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SPECIAL REPORT

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ABOUT THE REPORT

This report focuses on the role of the U.S. Treasury Department in providing finance-related state-building and institution-strengthening assistance. It draws on a series of high-level meetings and consultations convened by USIP's Center for Sustainable Economies between May and September 2008. The author of this report, Jeremiah S. Pam, is a USIP visiting research scholar. From May 2006 to May 2007, Pam served as the U.S. Treasury financial attaché in Baghdad, where he was the senior Treasury official in Iraq and led the U.S. Embassy's financial diplomacy and policy efforts. In March and April 2008, Pam was a member of a team that conducted an assessment of Iraqi governance and U.S. governance assistance efforts throughout Iraq for the U.S. Mission in Iraq and the Multi-National Force–Iraq. Previously, he was an international finance lawyer at Cleary Gottlieb in New York, where he advised governments, including Iraq, on resolving sovereign debt crises.

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The Treasury Approach to State-Building and Institution-Strengthening Assistance

Experience in Iraq and Broader Implications

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Summary

- The U.S. Treasury Department's approach to helping states build and strengthen their public institutions responsible for financial management is worth studying both because of the intrinsic importance of these institutions to an adequately functioning government and because it illustrates some key dynamics underlying state-building assistance more generally.
- A key premise of Treasury's approach is a primary orientation toward assisting local government institutions on mutually agreed-upon reform programs, based on a thorough understanding of the local administrative systems to be reformed. This orientation is reinforced by the fact that Treasury's contribution is typically only a small number of policy officials and embedded technical advisors, rather than large U.S.-funded programs.
- In the conventional case where state-building and institution-strengthening are pursued as part of a long-term development strategy, Treasury provides assistance through two activities that are organizationally and functionally distinct: advisors fielded by Treasury's Office of Technical Assistance (OTA), who are technical experts and usually based within local institutions at the request of host governments, and financial attachés, who act as financial policy officials/diplomats and are based at the U.S. embassies in a smaller group of countries.

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- In extraordinary situations where state-building follows an intervention (as in Iraq), deployed technical experts need to be partnered with a senior policy official (such as the Treasury attaché) who can create space for local institution-oriented work by shaping (and, where necessary, resisting) the many “centrifugal” external forces—from Washington, the military, and other civilian and international agencies—pulling in other directions.
- Improving interagency coordination mechanisms in Washington might do relatively little to enhance effectiveness by itself. Indeed, tighter Washington interagency “alignment” could end up strengthening Washington coordinating bodies at the expense of knowledgeable field officials and experts. It may be better to create the conditions for more effective interagency coordination in the field by deploying senior policy champions who both understand the importance of a local institution-oriented approach and possess sufficient delegated authority to tame the centrifugal forces necessary to make space for it.
- An expeditionary corps of technical experts by itself is insufficient to deal with the unconventional challenges presented by post-intervention state-building operations because the centrifugal forces present in such an environment are strong enough to undermine even the most sound assistance program absent the support of appropriately oriented policy champions.

Introduction

A great deal has been written in recent years about the shortcomings of and need to reform the way the United States conducts both foreign assistance generally and post-conflict state-building assistance in particular.¹ In these discussions, most attention has understandably been devoted to the agencies most closely associated with the “three Ds” of defense, diplomacy, and development: the Department of Defense (DOD), the Department of State, and the U.S. Agency for International Development (USAID). As observers have noted, however, other U.S. government agencies have also played an increasing role in foreign assistance and state-building.²

Among the other civilian agencies, the Treasury Department is notable for a few reasons. Since World War II, the Treasury Department has played a leading role in crafting policies toward the developing world in the Bretton Woods institutions, in trade and investment policy, and in other areas of international financial policy. In addition, Treasury has deployed personnel to work on fiscal and financial issues in a wide variety of contexts, from transition economies in Eastern Europe and the former Soviet Union, to emerging-market and frontier economies in Latin America and Africa, to post-conflict state-building efforts in Bosnia, Kosovo, Afghanistan, Liberia, and Iraq.³ Most experts agree that finance-related state-building is inherently important because governments cannot function without institutions that can adequately perform key financial functions such as formulating and executing budgets and maintaining macroeconomic stability.

Treasury’s overseas operations have also periodically been mentioned as particularly effective. For example, USIP’s Patricia Thomson and Daniel Serwer observed last year that, “The Treasury Department has a famously effective group of ‘Treasury advisors’ who help countries establish central banks, new currencies, and appropriate economic policies.”⁴ A 2005 report by the Government Accountability Office confirmed that “according to both Treasury and State officials, [Treasury] financial attachés have more specialized knowledge of financial issues.”⁵ Former Iraqi Finance Minister Ali A. Allawi wrote that in his experience, “The best-qualified staff were those who had been seconded or recruited by the US Treasury. . . . They understood the need to focus on human and technical parameters that made projects successful, as well as good policies.”⁶ Similarly, Beth Cole and Christina Parajon of USIP noted that Afghan officials contrasted “the relatively small

numbers of highly qualified experts provided by ... Treasury" with the numerous but "less than fully qualified" U.S. contractors from other programs.⁷ In short, even though the total amount of Treasury resources for foreign assistance and state-building is minuscule compared with the relevant budgets of State, USAID, or DOD, it is fair to say that, substantively, Treasury has long "punched above its weight."⁸

This report examines Treasury's approach to finance-related state-building assistance (defined broadly to include efforts both to build institutions from the ground up and to strengthen the capacity of and reform existing institutions) because of the intrinsic importance of this type of assistance and in order to gain insight into some of the key dynamics underlying state-building more generally. The report argues that Treasury's conventional approach to state-building assistance based on expertise and a core orientation toward local institutions is an insight of fundamental value to all state-building efforts. However, in extraordinary circumstances when state-building follows a military intervention, as in Iraq, this expertise and orientation are not enough. The report examines Treasury's comparatively successful adaptations to the circumstances of Iraq and identifies general lessons for effective post-intervention state-building as well as other policy implications.

The report begins with an overview of the two distinct components of Treasury's conventional overseas presence: financial attachés and technical advisors from Treasury's Office of Technical Assistance (OTA). The report then discusses the key factors that distinguish post-intervention state-building contexts such as Iraq from the environments in which attachés and OTA advisors normally operate. The following section describes how Treasury adapted to the unconventional environment of Iraq, most notably by having its attaché and OTA advisors work much more closely than usual. The final section presents lessons of broader applicability to the foreign assistance and state-building debates from both Treasury's conventional and unconventional approaches to financial diplomacy and technical assistance.

The Two Components of Treasury's Overseas Presence: Attachés and Advisors

Treasury headquarters in Washington has a substantial (relative to Treasury's size) Office of International Affairs (IA) overseen by an under secretary for international affairs and two assistant secretaries for international affairs. Although most of its staff is based in Washington, IA takes the lead in maintaining Treasury's worldwide overseas presence through two distinct activities.⁹

To inform and extend the reach of Treasury's senior Washington-based leadership, IA has for more than sixty years stationed policy officials known as financial attachés at embassies in select countries throughout the world. The traditional functions of financial attachés include providing insight into local conditions and serving as a direct policy line of communication to finance ministries and central banks—acting, in effect, as financial diplomats. Although for most of the program's history attachés were typically assigned to the most advanced industrial countries, in recent years, improved communications technology and more frequent direct contact between senior finance officials through the G-8 process have led Treasury to pull its attachés back from most of the G-8 countries (apart from Japan) and instead assign attachés to significant emerging markets (including China, Singapore, India, and Brazil, among others) and locations of significant national security concern, such as Iraq and Afghanistan.

The second, largely distinct, activity through which IA maintains a Treasury overseas presence is its Office of Technical Assistance (OTA). Treasury originally established its technical-assistance program in 1990 to send financial experts to advise the finance ministries and central banks of the former communist countries of Central and Eastern Europe on transitioning to market systems that would support growing economies and stable

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Current Treasury OTA Advisors

The Americas		
Colombia	GAFISUD	Mexico
Costa Rica	Guatemala	Nicaragua
Dominican Republic	Haiti	Paraguay
El Salvador	Honduras	
Asia		
Indonesia	Philippines	
Pakistan	Vietnam	
Central and Eastern Europe		
Albania	Bosnia	Kosovo
Former Soviet Union		
Armenia	Georgia	Ukraine
Azerbaijan	Kyrgyzstan	
The Greater Middle East and North Africa		
Afghanistan	Iraq	U.A.E.
Algeria	Jordan	Yemen
Egypt	Oman	
Sub-Saharan Africa		
Botswana	Liberia	Rwanda
Cape Verde	Madagascar	Sao Tomé
Ethiopia	Malawi	South Africa
Ghana	Mozambique	Tanzania
Guinea	Namibia	Uganda
Kenya	Niger	Zambia
Lesotho		

Source: U.S. Treasury Department, Office of Technical Assistance, August 2008.

democracies. Within a few years, the program was expanded to include the countries of the former Soviet Union. By the end of the decade, the program had assumed a worldwide scope (often in response to requests from countries that had heard positive reports about OTA's performance in emerging Europe and the former Soviet states), expanding to Latin America, Africa, Asia, and the Middle East.¹⁰

OTA advisors operate in five "core disciplines": banking and financial services, budget policy and management, financial enforcement, government debt issuance and management, and tax policy and administration. These core disciplines were originally selected to track areas where the Treasury Department has unique expertise. As noted earlier, they also relate directly to state functions such as budgeting and maintaining macroeconomic stability that are critical to sustainable economic development.

While OTA advisors are hired as contractors and are not permanent Treasury employees, some of those originally recruited were retired employees of Treasury or other federal agencies, and others had led successful careers in relevant parts of the private sector, particularly banking. OTA continues to recruit experienced practitioners from the public and private sectors with firsthand operational experience working in their core disciplines.

OTA usually sends out no more than one or two advisors per core discipline per country, and this small scale allows OTA to do its own recruiting for each core discipline. Each advisor is signed to an individual personal services contract with OTA.¹¹ A small management staff organized by core discipline is based in Washington to oversee the program, although given the typically high level of experience advisors have in their disciplines, OTA

management usually relies to a high degree on advisor judgment in the field. OTA's light administrative structure has allowed it to be experimental in trying flexible approaches to delivering assistance as they prove to be most effective in particular cases (for example, combining resident and intermittent advisors).

Perhaps most important, OTA advisors prepare work plans and deploy pursuant to formal Terms of Reference (ToR) agreed upon with the requesting finance ministry or central bank. The ToR sets forth the understanding between Treasury and the local agency as to the specific areas of reform in which the local agency wishes the advisor to work. It also usually specifies that advisors will work directly in the ministry or central bank (often in close proximity to the office of the minister, governor, or other senior officials) and provides that the advisor will have regular access to all relevant local government officials. This combination of agreed ToR, physical co-location, and assurances of access to senior officials all make it much more likely that OTA advisors and their local government counterparts will be both substantively and literally "in the same place" with the local ministry or central bank.¹²

The process by which OTA advisors are fielded varies depending on the country. In some cases, a foreign country will initiate the request as part of its regular dialogue with Treasury policy officials, while in other cases U.S. government officials may first raise the idea of Treasury technical assistance with a foreign government, often as part of a broader foreign policy dialogue about what the United States can do to help the country. In both cases, requests have often been linked to the foreign countries' IMF programs, which typically contain commitments to specific financial and monetary reforms with which Treasury advisor assistance can be helpful. Once a foreign request for a new advisor comes into OTA, it is discussed with the relevant Treasury policy officials (such as the IA regional desk and in certain cases the Office of Terrorist Finance and Intelligence) and through the relevant interagency mechanisms (typically involving at least State and USAID and often other agencies as well).

Once OTA advisors are deployed, their classic strength has been in helping local finance ministries and central banks implement the specific financial reforms mutually agreed upon between the two countries while operating consistent with local country leadership of the reform effort. This approach increases the likelihood that the host government will sustain the reforms after U.S. assistance has ended. Because OTA advisors are fully "embedded" within ministries or central banks—both physically and operationally—they are often able to contribute considerable "bang" for a relatively small "buck" while maintaining a low profile. This kind of light touch is precisely what many development experts have concluded is a key to the "autonomy-respecting help" that does not create dependencies or undercut the local government's ability or inclination to help itself but does increase the likelihood of sustainability.¹³

By contrast, where Treasury financial attachés are assigned, they normally play a number of distinctly policy roles of value to both the U.S. and local governments. First, given their expertise in financial policy, Treasury attachés are a useful resource wherever it is important for the U.S. government to have a detailed understanding of foreign financial policies and local conditions, or to communicate to the local government or public a better understanding of U.S. financial policies, particularly in high-priority countries that remain less than transparent and immediately accessible to Washington for any reason (whether cultural, developmental, or simply due to time differences). After the September 11, 2001, attacks, Treasury was given additional authority to counter the financing of terrorism and money laundering; as a result, attachés located in jurisdictions of national security concern have also played a role in supporting local efforts to crack down on illicit financial networks. Finally, attachés are a rare source of financial analysis that is at the same time integrally linked to, but necessarily removed from, the greater body of Treasury analytical resources in Washington. Because attachés have the time during a typical three- to four-year tour to develop close working relationships with both local government officials and local market participants, attachés can often contribute valuable

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perspectives to supplement, qualify, or otherwise enrich U.S. government decision-making and policy implementation. This cross-checking function from a locally informed source trusted by U.S. policymakers in Washington helps decrease the risk of avoidable “analysis failure” and poorly informed policy.

While both the financial attachés and OTA advisors are organizationally within Treasury IA, in conventional circumstances, their roles have usually been distinct. Until recently, attachés served in the most advanced economies, and advisors were typically assigned to developing nations; as a result, they rarely worked together in the same country. However, the recent move to redeploy financial attachés from advanced economies to significant emerging markets and countries of national security concern, such as Iraq and Afghanistan, has increased the number of situations where both an attaché and one or more OTA advisors are present.

Nonetheless, the conventional practice has been that once an advisor is sent out, neither IA policy nor other U.S. agencies usually exercise day-to-day oversight of the advisor. Indeed, it is OTA practice that advisors act as though the local minister or governor is his or her “customer” (consistent, of course, with the Terms of Reference and their contract with OTA).¹⁴ By contrast, as Treasury policy officials, financial attachés both report regularly to and receive regular policy guidance from other policy officials in both Main Treasury and the embassy.

The Challenges of Post-Intervention State-Building

As noted, the brief descriptions just given apply to the settings in which Treasury attachés and OTA advisors are conventionally situated—when the country in which they are serving is more or less at peace and not an immediate national security concern for the United States. However, the unconventional context of a state-building effort that follows a military intervention and stability operation (what we have been referring to as a “post-intervention state-building” environment) presents a different situation, which Treasury has faced not only in Iraq but in Bosnia, Kosovo, Afghanistan, and Liberia, among others.¹⁵

Taking Iraq as our central illustration, the post-intervention state-building environment differs from the conventional context in three important ways.¹⁶ First, a large foreign (in Iraq, the Coalition/U.S.) military force is present because of a dangerous security environment, making it difficult for both Americans and local officials to move around or operate. One result is that many of the normal modalities for interaction with counterparts followed by Treasury everywhere else in the world are much more difficult to practice. For example, in Iraq, OTA advisors (like almost all other civilians providing technical assistance) have generally had to be based in offices in the embassy compound in the cloistered International Zone, unable to be embedded with the Iraqis they are advising in the Finance Ministry and Central Bank per their standard operating procedures. Consequently, a greater-than-usual amount of the interaction between OTA advisors and their Iraqi counterparts has had to take place via phone and e-mail, supplemented by specially arranged meetings in and out of the International Zone (with the Iraqis also taking substantial risks traveling and navigating checkpoints). While OTA advisors and Iraqi finance officials have found ways to work together effectively despite this, it complicates the low-profile, light-touch approach of the conventional OTA model.

A second key difference is the tremendous scale, intensity, and comprehensiveness of the U.S. effort—there are simply more U.S. government parties more involved in the effort, both civilian and military, in country and in Washington, many of whom are eager to jump in anywhere they perceive an opportunity to do more.¹⁷ In Iraq, for example, because it has remained for the most part a “conflict” (rather than “post-conflict”) environment, the U.S. military presence dwarfs that of U.S. civilian agencies. This sizable military presence has been accompanied by an equally sizable military interest in all that goes on in the U.S. effort, including diplomacy and technical assistance.¹⁸ Consequently,

civilians have regularly found themselves deluged with requests from the many military organizations involved for status updates or priority action on issues of particular interest to the military. Furthermore, civilians must constantly worry about the risk of a military end run in which officers try to address an issue on their own if they perceive civilians as insufficiently responsive.

Comparable in complexity, if not in numbers, to the military presence is the overall civilian presence (including multiple programs funded by agencies like USAID). These actors may also request information or priority action from civilian agencies responsible for maintaining relationships with key ministries, such as Finance, presenting perhaps an even greater risk of end runs. In many situations, non-U.S. civilian agencies ranging from the IMF and the World Bank to various bilateral development agencies also require coordination. Finally, the interest of and requests from senior policymakers in Washington (and other capitals) can be, if anything, even more urgent than those of the various civilian and military parties.

The third key difference distinguishing the post-intervention state-building environment is the very fact that the local situation was thought grave enough to justify an extended intervention. When foreign involvement begins with an intervention and continues with a substantial military and civilian presence, there is a greater likelihood that those who have come in from the outside charged with “state-building” will be disinclined to give the benefit of the doubt to local government officials and institutions.¹⁹ (This approach contrasts with the conventional foreign-assistance scenario, where external parties provide aid to a state that needs help in specific areas but is nonetheless unmistakably sovereign in key respects.) After all, the reasoning goes, when most people see the country as a failed or fragile state, why spend time figuring out how it operated pre-intervention or rely on its failed institutions? In such a situation, the temptation to aim for overly ambitious post-intervention end states may be particularly hard to resist, since the chief constraint on reform—the legitimacy or even the existence of status quo approaches to state functioning—has been stipulated away.²⁰

The Treasury Approach in Iraq: Overcoming the Challenges

These three departures from the conventional setting that Treasury advisors and attachés encounter elsewhere in the world make business as usual much less feasible in a post-intervention state-building environment. Appropriately enough, Treasury has in these cases often departed from its conventional approach, most notably in Iraq.

In such an environment, a single-minded focus on local institutions and fully self-contained technical-assistance projects is difficult to maintain. For example, following the return of sovereignty, Treasury’s formal technical assistance plans initially focused on helping the Finance Ministry and Central Bank on a traditional group of discrete projects (many of them related to Iraq’s IMF program).²¹ In practice, however, the larger U.S. effort in Iraq relied on the Treasury presence in Baghdad to provide advice and technical assistance with respect to much broader areas of financial and monetary policy and functioning, such as the execution of Iraq’s federal and provincial budgets, the conduct of Iraq’s monetary policy, and Iraq’s preparation of an overall economic reform program for negotiation with the international community. In addition, because of the difficult security environment, advisors could not be co-located at the Finance Ministry and Central Bank, making it logistically more difficult to pursue projects in isolation from the overall U.S. presence.

Perhaps most important, the scale and intensity of the overall U.S. assistance effort in Iraq has meant that all those engaging with key Iraqi institutions, such as the Finance Ministry and Central Bank, were constantly subject to forces pulling them in directions far afield from a narrowly defined assistance strategy. For example, on any given day, Treasury might receive urgent queries from the military about the Iraqi government’s payment of police salaries or the closing of bank branches in particularly tense areas; priority requests

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from Washington agencies for progress on the internationally negotiated economic reform plan; and congressional questions about why Iraq is not spending its capital budget more quickly. In short, the extraordinary number of agencies, amounts of resources available, and high-level attention from multiple directions produce powerful “centrifugal forces” that interfere with efforts to stay focused on local institutions and needs in the interest of advancing reforms that will be locally sustained.

One source of these centrifugal forces is the lack of a coherent and reconciled set of priorities and approaches to implementation among the many foreign elements involved—between the United States and other bilateral and multilateral donors, between different U.S. civilian agencies and programs, between U.S. civilian officials and military commanders, and between officials in the field and in those in the capitals. The result is constant pressure to pursue a scattershot approach based on whatever issues happen to catch the attention of the incoherent collective consciousness of the intervening entities.

Paradoxically, another source of centrifugal forces is attempts to establish coherence (or “alignment”) from Washington. As much of a problem as incoherence is, coherence driven by parties far from the crucial knowledge about local priorities, institutions, openings, and constraints necessary for sustainable reform can rarely by itself be an effective solution.²² While information about the local situation can be transferred back to Washington, in an inherently fast-moving operational environment like that of post-intervention state-building, Washington will almost always be a step behind and lacking some of the tacit knowledge about the local dynamics that field officials pick up “through their pores” and cannot be put into a diplomatic cable or other situation report. Consequently, state-building assistance aimed at sustainable reform cannot simply be subordinated to alignment with the near-term policy priorities of capitals (although these will obviously be a principal starting point and crucial ongoing point of reference).

A final source of centrifugal forces is a common field response to a large and disorganized assistance effort: attempts by particular programs to evade incoherent demands by simply flying “under the radar” and out of sight of the rest of the U.S. effort (as attempted by various U.S. agencies in Iraq that set up their own compounds outside the embassy compound in the Green Zone). While this strategy may work for a time in narrow respects, it often results in the entities pursuing it being cut off from valuable resources, including information about other technical assistance work that is relevant to its efforts, and being perceived by policymakers as marginal or ineffective.²³ In some cases, this strategy has resulted in the creation of a new program to accomplish objectives already being addressed—but in a manner more visible to the funding agency.

Yet despite all these pressures in Iraq, it has remained as true as ever that the surest—perhaps the only—path to the country sustaining both specific financial reforms and improved state functioning generally is Iraqi leadership of (and not just acquiescence to) the efforts.²⁴ This principle is the fundamental insight of the Treasury OTA program’s traditional insistence on working only pursuant to work plans explicitly requested by and agreed with a counterpart finance ministry or central bank.²⁵ It is why it is central to OTA’s self-definition that its “advisors” really are advisors to counterpart government officials leading the reform effort, rather than decision-makers themselves.²⁶

Consequently, the fundamental challenge to effective state-building assistance in the post-intervention environment of Iraq has been striking a balance between the mission imperative to remain oriented toward Iraqi institutions, openings, and constraints in the interest of making a sustainable difference, on the one hand, and the political/bureaucratic imperative to respond to the many demands of the U.S. effort, on the other. Senior U.S. policymakers in Washington must be kept satisfied that the U.S. assistance effort is doing what is feasible to address the United States’ broad priorities, while field experts—who will often have the deepest knowledge of what specific policies are likely to gain traction with the local government—must be given the space to work on projects agreed with the local government. Squaring these imperatives requires identifying the areas of overlap between the priorities and approaches of the U.S. and

the local governments, then working to ensure that assistance in these areas remains relevant to both sides.

In Iraq, Treasury's organizational response to these complex dynamics and tensions developed over time. After the initial deployment of a sizable Treasury contingent including both senior policy officials and OTA advisors when the Coalition Provisional Authority (CPA) was established in 2003, Treasury drew down its presence to a single person (the financial attaché) after the CPA ended and sovereignty was transferred to the first transitional Iraqi government. (The attaché was also able to use some temporary State Department employees and a couple of military detailees.) In mid-2006, however, recognizing the limitations of this arrangement for providing effective finance-related assistance, Treasury began sending out OTA advisors again—while taking the unusual step of basing the OTA advisors in the office of the financial attaché (who was now also joined by some junior Treasury policy staff). This approach contrasts with conventional Treasury practice in most other places, where a clear functional separation is maintained between attachés and OTA advisors. In Iraq, however, the advisors were not only based in the financial attaché's office but jointly managed by the attaché in the field and OTA headquarters in Washington.

In addition to being a flexible adaptation to necessity, this arrangement has provided a number of advantages. The OTA advisors' practitioner's expertise and advisory orientation toward their Iraqi "customers" in the Finance Ministry and Central Bank have made the combined Treasury office (attaché staff plus OTA advisors) uniquely knowledgeable among the many elements of the U.S. assistance effort about the systems, institutions, and actual functioning of Iraqi finance and central banking. This expertise, which has for the most part been developed as a result of the close ties Treasury maintains with the Iraqis who actually operate the system, has been invaluable to the many parties concerned with the stable functioning of the Iraqi financial system. In addition, locating this expertise in the attaché's office has made it more available to inform U.S. policy and policymakers (through the attaché) within the embassy and Washington.

While this location admittedly has made the OTA advisors somewhat more exposed to immediate-term policy pressure than had they been embedded in the ministries and flying below the radar, having a reasonably senior Treasury policy official such as the financial attaché at the head of the effort in Baghdad has provided some valuable insulation, protecting the advisors from being overwhelmed by such pressure. Indeed, Treasury attachés have expended considerable effort and been generally successful at "pushing back" against other civilian or military officials in Baghdad and Washington tempted to let immediate priorities entirely crowd out the space for OTA advisors to pursue important medium-term projects of priority to the local government.²⁷

A further advantage of combining the Treasury attaché and OTA advisor resources in Iraq has been that successive attachés have been able to leverage their policy stature as a senior official within the embassy and the representative of Treasury (the senior agency on financial issues in Washington) to establish a more successful degree of coordination of the many civilian and military entities in Iraq concerned with one aspect or another of Iraqi finance than has been the case with respect to most other policy areas.²⁸ Given the scale and diversity of the comprehensive civilian and military effort that the post-intervention state-building environment of Iraq has called forth, this accomplishment should not be underestimated. As many observers have noted, a lack of meaningful coordination has been one of the most serious general weaknesses of U.S. assistance in Iraq, resulting in a disorganized, inefficient, and sometimes counterproductive overall effort.²⁹ The combination of the Treasury attaché's policy standing and OTA's technical expertise has helped keep the various agencies with an interest in the financial policy area more on the same page and contributed to a more effective and credible assistance effort.

The final benefit of Treasury's unconventional approach in Iraq is that it has proved better able to resist the tendency to overlook actual existing local systems and institutions, an inherent risk in state-building efforts following an intervention in what is seen

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as a failed or fragile state. This strength probably stems in part from Treasury's long-standing principal focus (on both the policy and technical assistance sides) on local public finance—what the foreign government chooses to do with its own money—rather than on creating large U.S.-funded assistance programs involving substantial contracts for U.S. institutional contractors. As financial diplomats, Treasury attachés have focused on understanding and influencing local finance ministry decisions about spending local budgets. As technical-assistance providers, Treasury advisors have focused on understanding and aiding local government reforms to financial-management practices and institutions. While distinct in important respects, these Treasury perspectives are clearly complementary. This combined Treasury presence is perhaps more willing and able than other more U.S. funding-focused agencies to, first, invest the effort and establish the relationships necessary to understand how Iraqi systems work in practice, and, then, to translate that knowledge into operationally effective action to assist Iraqis in their public financial management, using both diplomacy and technical assistance.

This combination of insight into local institutions, knowledge of U.S. policy and diplomatic priorities, and operational capability has often allowed Treasury to bridge the gap between traditional diplomats (who may be skilled at diplomacy but not understand the administrative intricacies of local systems and how they might be made to function better) and other more operationally oriented civilian or military agencies (that may be skilled at directly implementing plans and programs but less familiar with using finite indirect influence to persuade local governments to take and sustain actions consistent with the most important U.S. policy objectives). In short, Treasury has been able to leverage its policy role and local orientation creatively and flexibly to find ways to be responsive to the priorities of both the many interested U.S. parties and the interests and capabilities of Iraq and its institutions.

Conclusions

Many of the key dynamics underlying both Treasury's conventional and unconventional approaches to finance-related state-building assistance also apply to state-building assistance more generally, not just in the realm of financial policy: The core OTA orientation toward local institutions and ownership is invaluable to sustainable state-building, even where actual or perceived state failure has prompted an intervention; experts and officials in the field generally have an advantage with respect to understanding local institutions and priorities and recognizing local openings for and constraints on reform; and the extraordinary pressures of a post-intervention state-building effort require unconventional measures to maintain the focus on sustainable reform, manage Washington's temptation to micromanage, partner effectively with the military in a difficult security environment, and impose a degree of coordination on a diverse assistance effort.

This method suggests limitations to two widely discussed approaches to improving U.S. capacity for state-building. To begin with, improving high-level interagency coordination mechanisms in Washington may result in a better coordinated Washington effort, but it will by itself do relatively little to make better use of the knowledge about local institutions and priorities and local openings and constraints that field officials and experts generally have greater access to. Indeed, it is not difficult to imagine new mechanisms to tighten the alignment of the Washington interagency process such as the State Department's new "F Process" strengthening the lead Washington coordinator at the expense not only of other Washington agencies but the very officials and experts who possess the most local knowledge relevant to sustainable state-building—those in the field.³⁰

In addition, focusing on an expeditionary corps of technical experts by itself is also unlikely to be sufficient to meet the unconventional challenges presented by the next post-intervention state-building operation, any more than Treasury's existing corps of technical advisors was sufficient to deal with financial state-building in Iraq. To be

effective in that environment, technical experts must also be partnered with field policy officials who have the stature—beginning with delegated authority from Washington—to impose order, act as a credible counterpart to senior military leaders, and (perhaps most sensitively) push back against Washington policymakers when necessary in the interest of locally realistic and sustainable policy.

This analysis suggests a few key elements of an effective approach to the unconventional challenges of post-intervention state-building. As already noted, an important requirement should be a thorough orientation (exemplified in this report by the institutional philosophy of Treasury's Office of Technical Assistance) toward assisting local government institutions on mutually agreed upon reform programs, based on a thorough understanding of the local administrative systems to be reformed. While international best practices can be a useful point of reference, for local authorities to sustain the reforms, the more important point of reference will usually be the existing institutions and practices that are being reformed, which requires study and listening.

Another requirement is an integral link between the technical experts and a senior policy official in the field who is at once sympathetic to the technical assistance perspective and has the stature to serve as a credible and effective interface with the many other policy interests pulling in other directions from Washington, the military, other civilian agencies, and the international community. In essence, this policy champion's function is to perform an inherently tricky balancing act, bridging both the perspectives of policy and technical assistance and the worlds of Washington and the field.

Toward this end, such an approach to post-intervention state-building might be extended and strengthened by designating senior Washington-based policy officials with the appropriate expertise and stature within the relevant agencies to be prepared to deploy to lead combined policy/technical assistance efforts in the event of a major post-intervention state-building contingency. For example, at Treasury, an assistant secretary for international affairs could be designated to lead the interagency finance policy/technical assistance effort (which would include technical experts from OTA as well as from other agencies with relevant expertise). Designating a senior official with important Washington responsibilities to play a leading role in such a contingency would obviously represent a significant commitment by the agency and would not be undertaken lightly. However, by sending a trusted official from the agency's uppermost ranks, the agency would be indicating that it is serious about delegating the authority and providing the Washington assets necessary to lead an effective, locally oriented assistance effort against the countervailing pressures.

In closing, while it may be that Iraq is at the far end of the spectrum in terms of danger, scale, diversity of the U.S. effort, and the initially inadequate appreciation of the importance of understanding local institutions, the centrifugal dynamics that the Iraq experience highlights are not unique to Iraq. Other top foreign-policy priorities have produced before and will produce again a similar degree of urgency and a similar desire to use all U.S. government resources available and any shortcuts conceivable to achieve the objective posthaste. Consequently, U.S. state-building efforts generally could benefit from Treasury's example, both in its focus on policies that work with and strengthen local institutions, and in its organizational flexibility in finding creative ways to combine its policy and technical assistance strengths to overcome the formidable and widespread policy, organizational, and coordination challenges inevitably presented by such situations.

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Appendix

Treasury Experience in Other Recent Post-Intervention State-Building Efforts

How does Treasury's experience in Iraq compare with that in other recent post-intervention state-building efforts, such as Bosnia, Kosovo, Afghanistan, and Liberia? While a detailed examination of each of these is beyond the scope of this report, we review them

briefly here with particular reference to the key factors that this report suggests define post-intervention state-building—a large foreign military force and a dangerous security environment, a large-scale, intense, and comprehensive assistance effort, and a presumption against deferring to the local state’s pre-intervention institutions—and the extent to which the existence of these factors affected the conventional approaches of Treasury officials and experts.

Bosnia-Herzegovina

OTA deployed three to four finance and banking advisors to Sarajevo in December 1995, immediately following the November 1995 conclusion of the Dayton/Paris peace accords and the December 1995 entry into Bosnia of the NATO-led Implementation Force (IFOR). USAID also sent a small group initially. A Treasury attaché was later based at the U.S. Embassy.

Security/Military Situation: While the security environment was quite dangerous at first, it improved relatively quickly and was only a limited hindrance to Treasury’s assistance efforts. The NATO force totaled some 60,000 troops, including 20,000 Americans. However, the main U.S. base was initially in Tuzla, north of Sarajevo, and U.S. military officers and commanders generally did not play a principal role in U.S. civilian state-building efforts.

Scale of Assistance Effort: Although the immediate post-Dayton civilian state-building effort was relatively focused, it expanded quickly as additional international actors arrived (including the World Bank, the European Union, and other bilateral aid agencies such as the U.K.’s Department for International Development, or DFID), American agencies such as USAID significantly increased their presence, and the internationally mandated Office of the High Representative (OHR) established itself to oversee the civilian implementation effort. Also in December 1995, the IMF approved a program of emergency post-conflict assistance to Bosnia, which provided some elements of a framework for financial policy assistance. While the OTA presence remained constant after the initial deployment, its prominence in the overall effort diminished somewhat as the number of agencies proliferated and roles became institutionalized within the OHR structure.

Attitude Toward Pre-Intervention Institutions: As Bosnia-Herzegovina had previously been only a federal unit within Yugoslavia (akin to a state or province), it lacked national institutions such as a finance ministry. It was thus widely accepted by both Bosnian officials and foreign advisors that it would be necessary in many respects to build these institutions from the ground up. Indeed, the fact that the OHR had governmental powers and fiscal resources underscored the international community’s expectation that that the conditions for the transfer of full sovereignty to the Bosnian government would not exist for some time.³¹ However, some efforts were made (including by OTA advisors) to use such Bosnian financial institutions as there were to serve as a foundation for the new institutions. The overall foreign attitude toward existing Bosnian institutions thus included both a focus on their inadequacy for Bosnia’s new needs and some awareness that existing Bosnian institutions and officials should not be ignored entirely.

Kosovo

OTA deployed one to two advisors to Pristina in June 1999, immediately following the U.N. Security Council’s authorization of the U.N. Interim Administration Mission in Kosovo (UNMIK) and the entry of the NATO-led Kosovo Force (KFOR) peacekeepers.

Security/Military Situation: The security environment was not overly dangerous and it did not hinder Treasury’s assistance efforts. U.S. military officers and commanders generally did not play a principal role in U.S./international civilian state-building efforts. The initial deployment of approximately 40,000 NATO troops was drawn down to less than half of that after about three years; the U.S. contingent went from approximately 7,000 to 1,700.

Scale of Assistance Effort: The civilian state-building effort expanded quickly as U.S. and other bilateral development agencies arrived and UNMIK built its capacity to administer Kosovo directly. With technical assistance from the IMF, the World Bank, and other international advisors, UNMIK severed economic policy links to Yugoslavia and established independent economic institutions, including budgetary institutions and a Banking and Payments Authority to perform central bank functions. Once the OTA advisors' technical expertise became less critical, toward the end of UNMIK's first year of operation, OTA drew down its presence. (Recently, local authorities asked OTA to return, and advisors are now working on new technical-assistance projects.)

Attitude Toward Pre-Intervention Institutions: Like Bosnia, Kosovo had previously been only a federal unit, and it too lacked national institutions such as a finance ministry or central bank. It was thus widely accepted by UNMIK administrators, other foreign experts, and Kosovars that it would be necessary in many respects to build these institutions from the ground up. The very existence of UNMIK, which governed Kosovo more directly than OHR administered Bosnia by both writing and implementing a new set of laws, underscored the international community's belief that full sovereignty for Kosovo was an uncertain and (at a minimum) distant prospect. The role of Kosovar experts was initially limited to providing input only.³² The overall foreign attitude toward existing Kosovar institutions thus focused chiefly on their inadequacy for Kosovo's new requirements (and on the political risks that the appearance of Kosovar sovereignty would present to its sensitive political status vis-à-vis Serbia). However, this attitude also coexisted with some degree of awareness that in the medium term, once the international community determined Kosovo's final status, local institutions would have to stand independent of international administration.

Afghanistan

OTA deployed two to three advisors to Kabul shortly after the installation of the Afghan Interim Authority in Kabul at the end of December 2001 with the support of the U.S. military's Operation Enduring Freedom–Afghanistan (OEF-A). In 2002, the international community also established the International Security Assistance Force (ISAF), initially to take over responsibility for the security of Kabul; NATO took over command of ISAF in 2003. A Treasury attaché was later based at the U.S. Embassy.

Security/Military Situation: The security environment has generally permitted movement with security protection in Kabul, but the situation in many other parts of the country has often been extremely dangerous, and the overall situation has deteriorated recently. As of October 2008, OEF-A includes approximately 20,000 troops, almost all of whom are American. Approximately 15,000 additional U.S. troops are part of the NATO-led ISAF. Given the size and extent of the U.S. military presence, U.S. military officers and commanders have played a significant role in U.S./international civilian state-building efforts.

Scale of Assistance Effort: The civilian assistance effort expanded quickly as U.S. and other bilateral development agencies and international NGOs arrived in substantial numbers beginning in 2002. Since Hamid Karzai's appointment as president of the Afghan Transitional Administration in June 2002 and his subsequent election to a full term as president in October 2004, the Karzai administration has attempted to impose a degree of country leadership and coordination over the international assistance effort. A notable product of this effort was the Afghanistan Compact agreed between Afghanistan and international donors in London in 2006, which attempted to establish an agreed framework for international assistance to Afghanistan in accordance with the government's economic and political development priorities for the next five years. Despite these efforts, however, the Afghan government has continued to complain about uncoordinated donor assistance efforts.³³

Attitude Toward Pre-Intervention Institutions: Similarly, the Afghan government and its international donors have experienced regular tension over the degree to which

donors should defer to government plans and institutions. Although, as in Bosnia, a steady-state OTA presence amid a substantially increased international assistance presence has led to a somewhat decreased OTA prominence vis-à-vis other international actors, OTA's traditional emphasis on serving as advisors to host government officials and institutions on host government-led plans (as opposed to donor-initiated programs) has helped Treasury distinguish itself favorably with the Afghan government. However, it remains to be seen whether the Afghan government's more organic and prioritized approach to state-building or the international donor community's less coordinated and less locally oriented approach will prevail or prove most effective.

Liberia

OTA deployed four to five finance and banking advisors to Monrovia beginning in March 2004 following the conclusion of the August 2003 Accra Comprehensive Peace Agreement establishing a transitional government and the October 2003 establishment of the U.N. Mission in Liberia (UNMIL) peacekeeping force (largely comprising a previous ECOWAS peacekeeping force). The UNMIL force consisted of 15,000 troops, mostly from the Economic Community of West African States; the U.S. military provided a small number of advisors.

Security/Military Situation: While Treasury did not consider the security environment particularly dangerous, contrary assessments by the IMF and the World Bank limited the multilateral agencies' presence. Because the UNMIL force did not include a significant number of U.S. forces, the U.S. military did not play any role in U.S. civilian state-building efforts.

Scale of Assistance Effort: During the transitional government period, from early 2004 through mid-2005, there were relatively few technical advisors apart from the American OTA advisors and a small presence by a couple of other international agencies. In late summer 2005, however, international donors meeting at the International Contact Group on Liberia established the Governance and Economic Management Assistance Program (GEMAP) as a framework for the international administration of Liberia's finances due to widespread concerns about increasing corruption in the run-up to elections at the end of that year. The GEMAP operation was led by the World Bank with technical experts contributed by multiple international donor agencies including USAID and U.K. DFID, among others. A drawdown in OTA's technical assistance due to lack of additional financial resources being made available to Treasury largely coincided with the transition to GEMAP.

Attitude Toward Pre-Intervention Institutions: OTA advisors generally served in their customary roles as advisors to the relevant institutions of the transitional government. However, widespread international concerns about increasing corruption in advance of the 2005 elections convinced international donors that a more direct international role in the administration of Liberia's finances was required, prompting the establishment of GEMAP as an extraordinary transitional intervention. Even after the election of the widely respected Ellen Johnson Sirleaf as president in late 2005 and her taking office in January 2006, however, donors elected to keep some elements of the GEMAP framework in place, underscoring continuing international reservations about Liberian institutions. While endorsing and acknowledging the value of the technical skills made available to Liberia by GEMAP, President Johnson Sirleaf has criticized it for placing too little emphasis on local capacity and sustainability and noted that this has contributed to tensions between foreign and local experts and raised issues of ownership and sovereignty.³⁴

Notes

1. This report uses “state-building” in a broad sense to include both efforts to build institutions from the ground up (arguably the more common usage) and those to strengthen the capacity of and reform existing institutions (which some equate more with “development”) because one of the report’s premises is that the distinction between these two approaches is not always hard and fast. Some situations that appear initially to call for the building of new institutions from the ground up may also (and sometimes better) be approached by seeking first to understand and then to strengthen and reform existing institutions. As used here, state-building assistance includes technical assistance and capacity-building efforts as much as the physical building of roads or power plants.
2. Merriam Marshatt and Bob Polk, “Domestic Agencies in Reconstruction and Stabilization: The 4th D,” USIPeace Briefing (June 2008).
3. For more information on Treasury’s activities in post-intervention state-building environments other than Iraq, please see the appendix at the end of this report.
4. Patricia Thomson and Daniel Serwer, “Civilians Can Win the Peace,” USIPeace Briefing (February 2007).
5. GAO, “International Finance: Treasury Has Reduced the Number of Attachés Overseas,” GAO-05-1010 (September 2005), 10.
6. Ali A. Allawi, *The Occupation of Iraq: Winning the War, Losing the Peace* (New Haven, Conn.: Yale University Press, 2007), 263.
7. Beth Cole and Christina Parajon, “The Afghanistan Reconstruction Group: An Experiment with Future Potential,” USIPeace Briefing (September 2006).
8. Over the last ten years, the annual budget for Treasury’s Office of Technical Assistance has averaged about \$38 million, \$33 million if nonrecurring supplemental appropriations are excluded.
9. In recent years, Treasury’s Office of Terrorism and Financial Intelligence has also begun to work closely with IA in maintaining Treasury’s overseas presence.
10. GAO, “Foreign Assistance: Treasury’s Technical Assistance Program,” GAO/NSIAD-99-65 (March 1999).
11. By using individual personal services contracts, OTA has been able to avoid the commonly encountered dynamic of institutional contractors with a lucrative contract at stake investing more of their energy in ensuring that the contract is extended rather than completing the agreed reform plan.
12. Even if there are questions of corruption or insufficient transparency in particular policy or institutional areas, there are often still opportunities to pursue agreed reform programs in other areas. When that has proved impossible, advisors have been withdrawn.
13. David Ellerman, *Helping People Help Themselves* (Ann Arbor, Mich.: University of Michigan Press, 2006), 7.
14. While it is not uncommon for an OTA advisor to periodically consult and be consulted by embassy officials concerned with financial issues, OTA’s practice has been to give advisors significant discretion to maintain local government confidences where necessary to effectively carry out an advisory assignment for which OTA has received the proper clearances in Washington.
15. For more information on Treasury’s activities in these other post-intervention state-building environments, please see the appendix at the end of this report.
16. Although the following is principally informed by the Treasury experience in Iraq, many of the dynamics described here are or were present (even if not quite to the same degree) in the other recent post-intervention state-building cases discussed in the appendix.
17. This phenomenon has sometimes been associated with so-called whole-of-government efforts, although I’ve elected not to use that term here.
18. This military interest in diplomacy and technical assistance in Iraq is consistent with the Department of Defense’s increasing interest in state-building more generally. Experience in Iraq indicates that there have been real benefits from a close working relationship between Treasury and the military, not least is the willingness of many of the principal commands and agencies working in Iraq to detail officers with relevant finance-related backgrounds to work for the Treasury attaché. This has not only served as a valuable force multiplier but substantially eased the burden of coordinating with the many interested military entities. In general, forceful Treasury leadership of the finance-related state-building assistance effort coupled with active support from the military has proved to be a very effective combination.
19. An overt example of the disinclination to defer to local officials and institutions can be seen in the Governance and Economic Management Assistance Program (GEMAP) established by international donors in 2005 as a framework for the international administration of Liberia’s finances prior to the conclusion of elections at the end of that year. See the discussion at the USIP forum, “GEMAP in Liberia: A Model for Economic Management in Conflict-Affected Countries?” (April 9, 2008), available at http://www.usip.org/events/2008/0409_liberia.html and in the appendix to this report.
20. There is a wide continuum of state-building end states. For an example of a particularly modest conception of the feasible objectives for state-building arguing that “less is more,” see Amitai Etzioni, “A self-restrained approach to nation-building by foreign powers,” *International Affairs* 80, 1 (2004), 17. For a somewhat more detailed framework (but still far short of the most ambitious

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- initial plans for Iraq), see Daniel Serwer and Patricia Thomas, "A Framework for Success: International Intervention in Societies Emerging From Conflict," in *Leashing the Dogs of War*, eds. Chester Crocker, Fen Osler Hampson, and Pamela Aall (Washington, DC: U.S. Institute of Peace Press), 369–87.
21. For example: preparing for the restructuring of Iraq's state banks, establishing a single treasury account covering all funds of the central government, establishing a Financial Intelligence Unit to monitor suspicious financial transactions, and maintaining regular auctions of government Treasury bills.
 22. This is not to deny that Washington officials also possess knowledge of great importance to a successful state-building effort, including about administration priorities, broader foreign policy considerations, congressional dynamics, public opinion, and in some cases policy expertise. The point here is merely that Washington knowledge by itself cannot drive an effective strategy for sustainable state-building, which necessarily turns in significant part on what the local officials and institutions are willing and able to do.
 23. One example in Iraq was a capacity-building training program on budget execution that was initially developed in isolation from information about Iraqi budget execution regulations and procedures collected by another agency. For further examples of lack of coordination in general capacity-building efforts, see GAO, "Stabilizing and Rebuilding Iraq: Serious Challenges Confront U.S. Efforts to Build the Capacity of Iraqi Ministries," GAO-08-124T (October 4, 2007).
 24. The Special Inspector General for Iraq Reconstruction (SIGIR) recently underscored the costs to both the U.S. taxpayers and Iraqi citizens of past U.S. failures to seek Iraqi ownership of reconstruction projects in an audit report titled "Key Management Issues Identified in Audits of Iraq Reconstruction," SIGIR 08-020 (July 27, 2008), iii, 15–16.
 25. For a concise statement of the importance of local ownership in general, see Paolo de Renzio, Lindsay Whitfield, and Isaline Bergamaschi, "Reforming Foreign Aid Practices: What country ownership is and what donors can do to support it," Oxford Global Economic Governance Programme, Negotiating Aid Project briefing paper (June 2008). Available at: <http://www.globaleconomicgovernance.org/research.php?id=2>.
 26. For more on local reform teams, see Alberto Criscuolo and Vincente Palmade, "Reform Teams: How The Most Successful Reformers Organized Themselves," World Bank Group FIAS Policy Note 318 (February 2008). Available at: http://www.ifc.org/ifcext/fias.nsf/Content/FIAS_PolicyNotes.
 27. In the always urgent post-intervention state-building setting of Iraq, where explicitly medium-term thinking was sometimes anathema, such priorities were occasionally referred to more diplomatically as "other than immediate term."
 28. Corroborating this Treasury strength in the coordination of relevant civilian and military programs, the State Department and the Treasury Department recently announced that U.S. Mission–Iraq and Multi-National Force–Iraq had established an ambitious new structure operationally chaired by Treasury to coordinate all of the public finance-related assistance currently provided by multiple civilian and military agencies, the Public Financial Management Action Group (PFMAG). See Appendix III: Comments from the Department of State, Department of Treasury in GAO, "Securing, Stabilizing and Rebuilding Iraq: Progress Report: Some Gains Made, Updated Strategy Needed," GAO-08-837 (June 2008), 73.
 29. GAO, "Stabilizing and Rebuilding Iraq: U.S. Ministry Capacity Development Efforts Need an Overall Integrated Strategy to Guide Efforts and Manage Risk," GAO-08-117 (October 2007).
 30. For elaboration on this point, see Gerald F. Hyman, "Assessing Secretary of State Rice's Reform of U.S. Foreign Assistance," Carnegie Democracy and Rule of Law Program paper No. 90 (February 2008), 14–18.
 31. Jean Tesche, "An Assessment of the Peace Process in Bosnia and Kosovo," Woodrow Wilson International Center for Scholars, East European Studies, report of June 14, 2000, meeting available at http://www.wilsoncenter.org/index.cfm?topic_id=1422&fuseaction=topics.publications&group_id=7427.
 32. Ibid.
 33. Clare Lockhart, "The Aid Relationship in Afghanistan: Struggling for Government Leadership," Oxford Global Economic Governance Programme, Managing Aid Dependency Project, GEG Working Paper 2007/27 (June 2007), available at: http://www.globaleconomicgovernance.org/docs/Lockhart_Afghanistan_2007-27.pdf.
 34. Ellen Johnson Sirleaf, Key Note Address to U.N. Institute for Training and Research, Torino Retreat, August 31, 2007.



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