



# Postconflict Programming for Growth

Programs to improve economic governance, generate employment and income, and foster visible progress in private sector development are essential for postconflict stabilization and growth. And by reviving growth, these programs also help to establish legitimacy for postconflict regimes, further improving prospects for a durable peace.

A recent review of the economics of internal armed conflict in developing countries found that one-third of all nations have experienced episodes of civil war over the past half century, and that “economic conditions—both low income levels and slow growth rates—contribute to the outbreak of violence” (Blattman and Miguel 2010, 45). Other studies have shown that nearly half of the countries emerging from conflict return to conflict within five years, primarily because the factors that trigger violence—including low incomes and concentrated natural resources that can be captured for personal gain—often remain uncorrected (Collier et al. 2003, 83).

These observations highlight the need for effective support in postconflict settings to help typically weak governments, under extremely difficult circumstances, put their economy on a growth track in order to enhance the prospects for sustainable peace. This note explains how USAID’s economic growth (EG) programs have supported U.S. foreign policy goals in postconflict settings to help partner countries gain stability through short-term measures to improve economic conditions while setting the stage for longer-term economic recovery. (For a complete discussion of USAID’s postconflict growth strategy see its *Guide to Economic Growth in Post-Conflict Countries* and

for its approach to rebuilding fiscal infrastructure, see its *Building Fiscal Infrastructure in Post-conflict Societies*.)

## ECONOMIC GROWTH AS A POSTCONFLICT STRATEGY

At the end of World War I, the Treaty of Versailles imposed onerous reparations on Germany, which contributed to the subsequent collapse of peace in Europe. Since that bitter error, the U.S. Government has established a distinguished history of helping postconflict states to relaunch economic growth, ranging from the Marshall Plan and aid to Korea to recent programs in the Balkans, Iraq, Afghanistan, and Liberia, among others.

This approach was entrenched in National Security Directive NSPD-44 of 2005, which declared,

The United States has a significant stake in enhancing the capacity to assist in stabilizing and reconstructing countries or regions, especially those at risk of, in or in transition from conflict or civil strife, and to help them establish a sustainable path toward peaceful societies, democracies, and market economies (1).

Similarly, the 2008 U.S. Army Stability Operations Field Manual sets out a comprehensive framework for stability operations that encompasses economic objectives. Among the essential

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stability tasks are measures to support: (1) economic generation and enterprise creation, (2) monetary institutions and programs, (3) national treasury operations, (4) public sector investment programs, and (5) private sector development (pages 3-23 to 3-27).

The president's new National Security Strategy also highlights the links between national security and economic progress in postconflict and fragile states:

To advance our common security, we must address the underlying political and economic deficits that foster instability, enable radicalization and extremism, and ultimately undermine the ability of governments to manage threats within their borders and to be our partners in addressing common challenges. (White House 2010, 26)

USAID's EG programs are therefore a key element in the "Whole of Government" approach to postconflict stabilization. This approach requires close cooperation with other programs within USAID, particularly first-strike teams from the Office of Transition Initiatives, and with other U.S. government agencies, especially the State Department, the Treasury Department, the Defense Department, and the Agriculture Department. One example of interagency cooperation is the operation of Provincial Reconstruction Teams in Iraq and Afghanistan for coordinating diplomatic, economic, reconstruction, and counterinsurgency efforts. Close cooperation is also imperative in working with the host government and with other major development agencies to ensure that assistance is delivered efficiently and to provide clear signals to the host government on stabilization and reconstruction priorities.

## PROGRAMMING PRIORITIES FOR POSTCONFLICT ECONOMIC GROWTH

Conflicts undermine growth by destroying lives, property, and infrastructure, and indirectly by diverting resources from investment in physical and human capital, disrupting public services, degrading governance institutions, and causing the most educated people to emigrate. Hence, recovery needs are immense in the wake of a serious conflict. USAID's *Guide to Economic Growth in Post-Conflict Countries* (USAID 2009a) recognizes that

the top priorities are, first, to prevent a return to violence, and second, to establish a functioning government and other fundamental requirements for stimulating private sector development, as the primary engine for income generation and job creation. The first priority requires adopting measures to address short-term exigencies—such as temporary employment programs, reliance on trade taxes to generate revenue, or subsidies for food—even if they are not entirely consistent with the medium-term objective of fostering private sector-led growth. Decisions on the transition from stabilization to growth must be determined by conditions particular to each country.

Postconflict economies often experience an initial spurt of growth as people return to work and reconstruction projects get underway. This "rubber band" bounce, however, is no cause for complacency. Growth can only be sustained with major efforts to rebuild economic institutions and infrastructure, along with thorough reforms to stimulate private investment. Accordingly, EG assistance must also be sustained, to put in place

building blocks for long-term growth that meaningfully reduce the risk of renewed conflict.

USAID's postconflict guide lays out policy priorities for economic growth programming. These include macroeconomic foundations, employment generation, private sector development, and international trade and border management, as well as banking

and finance, regulatory institutions, agriculture, and infrastructure. Similar priorities apply to fragile states, which face the prospect of falling into armed conflict or becoming altogether dysfunctional. The following sections present examples illustrating how USAID's EG programs have contributed to postconflict stabilization in four major areas: immediate employment generation, building macroeconomic foundations for sustained recovery, support for private sector development, and facilitating international trade.

### **Employment Generation**

In the wake of a destructive conflict, humanitarian relief is the first resort for helping people who have lost their livelihoods. But the restoration of opportunities for income generation is a paramount concern. At the same time, the creation of productive jobs in the private sector is limited by the war-related devastation of infrastructure and productive capital, weak

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## BOX 1

### Transitional Employment Programs

The primary objective of postconflict transitional employment programs is to provide job opportunities during the initial postconflict years until security improves. The programs can take a variety of forms:

**Cash for work** programs can address two strategic problems: devastated infrastructure and unemployment. Under the Employment Generation Rural Infrastructure Program (EGRIP) in conflict-affected Nepal, for example, USAID supported the construction of a new road connecting remote hillside towns to marketing centers (USAID 2005), injecting liquidity and revenue into rural communities while integrating the rural economy into the national market.

**Community-driven development** programs can contribute to economic growth as well as conflict resolution. The Liberia Community Infrastructure Project (LCIP), for example, provided assistance to community-supported road and bridge rehabilitation, school renovations, agriculture and agribusiness developments, health center rehabilitations, and sanitation and drainage improvements.

LCIP used local labor and provided valuable job training to ex-combatants (USAID 2009a). Similarly, Timor Leste's Temporary Employment Program helped to create 63,000 short-term jobs throughout the country and inject liquidity into local economies, visibly jump-starting reconstruction before larger multilateral initiatives commenced (USAID 2003).

**Assistance to farmers and microentrepreneurs** can accelerate the recovery of agricultural production and promote the return of the population to farms and rural areas. In Mindanao province of the Philippines, for example, USAID's Growth with Equity in Mindanao program supported the 1996 peace agreement by targeting ex-combatants for assistance with farming activities (USAID 2008a and 2009a). USAID's postconflict assistance often focuses on farm units rather than other business start-ups. This is because the failure rate for nonfarm start-ups is likely to be very high for ex-combatants and unskilled rural laborers.

market institutions, and the slow return of private investment (USAID 2006). While reforms are needed to spur recovery of the private sector, these take time to deliver broad-based results. Hence, there is an urgent need for interim employment programs, such as those outlined in Box 1, to provide demo-

bilized youth with alternatives to violence and inject cash into depressed economies (USAID 2009a). By helping to prevent a relapse into conflict, these programs buy time for strengthening economic governance and thus complement interventions to restore economic growth.

### *Macroeconomic Foundations*

A second vital objective for economic support in the immediate postconflict phase is to establish sound macroeconomic foundations for recovery and growth. This includes programs to build institutional capacity for budget management, revenue mobilization, and expenditure policy; establish a stable currency for use in daily transactions; and create a sound banking system to attract savings and finance investment.

### *Budget Management*

A primary concern in postconflict stabilization is to strengthen what are typically very degraded systems for budget management (USAID 2009a). Improving the process of formulating, approving, executing, and tracking the state budget is important not only from a purely fiscal perspective, but also because the budget is the primary vehicle for translating public policy goals into action (Ghani and Lockhart 2008). Improved budget systems also strengthen government legitimacy, whereas ineffective or corrupt systems do the opposite.

The challenges can be huge. They include a lack of skilled cadres, a decimated revenue system, and weak organizations—along with massive public spending needs. In most postconflict settings, these challenges require extensive donor support and coordination (USAID 2007). In Bosnia, for example, USAID collaborated with the U.S. Treasury, the host government, and other donors to create a modern treasury system to replace a cumbersome Soviet-era approach to managing cash flow for the government (Box 2).

Expenditure control is another basic problem for postconflict governments, especially when they have suffered a large loss of skilled personnel in accounting and budgeting. In Liberia, under the Governance and Economic Management Assistance Program (GEMAP), USAID provided international advisers acting with cosignatory authority within the Bureau of the Budget and other key economic agencies of the state. This arrangement contributed to a major reduction in corruption and improved both revenue collections and expenditure management. At the Bureau of the Budget, the adviser's signatory role, together with

## BOX 2

### Bosnia-Herzegovina: Enhancing Fiscal Management Systems and Capacity

At the end of the Balkans war, Bosnia-Herzegovina (BiH) faced immense fiscal challenges. Prior to the disintegration of Yugoslavia, a single Payment Bureau was responsible for all transactions of the government and the entire state-run business sector. This centralized system was extremely inefficient and plagued by corruption. After independence, BiH replicated this approach with three regional payment bureaus.

Beginning in 1998, USAID and the U.S. Treasury, in cooperation with other donors, developed a plan for converting the payment bureaus into a modern treasury, helped to implement the institutional transformation, and introduced a capacity building program to strengthen the new institutions.

In January 2001 commercial banks took over the processing of all payment orders. Today, most transactions are conducted through the banking system. In addition to modernizing cash management for the government, these reforms had a large impact on reducing the size of the cash-based informal economy, where private economic agents had been operating to escape the stranglehold of the payment bureaus. As businesses entered the legal economy, they also began to comply with labor, safety, and other regulations, to the benefit of their workers (USAID 2004).

those of advisers to the Ministry of Finance and the Central Bank, was critical in addressing a chronic and serious problem of government officials approving expenditures outside the budget appropriation and far in excess of funds available in the Treasury (USAID 2007). Equally important, the program implemented training in transparent public financial management systems that were integrated into daily operations of these agencies (USAID 2008b).

#### *Revenue Collection*

Progress on the revenue side of the budget is also a top priority in rebuilding fiscal institutions. In some cases, such as in Kosovo (Box 3), the revenue system must be built from scratch. In Liberia, assistance focused on securing financial control over major revenue streams from state-owned enterprises and the For-

## BOX 3

### Developing a Revenue System in Kosovo

Following the cessation of open hostilities between Kosovo and Serbia in 1999, USAID worked closely with the World Bank, the IMF, and the European Union to create new institutions for economic governance in what was then the autonomous region of Kosovo. An initial step was the development of a revenue system. As a former region of Serbia, Kosovo had no experience with tax collection. The government had to design tax policies suitable to an environment characterized by a large informal sector, high unemployment, and low income and to create a wholly new system for tax administration.

On tax policy, USAID initially supported the creation of a simple value-added tax (VAT) at a rate of 15 percent covering nearly all goods and services, along with a simple tax on wages and a property tax. Since 2003, Kosovo has introduced a corporate income tax and established incentives to motivate municipalities to improve their tax collections.

For tax administration, USAID helped develop the full organization plan for the tax service, including personnel systems and operating procedures. USAID also provided an integrated IT system to control taxpayer records, process returns, reconcile cash positions, and provide management information. This was followed by a new tax administration law (2005) based on international standards (USAID 2007).

Fiscal experts initially expected that tax revenues might reach 14 percent of GDP by 2003, but the tax system proved far more effective, generating 32.8 percent of GDP. This provided room for tariff reductions in 2004 that boosted the private sector while lowering the revenue-to-GDP ratio to 24 percent (IMF 2004).

estry Development Agency, as well as customs and tax administration (USAID 2007).

#### *Expenditure Policy*

The allocation of public funds is just as important as the financial controls. In Iraq, USAID not only supported the transformation of public financial management, but also helped to reform one of the country's most important and costly social welfare programs: the pension system (Box 4). The new pension system provides retired workers with more regular payments, and in the process improves the legitimacy of the government. In Kosovo, too, USAID supported the introduction of a new

**BOX 4**

## Pension Reform in Iraq

Pension payments are the largest item of social spending in Iraq after food ration subsidies. The pension system inherited by the post-Saddam government was characterized by limited coverage for wage earners, weak and costly administration, and a structure that had adverse effects on incentives and equity. USAID's Economic Governance project (2004–2009) provided technical assistance to help Iraqi experts draft a progressive new pension law and introduce structural changes to create a more sustainable system, including provision for pension schemes in the private sector.

Parliament passed the Pension Reform Law in 2006, and in 2008 the government established a semiautonomous agency to manage and administer the major government-sponsored pension systems. USAID assisted the new agency with training for senior managers on best practices in management and administration. With support from USAID, the government also amended the State Pension Law that covered civil servants, the military and security forces, and employees in state-owned enterprises (USAID 2009b).

pension system with a mandatory defined-contribution saving scheme that accumulated assets amounting to 8 percent of GDP within just four years. The system is fiscally sustainable, leaving room for other needs-based social programs (USAID 2007). Most important, Kosovo's former pension system covered only half the elderly population, while the new scheme has almost universal coverage.

A very different example relates to the use of natural resource revenues. If badly managed, this common source of conflict can be a continuing curse—when it should be an advantage (Collier 2010). In resource-rich postconflict countries such as East-Timor and Sierra Leone, USAID and other donors have collaborated with new governments to establish prudent policies and institutions for managing resource earnings. At the end of Sierra Leone's devastating 11-year civil war, one major reform was the establishment of the Diamond Area Community Development Fund, which channels a portion of diamond export revenue to local community development projects. In support of

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this effort, USAID launched the Peace Diamond Alliance project in 2002 to educate miners and diggers on the benefits of producing for the formal economy. Diamond exports through legal channels climbed from just \$1.5 million in 1999 to over \$141 million in 2007 (USAID 2008c), converting “blood diamonds” into development diamonds.

### *Monetary Management, Exchange Rates, and Financial Sector Development*

Monetary authorities, such as the central bank, face two critical challenges in the aftermath of a serious conflict. First, they must establish a viable currency and payments system to support transactions and provide a reliable store of value (USAID 2009a); this may involve overcoming high inflation associated with printing money to cover large budget deficits. It is also important to establish the currency at an exchange rate that does not undermine the competitiveness of local producers in exporting or competing against imports; this problem often arises in countries with large foreign exchange earnings from natural resources—or large contributions from foreign donors.

Second, the monetary authorities have to establish or restore a sound banking system capable of handling and settling transactions, mobilizing savings, and allocating financial resources efficiently through lending for private sector development. This requires appropriate regulations and effective supervisory capacity within the central bank and other regulatory agencies

In most postconflict cases, the authorities have to address these critical challenges with a severe shortage of skilled and experienced personnel. Technical support is therefore extremely important. The IMF usually leads the assessment of monetary policies and institutions, but the World Bank, USAID, the U.S.

Treasury, and other international partners play a critical role in identifying and supporting priorities for reform, institutional change, and capacity building (USAID 2009a).

In the immediate postconflict period in Afghanistan, for example, USAID and the U.S. Treasury were instrumental in supporting the successful introduction of a new national currency. Under the

Afghan Economic Governance and Private Sector Strengthening project from 2005 to 2009, USAID also provided extensive capacity building support to the central bank, Da Afghanistan Bank

(DAB). Among other activities, USAID helped DAB establish accounts with the Federal Reserve Bank of New York to facilitate international transfers, draft new banking laws, consolidate government accounts, and improve the payment system.

USAID also provided vital assistance for the development of banking systems in the Balkans following conflicts precipitated by the break-up of Yugoslavia. In 1999, Kosovo had essentially no banking system. USAID helped to create the legal and regulatory framework for the financial system, establish the central bank, and provide capacity building support for the banking authorities. In Bosnia, USAID provided intensive training to nascent local banks and established credit lines that were initially run by USAID's Business Development Program and later transferred to qualifying commercial banks. These loan programs supported rapid recovery of the private sector and helped to create or sustain more than 45,000 jobs (USAID/Bosnia-Herzegovina 2009).

### **Private Sector Development**

Private sector development is a core element of USAID's economic growth programming in any context, but it is especially important in postconflict settings where growth contributes to consolidating the peace and building government legitimacy, as well as improving living standards. At the same time, private sector development is much more difficult in a postconflict setting, where the private sector may be nearly moribund, risks are high, and market institutions are weak or absent. Nonetheless, some EG measures can produce early benefits for private sector development and job creation.

As a case in point, USAID's Tijara Provincial Economic Growth Program in Iraq began in 2008 by establishing small business development centers to provide local businesses with a variety of support services, including management training for start-ups, training in marketing and financial management, business information services, consulting services, and trade fairs. By the end of 2010, Tijara had created 17 centers throughout Iraq. Resources such as strategic planning and business plan assistance are available on the program's website ([www.sbdc-iraq.com/cms](http://www.sbdc-iraq.com/cms)).

Tijara has also worked with local financial institutions to expand access to finance for micro, small, and medium enterprises through loan guarantees to mitigate lending risks and has supported other interventions to develop capacity for lending to this nontraditional clientele. By March 2010, Tijara support

#### **BOX 5**

### **Coffee Cooperative in Timor Leste**

Beginning in 1994, well before Timor Leste's violent separation from Indonesia, USAID began supporting the Cooperativa Café Timor (CCT), which was buying, processing, and marketing certified organic coffee through a cooperative of 800 farm families. Through CCT, cooperative members received a price premium of up to 75 percent for their coffee. By 2002, when Timor finally gained sovereignty, CCT was harvesting 9,200 metric tons of coffee cherry and generating \$6 million of revenue for cooperative members, with an additional \$1.2 million paid to Timorese workers for transportation, processing, and handling (USAID 2002). CCT today is a national coalition of 16 cooperatives with a membership of nearly 20,000 farmers. It has become the country's largest coffee exporter, processing nearly one-third of East Timor's coffee.

led to more than 3,700 loans to SMEs and more than 80,000 microenterprise loans (USAID/Iraq 2010).

In other postconflict countries, such as East Timor (Box 5), USAID programs have helped to jump-start the expansion of key industries, improving the well-being of many thousands of poor families while supporting sustainable economic recovery.

### **International Trade and Border Management**

Opportunities to trade in the world markets offer postconflict economies vast potential markets for reestablishing production of export products, along with wide access to goods and services for consumption and production at competitive prices. In contrast, highly protectionist policies constrict market opportunities while increasing the cost and reducing the availability of goods that could be obtained through trade, for consumers and producers alike. Measures to stimulate and facilitate trade are therefore valuable tools for postconflict recovery and job creation, particularly when accompanied by measures to improve the investment climate (USAID 2009a).

USAID has pursued a variety of approaches to help postconflict countries benefit from trade, including programs to restructure tariffs rates, streamline customs procedures, strengthen border procedures, and facilitate compliance with regional and international trade bodies. Efforts to strengthen customs administration can be mobilized quickly in a postconflict setting to boost revenue collections and simultaneously facilitate trade. One

## BOX 6

### Fixing a Leaky and Cumbersome Customs System in Liberia

Under the multilateral Governance and Economic Management Assistance Program (GEMAP), an IT expert funded by USAID worked with the Ministry of Finance and the Central Bank of Liberia to develop an electronic bank payments system to simplify customs clearances and strengthen customs receipts, which were the principal source of revenue for the postconflict government.

Before the bank payments system, importers faced a byzantine paper-based system for paying customs duties. First they had to deliver documents to the Ministry of Finance, then proceed across town to the Central Bank for a receipt, and then have the receipt authorized at the Ministry of Finance before returning to the port for additional steps to gain release of their goods.

The new system computerized cashier stations at the Ministry of Finance and later at the port, with direct connections to the Central Bank. The inauguration of the system in 2006 provided importers with efficient means for paying import taxes and helped to eliminate corruption and fraud in the system (USAID 2008b). Together with enforcement of offshore verification of import values, the new system also increased revenues from taxes on international trade by more than one-third in the first five months. In the early stages of recovery, customs revenue accounted for more than half of all domestic revenue (USAID 2007).

example is the support provided by USAID to reform basic customs collection procedures in Liberia (Box 6).

## MOVING FORWARD

The U.S. government's strategic concern with economic stabilization and growth in postconflict and fragile states has given rise to a new body of practical literature. In addition to documents cited earlier—notably, USAID's 2009 *Guide to Economic Growth in Post-Conflict States* and the 2008 *U.S. Army Stability Operations Field Manual*—the U. S. Institute for Peace recently issued the first strategic doctrine for civilian planners and practitioners in this field (U. S. Institute for Peace 2009). USAID has also developed special training on economic growth programming for fragile and postconflict states.

USAID's experience in postconflict conditions and fragile states suggests several lessons for the design of economic growth programs:

- Opportunities for employment and income generation are critical in the immediate aftermath of a conflict, particularly for ex-combatants.
- Effective fiscal and monetary policy management is an essential foundation for economic growth while simultaneously contributing to government legitimacy and the rule of law.
- Concerted efforts are often needed to strengthen and modernize host-country institutions for economic governance.
- Achieving sustainable economic growth and broad-based job creation requires a long-term engagement and flexibility to build momentum for reforms as political factors permit.
- Coordination in many dimensions is essential for stabilizing economic conditions and programming for growth, to ensure policy coherence and effective use of foreign assistance.
- Countries that are endowed with resource wealth require the development of institutions to manage these resources transparently, prudently, and equitably.

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