight Post-Conflict Countries: Use of MFD Personnel Resources, FY1999-2004
(in percent of total MFD/TA personnel resources)

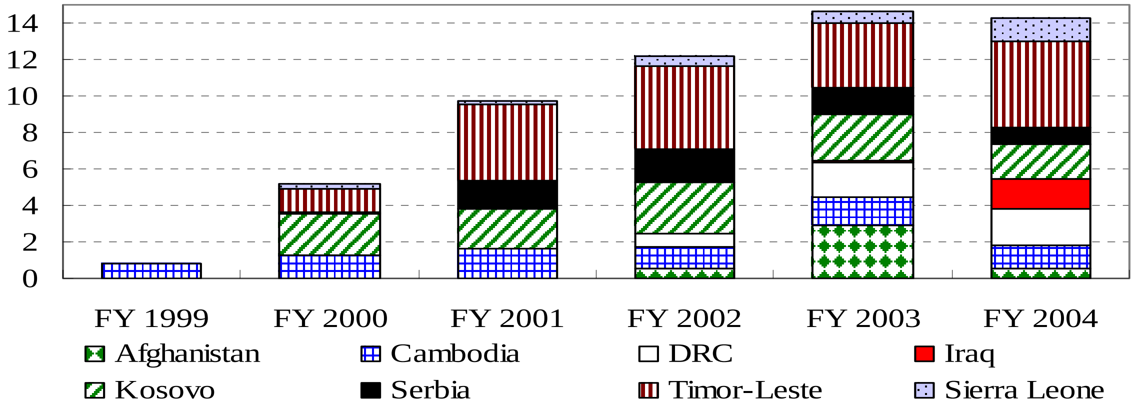


Figure 2. Eight Post-Conflict Countries: MFD Staff Assignments, FY1999-2004
(number of days in the field)

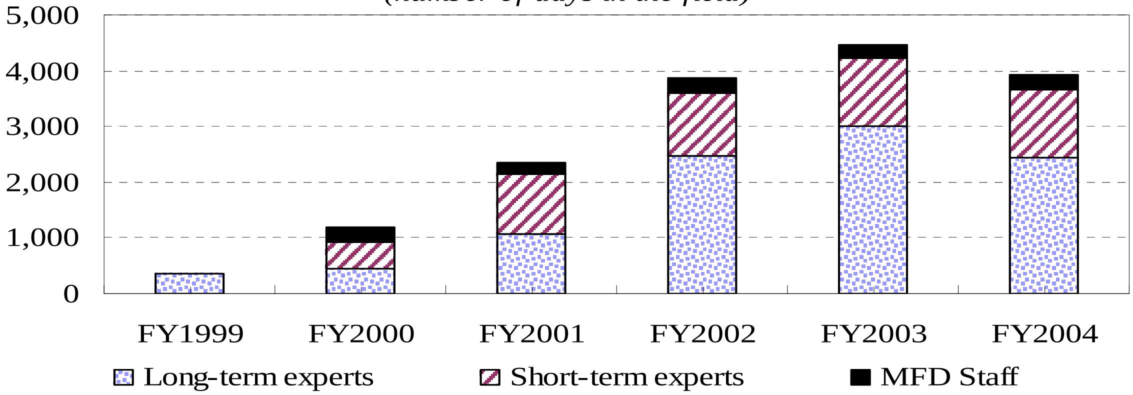
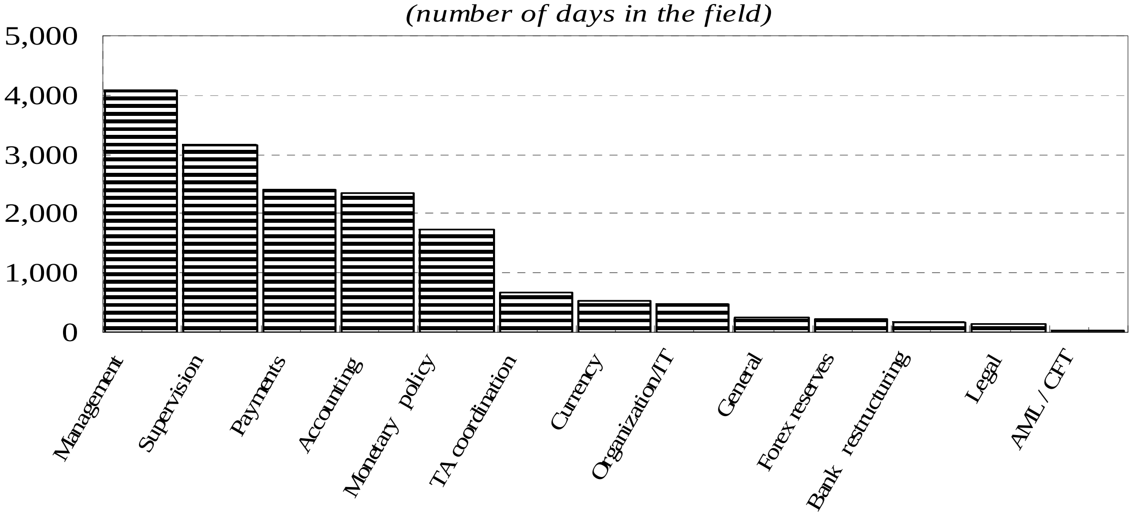


Figure 3. Eight Post-Conflict Countries: MFD Technical Assistance Areas, FY1999-2004
(number of days in the field)



Source: TIMS and BRS.

59. **Long-term expert assignments typically dominate post-conflict TA delivery in the field, in contrast to regular TA (Figure 2)**. Cambodia involved the use of long-term experts in all years except in FY 2001, and MFD used experts in line positions in Kosovo, Serbia, and Timor-Leste. A bridge in the transition from resident advisors to more regular short-term expert visits can be the use of peripatetic arrangements with experts making visits every two or three months. Other forms of peripatetic TA were used in the DRC in areas such as supervision and internal audit. In the case of Sierra Leone, long-term experts could not be used because of security and safety concerns and intensive peripatetic visits by short-term experts were arranged instead. It is also worthwhile to note that the number of days of MFD staff in the field has been rather constant since FY 2000.

60. **Management and supervision are the two major areas of MFD TA delivery (Figure 3)**. Of the resident advisors in line positions, three were engaged in top management, while of the other three specialized in supervision, payments, and accounting/internal audit. During Stages II and III, TA missions are particularly important vehicles for TA delivery. Once agreement has been reached with the authorities on the framework for future assistance, visits by short-term experts and long-term resident arrangements plays an increasing role. As a country graduates from its post-conflict status, the TA already has shifted from multi-topic missions to small focused visits and from long-term advisors toward short-term targeted expert visits. An increase in external seminars and workshops is also anticipated.

61. **When the security situation does not allow for visits to a country, nontraditional forms of TA delivery are used**. In the case of Iraq, Fund visits were no longer permitted after the bombing of the UN headquarters on August 19, 2003. As a result, meetings, seminars, and workshops were arranged in third countries, often in the region. In addition, once phone connections were restored, video conferences have been used.

V. Lessons and Implications for Future Work

62. **MFD's rich experience with providing TA to recent post-conflict countries provides important lessons for future cases**. The post-conflict assistance provided by MFD, other Fund TA delivering departments, and other institutions is in many ways unique. This unique experience provides a special vantage point for drawing lessons for rebuilding monetary and financial systems:

- ***Security must be well in place before effective TA can be delivered*****—**Further, suitable premises must be identified by the authorities at the earliest possible opportunity.

- ***The impracticality of long-term planning means that judgment and flexibility are especially important*****—**Often the second and third best solutions must be chosen in the context of shifting and highly country-specific circumstances.

- ***A particular sequencing of key policy decisions has been adopted in most cases*****—** Usually currency reform comes first, followed by the establishment of payments, the restoration of basic central bank services, improved monetary operations, and reforms in bank supervision and bank restructuring.

- ***Careful coordination of TA within the authorities and between donors is needed to minimize conflicts*****—**Conflicts can be avoided by full communication and cooperation among the external donors and between them and local entities.

- ***Special efforts must be made to find qualified foreign advisors and managers*****—** Notwithstanding the difficult local conditions it is essential to attract foreign advisors that are open and flexible.

- ***Local counterparts should be trained to take over key central bank line positions from foreigners*****—**Foreign managers should be willing and able to train local staff to step into their line positions over time to transfer of know-how and secure national ownership of reforms.

63. **These lessons are relevant not just for future work in post-conflict countries but also for countries without a legacy of conflict but that nevertheless must build institutional capacity from the ground up**. MFD TA to post-conflict countries to help them build institutional capacity can be expected to remain at the current level for the short-term and possible longer. There are also two other groups of countries with very limited institutional capacity. First, there are many low-income countries that have very limited institutional capacity and thus for TA purposes are closer to post-conflict countries than to other TA recipients. Second, looking ahead, there are member and non-member countries that will sooner or later emerge from long periods of isolation and require support for building institutional capacity. Both of these groups of countries will ultimately require extensive assistance to establish modern monetary and financial systems in support of recovery and growth. In the staff's view, the above developed five stage post-conflict approach, and the lessons learned, can be usefully applied in these countries as well [Box 1].

VI. Issues for Discussion

64. The Board may wish to consider the following issues for discussion:

- **The approach to providing TA to post-conflict countries:** How do Directors assess the scope, content and sequencing of TA to post-conflict countries by MFD? Do they see it as sufficiently flexible and responsive to the political, institutional and capacity constraints relevant to these countries?

- **Fund's role in design and implementation of TA strategy:** Taking the lead role in assisting post-conflict countries design and implement a strategy for rebuilding monetary and financial institutions is resource intensive, including in terms of coordination with donors. How do Directors view the priority to be attached to such a role vis-à-vis other uses of MFD's limited resources?

- **Coordination among donors and providers of TA:** Experience has shown that the effectiveness of TA can be limited by a lack of coordination between external donors and agencies and between them and national government entities. Do Directors have suggestions on how such coordination can be strengthened?

- **Conditionality in Fund-supported programs:** Do Directors agree that incorporating key TA recommendations as conditionality in Fund-supported programs in post-conflict countries can facilitate their implementation, and should continue on a selective basis?

Box 1. Lessons for Other Weak Capacity Countries

The experience of the Fund with providing TA to post-conflict countries can be applied to other countries as well. Major support for building institutional capacity will be required for low-income countries with very limited institutional capacity, countries emerging from long periods of isolation, and countries where natural disasters resulted in widespread destruction. The commonalities between these weak capacity countries and post-conflict countries include: difficult social conditions, macroeconomic instability, deficient physical infrastructure, lack of a supporting legal framework, and weak administrative capacity.

The phased approach applied to post-conflict countries is equally applicable for the weak capacity countries. In particular, capacity building efforts should begin with entrenching monetary control especially with respect to currency reform, followed by the establishment of basic payment services. Thereafter, basic central bank services should be developed in close cooperation with other government entities, and practical approaches to monetary policy and operations adopted. Commercial banks should be assessed as soon as possible and efforts aimed at establishing a market-based and properly supervised banking system.

Many of the same coordination issues that mark post-conflict countries should be expected to arise in other weak capacity countries. The resumption of assistance to these countries is typically rapid and the large number of interested donors and limited local administrative capacity can be expected to create logistical problems. If the authorities are not able to take the lead in the coordination of technical assistance, then the Fund, at the request of the government and in consultation with other providers, could take the lead.

Finally, the post-conflict work of the Fund has led to the development of institutional human capital for capacity building. Fund staff that have worked on post-conflict countries have considerable experience and contacts in capacity building. This unique pool of human capital should enhance the effectiveness of assistance to non-conflict weak capacity countries.

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