

# AFGHANISTAN: THE UNCERTAIN ECONOMICS OF TRANSITION

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The economics of Afghanistan are only one aspect of the challenges posed by US, allied, and Afghan efforts to accomplish a successful Transition. There are many reasons that Transition will either fail or be determined by Afghanistan's internal dynamics and the role of regional states regardless of what the US, Europe, and other aid donors do:

- The weakness and corruption of Afghan governance mixed with growing de facto power of regional and ethnic power brokers.
- Continued insurgent sanctuaries in Pakistan mixed with divisions and radicalization within the Taliban, a rise in Haqqani influence, political efforts by the Hekmatyar group – creating an insurgent ability to win a battle of political attrition during 2012-2015 and beyond --
- The difficulties of making a Transition to a non-Karzai government in 2014, and creating an election that produces meaningful consensus versus region, ethnic, and sectarian divisions and power struggles.
- The inability to create an effective mix of Afghan forces to replace US and other ISAF forces.
- Peace negotiations that re-empower the Taliban and other insurgents at least regionally, and give them a form of victory by other means – the Cambodia-Nepal outcome.
- A steady increase in the rate of US and allied force cuts and spending and unwillingness to sustain high levels of spending, advisory effort, and partnering after 2014.
- An Afghan rush for the exits by wealthy and powerful Afghans mixed with a division of those who choose or must stay behind on regional, ethnic, sectarian and tribal lines – flight mixed with a revision to “Kabulstan.”
- A rise in outside pressure from Pakistan, Iran, India, the other “Stans,” China, and Russia – the “new great game.”
- The cumulative political pressure of “incidents” between the US/IAF and Afghan leadership, the US and Pakistan, border incidents, and blue-green, ISAF-on-civilian, and cultural clashes.
- Transition becomes increasing irrelevant in strategic terms relative to problems in Pakistan, the rise of other forms of civil conflict and religious extremism rising out of the political upheavals in the Arab world, the rising priority for US military resources in the Middle East and particularly Gulf, and/or the rise of new centers of terrorism in movements like Al Qaeda in the Arabian Peninsula (AQAP), Al Qaeda in the Islamic Maghreb (AQIM), and Al Qaeda and Associated Movements (AQAM).

It is still clear, however, that the economics of Transition – and the level of future US and other donor military and civil aid efforts – are critical if Transition is to have any chance of creating a reasonable level of post-2014 security and stability. It is also important to remember – for all the problems involved in creating any form of successful Transition – that the various insurgent groups still represent relatively small, unpopular movements with ethnic and sectarian ties that limit their influence to part of the country.

Even if the US and its allies cannot achieve the level of post-2014 stability and security they desire, this does not mean that Afghanistan cannot achieve relative stability based on some form of de facto federalism. This will limit insurgent gains and control as well as mitigate the risk that Afghanistan will become a center of terrorism.

Developing this stability, however, requires as much focus on economics as politics, governance, and security. It also requires that planners approach economics with a level of integrity that has been sadly lacking to date. Transition planners and managers need to be honest when the data and sources are in conflict, or so conflicting and poorly based that they cannot credibly be used for planning.

They need to stop spinning claims of progress driven by uncertain methodologies, uncertain databases, or analytic structures that are not related to any other aspect of data collection and analysis. They need to stop creating modeling dependent on at least one variable that is uncertain or lacking in credibility to be useful in planning and analysis. They need to stop confusing the direct and indirect effects of wartime time and aid investments with legitimate economic growth and domestic revenues.

They need to address corruption, the steady outflow of capital, the inability to determine what portion of spending is actually spent in – and stays in – Afghanistan. They need to address the fact that narcotics and grey and black economic activity is a major part of the Afghan domestic economy. They need to stop making absurdly optimistic assumptions about the “New Silk Road,” future domestic revenues and exports, and the other techniques being used to promise progress that cannot happen.

At present, no official source of economic data and analysis – US, allied, Afghan, or international – meets these basic tests of professional integrity. Worse, most analyses make no explicit effort to deal with security and the fact that the nation is still at war, assess the possible economic consequences of any peace, or break out the very different impacts of Transition in areas that are dependent on foreign spending and the market economy versus subsistence or purely domestic activity.

There is often the tacit assumption that the nation will be at peace, and the impact of war zones will be the same as the rest of the country. Credible Transition planning cannot be based on systematic dishonesty and omission of key variables, and it must be based on explicit statements of the range of uncertainty in the data and whether it has a major impact on a given policy, program, or funding effort.

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## **Real World vs. “Mythical-macro” Economics**

There is only limited time for the US and its allies to deal with the economic problems in Transition. Moreover, if they are to have any chance of success, they need to address these economic problems as honestly and objectively as possible, admit how serious they are and admit how limited the progress has been to date. They also need to stop treating the economics of Afghanistan as if there are reliable data on the challenges involved, or even reliable data on basic economic measures like population and GDP.

This means planning must concentrate on the art of the possible in terms of defining what military and civil aid can realistically do to achieve stability and securing Afghanistan between 2012 and 2020 in spite of the lack of adequate data for planning. It means looking far enough beyond 2014 to see what may be needed to ensure some form of stability, and to create an integrated civil-military approach that deals as honestly with the challenges involved as possible.

### ***There are No Reliable Macroeconomic Data on Afghanistan***

The first step is to admit just how bad and conflicting many of the data now being used really are. If effective planning is to take place, organizations like the World Bank, IMF, UNAMA, USAID, the State Department, and other countries and donors need to adopt basic standards of professionalism in approaching their efforts to plan Transition. They need to stop using point estimates with no clear source, definition, or effort to estimate uncertainty.

**Figure One** compares the most basic macroeconomic data on Afghanistan using some of the primary sources now being used in Transition planning. The data on GDP differ so radically that it is clear there is no meaningful baseline for economic planning. The population data appear to agree only because different sources borrow from the same guesstimate in the absence of any meaningful census, and even so, the Afghan data differ significantly from the data used by outside sources.

### **No Useful or Reliable GDP Data**

The lack of a meaningful census, the inability to assess the domestic GDP accurately in either market or PPP terms, and on all other key measures result in real world uncertainty levels that can easily reach 20-30%. It is time that honesty and integrity – as well as clear explanations and definitions of the source of the data and exact methodology used in key estimates – were made part of official efforts.

**Figure One: Baseline Economic Statistics: Will the Real Afghanistan Please Stand Up?**

Estimate	Population (M)	GDP (\$USB)		GDP per Capita (\$US)
		Market/Real	PPP/Nominal	
Afghan Central Statistics Organization	24.485** to 26.0	18.4 <sup>10/11</sup>	*	*
CIA World Factbook	30.4 <sup>12</sup>	17.9 <sup>11</sup>	29.99 <sup>11</sup>	1,000 <sup>11</sup>
US State Department Background Note	29.396 <sup>09</sup>	-	27.36 <sup>10</sup>	900 <sup>09</sup>
World Bank Economic Update 10/11	30.18 <sup>10/11</sup>	7.45 <sup>10/11</sup>	15.928 <sup>10/11</sup>	489 <sup>10/11</sup>
IMF WEO Database 9/11	32.07 <sup>12</sup>	19.38 <sup>12</sup>	32.017 <sup>12</sup>	1,015.647 <sup>12</sup>
UN Country Profile	28.15 <sup>09</sup>	12.853 <sup>09</sup>	-	456.6 <sup>09</sup>
US Census Bureau IDB	30.420 <sup>12</sup>	-	-	-

\*Did not function when access was attempted.

\*\*Settled population in yearbook for 2010-2011.

Note: Superscript shows year for estimate. Assumes 1 \$USD = 49.5 Afghanis unless conversion done by source

There is a 4:1 difference in the various GDP estimates shown in **Figure One**. Ironically, the primary outlier is the World Bank, which US and Afghan government planners have used in much of their Transition planning – although the US and Afghan estimates of GDP growth are anywhere from more than two times higher to four times – depending on which measure of GDP is used.

Unfortunately, there is no way to put these differences in perspective. None of the sources fully explain where the data for their estimates of the Afghan GDP come from, or how it is calculated in any meaningful detail. No source describes the key uncertainties in the estimate, or attempts to indicate the uncertainty in percent.

Normally, market or currency transaction-driven estimates are more accurate than estimates that include efforts to compensate for the larger part of developing economics that either do not use currency, do not take place at market prices, or are not recorded. In Afghanistan's case, however, there do not seem to be meaningful base points for market estimates of the GNP during the Taliban years, or any reliable basis for estimating how much the massive flow of US, other International Security Assistance Force (ISAF) country, and donor spending that built up after 2002 was actually spent in country versus spent on the war and aid outside it.

Moreover, the trend data on economics are particularly suspect because it is unclear if there is any valid base point, or consistent database and methodology, to be used in calculating such trends. In fact, many estimates are actively dishonest exercises in “spin,” that use the worst Taliban year as their base point, often measuring in market GDP terms, and then acting as if steadily rising wartime and aid spending was somehow a sign of valid progress in the domestic economy and investment.

There has been very real progress in Afghanistan since the fall of the Taliban, but much of the “growth” in every measure – not just GDP – is outside wartime and aid spending that is not sustainable. These indicators also use the worst data point in a wartime environment for the most negative methods of measurement, which compounds the fundamental dishonesty in such reporting and ignores the possible scale of the challenge posed by Transition

### **Population Data With Great Uncertainty**

The economics of Transition are driven as much by demographic pressures as by the underlying nature of the Afghan economy. There is more apparent agreement in **Figure One** on data like total population than GDP, but largely because all the groups making estimates seem to be using the same guestimate for their statistical base in the absence of a truly reliable census and set of figures.

The acute limits to -- or failure of -- the 1979 census supervised by the Soviet Union had led most sources to cut back on the estimate of roughly 33 to 34 million Afghans used in the past. This was based on data drawn from a 1979 census that the FSU began but never completed, although a few experts still seem to believe more recent figures are a major undercount and do use figures as high as 34 to 36 million.

It is unclear that even if there were correct figures for the total population that this would matter, given the acute differences in security, ethnicity, the economy, and dependence on drug markets that affect the Afghan population – particularly when it is obvious that a narrow part of the Afghan population has benefited legally and illegally from much of the outside spending and has often moved much of their income outside the country. While nothing approaching a Ginni index of income distribution exists, it is brutally obvious to every observer of Afghan corruption, contract awards and management, power brokers, and criminal networks that a vast amount of the spending that was supposed to benefit the Afghan people has benefited a tiny fraction of the Afghan elites – as well as outside contractors and fundraisers.

The Afghan Central Statistics Office (CSO) does provide a breakout of population by sex by province and district for settled population, and distinguishes between rural and urban areas in each sub-category.<sup>1</sup> It does not, however, explain the probable accuracy of its figures for the settled population. The CSO also highlights the fact in its statistical yearbook that at least several million Afghans do not have a stable enough location to estimate, and its high estimate is a little over 80% of the estimate used by most outside

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<sup>1</sup> Afghan CSO, <http://cso.gov.af/en/page/6070>.

sources. As is the case with every aspect of the econometric data available for Transition planning, no effort is made to distinguish uncertainty by province or district, or to measure the impact of both the current war on key areas of fighting and insurgent activity or the cumulative impact of more than thirty years of constant insecurity since 1979.

The UN statistics office shows how the CSO sought to conduct a census, but does not explain how this can be done in a nation at war, and with massive numbers of citizens living outside the country due to war and economic pressure, in remote rural areas or in urban slums.<sup>2</sup>

The end result is that the CSO – and sources that draw upon it – provides a great deal of highly detailed information that could have potential value for Transition planning, but cannot be validated or trusted. This information does not distinguish between security conditions or add uncertainty in combat and high-risk areas, or between areas where estimates may be reliable and areas where they are not.

Other Afghan sources present similar problems relating to education, public health, and other critical metrics for judging aid and the effectiveness of governance. They provide a figure that is not defined as to methodology or uncertainty, and may not track with other data provided by the same source. For example, the Ministry of Education data on students do not track credibly with the number of schools or data on teachers, or reflect the probable impact of combat and Taliban influence in high-risk areas.

The estimated student body seems far too high for the number of schools and trained teachers and it is unclear how active many schools really are. Similarly, public health data on access to basic health care do not seem to have a credible source or methodology.

These problems are particularly serious when any trend line is applied. Since current Afghan population estimates reject the estimates made following a partial Soviet census, there is no clear basis for estimating population migration during the Soviet occupation and long period of civil war. Any statistical regression has to be even more of a guesstimate than the current population data.

It also makes it almost impossible to put together any meaningful data on the number of Afghans working in given sectors of the economy, the levels of real and disguised unemployment, student populations, health data, and other key metrics unless there is a valid survey that is conducted independently of other sources of data. This, however, presents the problems that most surveys at best claim a narrowly defined statistical validity based on the mathematics of the statistical method used without regard to the validity of the sample, the credibility of the baselines and collection methods used, and the quality of the control questions and validation involved.

This is particularly true when the analysis does not provide maps of the collection effort or relies on phone sampling and interview numbers where the collector is effectively paid

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<sup>2</sup> See the Afghan census methodology data in the CSO web page - <http://cso.gov.af/en> -- and in UN Statistics Division web page, [http://unstats.un.org/unsd/demographic/sources/census/country\\_impl.htm](http://unstats.un.org/unsd/demographic/sources/census/country_impl.htm).

by the claim or simply for providing output, and not by a validated collection effort. Corruption is not simply the privilege of senior power brokers and the wealthy.

### **If There are No Baseline Data, More Sophisticated Breakouts Become Impossible**

Given these uncertainties, it is unclear that the data on per capita income in **Figure One** are anything more than a “guesstimate.” Moreover, the data on GDP per capita do not always track clearly with the population and GDP estimates. This illustrates an obvious fact. If the GDP data are in conflict and lack a source, all of the more sophisticated economic analysis based on the size of the economy become even more uncertain, as do any data based on population – such as the figures for children at school or Afghans with access to health care.

It is also important to note that Afghanistan presents special problems because – uncertain as the data are – the United Nations Development Program (UNDP) ranks Afghanistan 172<sup>nd</sup> out of 186 nations in the Human Development Index, and the CIA estimates its per capita income as ranking 214<sup>th</sup> in the world out of 226 countries.<sup>3</sup> Far too much of the data being generated assume that increases in GDP somehow reached a nation of subsistence farmers, “self-employed” workers in urbanized areas, semi-feudal poor farmers-share croppers-migratory workers tied to the drug economy. The bad news is there seem to be no valid surveys indicating what level of real benefit actually occurred.

It is particularly striking that some analyses not only ignore the fact that the nation is at war, and the massive population disruption and insecurity that results, they also ignore the highly cyclical nature of Afghan agriculture shown in **Figure Two**, and the fact that the UN’s World Food Organization (WFO) has consistently warned that Afghanistan really is a sub-subsistence economy.

The current WFO web page states that, “Afghanistan faces enormous recovery needs after three decades of war, civil unrest and recurring natural disasters. Despite recent progress, millions of Afghans still live in severe poverty with a crumbling infrastructure and a landscape that is suffering from environmental damage. This rugged, landlocked country remains one of the poorest in the world, with more than half the population living below the poverty line.”<sup>4</sup>

This winter, the WFO warned that, “In northern Afghanistan, WFP [UN World Food Program] is distributing food to people who lost their harvest last year due to a lack of rainfall. About 2.8 million people were affected by the drought in 14 provinces of the country. Now, a harsh winter is making the situation even more difficult.” If the CSO is

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<sup>3</sup> United Nations Development Program (UNDP), *Human Development Report 2011, Sustainability and Equity: A Better Future for All*, 2011, p. 126; CIA, *World Factbook*, “Afghanistan,” accessed 16.4.12, <https://www.cia.gov/library/publications/the-world-factbook/geos/af.html>.

<sup>4</sup> World Food Organization accessed April 16, 2012, <http://www.wfp.org/countries/afghanistan>.

correct, this is more than 10% of the entire population and the winter of 2011/2012 is scarcely exceptional.<sup>5</sup>

The WFO states that its 2012 requirement is for some \$US 487 million to feed 7,597,600 Afghans with 346,227 metric tons of food. This level of precision is no more convincing than that from any other government, NGO, or international agency, talking about progress in terms of farmer's aid and general economic average for the country. It also ignores the fact that a key UN agency claims that roughly 30% of the population is dependent on its aid for basic survival.<sup>6</sup>

The good news is that many Afghans probably got so little that massive cutbacks in military and aid spending will have far less impact than might otherwise be the case. However, the very real risk exists risk that *any* impact – direct or trickle down – can be critical in the large subsistence or sub-subsistence part of the Afghan economy.

This reinforces the fact that any models or Transition recommendations based on available figures are suspect at best. Several sources for detailed data on Afghanistan provide an amazing amount of precision for a country at war, that has had massive population displacements, and that has been in a crisis or civil war for more than three decades. The fact that such data are generated, however, in no way makes them reliable or useful.

Trend data are particularly suspect because many past estimates are either made long after the fact, or rely on estimates that had to be made at a time when the Afghan government either did not have any real sources for such data, had nothing approaching its current CSO, and/or did not have a functioning presence in many districts throughout the country.

***No One Knows How Much Money is Being Spent in Afghanistan and to Whom it Goes***

**Figure Two** illustrates another set of problems affecting the use of GDP data, and one is confirmed if one reviews the web site of the Afghan CSO and its detailed estimates of the activity within the Afghan economy. The figures shown for the annual components driving the estimate of GDP show a sharp annual fluctuation up and down for the years between 2005 and 2011. As has been touched upon earlier, this is partly due to the fact that *the legal part of* Afghan agriculture – which evidently is the only part quoted in the CSO estimate -- is driven more by climate than productivity.

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<sup>5</sup> World Food Organization, accessed April 16, 2012, <http://www.wfp.org/countries/afghanistan>.

<sup>6</sup> World Food Organization, accessed April 16, 2012, <http://www.wfp.org/countries/afghanistan>.

## **No Effort to Determine How Much is Being Spent by All ISAF and Donor Countries and NGOs or Where it Actually Goes**

The CSO estimates of sectoral activity within the Afghan economy present all of the same problems as the various estimates of GDP, and population combined, but this is only part of the story. The growth of the Afghan economy since 2001 has been driven by a massive increase in military and civil spending in Afghanistan from 2008-2010, with very high levels still in 2011.

As an illustration of the problems this creates for the economic side of Transition planning, the fluctuation in the World Bank estimate of the role the growth in services and construction plays in GDP growth shown in **Figure Two** can only be correct if it does not reflect the impact of increase in outside spending. This means that the estimates are at least partly insensitive to the real world impact that massive amounts of outside spending have actually had on Afghanistan.

This raises a critical area of ignorance in planning a successful Transition that is at least as serious as the problems in finding meaningful data on the population and economy. It is clear that outside military and aid spending *in country* plays a critical role in the current Afghan economy and that the coming cuts as outside combat forces and aid are cut will have a critical impact on the Afghan economy as Transition takes place. This can potentially drive the country into recession or depression in 2014-2020, depending on whether donors provide aid to help Afghanistan adjust during that period of time.

*Unfortunately, however, no one knows how much outside money is being spent on, much less inside, Afghanistan.* There are no reliable figures for how the US and other ISAF countries are actually spending on the war. Neither UN Assistance Mission in Afghanistan (UNAMA) nor the Afghan CSO are able to make useful estimates of total aid spending – in part because countries simply do not report such expenditures.

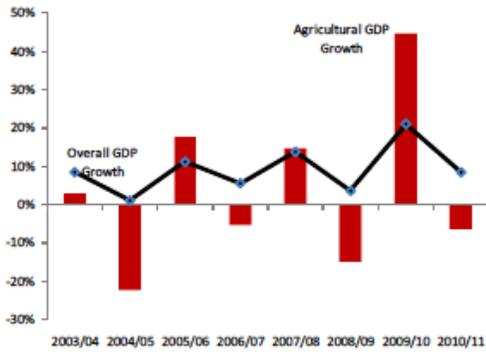
UNAMA prepares a “Progress Against Benchmarks” annex to the Secretary General’s reports on Afghanistan to the General Assembly, but this consists largely of project reports and isolated progress claims. There are no estimates of overall aid spending, and the benchmarks listed cover broad areas that are not related to any measure of effectiveness or overall national requirements.<sup>7</sup> Moreover, UNAMA does not list a single report on aid activity on its web page.

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<sup>7</sup> For example, see Report of the Secretary-General, “The situation in Afghanistan and its implications for international peace and security,” A/66/728–S/2012/133, March 5, 2012, pp. 18-30.

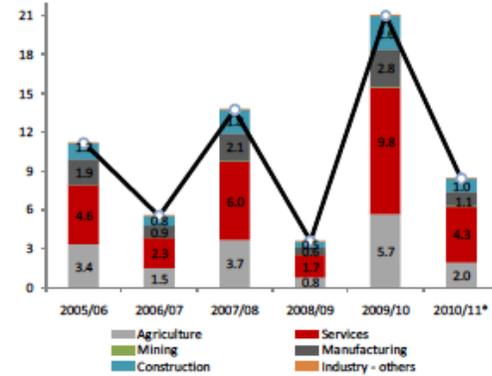
Figure Two: World Bank Estimate of Afghan GDP At a Glance

Strong, but volatile real GDP growth...  
Figure A



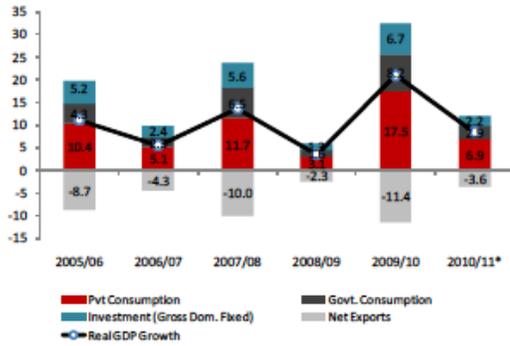
Source: IMF

... driven by the services sector and fluctuating agriculture output.  
Figure B: Contribution to Real GDP Growth (%)



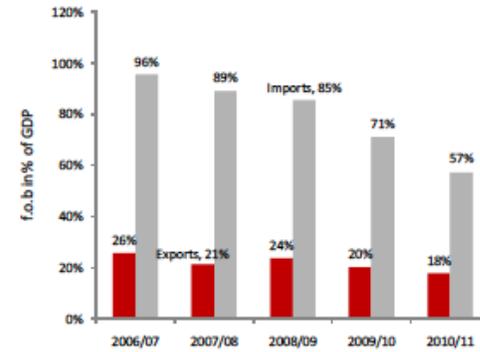
Source: IMF

Private consumption is the motor of growth from donor inflows and the security economy...  
Figure C



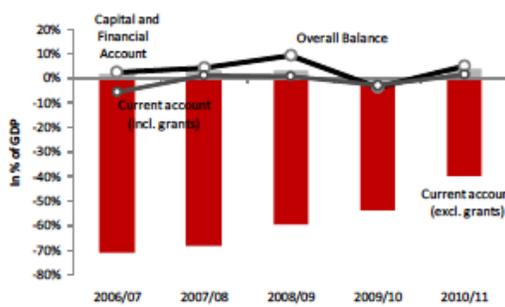
Source: IMF

... but trade is declining,  
Figure D



Source: IMF

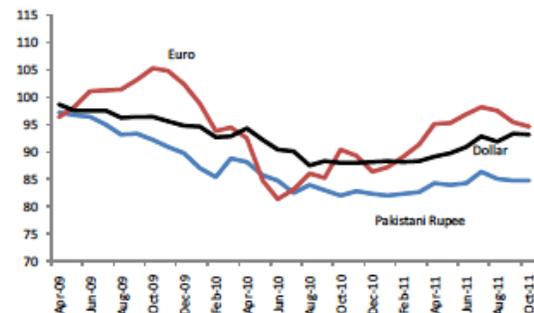
... the current account deficit reduced, which is financed by donor grants.  
Figure E



Source: IMF

Note: The symbol \* refers to Initial estimates

The Afghani is depreciating.  
Figure F: Nominal Exchange Rates, to Afs (Index Mar, 22, 2009=100)



Source: DAB

There is no credible basis for making the much more important estimate of how much money actually is being spent in Afghanistan – as distinguished from being spent on Afghanistan. It is clear that most military spending is spent on national military forces and military operations, and most is spent outside Afghanistan. Similarly, the bulk of aid spending is spent on acquiring goods and service outside Afghanistan, or in ways where pay goes to foreign nationals in Afghanistan.

Furthermore, it is all too clear from a decade's worth of studies of corruption in Afghanistan that a major amount of money goes to a narrow range of power brokers, government officials, and businessmen who immediately transfer the money outside of Afghanistan. This is a problem that is steadily increasing because of Afghan fears of the impact of withdrawing US and ISAF combat forces by the end of 2014. Some experts have guessed that only about 40% of the aid money spent *on* Afghanistan is spent *in* Afghanistan, but such percentages are literally guesses.

### The US as a Case Study and A Warning

If one looks only at the US, the Congressional Research Service provides the estimate of total US spending shown in **Figure Three**:

*Figure Three: Total US Spending on the War in Afghanistan: FY2002-FY2003*

(CRS estimates in billions of dollars of budget authority)

Operation and Funding Source	FY01 & FY02	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY2011 CRA P.L. 112-6	FY2012 Request	Cum. Enacted FY2001-FY2011	Cum. Total w/ FY2011 CRA & FY2012 Request
DOD	20.0	14.0	12.4	17.2	17.9	37.2	40.6	56.1	87.7	113.3	107.3	416.2	523.5
State/USAID	0.8	0.7	2.2	2.8	1.1	1.9	2.7	3.1	5.7	4.1	4.3	25.1	29.4
VA Medical	0	0	0	0	0	0.1	0.1	0.2	0.5	1.1	2.1	2.1	4.2
<b>Total: Afghanistan</b>	<b>20.8</b>	<b>14.7</b>	<b>14.6</b>	<b>20.0</b>	<b>19.0</b>	<b>39.2</b>	<b>43.4</b>	<b>59.5</b>	<b>93.8</b>	<b>118.6</b>	<b>113.7</b>	<b>443.5</b>	<b>557.1</b>

Source: Amy Belasco, The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations Since 9/11, Congressional Research Service, RL33110, March 29, 2011, [www.crs.gov](http://www.crs.gov).

The estimates in **Figure Three** indicate that the US authorized a total of \$118.6 billion in FY2011 and \$113.7 billion in FY2012. US fiscal years, are not calendar years - authorized money can be spend over a period of several years - and there is no way to know how much money was actually being spent in-country. Nevertheless, several facts about these figures are striking:

- US spending per fiscal year alone were at least 7 to 10 times the total World Bank estimate of the Afghan GDP shown for the same calendar year in **Figure One**. There is no way to reliably estimate the Afghan GDP during the period from 2002-2012, but it seems likely that the US spent 7-10 times as much on the war during this period as the total of Afghan GDP for all the years during the same period.
- US civil aid related spending (State/USAID), much of which was overhead and security peaked in FY2010 at \$5.7 billion, but was only a little over 6% of total military spending. If one looks at the

entire war – from FY2001-FY2012 – the US Department of Defense spent \$523.5 billion on the war, and State USAID spent \$29.4 billion, or less than 6%.

These figures illustrate just how important outside spending has been in the past in giving Afghanistan stability, economic growth, and the ability to fund its security forces. It is also clear that the cut backs in such spending will become steadily more important during the “Transition” and after 2014.

### **The Unknown Impact of Coming Cuts in Spending**

This is particularly salient because the US has begun to make major cuts in civil aid and military spending even before the timing of the current Transition effort was decided upon. **Figure Four** shows the President’s budget request for Department of Defense (DoD) Spending on the War in FY2013. **Figure Four** only hints at the further cuts in spending that will take place in the key Transition year of FY2014 and beyond, but it is clear that the total for FY2013 is only 75% of the peak spending in FY2010, and the nominal estimate for FY2014 is \$50 billion – or less than half. The State/USAID budget request for the war in FY2013 is also rough 75% of the FY2012 figure.

Once again, it must be stressed that there is no way to know how much of the money in **Figure Three** will be spent in Afghanistan and its impact on the Afghan economy. However, a significant amount of operations funding is spent in country, along with much of the Afghan National Security Forces (ANSF), Afghanistan Infrastructure Fund (AIF), and Commander’s Emergency Response Program (CERP) funds. There are additionally many individual program areas like \$179 million for the Task Force for Business Stability Operations, which “supports the mission in Afghanistan to reduce violence, enhance stability, and restore economic normalcy in areas where unrest and insurgency have created a synchronous downward spiral of economic hardship and violence.”

It is also clear from **Figure Four** that the FY2013 funding for the ANSF – an area where much of the money is spent in country – will drop by 49% between FY2012 and FY2013. US officials have said on background that far more serious cuts will come after FY2014, and that the US goal is for the total spending to drop to \$4.4 billion a year, of which the US would only pay around 25% -- or \$1.1 billion. This would be roughly 10% of the spending on the ANSF in FY2012.

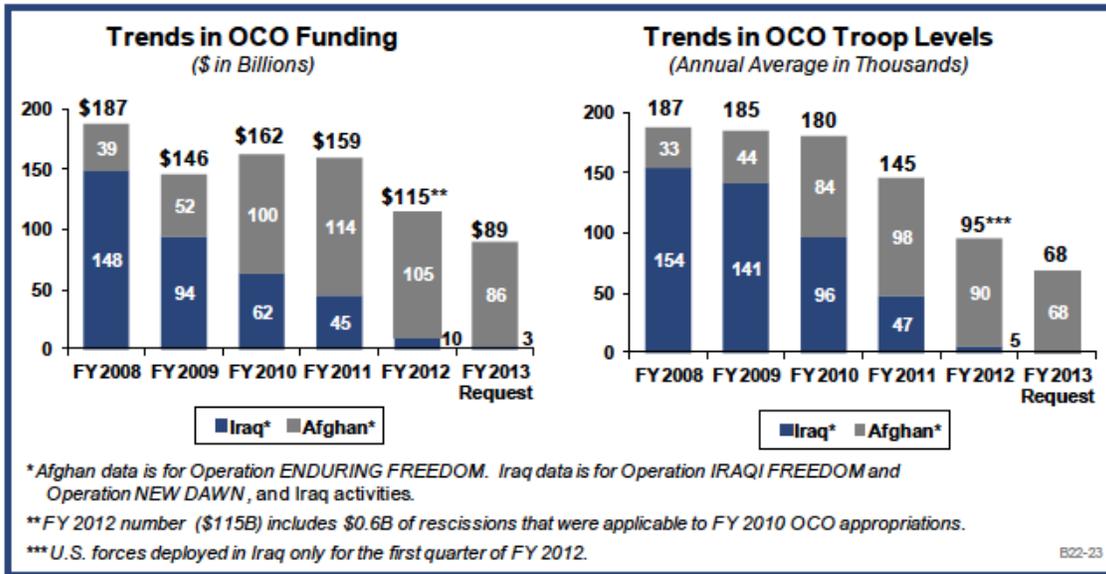
### **Past Spending is Not a Measure of Merit, and Future Spending Never Will Be**

There is no practical way to provide similar data for other countries. Most do not provide detailed reporting on their web sites that would make this possible. Moreover, when countries do report on spending, it is invariably on total spending and not on actual in country spending, or in any way that makes it clear how much money actually went into the Afghan economy versus through Afghan officials and to outside accounts. No international organization or country seems to have accounting and reporting tools that make such data available.

Unfortunately, one side effect of this problem is reporting by some aid agencies, military aid donors, and NGOs that borders on the absurd. Even in developed countries, the ability of government to spend in country has never been a measure of effectiveness or merit. In

the case of Afghanistan, far too many agencies and donors do use total aid budgets as a measure of merit or effectiveness – sometimes counting pledged money and not actual funding. Such claims are worthless and dishonest, and a red flag as to the professional integrity of those who make them. What counts is what the money buys, and if there is no ability to even know how much actually goes to, and stays in, Afghanistan; Using spending levels to measure success is ridiculous.

*Figure Four: Department of Defense Budget Request for Spending on the Afghan War in FY2013*



(Dollars in Billions)

	FY 2012 Enacted*	FY2013 Request
Operations	60.2	48.2
Force Protection	6.5	5.1
Improvised Explosive Devices (IED) Defeat	2.4	1.7
Military Intelligence Program (MIP) (Includes ISR)	5.8	4.5
Afghanistan Security Forces Fund (ASFF)	11.2	5.7
Afghanistan Infrastructure Fund (AIF)*	0.4	0.4
Commander's Emergency Response Program (CERP)*	0.4	0.4
Support for Coalition Forces	2.1	2.2
Equipment Reset	13.0	9.3
Military Construction	0.3	–
Temporary End Strength	2.2	6.1
Non-DoD Classified	5.4	4.9
Non-war/Other*	5.8	–
<b>Total</b>	<b>115.7</b>	<b>88.5</b>
Rescissions**	-0.6	–
<b>Total including Rescissions</b>	<b>115.1</b>	<b>88.5</b>

\* Reflects base budget amounts transferred by the Congress to OCO, and congressional non-war adds (e.g., \$1B for domestic National Guard and Reserve Equipment).

\*\*Includes rescissions enacted in FY 2012 for FY 2010 OCO appropriations.

Source: Department of Defense, **FY2013 Budget Overview**, February 2012, pp. 6-1 and 6-3.

## **Aid Spending and Effectiveness**

Aid is only one part of the outside spending in Afghanistan that will be affected by Transition. It is clear, however, that if virtually all combat troops leave Afghanistan by the end of 2014, it is aid spending that will be critical in the future. It is also clear that the primary burden of international action during Transition in Afghanistan and Pakistan will fall upon the US, individual European states, and major outside aid donors.

### ***Lack of Meaningful data on the Total Size of the International Aid Effort***

As noted earlier, major uncertainties exist regarding the size and flow of international aid. The key UN agency that is supposed to coordinate aid – UNAMA -- has consistently failed in this aspect of its mission and has never published a meaningful report on the size, status, and effectiveness of international aid during its nearly ten years of existence.

**Figure Five** does, however, provide some insights into the relative flow of aid to the ANSF, Afghan governance, and the national economy. It is clear that US military spending accounts for the vast majority of such spending, that the US has overwhelmingly dominated the flow of aid and has been the only member of NATO/ISAF actively involved in Pakistan and is the major donor of aid to that country.

The data in **Figure Five** also show why it is the US role during “Transition” – and the level of US spending -- that will define the role of the West, although key European states and other donors will play a critical role in shaping the pace of reductions in troops, military spending, and aid. **Figure Five** indicates that the US spent or planned to spend \$31.9 billion on aid through 2011 – or 56% of an estimated total of \$57.1 billion spent or pledged from all donors. In practice, the US share was substantially larger since a number of countries did not deliver what they pledged.

As **Figure Six** shows, only a small portion of this money went through UNDP – which severely limits the role UNAMA and UNDP can play as planners and coordinators of even civil aid (military aid is not included). This may help explain why UNAMA has never attempted any overview of aid activity, and why documents like the UNDP program for 2010-2013 have stayed conceptual, and never laid out specific programs and program goals.<sup>8</sup>

Other Special Inspector General for Afghanistan Reconstruction (SIGAR) reporting provides another measure of the international effort, and one that reflects the problems the Afghan government now faces after years in which much of the total flow of aid funds bypassed it entirely and went directly to projects and programs that it did not control. SIGAR reports that,

“The largest share of international contributions to the Afghan operational and development

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<sup>8</sup> Executive Board of the United Nations Development Programme and of the United Nations Population Fund, **Draft country programme document for Afghanistan** (2010-2013), DP/DCP/AFG/2, 7 April 2009

budgets comes through the ARTF [Afghanistan Reconstruction Trust Fund]. From 2002 to December 21, 2011, the World Bank reported that 33 donors had pledged more than \$5.15 billion, of which nearly \$4.56 billion had been paid in. The United States and the United Kingdom are the two biggest donors to the ARTF, together contributing nearly 43% of total ARTF funding...According to the World Bank, donors have pledged \$913.67 million to the ARTF for the current Afghan fiscal year—solar year 1390—which runs from March 21, 2011, to March 20, 2012.

Contributions to the ARTF are divided into two funding channels—the Recurrent Cost (RC) Window and the Investment Window. ...As of December 21, 2011, according to the World Bank, nearly \$2.30 billion of ARTF funds had been disbursed to the Afghan government through the RC Window to assist with recurrent costs such as salaries of civil servants. The RC Window supports the operating costs of the Afghan government because the government's domestic revenues continue to be insufficient to support its recurring costs. To ensure that the RC Window receives sufficient funding, donors to the ARTF may not "preference" (earmark) more than half of their annual contributions for desired projects.

The Investment Window supports the costs of development programs. As of December 21, 2011, according to the World Bank, more than \$1.98 billion had been committed for projects funded through the Investment Window, of which more than \$1.50 billion had been disbursed. The World Bank reported 20 active projects with a combined commitment value of \$981.55 million, of which approximately \$497.40 million had been disbursed.

A total of \$5.15 billion is scarcely small, but its only 9% of the total of \$57.1 billion estimated for aid spending earlier.<sup>9</sup>

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<sup>9</sup> SIGAR, *Quarterly Report to Congress, January 30, 2012*, p. 64

*Figure Five: International Aid to Afghanistan: 2003-2011*  
(Pledges Through 2011 as of March 2010 in \$US Millions)

Donor	Pledges at the Paris Conference to support the Afghanistan National Development Strategy			Total Pledges—4Q FY1380 to FY1389 (January 2002- March 2011)
	Fresh	Old	Total Pledge	
Luxembourg	0.00		0.00	7.20
Malta	0.30		0.30	0.30
Netherlands	1,209.00		1,209.00	1,697.00
New Zealand	15.00		15.00	30.85
Norway	669.00	6.00	675.00	977.00
Oman	3.00		3.00	9.00
Org Islamic Conf	0.00		0.00	15.00
Pakistan	20.00		20.00	305.00
Poland	1.30		1.30	6.33
Portugal	0.00		0.00	1.20
Qatar	4.00		4.00	24.00
Russian Federation	0.00	0.00	0.00	141.00
Saudi Arabia	0.00	0.00	0.00	533.00
Slovakia	1.00		1.00	1.00
Spain	234.00		234.00	486.47
Sweden	0.00		0.00	288.60
Switzerland			0.00	134.00
Taiwan	0.00		0.00	28.60
Turkey	100.00		100.00	190.00
UAE	250.00		250.00	323.70
UK	1,200.00		1,200.00	2,897.00
UN Agencies	0.00	0.00	0.00	252.40
USA	7,095.40	3,104.60	10,200.00	31,851.86
Vietnam	0.01		0.01	0.01
World Bank	433.00	667.00	1,100.00	2,803.00
Other Donors	0.00	0.00	0.00	92.77
Total	15,305.97	5,815.70	21,121.87	57,149.62

**Sources:** Work by the CRS, Special Inspector General for Afghanistan Reconstruction. October 2008 report, p. 140; various press announcements. Figures include funds pledged at April 2009 NATO summit and Japan's October 2009 pledge of \$5 billion over the next five years.

**Figure Six: International Aid Donors to UNDP Effort in Afghanistan:  
2008-2011**

Donor Name	2008	2009	2010	2011	2012	Grand Total
UNESCO	10,000					10,000
UNITED NATIONS DEVELOPMENT PRO		1,904,762				1,904,762
GOVERNMENT OF AFGHANISTAN		500,000	2,000,000			2,500,000
GOVERNMENT OF AUSTRALIA	1,919,386					1,919,386
GOVERNMENT OF BELGIUM		1,404,494				1,404,494
GOVERNMENT OF CZECH REPUBLIC		150,602				150,602
GOVERNMENT OF CROATIA		50,000				50,000
GOVERNMENT OF DENMARK	1,800,000	13,392,753	9,850,105	566,679	5,883,760	31,493,297
GOVERNMENT OF ESTONIA, REPUBLI		40,000				40,000
GOVERNMENT OF FINLAND		639,386	3,059,865			3,699,251
GOVERNMENT OF TURKEY		3,000,000	2,000,000			5,000,000
GOVERNMENT OF UNITED KINGDOM	9,727,178	18,188,465	14,982,885	11,653,291	16,731,756	71,283,575
GOVERNMENT OF UNITED STATES OF	91,667,223	140,000,000	208,947,501	250,000,308		690,615,032
EUROPEAN UNION	103,028,060	115,619,142	41,082,100	54,333,333		314,062,636
CANADIAN INTERNATIONAL DEVELOP	52,227,023	1,481,225	21,710,535			75,418,784
DEPARTMENT FOR INTERNATIONAL D	13,419,576	65,178,387		7,209,246		85,807,210
SWEDISH INTERNATIONAL DEVELOPM	8,055,143	2,472,188				10,527,331
UNAMA, KABUL			5,000,000			5,000,000
AG. ESPANOLA DE COOPERACION IN	1,321,978	23,410,596				24,732,574
DEPT OF FOR AFF & INTL TRADE C	10,566,109	22,234,946	5,899,705	12,337,397		51,038,156
SWISS AGENCY FOR DEVELOPMENT A		3,875,637		300,000		4,175,637
USAID	600,000	55,000,000	3,500,000			59,100,000
UNDP AS AA FOR JP PASS THROUGH	2,500,000					2,500,000
Irish Aid		354,476				354,476
Australian Agency for Internat	4,103,968		225,630	2,000,000		6,329,598
	423,388,942	619,354,922	937,388,293	419,744,987	39,448,850	2,439,325,994

Source:

[http://www.undp.org.af/demo/index.php?option=com\\_content&view=article&id=54&Itemid=58](http://www.undp.org.af/demo/index.php?option=com_content&view=article&id=54&Itemid=58). UNDP,

### *The US as a Case Study*

Once again, the US acts as a case study that helps highlight the issues in planning the economic side of Transition. There is no question that US aid has helped many Afghans, and played a critical role in winning popular support. At the same time -- like the open source reporting of US allies, most US government reporting is stove piped in ways that divide military and civilian aid activities.

The US provides little or no justification for the priority given to any specific aid activity, does not validate overall national requirements for aid, does not measure actual cash flow and how money is allocated, and does not provide any meaningful measures of effectiveness in terms of the overall benefits of a given program and its impact on the Afghan economy, or on the war. While USAID has made some important recent efforts to correct this situation, including a new publication called “USAID in Afghanistan: Partnership, Program, Perseverance,” USAID is still experimenting with measures of effectiveness and most use extremely uncertain and undefined data, and often have no clear relationship to US aid efforts or do not provide credible trend lines.<sup>10</sup>

The US SIGAR does, however, provide data that show the total size of both US military and civil aid to date. These data are summarized in **Figure Seven**. SIGAR notes that As of December 31, 2011, the United States had appropriated nearly \$85.54 billion for relief and reconstruction in Afghanistan since FY 2002.

- • \$52.14 billion for security
- • \$20.28 billion for governance and development
- • \$5.67 billion for counter-narcotics efforts
- • \$2.24 billion for humanitarian aid
- • \$5.20 billion for oversight and operations

**Figure Seven** also shows just how much of the US aid effort during FY2000-FY2012 was military: \$57.66 billion of a total of \$85.54 billion, or 67%, came from the DoD. The bulk of the military aid money was allocated to Afghan forces: \$50.63 billion, or 88%, of \$57.66 billion in military aid, and 59% of the civil-military total of \$85.54 billion. USAID received a total of \$13.02 billion, or 15%, State received \$3.26 billion for counternarcotics, and six other agencies received \$11.60 billion (14%).

**Figure Eight** shows most of the spending on the ANSF for goods and services occurred outside Afghanistan, although the spending that did occur domestically was large enough to be a major portion of the Afghan domestic GNP, and a critical source of hard currency, employment, and growth in the services and construction sectors.

Data are lacking on the breakout of civil aid spending, but it is striking that major cuts have already been made in annual spending in key areas like the Economic Support Fund (ESF), and this will somewhat reduce the impact of the further cuts made during

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<sup>10</sup> The report was issued in April 2012, and is available on the USAID web site at <http://afghanistan.usaid.gov>.

Transition and after 2014 – subject to the fact that the actual cash flow lag between the cuts in appropriations and disbursements means that Afghans are only just beginning to feel the effect of past cuts in appropriations.

The exception is counternarcotics – an aid program which may well prove to have been a waste of money - given the fact that the UN estimates that Afghan production is still driven more by climate and other natural factors after ten years of effort, and reversion to narcotics as well as the probable reversion to a larger narco-economy once Transition is completed.

While some efforts were made to coordinate these activities, this coordination was largely conceptual. A senior USAID official described their activity as “as a series of golden silos” in the summer of 2011, and there so far seems to be no evidence that the new focus on “Transition” has led to any more real world coordination, or focus on the overall needs of the Afghan economy, than in the past.

As noted earlier, the US is already making massive cuts in the form of aid to the Afghan forces in FY2013, essentially cutting the largest element of aid spending – and one with the most direct impact in country – in half.

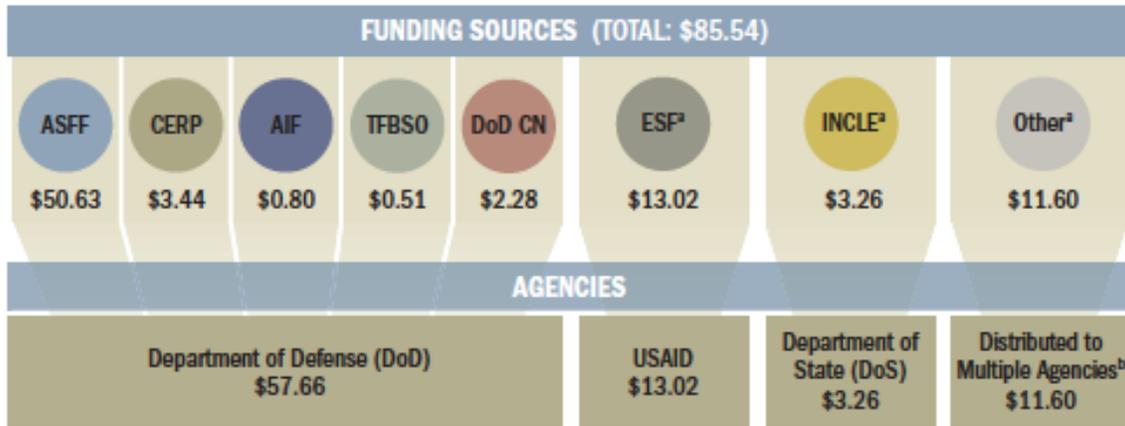
It also seems likely that similar cuts will occur in the Law and Order Trust Fund for Afghanistan or LOFTA. SIGAR reports that the UNDP administers the LOTFA to pay ANP salaries and build the capacity of the Ministry of Interior. Since 2002, donors had pledged nearly \$2.13 billion to the LOTFA, of which more than \$2.12 billion had been paid in as of September 30, 2011, according to the most recent data available:<sup>11</sup>

The LOTFA’s sixth support phase started on January 1, 2011, and will run through March 31, 2013. In Phase VI, the LOTFA has transferred more than \$356.35 million to the Afghan government to cover ANP salaries, nearly \$11.60 million for Central Prisons Department staff remunerations, and an additional \$6.67 million for capacity development and other LOTFA initiatives for the first nine months of 2011.<sup>99</sup> As of September 30, 2011, donors had committed more than \$598.35 million to the LOTFA for Phase VI. Of that amount, the United States had committed more than \$257.07 million, and Japan had committed \$240.00 million. Their combined commitments make up more than 83% of LOTFA Phase VI commitments as of September 30, 2011... The United States had contributed nearly \$812.74 million to the LOTFA since the fund’s inception.

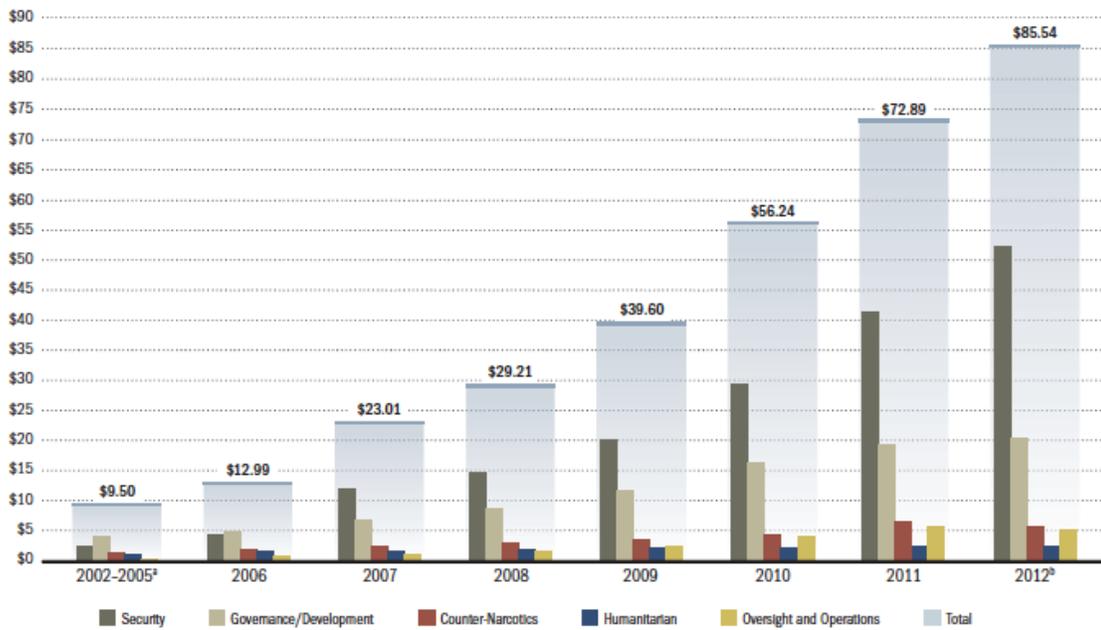
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<sup>11</sup> SIGAR, *Quarterly Report to Congress, January 30, 2012*, p. 65

*Figure Seven: Total US Military and Civil Aid Spending: FY2000- FY 2012 – Part I*



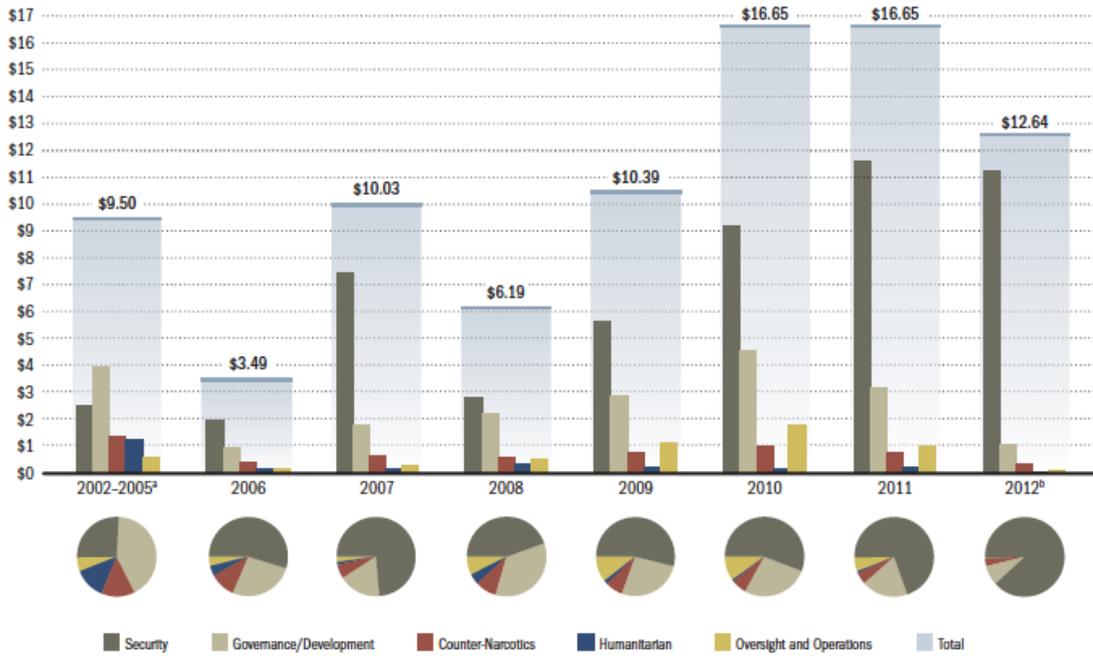
CUMULATIVE APPROPRIATIONS BY FUNDING CATEGORY, AS OF DECEMBER 31, 2011 (\$ BILLIONS)



Note: Numbers affected by rounding

*Figure Seven: Total US Military and Civil Aid Spending: FY2000-  
FY2012 – Part II*

APPROPRIATIONS BY FISCAL YEAR AND FUNDING CATEGORY (\$ BILLIONS AND PERCENT)



- ASFF:** Afghanistan Security Forces Fund
- CERP:** Commander's Emergency Response Program
- AIF:** Afghanistan Infrastructure Fund
- TFBSO:** Task Force for Business and Stability Operations
- DoD CN:** DoD Drug Interdiction and Counter-Drug Activities
- ESF:** Economic Support Fund
- INCLE:** International Narcotics Control and Law Enforcement
- Other:** Other Funding

Source: SIGAR, **Quarterly Report to Congress, January 2012**, pp. 53-55

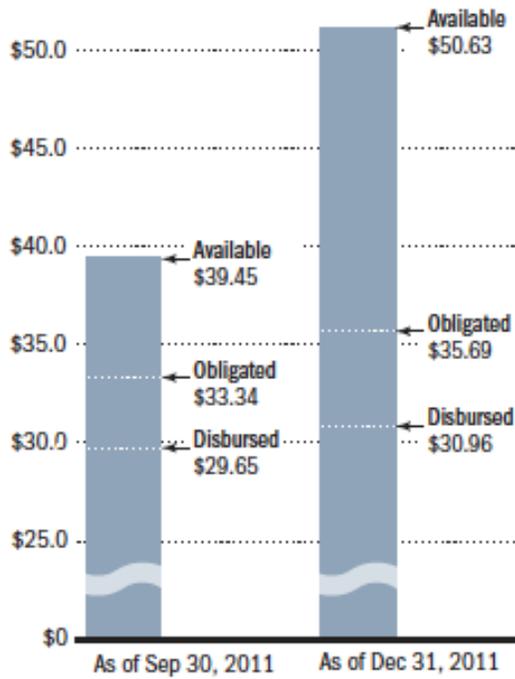
*Figure Eight: Indicators of Spending Inside and Outside Afghanistan – Part I*

**Spending on the ANSF:**

**ASFF AVAILABLE FUNDS BY FISCAL YEAR**  
(\$ BILLIONS)

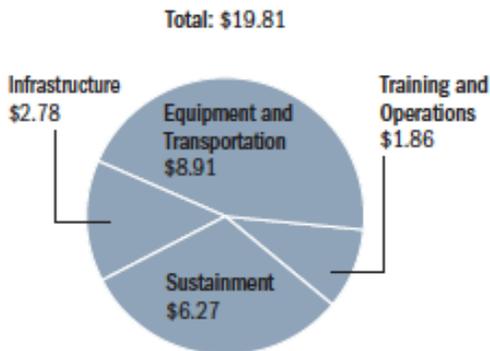


**ASFF FUNDS, CUMULATIVE COMPARISON**  
(\$ BILLIONS)

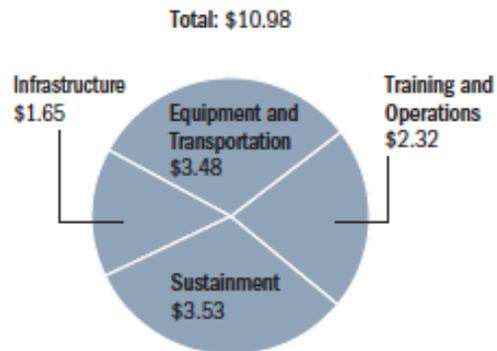


Note that significant expenditures did occur in Afghanistan on transportation, infrastructure, sustainment and training and operation, but most occurred outside the country.

**ASFF DISBURSEMENTS FOR THE ANA**  
By Sub-Activity Group,  
FY 2005–December 31, 2011 (\$ BILLIONS)

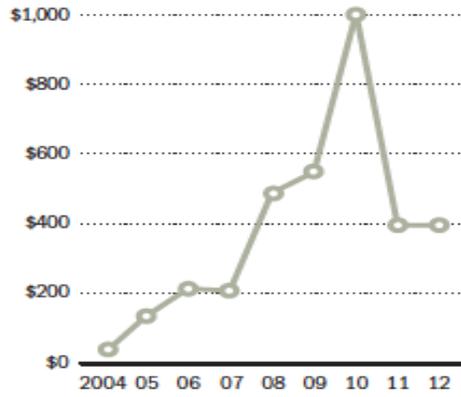


**ASFF DISBURSEMENTS FOR THE ANP**  
By Sub-Activity Group,  
FY 2005–December 31, 2011 (\$ BILLIONS)

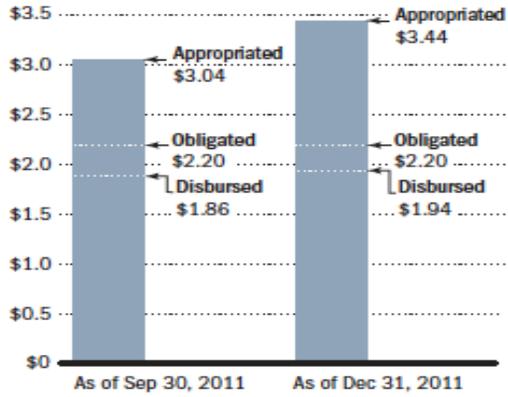


*Figure Eight: Indicators of Spending Inside and Outside Afghanistan – Part II*

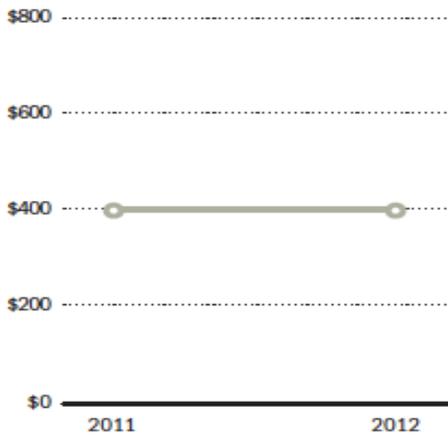
**CERP APPROPRIATIONS BY FISCAL YEAR**  
(\$ MILLIONS)



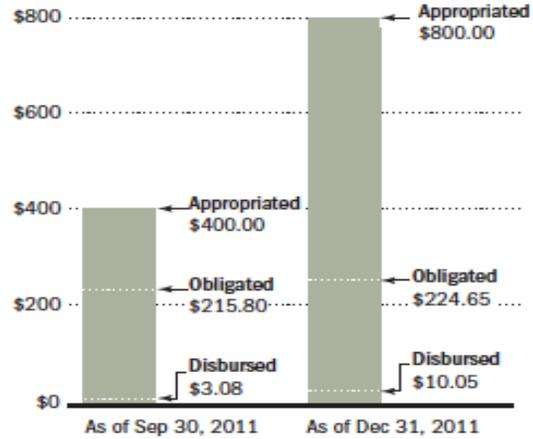
**CERP FUNDS, CUMULATIVE COMPARISON**  
(\$ BILLIONS)



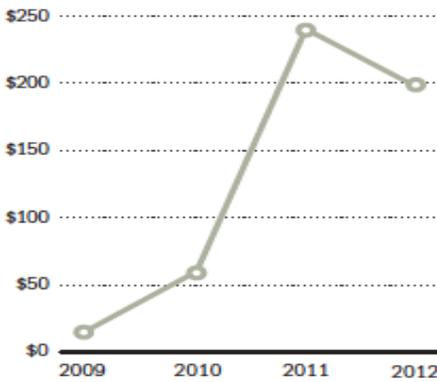
**AIF APPROPRIATIONS BY FISCAL YEAR**  
(\$ MILLIONS)



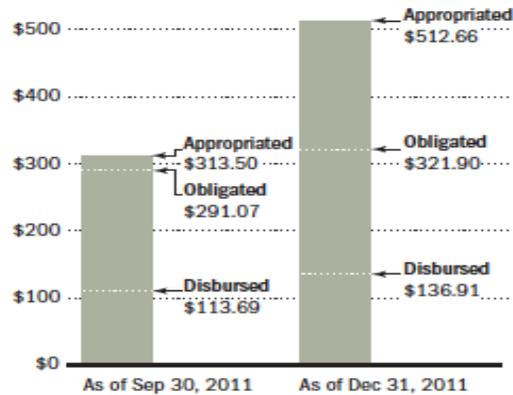
**AIF FUNDS, CUMULATIVE COMPARISON**  
(\$ MILLIONS)



**TFBSO APPROPRIATIONS BY FISCAL YEAR**  
(\$ MILLIONS)

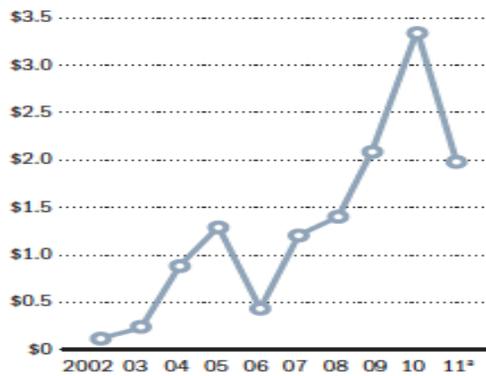


**TFBSO FUNDS, CUMULATIVE COMPARISON**  
(\$ MILLIONS)

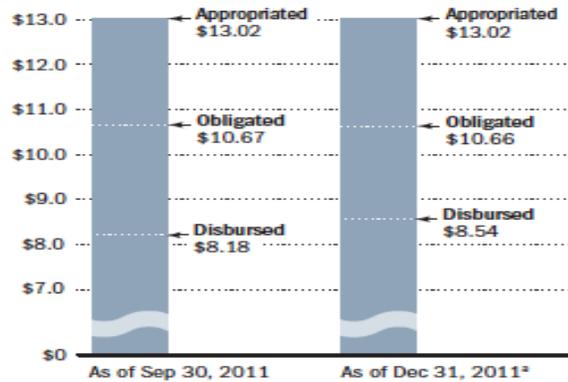


*Figure Eight: Indicators of Spending Inside and Outside Afghanistan – Part III*

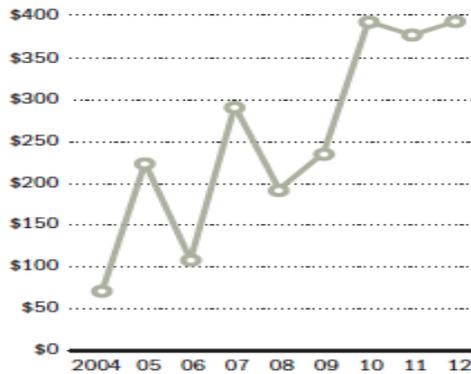
**ESF APPROPRIATIONS BY FISCAL YEAR**  
(\$ BILLIONS)



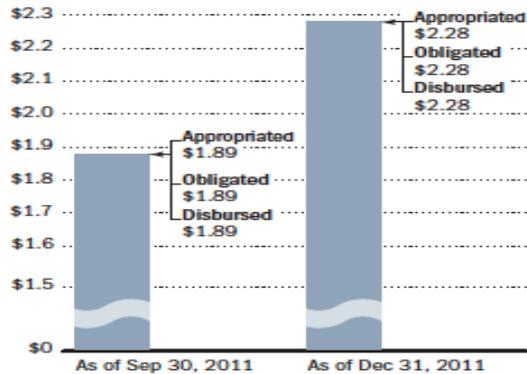
**ESF FUNDS, CUMULATIVE COMPARISON**  
(\$ BILLIONS)



**DoD CN APPROPRIATIONS BY FISCAL YEAR**  
(\$ MILLIONS)



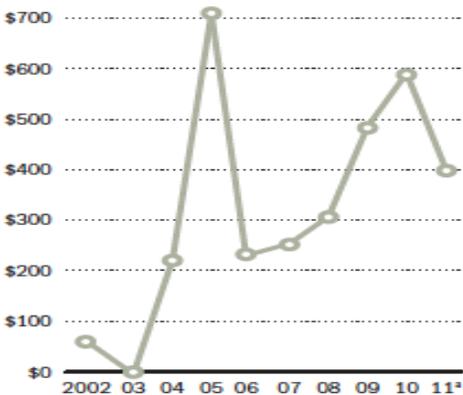
**DoD CN FUNDS, CUMULATIVE COMPARISON**  
(\$ BILLIONS)



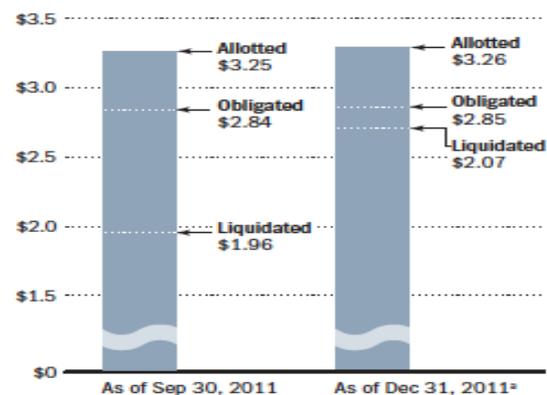
Notes: Numbers affected by rounding. Data may include inter-agency transfers.  
Source: DoD, response to SIGAR data call, 1/4/2012.

Note: Numbers affected by rounding.  
Source: DoD, responses to SIGAR data call, 1/4/2012 and 10/4/2011.

**INCLE ALLOTMENTS BY FISCAL YEAR**  
(\$ MILLIONS)



**INCLE FUNDS, CUMULATIVE COMPARISON**  
(\$ BILLIONS)



Source: SIGAR, Quarterly Report to Congress, January 2012, pp. 57, 59, 61, 62, 63

## Trying to Estimate Afghan Ability to Generate Revenues

It is all too clear from the previous analysis that there is no way to accurately estimate the ability of the Afghan economy to operate without the current level of outside military and aid spending, or to know how much – and where -- it will be affected by given rates of cuts in that spending. There has been ten years of failure in which even the most credible working estimate, a rough “guesstimate,” cannot be tied to a working estimate of the impact of spending cuts on given areas and segments of the Afghan population.

Unfortunately, there is no better ability to estimate the impact of given levels of spending cuts – and future aid – on Afghan government revenues. There are many sources that show a steady rise in such estimates, but there are no sources that provide a credible way of distinguishing the real world rise in purely domestic sources of Afghan government revenue from the direct and indirect effects of outside spending shown in **Figures Five** through **Eight**.

### *The Lack of Meaningful Transition Data on the Sources of Afghan Government Domestic Revenues*

Most attempts to measure Afghan government domestic revenues border on the absurd since they show a far smoother rise in revenue than is credible given the cycles in Afghan agriculture, and the impact of outside military spending and aid. The only way smooth upward curves can exist is if the method actually measures improvements in Afghan revenue collection efforts that are largely independent of the growth in the economy and spending base for revenue collection.

Some of these critical problems in planning the economics of Transition are reflected in the “guesstimates” in **Figures Nine and Ten**. **Figure Nine** provides a typical estimate of the level of outside spending as a percentage of Afghan government revenues. The basic problems with this estimate is that there is no accurate way to know how much outside military and aid spending actually contributed to Afghan revenues, or what level of outside spending that was never part of the government’s revenue base was not actually domestic, but was an indirect result of outside spending.

**Figure Ten** provides a rough breakout and “snap shot” of the current Afghan revenue base, but it is clear from the categories shown that large amounts of this “domestic” revenue almost certainly had to come from the indirect impact of massive outside spending on the Afghan economy. As a result, talking about the steady rise in Afghan domestic revenues ignore the real world nature of a war driven economy, dependent for most of its market sector on outside wartime spending and illegal drug exports. This is particularly true of the construction industry and customs duties.

It is important to note that the World Bank raises a key warning about these data of the kind that is needed far more often in Transition planning,<sup>12</sup>

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<sup>12</sup> World Bank, *Afghanistan Economic Update*, October 2011, pp. 9-10.

Although domestic revenues have grown at 20 percent, operating expenditures have been rising at 27 per cent per year for the past three years. The operating budget is like to face increasing pressures. The announced increase in security spending, mostly financed through security-related donor contributions, will have a medium- to long-term impact because of the associated spending on benefits and pensions. The authorities have set a target of 378,000 for ANA [Afghan National Army] and ANP [Afghan National Police] troops by October 2012, a 42 percent increase over current numbers. On the civilian side, the pay & grading reform represents net costs for non-security salaries equivalent to 0.8 percent of GDP per year for the next five years (FY2010/11-2014/15).

The Afghan budget will continue to rely heavily on external financing. Of the roughly US\$10.6 billion in total public spending in 2010, only US\$4.6 was channeled through the core budget and was under the control of the government's formal PFM systems. Of this, domestic revenues accounted for only 35 percent with the remainder being financed by donors. The operating budget is composed mostly of wages and salaries (74 percent), of which security accounts for two-thirds. (**Figure Nine**).

**The disbursement of the development budget has flattened out over last three years.** A closer look at development expenditures shows these have increased in absolute terms, but remained at roughly the same level and slightly above US\$900 million for the past three years. This marks a low and declining trend in budget-execution rates since FY2007/08 because the size of the development budget has significantly increased over this period. The lower development budget execution this year reflected the expected closing of the National Solidarity Program (NSP) II and the gearing up of the new NSP III at MRRD [Ministry of Rural Rehabilitation and Development]; a program that accounts for 17% of the total core on-budget expenditures.

**Structural and capacity constraints explain the low budget-execution rates.** Several reasons explain the drop in execution rates: (1) Authorities have little discretion over two-thirds of the development budget because it is linked directly with project-tied donor funding and pledges. Thus, the lack of predictability in donor financing makes planning difficult and delays in donor disbursement result in slower execution; (2) A few projects account for a large share of total development expenditures, so their implementation cycles determine the overall volatility of the budget execution numbers.

The low development-budget execution ratio is also a reflection of unrealistic budget formulation by line ministries and donors, who often plan for larger amounts than they can disburse, to avoid breaks in implementation. In addition, weaknesses in the current system of allocating funds from the center to the provinces & districts take a toll and slow project implementation at the local level; and (4) The limited capacity, in terms of adequate planning, financial management, procurement and project management technical expertise within line ministries, has become a major bottleneck for the delivery of programs. However, given the before-mentioned structural weaknesses the budget execution rate is not a very adequate predictor for absorption capacity of the Government.

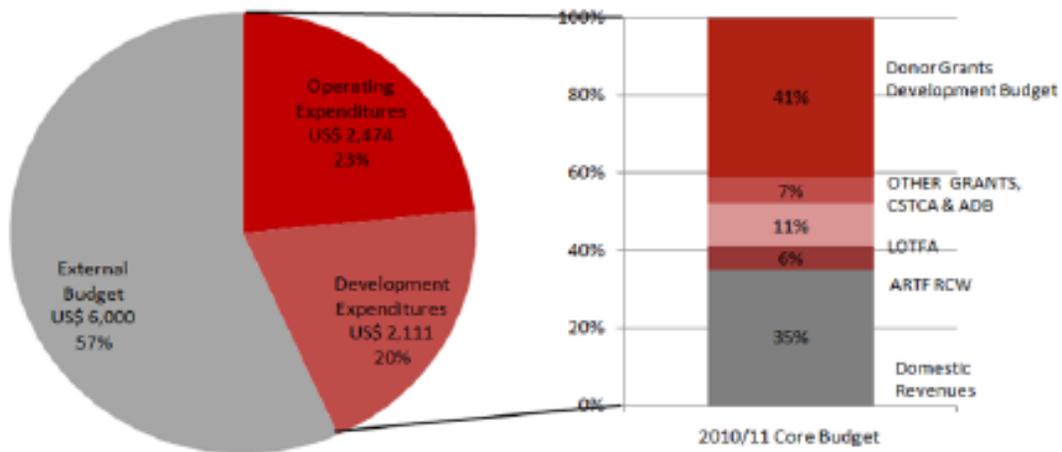
The size of future aid and revenues also has a major security impact. In early 2011, the US and ISAF were planning on spending some \$7-9 billion a year after Transition in 2014 on the ANSF for a force of over 300,000 through 2020 – with most of the financing coming from the US. As of April 2012, the US was talking about a total of \$4.1 billion a year for a force of 230,000, with only 25% to come from the US, 50% from other donors, and 25% from the Afghan government.

This may be a more credible and sustainable figure, but it presents a real risk that Afghanistan cannot sustain the forces it needs and will see large numbers of young men with arms and military/police experience thrust back on an economy that cannot give them anything like the same job opportunities or income. This impact will be

compounded by the fact that the funding and support for the Afghan Local Police, and the new force of security guards called the Afghan Public Protection Force (APPF) may also lose funding.

Furthermore, while no credible data exist on actual expenditure in high-risk or combat areas, the data on the allocation of money for aid projects show that high-risk or combat areas – as well as politically sensitive areas – have gotten much of the aid in the past. This is illustrated in the US aid spending data in **Figure Eleven**. As a result, other funding cuts will take place in high-risk areas versus the country as whole, compounding the strain on Afghan revenues.

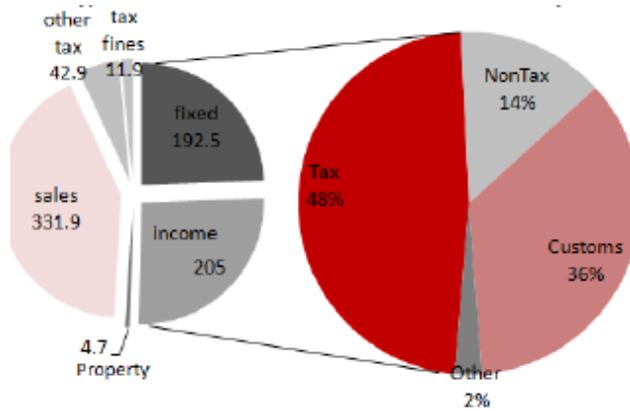
*Figure Nine: World Bank Estimate of Afghan Sources of Total Foreign and Domestic Spending: 2010-2011 (\$US Millions)*



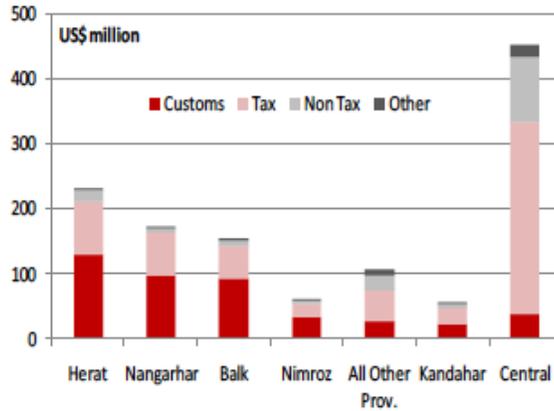
Source: World Bank, **Afghanistan, Economic Update, May 2011**, pp. 7-8

*Figure Ten: World Bank Estimate of Afghan Sources of Domestic Revenue: 2011-2012*

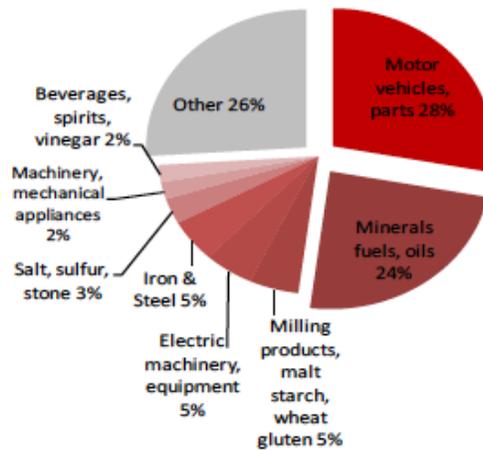
**Afghan Sources of Revenue: 2010/2011**



**Total Revenue by Province: 2010/2011**

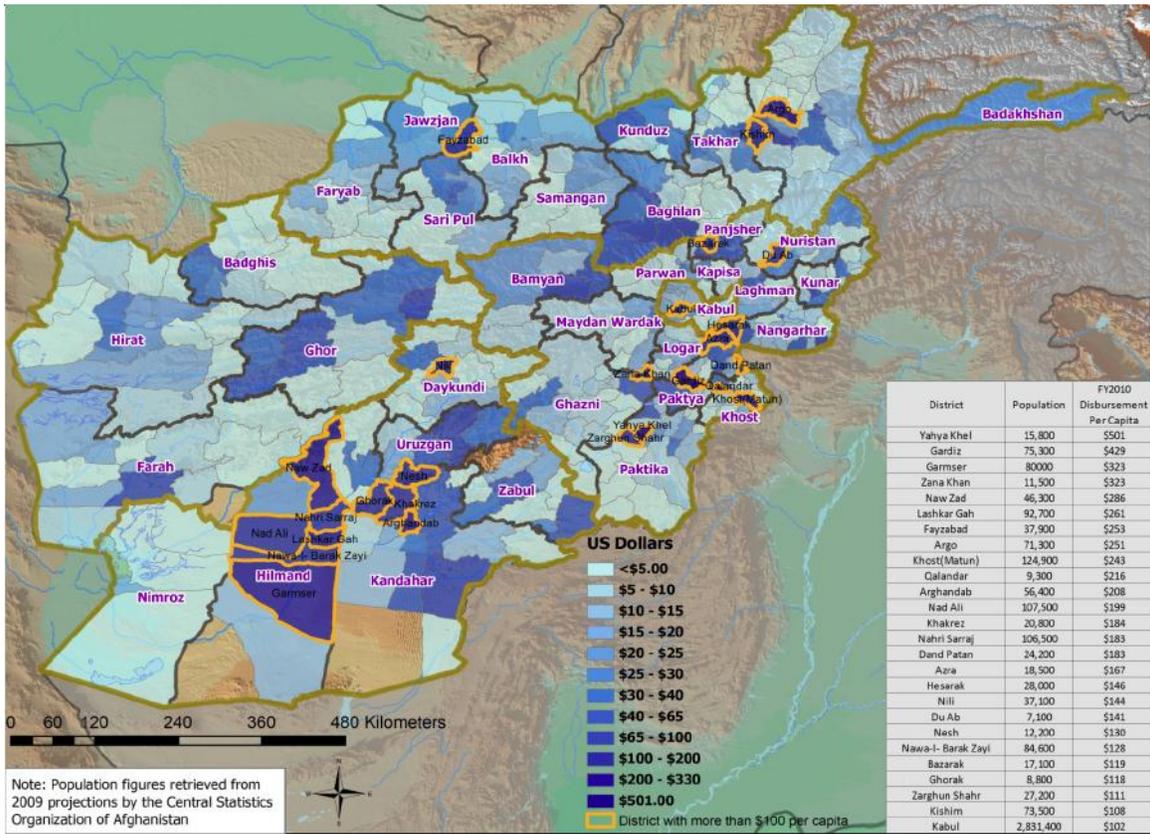


**Customs Revenue: 2010/2011**



Source: World Bank, *Afghanistan, Economic Update*, May 2011, pp. 7-8

Figure Eleven: USAID Disbursements Per Capita, 2010



Source: Adapted from USAID, US Aid to Afghanistan and Pakistan at a Glance, 2010, p. 5.

Note that data on population are taken from CSO estimate dating to 2009, and spending data are based on the cost of the program or project, not actual spending in the area shown.

## *Afghan Investment and Future Sources of Revenue*

The problems inherent in the New Silk Road are discussed later in this analysis, but it is important to stress that all of the same problems occur in in trying to estimate domestic investment levels as occur in other aspects of Afghan economic data. This is particularly true when the analysis shows a consistent rise in investment over time, and the analysis implies that these are self-generating and self-sustainable trends and not the reflection of the indirect effects of massive outside spending.

Here again, the World Bank does provide a useful warning. As does its analysis in **Figure Eleven**, which shows that Afghanistan often ranks last in providing the peacetime conditions for investment (and new government revenue generation) in a region notoriously bad in creating an environment conducive to outside and market-driven domestic investment:<sup>13</sup>

**Doing Business in Afghanistan is more difficult than in other South Asian countries.** The World Bank's Doing Business Index 2011 ranked Afghanistan lowest in the region and 167th out of 183 countries surveyed. Afghan businesses are restrained by red tape, lack of policy predictability, and corruption. Its regulatory framework is relatively well ranked on two indicators – Starting a Business (25th) and Paying Taxes (53th). However, it is ranked last (183th) for three indicators, on Protecting Investors, Trading Across Borders and Closing a Business (see table below). In order to address and enhance Afghanistan's ranking in the Doing Business Report, the Ministry of Commerce and Industries launched an initiative in December 2010 aimed to make improvements across five Doing Business areas.

**The financial sector developments were dominated by the Kabul Bank crisis.** Kabul Bank was the first private bank established in Afghanistan, post-2001, and had become the country's largest financial institution. Its near-collapse triggered fears of financial instability, as it held one-third of all country deposits and nearly 57 percent of total reported loans in 2009. Moreover, the bank transfers the salaries of over 220,000 civil servants including those in rural areas where no other financial institution is present. In September 2010, its top two executives were forced to resign under allegations of insider-lending and fraudulent activities. This triggered a bank run that resulted in the withdrawal of half of its deposit base over the course of one week, depleting Kabul Bank's liquid assets, and forcing DAB [Da Afghanistan Bank] to provide a substantial lender-of-last-resort facility to meet customer withdrawals and avoid a collapse. According to estimates, the fraudulent loan activities amounted [to] US\$850 million, or 94 percent of the bank's reported loan portfolio.

**The events at Kabul Bank have highlighted the potential fragility of the financial sector and the limited capacity of the Central Bank to effectively supervise the banking sector and enforce regulations.** To stem the crisis, DAB responded by providing appropriate liquidity, banknotes and logistical support, and placed a conservator at Kabul Bank (thereby suspending shareholders' rights), while announcing a guarantee on all deposits. Currently, the bank continues to operate under restricted conditions.

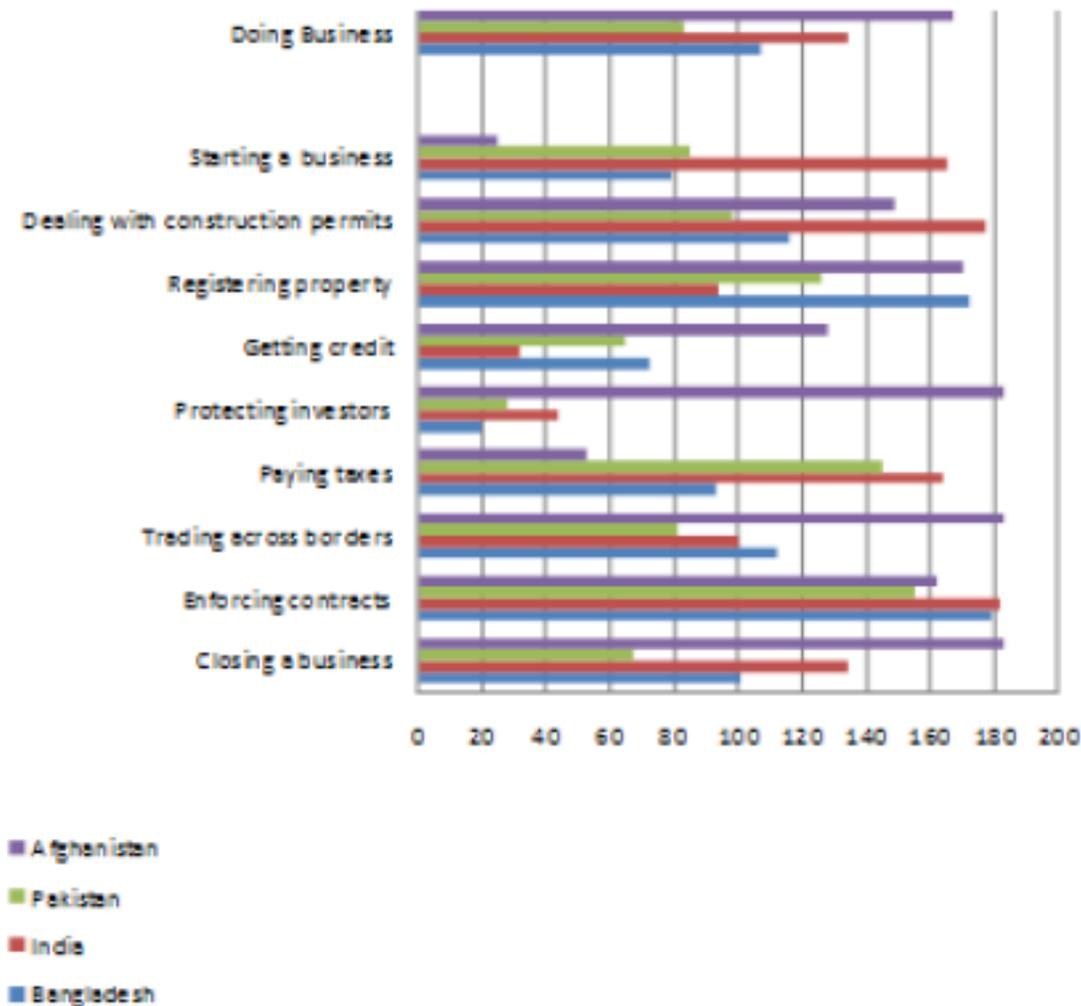
**The resolution of the Kabul Bank crisis has been at the center of discussions between the government of Afghanistan and the international community in the context of a proposed IMF-supported program.** A satisfactory resolution plan is a critical condition for the establishment of an Extended Credit Facility with the IMF. The authorities are expected to finalize a resolution plan for Kabul Bank shortly; meanwhile, the continued uncertainty had negative

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<sup>13</sup> World Bank, *Afghanistan Economic Update*, October 2011, pp. 9-10

implications for the fiscal situation and overall development of the financial sector. Some development partners have indicated that they may not be able to provide additional budgetary resources to the government of Afghanistan if no IMF-supported program is put in place.

*Figure Twelve: World Bank Estimate of Doing Business Indicators 2011, Regional Comparison*



Source: World Bank, Afghanistan Economic Update, October 2011, pp. 9-10

It is also important to note that it is easy to propose reforms to Afghanistan's financial sector in mid-Transition, and quite another to carry them out. The incentives for corruption and capital flight are rising sharply in a country with a long history of unmet pledges for reform precisely at the time when they are needed most.

### **Spend, Not Build (and Then Stop Spending)?**

It should be obvious from the preceding analysis that the economic dimension of Transition planning is critical to any hope of success, and that outside spending and aid will be the key unless some truly miraculous peace settlement Transitions the entire course of the war and the history of Afghanistan. There is a "new great game" being played in other parts of Central Asia, but neither Russia nor China has predictable

incentives to engage in Afghanistan or Pakistan at levels that will ease the problems the US, Europe, and other ISAF and donor states face during Transition. In the real world, the success of Transition will depend on US, European, and other existing countries that already have forces or donate significant aid to Afghanistan.

### ***The Problem of Sustaining Aid Levels***

The success of such US, European, and donor efforts is highly uncertain. As **Figure Thirteen** shows, Transition is coming after aid has already peaked, and at a time far too few aid workers are present in the field. These data only show the figures for USAID, but the US is by far the largest donor.

Moreover, **Figure Thirteen** shows that the US “surge” in aid workers during 2009-2010 was at token levels compared to the roughly 1,800 USAID personnel assigned in Vietnam. The surge was also hindered by the fact that most of the new personnel never really got to the field. Worse, it will be far too temporary. The US Provincial Reconstruction Teams (PRT) and their security are due to leave the field in most areas, and to shrink to five much smaller regional centers no later than the end of 2014. In practice, the entire ISAF PRT system may shrink to a fraction of its current level before then end of 2014.

At the same time, for all the weaknesses in the quality of their data and methodology, studies by the World Bank, and ongoing studies by the IMF, the US, and key European governments are almost certainly correct in showing that that Transition requires massive levels of continuing aid to avoid triggering major security and stability problems.

### ***Unaffordable “Needs” and the Rush for the Exits***

President Karzai requested some \$10 billion a year through 2025 at the Bonn Conference in December 2011, or roughly \$120 billion over the entire period.<sup>14</sup> This total seems minor compared to a total cost of the war to the US and ISAF which reached some \$140 billion in FY2011. It is also almost certainly too low to both cover the cost of funding the ANSF during Transition and beyond, and give Afghanistan the resources to cope with the loss of US and ISAF military spending during 2012-2014 and the probable cuts in donor civil aid.

Many US and European actions have already begun to look like a cover for an exit strategy from Afghanistan. Development aid from US, the largest aid donor, dropped from \$3.5 billion last year to about \$2 billion in 2011. Aid to support democracy, governance and civil society dropped by more than 50%, and from \$231 million to \$93 million. Aid for “rule of law” dropped from \$43 million to \$16 million.<sup>15</sup> Many aid

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<sup>14</sup> Karen DeYoung, *Afghanistan says it will need outside aid until 2025*, Washington Post, December 4, 2011, [http://www.washingtonpost.com/world/asia\\_pacific/afghanistan-says-it-will-need-outside-aid-until-2015/2011/12/04/gIQAZtp6TO\\_print.html](http://www.washingtonpost.com/world/asia_pacific/afghanistan-says-it-will-need-outside-aid-until-2015/2011/12/04/gIQAZtp6TO_print.html).

<sup>15</sup> Julian Borger, *Afghanistan conference promises support after troop withdrawal*, The Guardian, 5 December, 2011, <http://www.guardian.co.uk/world/2011/dec/05/afghanistan-conference-support-troop-withdrawal>.

agencies and NGOs are already making major cuts in their programs, and some are already having to eliminate programs or withdraw from the country.<sup>16</sup>

While US Secretary of State Hillary Clinton joined her European colleagues in pledging continued aid at the Bonn Conference in December 2001, no long-term pledges were made in concrete terms. The conference – which Pakistan did not attend and the Taliban stated would “further ensnare Afghanistan into the flames of occupation”-- focused on vague calls for aid and regional cooperation.

The speeches at the conference also called for Afghan reforms, and reductions in corruption, in ways that implied new conditions for aid that Afghanistan may well not be able to meet. It discussed continuing past security and economic aid, but did not deal with the massive impact of ending US and European military spending in Afghanistan as each ISAF country’s forces departs – spending which totaled \$4.3 billion for US military direct contracts with Afghans in FY2011 – which was only a small portion of US military spending in the country.<sup>17</sup> At the same time, President Karzai called for continued aid and promised vague reforms without any clear plan for using such aid or justifying his request. As Louise Hancock, Oxfam's Afghanistan policy officer, put it, “It’s been another conference of flowery speeches: big on rhetoric and short on substance.”<sup>18</sup>

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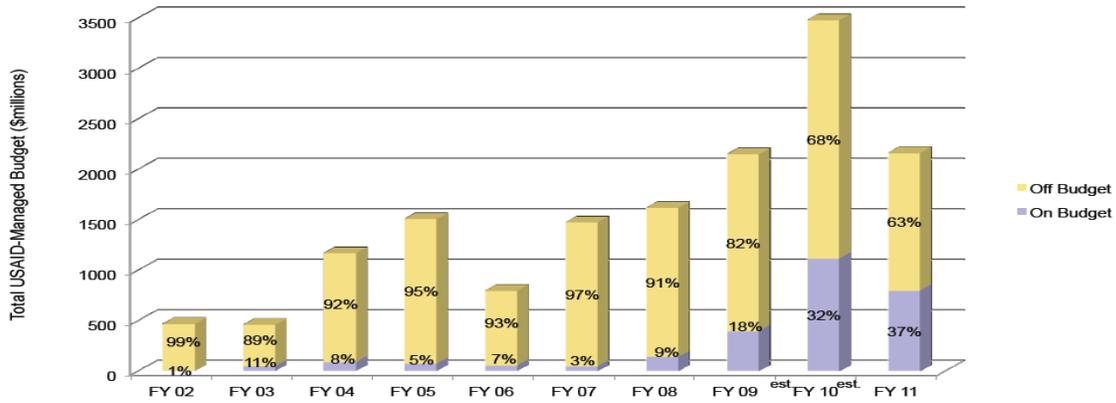
<sup>16</sup> Julian Borger, *Afghanistan conference promises support after troop withdrawal*, The Guardian, 5 December, 2011, <http://www.guardian.co.uk/world/2011/dec/05/afghanistan-conference-support-troop-withdrawal>; Rod Norland, *Aid Agencies in Afghanistan Fear Reversals* New York Times, December 6, 2011, p. A1; Steven Lee Myers and Rod Norland, *Afghans Say Assistance Will Be Needed for Years*, New York Times, December 6, 2011. P. A14.

<sup>17</sup> Julian Borger, *Afghanistan conference promises support after troop withdrawal*, The Guardian, 5 December, 2011, <http://www.guardian.co.uk/world/2011/dec/05/afghanistan-conference-support-troop-withdrawal>; UN Secretary-General's statement to Conference on Afghanistan in Bonn, <http://unama.unmissions.org/Default.aspx?tabid=1741&ctl=Details&mid=1882&ItemID=15874>; Rod Norland, *Aid Agencies in Afghanistan Fear Reversals* New York Times, December 6, 2011, p. A1; AFP/Reuters, Bonn conference: Afghanistan assured conditional aid for another decade, December 5, 2011, <http://tribune.com.pk/story/302502/bonn-conference-us-lifts-hold-on-development-funds-for-afghanistan/>,

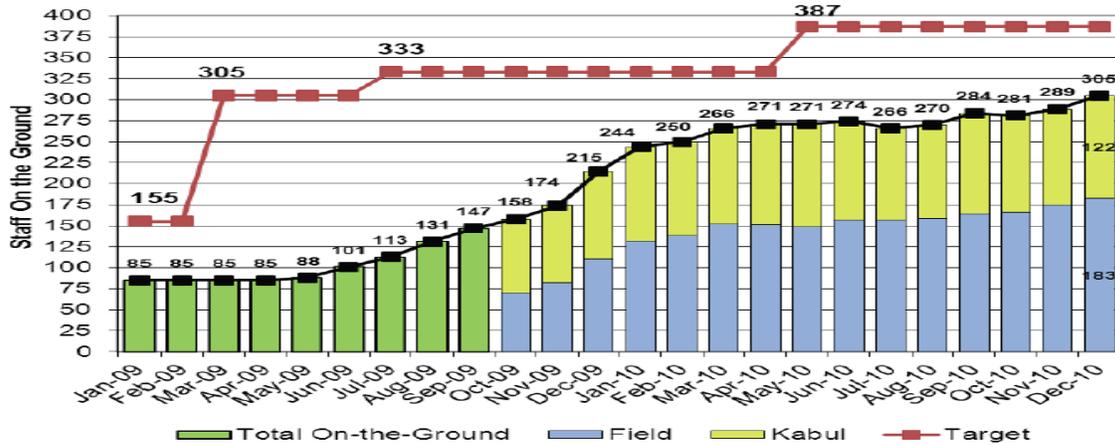
<sup>18</sup> <http://www.oxfam.org/en/pressroom/reactions/oxfams-reaction-2011-bonn-conference-afghanistan>.

**Figure Thirteen: The Slow and Limited Surge of USAID**

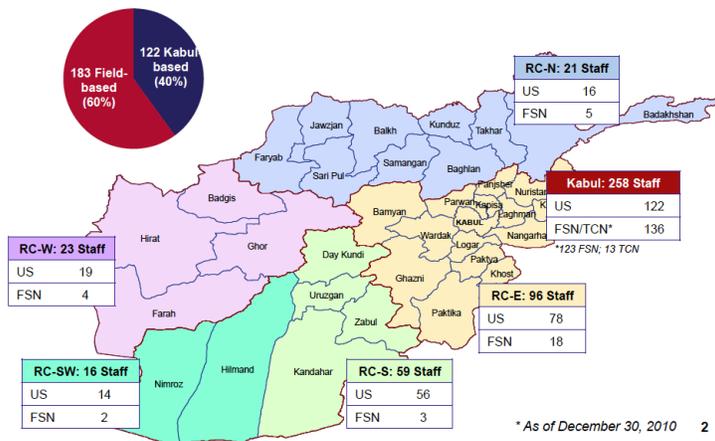
USAID program funds of \$3.4 billion in FY 2010 and \$2.1 billion in FY 2011.



**History of USAID Staffing in Afghanistan**



Location of USAID U.S. Employees



Source: Adapted from USAID, US Aid to Afghanistan and Pakistan at a Glance, 2010, pp. 1-3.

### ***Building on a Weak Foundation***

The problem since 2001 has been that a US, Allied, and UN effort with little or no real world capacity for nation building on the scale required failed to help the Afghans restore an Afghan government on Afghan terms. A fragmented international effort with no effective UN coordination instead attempted a sudden, comprehensive transformation of Afghanistan into a unitary state with a flawed, over-centralized constitution and system of government that was to operate according to US/Western values of representative democracy, human rights, and rule of law.

This effort ignored the realities of Pakistani and regional competition and interests. It attempted to conduct “national transformation,” rather than “nation building,” on the cheap by dividing much of the task among its allies, delegating key responsibilities for them to fund, and setting impossible goals for near and mid-term economic development. Finally, it ignored the real world consequences, the failures in the US and international effort, the failures in Afghan governance, and how serious the rebirth of the Taliban and other insurgent movements were during 2003-2008.

### **Unready to Move Forward After a Decade of Experience**

Unfortunately, far too many elements of this exercise in strategic hubris still affect the civil effort in Afghanistan. Donor governments and UNAMA are all fond of claiming civil progress using factoids taken out of the context of Afghan perceptions and needs, and drawn from sources of uncertain credibility. They report spending as if the amount of money was a measure of effectiveness, and rarely make an attempt to tie such spending to its effectiveness.

### ***A Crippling Afghan Dependence on Outside Spending***

As noted earlier, there is no way to know how much US, Europe, and donor military and aid spending actually occurs in Afghanistan and stays there. Groups like Oxfam indicate that more than 40% of the aid target towards Afghanistan is not actually spent in country as aid. A different World Bank study conducted in November 2011 produced different results from the one shown earlier, and found that some \$15.7 billion worth of aid went to Afghanistan in 2010/2011, and \$13.8 billion was spent outside the Afghan national budget. It also estimated that only 10-15% of \$8.6 billion of this in external security aid and 20-25% of \$5.2 billion in civilian aid actually was spent in country.

**Figure Fourteen** shows a still more recent working estimate of total Afghan dependence on outside spending dating back to the spring of 2011. **Figure Fifteen** shows the level of dependence estimated somewhat earlier by the US General Accountability Office (GAO). As usual, there is only a limited correlation between estimates – even within the same organization – but the challenges involved are all too clear.

A World Bank study that did not attempt to estimate the impact of military spending as well as aid, estimated that the total Afghan national core budget was \$3.8 billion, of which \$1.9 billion was also aid. It estimated that 90-95% of the security aid actually

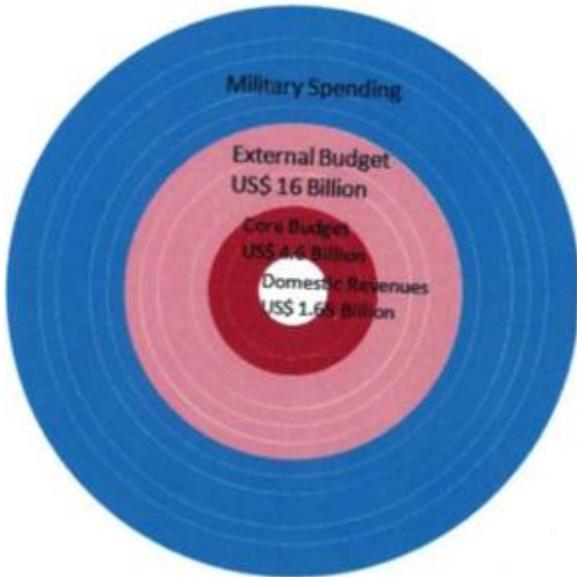
reached Afghanistan but substantially less than 70% of the civil aid. The study stated that the,<sup>19</sup>

...cumulative US spending for the Afghanistan mission is estimated to be as high as \$444 billion (\$118.6 billion in FY2011 alone)...But most of that spending does not reach Afghanistan because it primarily funds salaries of international soldiers, purchases of military hardware, and the like...And not even all aid spent “in” Afghanistan feeds into the domestic economy, as it goes out in imports of goods and services, expatriated profits, and remittances.

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<sup>19</sup> World Bank, *TRANSITION IN AFGHANISTAN LOOKING BEYOND 2014*, November 21, 2011, pp. 6-7.

**Figure Fourteen: World Bank Estimate of The Crippling Dependence of Afghanistan on Outside Funding**



- Domestic revenue collection reached US \$1.65 billion in 2010-2011 (doubled since 2007/2008) as a result of a significant effort by the Ministry of Finance (MoF) – although much came indirectly from outside spending
- The Core Budget (Domestic revenue + budget donor aid) was US \$4.6 billion
- While the MoF estimated that donor financed budget expenditures were US \$8 billion, the World Bank indicates they could be as high as \$16 billion)
- Total International military spending in Afghanistan is unknown, but could be many times greater than domestic revenue. Most such spending is spent largely outside Afghanistan, but is so large that even the part spent in Afghanistan is a major source of growth

•Over past 3 years, domestic revenues grew on average 20% per annum on back of significant MoF effort in customs reform and tax administration.

•During same period, operating expenditures grew by 27% per annum as a result of:

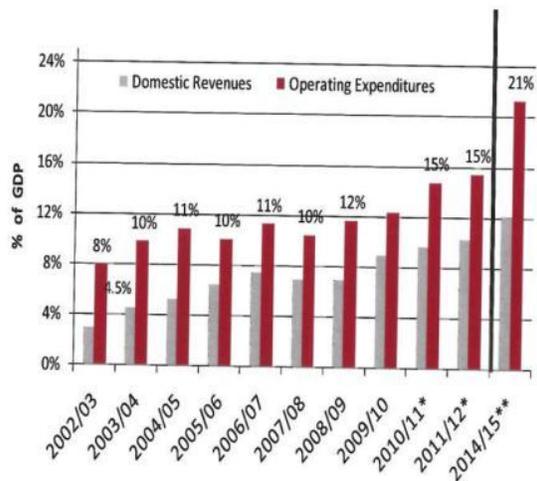
- Hiring of teachers
- Security expenditures (Police & ANA, which will require external financing beyond 2015)
- Pay & Grading reform in line ministries

•Fiscal Sustainability in Afghan context would mean domestic revenues in 2014/15 should cover non-security operating expenditures + small portion of security costs. This requires mining revenues coming on line. (Presumption is that balance of extraordinary security costs are an externality and need to be financed by international community beyond 2014.)

•Financing Operations & Maintenance (O&M) a huge challenge:

- O&M already severely underfunded.
- Requires good system of budget transfer from central government to provinces/districts.
- Past and ongoing creation of assets off-budget by donor aid and PRTs poses unknown recurrent liabilities on Government.

**Core Operating Budget\***

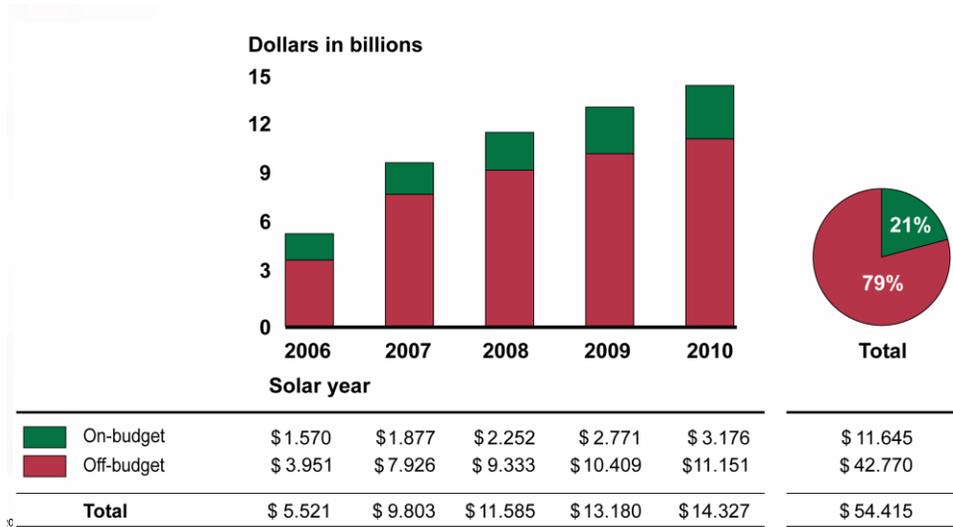


Source: MOF, WB calculations

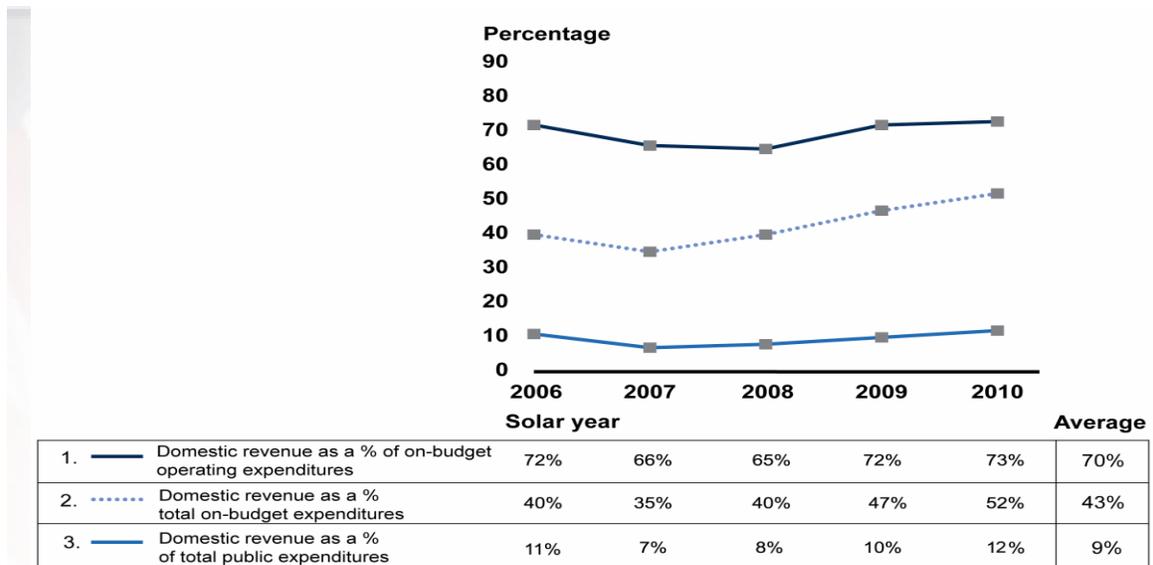
Source: World Bank, March 14, 2011

*Figure Fifteen, Part One: GAO Estimate of The Crippling Dependence of Afghanistan on Outside Funding*

**79% Dependence of Public Expenditures on Off Budget Sources**



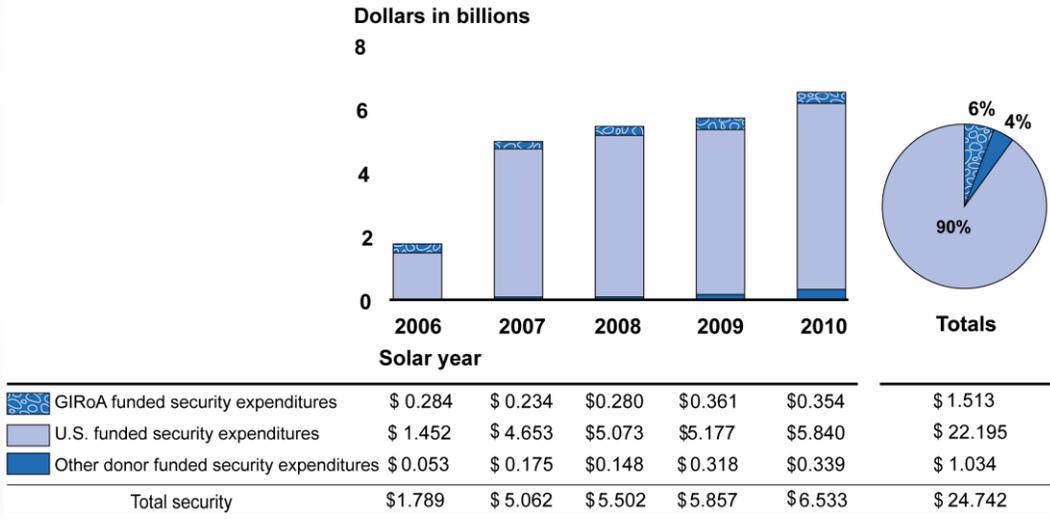
**Afghan Revenue as a Share of Expenditures**



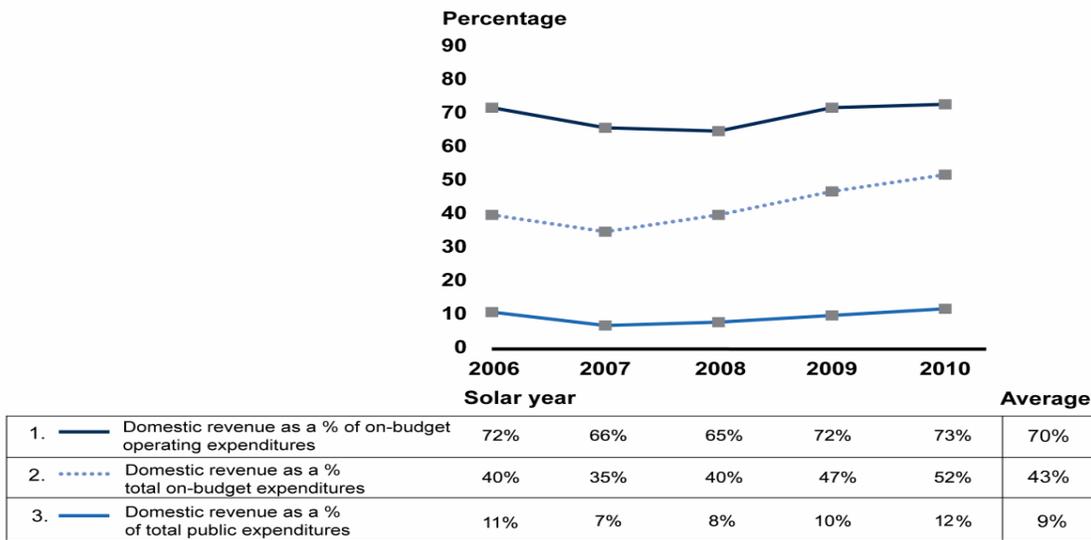
Source: GAO, Afghanistan’s Donor Dependence, September 21, 2011, pp. 5, 8, 9, 18.

*Figure Fifteen, Part Two: GAO Estimate of The Crippling Dependence of Afghanistan on Outside Funding*

**Dependence on US for 90% of Past Security Expenditures: Other donors have funded 4%; GIROA has only funded 6%**



**Dependence on US for 39% of Past Security Expenditures: Other donors have funded 47%; GIROA has only funded 14%**



Source: GAO, Afghanistan’s Donor Dependence, September 21, 2011, pp. 13-14<sup>20</sup>

## Wasting Past Aid and a Highly Uncertain Future

Once again, it needs to be stressed that it is now the eleventh year of the war and the UN, the US State Department and USAID, other donor nations, the World Bank, and the Afghan government have never published a meaningful assessment of the total flow of aid to Afghanistan, the overall impact of the civil and security aid programs, an assessment of how aid and outside spending have impacted on the trends in the Afghan economy, and how to develop credible measures of the effectiveness aid efforts.

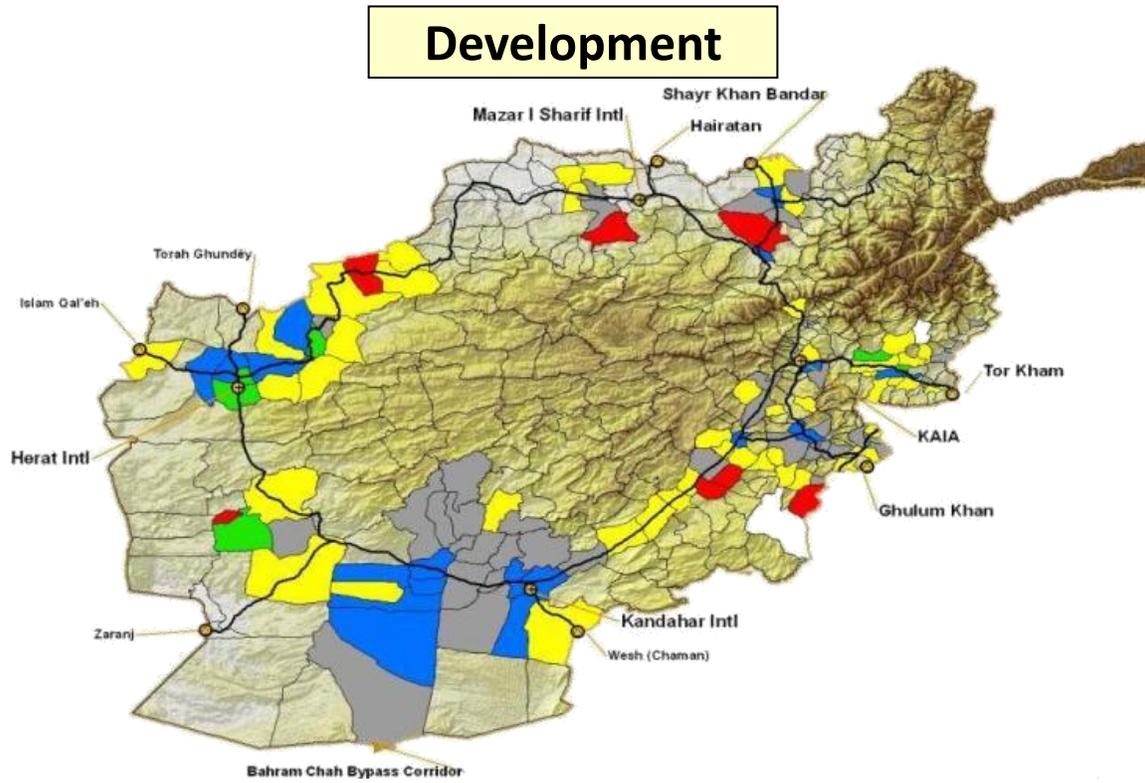
The US SIGAR does make some assessments of US effectiveness. Unlike its Iraqi counterpart (SIGIR), however, SIGAR focuses almost exclusively on US spending and makes little effort to validate plans and requirements for civil and security aid efforts versus traditional audits which can do little more than document past failures.

**Figures Six through Eight** have already shown just how massively the flow of aid increased in recent years – increasing Afghan dependence and the problems in Transition along with each year's increase. These data – *which only cover US spending* – provide a grim warning of the sheer scale of the spending, the erratic funding patterns that have taken place in the past, and how drastic the impact could be of sudden funding cuts for the ANSF and civil sector before Afghanistan can adapt to the loss of donor aid. This loss can be some nine to 14 times its current revenue earnings, and spending on military operations in inside Afghanistan which is at least another 20 to 30 times the revenue earnings of the Afghan government.

Moreover, while ISAF has stopped reporting progress in development by Afghan district, **Figure Sixteen** shows that past trends were anything but reassuring. UN reporting also indicates that security for both aid activity and Afghan governance is still lacking in many of Afghanistan's 403 districts, and the aid reporting that does come from individual districts is often based on the success of limited projects in a small part of the district or city – grossly exaggerating the impact of aid.

It is far from clear how the withdrawal of US and ISAF forces and aid teams in the field will impact security in many Pashtun and border areas, as well as key urban complexes and lines of communication like the ring road. Many current development models tacitly assume that Afghanistan will be secure on a nationwide basis by the end of 2014, that the impact of criminal networks and power brokers will not place critical limits on governance and development, and that Pakistan will be a willing and secure economic partner.

Figure Sixteen: Little or No Progress in Development in Many Areas



04-Feb-10	29-A	10	Development Assessment
6		7	Sustainable Growth
16		9	Dependent Growth
47		5	Minimal Growth
40		41	Stalled Growth
10		7	Population at Risk
3		2	Not Assessed

## **Current Problems in the Political, Governance, Security and Economic Aspects of the Build Effort**

The challenges to the US and Europe go beyond providing aid. They involve major problems in security, in Afghan governance and society, and in structuring and funding effective Afghan national security forces to replace US and allied forces.

The DoD October 2011 report on progress in the war describes a wide range of ongoing aid efforts (as well as presents the tenth annual set of new concepts and future good intentions for reshaping future aid on the part of State and USAID.)

**Figure Seventeen** shows that the DoD and ISAF reports that the Afghan government is expanding its capacity at the Provincial and District levels in some areas, although others are less capable and the overall rate of progress is far too slow to guarantee a successful Transition.

At the same time, passages throughout the DoD report warn how many aspects of the “build” effort are already in trouble, that reaching enough progress for a stable Transition by 2014 is unlikely, and that future outside aid will have to be carefully targeted and limited to Afghanistan’s ability to absorb aid effectively on its own terms if it is to be more successful:

...four conditions are evaluated when considering an area’s eligibility to begin the Transition process. First, the security environment must be at a level that allows the population to pursue routine daily activities. Second, the ANSF must be capable of shouldering additional security tasks with less assistance from ISAF. Third, local governance must be sufficiently developed so that security will not be undermined as ISAF assistance is reduced. Finally, ISAF must be postured properly to thin out as ANSF capabilities increase and threat levels stabilize or diminish.

Once an area enters the Transition implementation process, NATO and ISAF support continues through four stages, ranging from support to strategic overwatch. The security of the Afghan people and the stability of the government will be used to judge the readiness of the province to move to each successive stage of Transition implementation. Although a province can enter Transition implementation as soon as any part of its area is eligible, the province will not exit Transition until all its areas meet the required criteria.

...governance and development capacity remain the most challenging aspects of Transition. The first tranche of provinces and municipalities to Transition has been slow to develop the necessary service delivery and governance structures to underpin security gains, yet arguably these are the most difficult capacities to develop and grow. Efforts by the Department of State, U.S. Agency for International Development, and PRTs are focusing on the development and expansion of Afghan capacity in governance, rule of law, and service delivery, as well as linkages between national and sub-national governance structures. The development of these sectors will reinforce long-term stability and ensure that Transition is irreversible, as well as encourage the Afghan people to rely on the Afghan Government, rather than Taliban shadow governments, for necessary services.

...the capacity of the Afghan Government has been limited by a number of issues, including the political dispute in the Lower House of the Afghan Parliament, the continued absence of an International Monetary Fund program, widespread corruption, and the lack of political progress in enacting key reforms announced at the July 2010 Kabul Conference. Setbacks in governance and development continue to slow the reinforcement of security gains and threaten the legitimacy and long-term viability of the Afghan Government. The United States and the international community continue to work closely with their Afghan partners to address these challenges.

...During the reporting period, the Afghan Government made only limited progress in building the human and institutional capacity necessary for sustainable government. The most notable

developments were efforts to build the human capacity necessary to extend governance throughout the country; merit-based appointments of senior civil servants continued, and a civil service recruiting campaign, focused on less-secure provinces, maintained momentum. However, the extension of effective governance in Afghanistan continues to face significant challenges, including: difficulty linking sub-national governance structures to the central government, the continued lack of an International Monetary Fund (IMF) program, minimal progress on Kabul Conference commitments, widespread corruption, and delays in the legislative process resulting from the September 2010 *Wolesi Jirga* elections.

...the capacity of provincial governors' offices and provincial line departments remains fairly low and largely dependent on contractors. This is due in part to difficulties of recruiting qualified individuals and a lack of resources for a basic operating budget for maintenance and repairs. Another challenge facing the continued development of sub-national governance capacity is the difficulty of linking provincial planning exercises into the national budgeting cycle. Provincial governors and provincial line departments all have limited roles in the process due to the highly centralized system of governance in which they have limited service delivery and budget execution authority. This centralized system adversely affects the provincial governor's ability to lead provincial line departments, since their reporting chain is through the central ministries.

...Despite effective programs and signs of progress, several challenges persist that limit recruiting and retention of qualified civil servants. Standardized pay scales are low in comparison to the technical assistant salaries offered by donors, and heightened threats and targeting of government officials also hamper recruiting efforts. Public administration reforms and capacity-building programs are essential for the development of sufficient human and institutional capacity to deliver governance and basic services to the Afghan people.

...Overall, there continues to be little progress in the development of Afghanistan's justice sector. Plans to expand the justice sector to underserved areas, particularly in the Pashtun regions of Afghanistan, are ongoing, but have yet to yield results, and the fraud allegations of the 2010 Parliamentary elections stopped progress on necessary legal reforms for several months. Furthermore, the capacity of the justice sector continues to be limited by a lack of infrastructure and the inability to offer salaries sufficient enough to attract and retain trained legal personnel.

Corruption and organized crime present a significant threat to the success of the ISAF mission and the security and stability of the Afghan state. Corruption undermines the effectiveness, cohesion, and legitimacy of the Afghan Government; it alienates elements of the population and generates popular discontent from which insurgent groups draw strength; it deters investment, encourages the diversion of international assistance, and impedes licit economic growth; it enables criminal networks to influence important state institutions and functions; and it facilitates the narcotics trade and other transnational threats emerging from Afghanistan. Counter-corruption efforts are essential to strengthening Afghan institutions and to consolidating gains in the wake of improved security, and will grow in importance as the process of Transition continues.

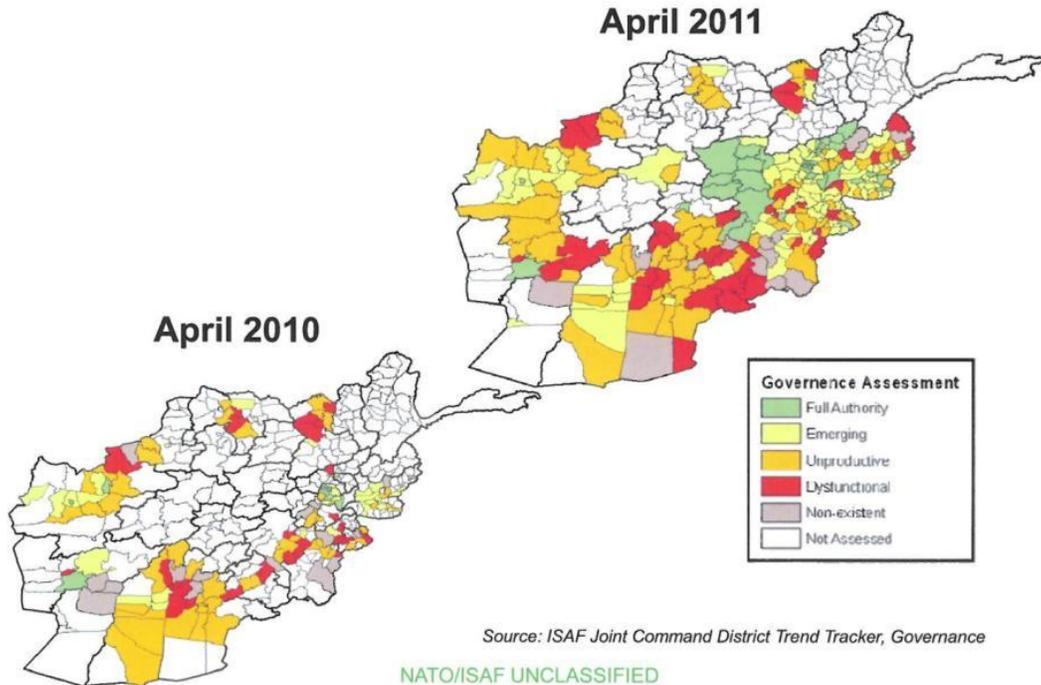
The limited capacity of the Afghan Government continues to impede reconstruction and development efforts in Afghanistan. The availability of essential services remains mixed, and the government has yet to develop a comprehensive economic growth strategy or plan for private sector-led economic development.

Beyond security concerns, governance and development capacity remain the most challenging aspects of Transition. The first tranche of provinces and municipalities to Transition has been slow to develop the necessary service delivery and governance structures to underpin security gains, yet arguably these are the most difficult capacities to develop and grow. Efforts by the Department of State, U.S. Agency for International Development, and PRTs are focusing on the development and expansion of Afghan capacity in governance, rule of law, and service delivery, as well as linkages between national and sub-national governance structures. The development of these sectors will reinforce long-term stability and ensure that Transition is irreversible, as well as encourage the Afghan people to rely on the Afghan Government, rather than Taliban shadow governments, for necessary services.

Many of these assessments track closely with the reporting that is provided in the SIGAR Quarterly Report for October 30, 2011, and in conversations with UNAMA personnel and aid experts from other countries. They also track with the many NGO and international estimates of the ongoing impact of corruption, power brokers, criminal networks and lack of supervision by donors and ISAF military forces over how contract and aid money are used.

SIGAR reporting also describes progress and plans for new activity, but it also provides a summary warning of the lack of adequate progress to date. (pp. 86-87) It also notes that, As of September 18, 2011, only 60% of civil servant positions were filled in the 14 most insecure provinces, according to USAID. Southern and eastern provinces faced the most difficulties in staffing, as shown in **Figure Eighteen**. This is an improvement from April 2011, when 50% of positions were filled. Lack of security and candidates' lack of experience and education continued to pose challenges in filling local positions.”

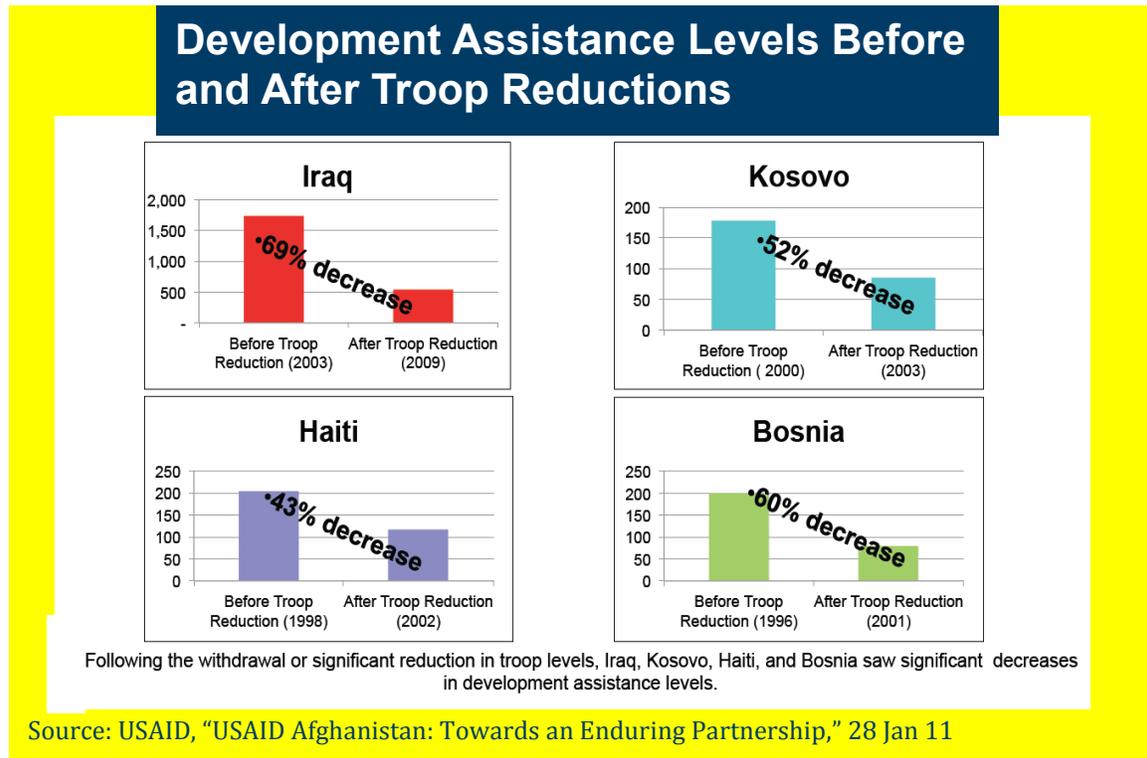
*Figure Seventeen: Uncertain Progress in District Governance: 2010-2011*



Source: ISAF 5/2011



*Figure Nineteen: Post Crisis Aid - Killing the Golden Goose As Soon as Possible*



A November 2011 World Bank study of future Afghan funding and aid needs provides the same warnings:<sup>21</sup>

- Abrupt aid cut-offs lead to fiscal implosion, loss of control over security sector, collapse of political authority, and possibly civil war (Somalia)
- Political stability and state consolidation (based on building "inclusive enough" coalitions) are critical for successful transitions (Mozambique, Rwanda, Cambodia, Mali)
- Fragmented, short-term oriented factionalism, "political marketplace" (Sudan) can lead to endemic high levels of violence, and regional "spoilers" can perpetuate conflicts (Democratic Republic of Congo)
- Effective transitions are generally associated with robust economic growth (for example, Mozambique, Rwanda) – less successful transitions with slower or negative economic growth
- These lessons indicate the importance of a well-managed transition and highlight the sense of urgency

### **Trying to Make Aid Work as PRTs are Eliminated and With Inadequate US, European, Donor, and UN Structures**

The aid effort and the ability to conduct joint civil-military efforts in the field seem likely to be a major casualty of Transition. The "civilian surge" that was supposed to be part of

<sup>21</sup> World Bank, *TRANSITION IN AFGHANISTAN LOOKING BEYOND 2014*, November 21, 2011, p. 24

the new US strategy has lagged, had uncertain organization and quality, and already faces funding cuts in FY2012. As has been touched upon earlier, an October 30, 2011 report by the US Department of Defense notes that major cuts are already planned in key aspects of the civil effort like the PRTs:

Provincial Reconstruction Teams (PRTs) led by coalition partners have made a significant contribution to Afghanistan's peace and stability. However, the beginning of the Transition process and the Afghan Government's assumption of its full responsibilities country-wide requires the evolution and ultimate dissolution of these entities. In June 2011, PRT-contributing nations reaffirmed that as a part of the Transition process, and in recognition of Afghan concerns regarding parallel structures, PRTs would evolve and phase out based on a set of six guidelines, which include:

1. Evolve, reinvest, and phase out. By the end of their province's Transition period, PRTs will methodically hand-off their functions and phase out. Each PRT's evolution plan will depend on Afghan priorities, the unique circumstances in its province, and the PRT's capabilities and structure.
2. Incentivize Transition. PRTs should support governance and development efforts that promote the Transition's sustainability.
3. Set the conditions to make Transition irreversible. PRTs should focus on supporting and building capacity.
4. Shift to technical assistance, build capacity, and improve national and sub-national linkages.
5. Network and reach back. PRT nations should exchange information and share expertise amongst one another to meet needs in Afghanistan.<sup>22</sup>

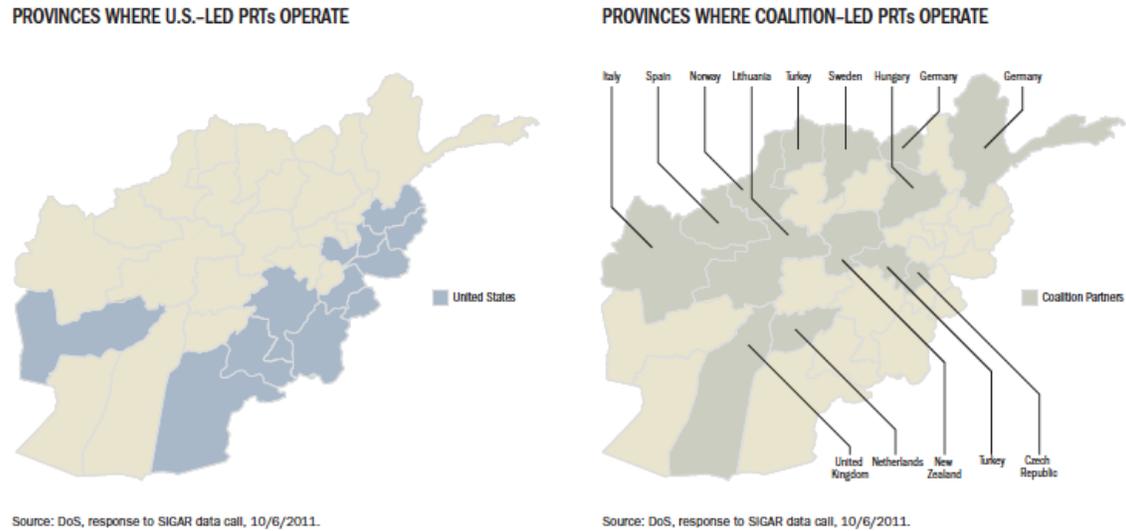
SIGAR reports that the entire PRT effort may phase out before 2014 – which is a date long before the Afghan government will have the capacity it needs in the field:

Early in 2011, President Karzai said that PRTs must be dismantled as the Afghan government takes over responsibility for the country in the Transition process...As of September 30, 2011, DoS was reviewing the composition of the U.S. civilian presence, and no decision had been made on the disposition of PRTs. The review was conducted to ensure that the U.S. presence reflects the U.S. goals and mission and aligns with the two nations' strategic partnership. U.S.-led PRTs operate in 12 provinces, most of them in the east and south of the country, as shown in **Figure Twenty**; 12 coalition partners lead the other 14 PRTs. DoS noted that PRTs and DSTs focus primarily on building government capacity.<sup>23</sup>

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<sup>22</sup> Department of Defense, *Report on Progress Towards Security and Stability in Afghanistan*, October 30, 2011, p. 56.

<sup>23</sup> SIGAR, Quarterly Report to US Congress, October 30, 2011, pp. 87-88

*Figure Twenty: The Fading Role of PRTs in Aid Activity in the Field*

Source: SIGAR, Quarterly Report to US Congress, October 30, 2011, p. 88.

## Trying to Rely on the Afghan Central Government

The withdrawal of US and ISAF forces, and aid teams in the field, also highlights the problems in trying to carry Transition by funneling aid through a corrupt central government with limited capability to spend its budget, much less develop effective programs, implement them without massive waste and corruption, control contractors, and measure the effectiveness of the project as distinguished from how much money has been spent on it.

It is far from clear that the Afghan government will have the combination of capacity and integrity it needs before some point well beyond 2020, if at any time in the near and mid-term. Its current level of corruption is legion, it lacks capacity at every level, its planning and spending efforts are grossly over-centralized, and its provincial and district governments often have only tenuous capacity to absorb and use money effectively.

### *Corruption, Capital Flight, and Power Brokers*

Corruption is a crippling problem that affects both every aspect of Transition, and the ability of the Afghan government to win popular support as outside forces and money leave. Transparency International ranked Afghanistan 180th in a 2011 survey of four different estimates of international corruption -- where the worst country ranked 183<sup>rd</sup>. (Pakistan was marginally better: It ranked 134th).<sup>24</sup> The Konrad Adenauer Stiftung and

<sup>24</sup> [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2011/results](http://www.transparency.org/policy_research/surveys_indices/cpi/2011/results).

the Royal United Services Institute (RUSI), it issued the following warning in May 2011:<sup>25</sup>

Many major international organizations have been witnessing and helping shape the Transition to Afghan Leadership since 2009, when President Obama announced a new strategy for Afghanistan. Konrad Adenauer Stiftung, the Royal United Services Institute (RUSI), and the Defense and Security Programme at Transparency International UK believe the Afghan Transition can be successful. After a round of seminars with over sixty experts and officials from the Governments of Afghanistan, the UK, Germany, NATO, the UN, and other experts on governance and development, they put together the 28 detailed recommendations in the **report *Afghanistan in Transition: Re-Shaping Priorities for 2015 and Beyond***, which will be launched on May 13th in Berlin.

Besides other important issues, the report makes 3 key recommendations regarding corruption which are interlinked:

- First, corruption threatens the success of the international Mission in Afghanistan. The vast public anger against corruption and the damage that it is doing to Afghan society need to be harnessed and channeled into a force for change. Afghan citizens are well aware of many of the current injustices and would be ready to participate in efforts to promote change. Leadership from the Afghan Government would catalyze this process.
- Second, the President of Afghanistan must embrace these recommendations as his own mission. The Afghan Government must also make counter corruption work a centerpiece of its Transition strategy. Measures to reform Afghanistan institutions, build integrity, and curtail corruption need to be scaled up immediately and dramatically, to halt the current decline.
- Third, the international community contributes to the problem. It must radically and urgently change the way it handles its financial flows, especially the money associated with massive security operations and the way it offers contracts for goods and services. In particular, it must direct more effort into contracting with Afghan companies, and it must do so in ways that improve national economic capacity.

Corruption, weak institutions and a lack of economic development pose a fatal threat to the viability of Afghanistan. "It is increasingly becoming part of the political dynamic of the country and entwined with organized crime. This threat has been consistently and seriously underestimated, both by the Afghan government and the International Community" stresses Mark Pyman, Director of the Defense and Security Programme at Transparency International UK. At the same time, weak and dysfunctional political institutions, lack of respect for the Afghan constitution and a slow economic process are posing major risks for Afghanistan's future development.

More recent reporting by the Special Inspector General for Afghan Reconstruction (SIGAR) noted that,<sup>26</sup>

Corruption and organized crime remain grave threats to ISAF's mission and the viability of the Afghan government, according to DoD. Criminal patronage networks continue to penetrate and subvert critical state functions and institutions... Transparency International released its annual corruption perception index rankings. Afghanistan tied with Myanmar for the third most corrupt country in the world. The only countries that ranked lower were North Korea and Somalia.

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<sup>25</sup> [http://www.transparency.org/news\\_room/latest\\_news/press\\_releases\\_nc/2011/2011\\_05\\_18\\_afghanistan\\_in\\_transition](http://www.transparency.org/news_room/latest_news/press_releases_nc/2011/2011_05_18_afghanistan_in_transition)

<sup>26</sup> SIGAR, *Quarterly Report*, January 2012, pp. 107-108.

According to the Asia Foundation survey, despite a relatively positive perception of the government, a large majority of Afghans (76%) see corruption as a major problem in the country; only 5% said it was not a problem. Corruption frequently affects Afghans in their daily life: 56% saw it as a major daily problem, and an additional 31% saw it as a minor daily problem. The type of corruption that affected individuals the most was administrative corruption (39%), which was identified significantly more often than moral corruption, bribes, and corruption in the legal and education systems.

This quarter, an initiative facilitated by the UN Assistance Mission in Afghanistan (UNAMA) that brought together 1,500 Afghans in 65 focus groups found further evidence about the extent of the corruption problem. Afghans themselves see corruption as pervasive; it affects nearly every aspect of their lives and leads to security concerns, limited economic development, and human rights abuses, according to the UN Secretary-General. Afghans also said that ISAF and international development partners need to play larger roles in efforts to address the problem

The Asian Foundation study referred to above also found broad patterns of corruption in terms of bribes, the police, courts, and education.<sup>27</sup>

More than a decade of promises to fight corruption and reform have so far produced little more than scapegoats, new investigative bodies, and the systematic suppression of any real effort to deal with the problem. As noted earlier, a corrupting flood on unaudited and poorly controlled outside aid and military spending has continued with only limited checks and balances, and real reform of the contracting system was not even attempted until 2011. Given the timing of Transition, such efforts are certain to be too late and too little, and interact with a massive lack of afghan capacity for governance – or even meaningful government presence in the field.

### ***An Afghan Government that Cannot Manage Transition Effectively or Honestly***

The World Bank is necessarily polite about the limit to Afghan central government capacity to use outside funds and aid, but a November 2011 analysis notes that,<sup>28</sup>

- To maintain and increase on-budget spending and service delivery, urgent action is needed to build the core capacity of line ministries, and ensure that skilled staff can be recruited and retained by the government in the medium term.
- While large amounts have been spent on capacity building, it has created a fragmented “second civil service” of an estimated 7,000 skilled Afghan consultants managing projects, without building sufficient government capacity.
- In nine ministries, externally funded staff (EFS) make up only 5% of positions but 40% of payroll costs. Reductions in EFS positions in Transition would compromise service delivery as the burdens on government increase.
- Donors should support efforts to reduce inflated salary scales and build government capacity in a strategic and targeted manner by transferring capacity from the second civil service to the core civil service. This would be more cost-effective and provide greater stability.

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<sup>27</sup> Asia Foundation, “Afghanistan in 2011: A Survey of the Afghan People,” 10/2011, p. 99.

<sup>28</sup> World Bank, *TRANSITION IN AFGHANISTAN LOOKING BEYOND 2014*, November 21, 2011, pp. 14.

- Development budget execution increased in absolute terms, but flattened out at below \$1 billion over the last four years, largely due to capacity constraints, unrealistic budget formulation, and donor earmarking and funding delays.
- While the execution of the operational budget has been historically high, Afghanistan does not have capacity to handle large O&M expenditures (O&M only accounts for roughly \$335 million, or 10% of total core expenditure), which are expected to increase to \$4.8 billion by 2015/16.
- There are problems with efficiently allocating funds from the center to provinces/districts and considerable weaknesses in government capacity at sub-national levels.
- Investing in government capacity in budget management therefore remains an important priority.

### ***Uncertain Afghan Promises of Reform***

The good news is that the Afghan government publically acknowledged the scale of the problem at the Bonn Conference in late 2011,<sup>29</sup>

The Government of Afghanistan is committed to building a secure, prosperous, democratic Afghanistan based on fiscally sustainable private sector-led economic growth, well-governed and transparent government institutions, and mutually beneficial regional economic cooperation. We will set priorities and take difficult decisions to embrace reform and make effective use of international assistance, in accordance with the following objectives:

- Increasing Government capacity and building on structural reforms to improve public service delivery;
- Strengthening public financial management systems, improving budget execution, and increasing revenue collection, including phased implementation of a value-added tax;
- Increasing transparency and accountability to prevent corruption;
- Creating a strong enabling environment for private sector investment, including public-private partnerships in social and economic development, supported by adequate regulatory and institutional reforms and a robust financial sector; and – Working closely with the International Community to develop strategies to reduce overall security costs.

Progress towards the achievement of these objectives is vital. They will help us to reach shared goals for improved security, governance, and development. The Government believes that clear, mutually agreed targets, pursued with the International Community, are the best means for monitoring our joint performance. For these reasons, and with the support of the International Community, the Government commits to:

- Improve Afghanistan's ranking in the Transparency International's Corruption Perception Index, moving from a current rank of 176 to a rank of 150 within three years,
- Improve by 15 positions on the IFC's [International Finance Corporation] Doing Business Survey within three years, and maintain or improve our ranking on each of the ten indicators,
- Grow the ratio of revenue collection to GDP from 11% to 15% within four years, and to 20% by 2025,
- Within five years: to improve the management of public funds as measured by the PEFA [Public Expenditure and Financial Accountability] assessment by 20%, to improve transparent

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<sup>29</sup> *Towards a Self-Sustaining Afghanistan, An Economic Transition Strategy.* Government of the Islamic Republic of Afghanistan, and dated November 29, 2011.

accountable use of public funds measured by the Open Budget Index to 40% and to improve budget execution to 75%, and

- Improve our score in the UNDP human development index by 25% in the next three years; and by 50% in the next ten years.

The Government of Afghanistan believes that with the support of the International Community these commitments are realistic and achievable... The Kabul Process, initiated at the London Conference January 2010 and formalized at the Kabul Conference July 2010, provides the framework for partnership and mutual accountability for the Afghan Government to assume full responsibility for security, development and governance and the realization of a secure country with a sustainable economy... The Government will continue to employ the Kabul Process including increased donor engagement to channel international support for the specific activities that can further these overarching objectives. These activities will support the Government of Afghanistan to

develop policies and undertake programs aimed at: (a) achieving financial sustainability through future revenue streams by creating critical infrastructure that is sustainable and can be supported by Afghanistan's budget, (b) reforming and creating critical institutions for effective governance, (c) increasing productivity in agriculture and rural areas for growth, poverty reduction and increased food security, (d) strengthening rule of law, and continuing improvement to Afghanistan's legal framework, (e) establishing an enabling environment for private sector-led growth and private investment, including a strong financial sector, secure access to capital and transparent responsible regulatory environments, (f) building skilled human capital, (g) achieving economic and social stability through increased access to improved job opportunities, (h) strengthening regional economic integration through initiatives such as the New Silk Road vision and the Central Asia Regional Economic Cooperation (CAREC) Program to promote trade, facilitate transit, expand market access and support economic growth.

Successful implementation of this strategy will be a gradual process and the Government of Afghanistan seeks continued support from the International Community – in both security and non-security assistance – to achieve shared objectives in governance and development. This will involve implementing existing commitments and directing diminishing international resources towards the most effective and efficient channels for expenditure of aid funds. The Government, therefore, urges the International Community to fully implement best practices in aid effectiveness as agreed at the London and Kabul Conferences.

The bad news is that nothing to date indicates that the Afghan government's ability to make promises and state good intentions matches its ability to implement them. As a whole new range of reporting in late 2011 shows, no progress is yet being made. Senior Afghan officials ranging from key anti-corruption officials to the head of Afghanistan's orphanages see critical problems in government behavior and leadership, and handling of human rights. It is all too clear that reform of the Afghan central government's contracting effort may be impossible or only be possible with different leadership and long after 2014.<sup>30</sup> A decade of anti-corruption efforts has produced little more than the

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<sup>30</sup> See David Alexander, *Afghan security contractor oversight poor: Senate report*, Reuters, [Washington](#), Fri Oct 8, 2010 6:58am EDT; Ray Rivera, *Obstacles Hinder Formation of Afghan Security Force, Report Says*, New York Times, November 1, 2011; and Moshe Schwartz, Congressional Research Service, *Wartime Contracting in Afghanistan: Analysis and Issues for Congress, November 14, 2011*, [http://www.scribd.com/doc/73041739/Wartime\\_Contracting-in-Afghanistan-11142011](http://www.scribd.com/doc/73041739/Wartime_Contracting-in-Afghanistan-11142011); Rod Norland, *Orphans' Defender Jostles With Afghan Corruption*, New York Times, December 31, 2011; Justin Elliot, *Corruption in Afghanistan: Worse than you thought; A new report suggests up to 30 percent of U.S. taxpayer money spent on certain aid projects is stolen*, Salon, November 19, 2011; Julian Borger, *Afghan anti-corruption watchdog threatens to quit; Hamid Karzai warned corrupt senior officials must be*

occasional scapegoat and a constant reshuffling of positions for corrupt and incompetent officials and police officers that have political influence.

### ***The Corrupting Effect of Military and Aid Spending Without Proper Planning and Controls***

At the same time, US, European, and other donors have not shown that they can convincingly substitute for the Afghan government's lack of capacity. They have consistently thrown money at various aid tasks without adequate analysis of requirements, planning, coordination, and measures of effectiveness that go beyond the ability to throw money at a project.

A 2010-2011 ISAF task force led by Brigadier General H. R. McMasters found this lack of management had led to massive contractor waste and fraud, and had an equally massive corrupting and inflationary impact on Afghans and outside contractors who took money that was never properly controlled. These conclusions have been confirmed by a variety of audits by the US SIGAR, other US inspector generals, the US GAO, and a number of in-house reviews by European governments.

It is all too clear that US, NATO/ISAF military spending and aid donors have operated in ways that were intensely corrupting and must take at least as much of the blame as the Afghans. What is not clear is that any effective reform will be possible as the US, NATO/ISAF, and donor countries cut both their spending and presence in the field, and many Afghans come to fear Transition so much that their main goal becomes leaving the country.

This raises a whole new set of questions about how to manage Transition during 2012-2014, and when and whether any effective Afghan and international program can be developed to deal with the post 2014 Transition period.

A major cutback in the size of civil aid efforts seems inevitable, but so far, the emphasis seems to be on cuts and not finding some functional approach to phasing the civil efforts down that offers a reasonable path toward a stable Transition. The civil surge is on a path where it will be replaced by a rush to the exits.

### **The Need for Realism: Death of the Afghan Compact and National Development Plan**

Whatever happens, current aid and development plans need to be recalibrated from the ground up through a more realistic approach to Transition. **Figure Twenty-One** shows that the US has abandoned any real world hope that US, Europe, and other donors can finance the ambitious aid plans called for in the Afghan Compact and Afghan Development Plan. The US did so early in 2011 – long before the current budget crisis began to force major changes in US aid plans and help speed the pace of US military

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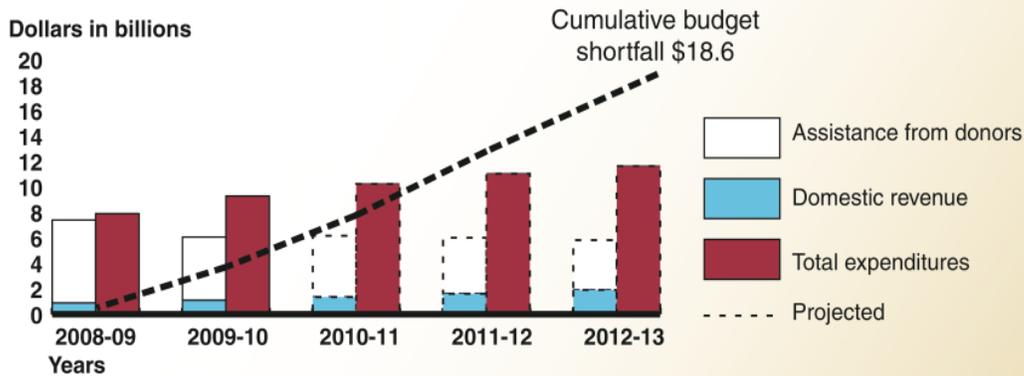
*prosecuted to end stalemate in battle with Taliban*; The Guardian, December 4, 2011; Patricia Grossman, *Kabul's Stealth Attack on Human Rights*, New York Times, December 26, 2011.

withdrawal. It is a warning of just how decoupled past and ongoing aid and development plans were from reality before the current focus on “Transition.”

It is now all too likely that cuts in military and outside aid spending will plunge Afghanistan into a major recession, and possibly depression, just as US troops exit.

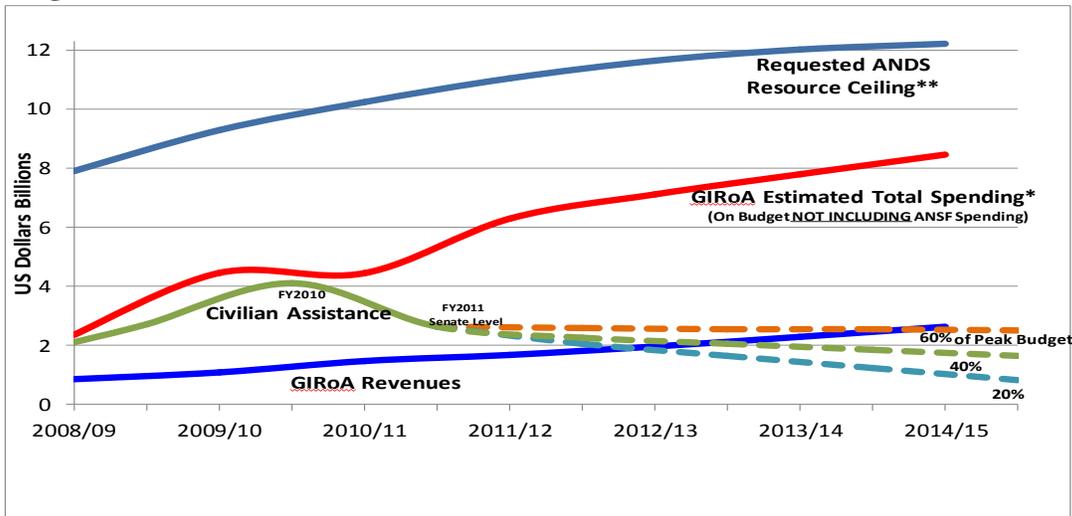
*Figure Twenty-One: The Pre-Transition Crisis in Aid and Development Funding*

**Anticipated funding and expected expenditures, 2008-2013**



Source: Afghanistan National Development Strategy - 2008 (data); Defense Imagery (photo).

**GIRoA Spending Expectations In consistent with Future Budget Restrictions**



Source: Source: GAO, 10-655R, June 15, 2010 and USAID, “USAID Afghanistan: Towards an Enduring Partnership,” January 28, 2011

***Creating an Aid and Afghan Budget Crisis by 2014: The Year Troops Leave and a Presidential Election is Supposed to be Held***

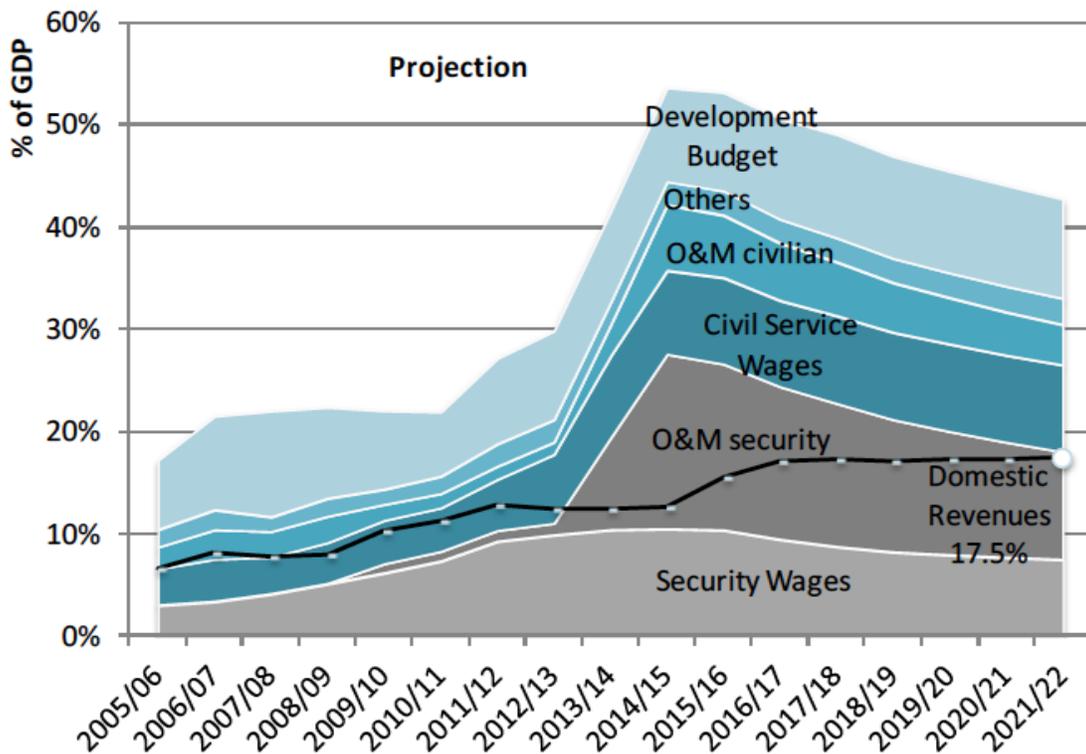
All of these issue raise critical challenges for the US, Europe, and the Afghan government in dealing with the probable impact of the cuts in donor spending on civil and security programs, along with the massive cuts that will occur in US and ISAF military spending as combat forces withdraw. Working level estimates by the IMF and World Bank, as well as US and British officials, warn that the end result could be a major recession or depression by 2014 – the same year Afghanistan is scheduled to hold an election an rely fully on Afghan forces for its security.

**The World Bank Warning**

A November 2011 World Bank estimate of the impact of “Transition” on the Afghan national budget – driven by estimated cuts in military spending and limited cuts in aid is shown in **Figure Twenty-Two**. This figure highlights the problems created by

*Figure Twenty-Two: World Bank Estimate that Domestic Revenues are Projected to Increase, but Operating Spending is Likely to Grow Faster*

(Total budget expenditure and revenues)



World Bank, *TRANSITION IN AFGHANISTAN LOOKING BEYOND 2014*, November 21, 2011, p. 9

the

the inability to calculate domestic revenue sources, or make credible projections, as discussed earlier. Taken at face value, however, the key points in the World Bank analysis of these trends are:<sup>31</sup>

Domestic revenues are projected to increase from 10% of GDP to 17.5% by 2021/22, driven largely by the planned value added tax and mining revenues[.]

But over the same period, operating spending on:

**Security:** Wage bill to increase from 7% of GDP to 10% to reach 352,000 troops and Operations & Maintenance (O&M) from 1% to 10.5% of GDP (\$3.5 billion annually in 2011 prices) by 2014/15

**Non-security:** Civil service wage bill will increase from 5% of GDP to 9%, and O&M spending required to sustain donor capital investments from 1% to 4% by 2014/15 (\$1.3 billion in 2011 prices)

Combined, these operating expenditures will be almost twice the size of domestic revenues by 2021/22

The updated World Bank analysis used here estimates that Afghanistan's domestic revenues will continue to rise, but that operating costs will rise much more quickly than revenues. It estimated that security costs could reach 17% of GDP and that other governmental wages, operating costs, and maintenance costs could reach another 14% of GDP. The current Afghan budget projects some \$2.5 billion in outside aid for 2012-2017, but this ignores large amounts of off-budget donor aid. If all such expenditures were included in the cost of replacing items currently covered by the external budget, the total deficit could reach some 25% of the GDP (\$7.2 billion in current \$US 2011 dollars)

Other working level studies indicate that foreign spending will total some 40% to 75% of Afghan GDP in 2011. No one can currently predict just how serious the drop in outside spending will be by 2014, or in the year beyond, but estimates of the cut in current military spending in Afghanistan range from 70 to 90%.

### ***An Impossible Financing Gap in Aid?***

The de facto level of Afghan government revenues, and the need for spending on security and stability, will almost certainly outpace the level of aid the US, Europe, Russia, China, and other donors will provide. A World Bank estimate of aid needs – subject to all of the critical uncertainties in data, methodology, and need analyzed earlier -- is shown in **Figure Twenty-Three**. The key points in the World Bank analysis of future Afghan need for aid are:<sup>32</sup>

- **25% of GDP (\$7.2 billion in 2011 prices) would still be needed to bridge the gap even in 2021/22**
  - While aid could finance any combination of these expenditures, a reasonable option to fill the gap could be:
  - The Afghan budget funds civilian O&M (\$1.3 billion) and a contribution to the security

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<sup>31</sup> World Bank, *TRANSITION IN AFGHANISTAN LOOKING BEYOND 2014*, November 21, 2011, p. 11.

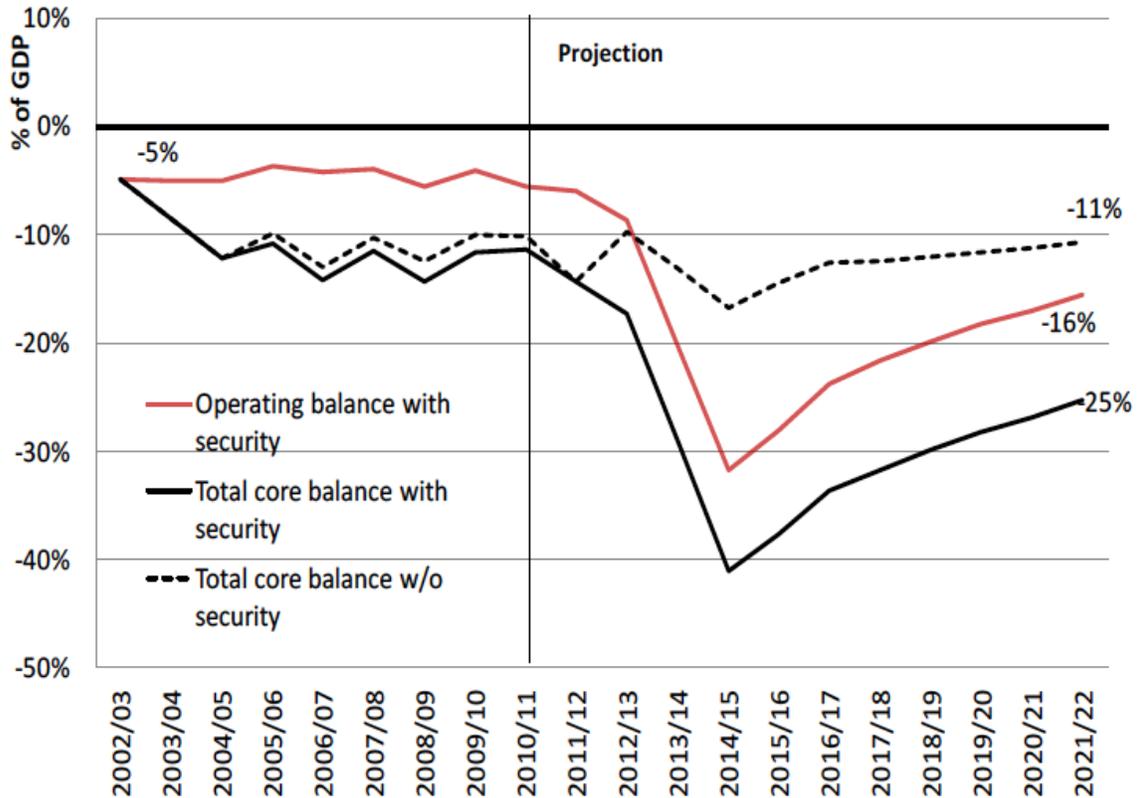
<sup>32</sup> World Bank, *TRANSITION IN AFGHANISTAN LOOKING BEYOND 2014*, November 21, 2011, pp. 13-16.

- wage bill at 2010 level
- Donors absorb the additional increasing security expenditures (that is, security wages plus security O&M)
- Donors increase on-budget contributions by around 11% in development budget grants
- **Non-security services are threatened by reductions in project-based donor funding and/or by continued underfunding of O&M**
  - Risks vary between sectors:
  - Transportation and health are highly vulnerable due to high reliance on donor-funding and low O&M spending
  - Electricity is less vulnerable, due to potential recovery of costs through user fees
  - Although less reliant on donors, O&M in education is underfunded
- **Tough expenditure choices need to be made (both by the Government and donors) in dealing with the civil sector:**
  - Choosing investment projects that are growth-enhancing and affordable and that can be operated and maintained
  - Prioritizing O&M spending, which will require inter- and intra-sectoral trade-offs
  - Maintaining social spending and delivering basic services (education, health, rural livelihoods)
  - Revenue collection needs to improve to reach planned targets. To minimize leakage:
  - Forcefully implement customs reforms
  - Enhance capacity in tax administration to implement the value-added tax
  - Establish robust accountability mechanisms for managing mineral revenues
  - Government capacity to implement on-budget financing needs to improve

While this may seem “reasonable” to the World Bank, it is far from clear that anything like these totals will come from the outside, and the failure to provide them would cripple the Afghan government in both its security and civil operations. Moreover, this level of aid would only meet Afghan budget requirements. It does not attempt to compensate for the economic impact of massive cuts in spending on military operations.

*Figure Twenty-Three: A World Bank Guesstimate of the Financing Gap in 2021/22*

Financing gap with and without security (% of GDP, excluding grants)



World Bank, *TRANSITION IN AFGHANISTAN LOOKING BEYOND 2014*, November 21, 2011, p. 11

## Transition without Growth and Producing a Possible Recession or Depression

Afghanistan is not Iraq. It cannot fund Transition, and massive economic problems will occur during 2014-2020 if aid is not phased out in ways that allow Afghanistan to ease the impact. These years will be critical since there are literally hundreds of thousands of armed Afghans dependent on outside funding, in addition to the fact that the Afghan government must fund a Presidential election in 2014 – the same year US and ISAF troops are to withdraw.

### *The Risks in Cutting Outside Spending*

There is broad agreement at the working level in the World Bank, IMF, and donor governments that most of the growth in the Afghan GDP since 2002 has come from military spending and donor aid, and not from sustainable growth in the Afghan economy.

Some experts believe that cuts in foreign spending could reduce the Afghan GDP by some 15% to 40% during Transition – the same year that combat troops will be gone and a Presidential election is schedule to take place.

It should again be stressed that the ability to conduct such analysis suffers from the fact that the UN, US, other donors, and other international institutions never created a credible model of the Afghan economy during ten years of war, estimates of the size and impact of all forms of outside spending, or models that examined the situation that given groups of Afghans faced by sector, region, and class of employment and income distribution. They never based its aid programs on an effective model of the economy, the impact of existing levels of aid, or the impact of outside national and NGO aid.

Similarly, UNAMA failed in its mission of coordinating the overall aid effort, and has never produced a meaningful public analysis of either the economy or aid effort. The World Bank has largely operated from outside the country. While it has attempted to produce a recent analysis of the economy, this analysis is not currently available to outside researchers.

Moreover – as has been noted earlier – the US DoD, ISAF, and other ISAF member countries do not have reliable estimates of the portion of total military spending that is actually spent in Afghanistan. And, these problems are further compounded by the inability to know how much domestic revenue collection actually comes directly or indirectly from activity that is only possible because of vast foreign spending. The World Bank also warned in March 2011 that only about 30% of the Afghan budget was actually discretionary, and that some 70% was non-discretionary carryforward and new expenditure.<sup>33</sup> These rigidities will further limit Afghan ability to respond to outside funding cuts.

In spite of these uncertainties, however, it is all too clear that the Afghan economy could plunge into recession and depression if US, ISAF, and donors make sudden, crippling cuts to their military and aid spending. It is also clear that efforts to disguise this fact by focusing on optimistic estimates of the direct impact of spending cuts that ignore the total direct and *indirect* impact of cuts in aid and military spending are misleading to the point of being actively dishonest.

These are issues that no amount of obfuscation, conceptual PowerPoints, and political dodging around the issue can deal with. Any US government, UNAMA, or other document that does not explicitly model the full set of risks involved, and set forth a detailed spending program to minimize their impact goes beyond political spin. It is a fundamental failure in ethical behavior and basic professional competence on the part of anyone involved.

This is clear both from recent working studies by individual governments, work being done now on progress by the IMF, and work that has been published by the World Bank.

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<sup>33</sup> World Bank, March 14, 2011.

The World Bank notes how dependent Afghanistan is on aid for growth as well as for security and stability:

- Afghanistan remains one of the least developed countries
  - Average GDP growth over FY 2003/04–10/11 was 9.1% (8.4% without “outlier” years)
- Private investment (8.5% of GDP) and exports (2.5% of GDP) have been low; GDP growth has been mainly driven by consumption
  - Severe constraints to future growth: conflict, landlocked, and narrow economic base
- A nation of 30.6 million people with a per capita GDP of \$528 in 2010/11, among the poorest 10 countries
- In 2008, 36% of the population lived below the poverty line; more than half of the population is considered vulnerable
- Infant mortality (134 per 1,000 live births) is highest in the world
- Life expectancy is 48.1 years
- 75% of the population is illiterate
- With population growth at 2.8%, Afghanistan needs strong economic growth to reduce poverty and improve development outcomes
- A growth rate of 6% a year would be required to double Afghanistan’s per capita GDP in about 22 years (in about a generation)

### ***Dodging the Worst Case, But the Bad Case is Bad Enough***

The World Bank does not explicitly examine a worst case scenario where the US and other outside powers do not provide significant aid, but **Figure Twenty-Four** does show several cases that warn how much aid Transition will need to be successful.

**Figure Twenty-Five** provides a rough estimate of the impact of a rapid scale-down of aid – although it should be stressed that the World Bank does not tie the analysis in either figure to a case where Afghanistan still faces major military challenges in 2014 and beyond, and/or problems in dealing with Pakistan or its own internal divisions.

Even if one only takes account of classic economic effects from cuts in growth – which can only tell part of the story in Afghanistan, the World Bank warns that,

- Disruptions in service delivery will be felt by most households across all provinces
- Direct impact of declining aid on the poor is likely to be modest. Likely reasons:
  - Only a fraction of aid reaches the poor—The majority of aid was directed not to reducing poverty but to improving security and governance
  - Aid has not been well targeted—Direct benefits of aid flows appear to have accrued disproportionately to provinces with less poverty and higher income households
  - Impact is expected to be uneven across provinces—larger in conflict provinces and urban centers because they received most of the aid
- Declining aid is likely to aggravate underemployment more than unemployment
- Research suggests that most aid-financed jobs are “casual” (last less than 6 months)
- Estimates suggest that a \$0.5 billion decline in the external budget could affect 11,000–18,000 job opportunities (six-month basis)

- The job impact will be felt by low-skilled workers in construction, transportation, and retail as well as by higher skilled technical professionals who directly work on aid projects

A separate World Bank document issued in November 2011 provides further insight into the potential impact of spending and aid cuts on the Afghan economy:<sup>34</sup>

- ***The extremely high level of current annual aid (estimated at \$15.7 billion in 2010) is roughly the same dollar amount as Afghanistan's GDP and cannot be sustained.*** Aid has funded the delivery of essential services including education and health, infrastructure investments, and government administration. There have been substantial improvements in the lives of Afghans over the last 10 years as a result of this effort. But these inflows, most outside the Afghan budget, have been so high that inevitable waste and corruption, aid dependency and use of parallel systems to circumvent limited Government absorptive capacity have impeded aid delivery and the building of a more effective Afghan state.
- ***The level of public spending -- both on and off budget -- that has been financed by such high aid flows will be fiscally unsustainable for Afghanistan once donor funds decline.*** Lesser amounts, matched by more effective aid delivery could, in the end, lead to some more positive outcomes. The key issue is how to manage this change and mitigate the adverse impacts, and put aid and spending on a more sustainable path for the longer-term. International experience and Afghanistan's history after the Soviet military withdrawal in 1989 demonstrate that violent fluctuations in aid, especially abrupt aid cutoffs, are extremely damaging and destabilizing.
- ***Large financial inflows outside the Afghan budget and fragmented aid in a situation of weak governance have been major sources of rents, patronage, and political power.*** This has inadvertently exacerbated grievances and conflicts as the relative strength of elite groups in Afghan society shifted. As aid declines, reliance on the opium economy and other illicit activities could increase. Ensuring that increasingly constrained public funds are well used reinforces the need to maintain and improve upon the significant progress made by the Finance Ministry in establishing public financial management systems and a robust Afghan budget process.
- ***The impact of declining aid on economic growth may be less than expected.*** Why? Because most international spending "on" Afghanistan is not spent "in" Afghanistan, and much of what is spent in Afghanistan leaves the economy through imports, expatriated profits and outward remittances. Nevertheless, projections suggest that, under even favorable assumptions, real GDP growth may fall from 9% a year over the past decade to 5-6% during 2011-18. Given Afghanistan's annual population growth of 2.8%, this would mean only limited improvement in average per capita income, continuing high rates of underemployment and little progress in reducing poverty. Only growth at the very maximum of the range of plausible scenarios would enable Afghanistan to achieve meaningful reductions in poverty and higher average per capita incomes. For example, with real GDP growth of 6% a year, average per capita income – currently one of the world's lowest at \$528 dollars – would take 22 years or about a generation to double.
- ***Economic growth is much slower under less favorable scenarios.*** The growth projections are based on a set of assumptions (scenarios) related mainly to security, sources of growth, aid levels, and changes in investment climate. If the assumptions in the less favorable scenarios come to pass—for example, if agriculture performance is poor, if major mining investments (Aynak for copper and Hajigak for iron ore) do not materialize, or if aid declines precipitously over the period – then growth could drop to 3-4%. Deteriorating security and governance would lead to further economic decline. The underdeveloped financial sector and low rates of financial intermediation leave little scope for helping Afghan businesses adjust to slowing growth. Conversely, the decline could be partly mitigated by reducing aid in a gradual, planned manner and by increasing the amount of aid

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<sup>34</sup> World Bank, *Transition in Afghanistan: Looking Beyond 2014, Executive Summary*, November 2011, pp. 1-2.

that is actually spent within Afghanistan that would result if more aid channeled through the Afghan budget.

- ***Underemployment will increase because the activities affected by declining financial inflows (services, construction) are relatively labor-intensive.*** Unemployment and especially underemployment in Afghanistan—respectively estimated at 8% and 48%—are already high, even with today's rapid economic growth. Roughly 6–10% of the working population has benefited from aid-financed job opportunities, most of these in short-term employment. Declining aid, therefore, can be expected to exacerbate underemployment levels (with fewer casual labor opportunities and lower pay for skilled employees).
- ***The impact of the decline will affect some groups more than others.*** Aid has not been evenly spread across the country. Because of the choices made by donors, and the predominant role of stabilization and military spending, the conflict-affected provinces have had significantly higher per capita aid than the more peaceful (and often poorer) provinces. As a result, the slowdown in aid will be felt more acutely in the conflict-affected areas and in urban centers. If aid declines gradually so that it can be partly offset by growth of the security, mining, and civilian public sectors, the impact could be softened and spread over time. This would allow labor markets more time to adjust.
- ***The direct poverty impact of declining international spending might be limited if aid becomes more equally distributed across provinces and the composition shifts toward development programs rather than short-run stabilization activities.*** Aid disproportionately devoted to the more conflict-affected provinces has had only a modest impact on poverty. Households in the conflict-affected provinces were less poor on average to begin with, so this concentration of aid inadvertently increased inequality amongst provinces and between groups. National programs delivered through the Government, such as NSP, have benefitted Afghans more equitably.
- ***The worst impact of Transition will be on the fiscal situation with a projected financing gap of 25% of GDP by 2021/22.*** Even assuming ambitious targets for robust growth in domestic revenue are met (with a projected rise from 10% of GDP to more than 17% of GDP a decade from now), there will be an unmanageable fiscal gap. This gap arises primarily as a result of operations and maintenance (O&M) spending and the wage bill for security that together will be 17.5% of GDP by 2021. The civilian wage bill will increase to 9%, the non-security operation and maintenance (O&M) expenditure to 4%, other operating spending to 2.5%, and the core development budget to 10% of GDP.

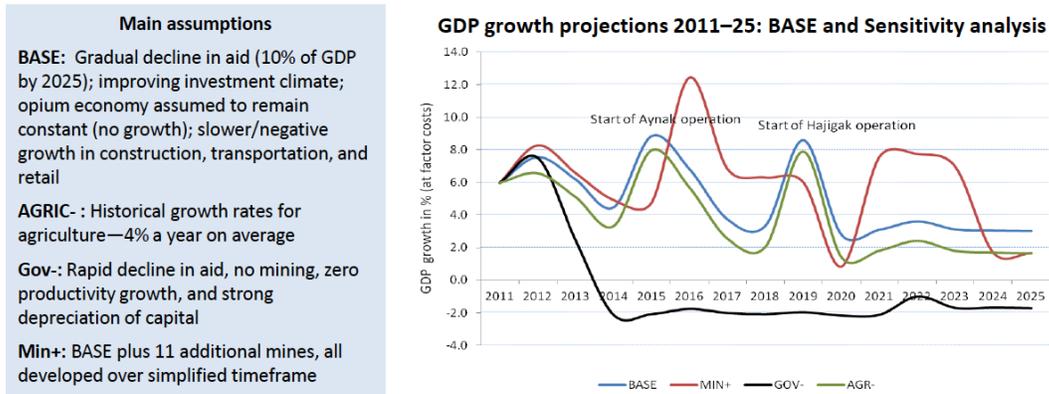
Working studies by the World Bank and IMF, as well as by several ISAF governments, recognize that a major planning effort is needed, and makes several generic suggestions to mitigate the impact of cuts in outside spending:

- Channel more aid through the budget and increase Afghan capacity to absorb and use aid effectively by reducing corruption and enhancing financial management;
- Design smaller development contracts with a far larger share for Afghan contractors;
- Sustain military assistance transfers and aid to the ANSF even as troops draw down;
- Afghans should take steps to increase revenues through taxes like VAT, by reducing corruption, and strengthening public financial systems;
- Strengthening the banking system by resolving the banking crisis and developing a more stable banking sector capable and willing to increase credit; and,
- Integrate regional markets, and open US and other Western markets to Afghan exports.

No effort has yet been made, however, to quantify the impact of such measures, and it is far from clear that they will be adequate. Much will also depend on whether Afghanistan can maintain and grow its service and financial sectors, and achieve enough stability, security, rule of law, and governance to grow its agriculture, power output, and supply of water. Various studies indicate that all three areas have potential, particularly urban services and agriculture.

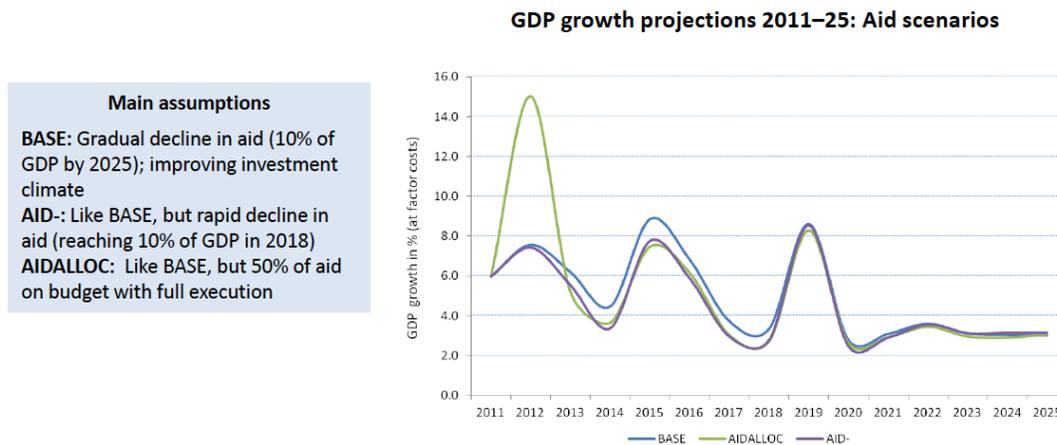
**Figure Twenty-Four: Security is Critical for Economic Growth**

- The economic outlook is very sensitive to drought, security, changes in fuel and food prices and governance
- In the more favorable scenarios (BASE and AGRIC-), the economy is projected to grow between 4.5% and 6.2% annually between 2011 and 2018 and converge to around 3–4%—further improvements in investment climate and infrastructure (starting now) could lead to even higher growth (MIN+).
- Any serious deterioration in security or governance (Gov-) could lead to negative growth



World Bank, *TRANSITION IN AFGHANISTAN LOOKING BEYOND 2014*, November 21, 2011, p. 20

**Figure Twenty-Five: How a Scale Down of Aid Would Affect Growth**



A rapid decline of aid would reduce growth to 5.5% until 2018 and around 3% in the long term due to less consumption and investment. This is roughly 1 percentage point on average than the BASE scenario, or roughly 50% less than current growth.

Putting more aid on budget (the AIDALLOC scenario) increases the local content of aid and can mitigate some of the negative impact during the early years of transition—though absorptive capacity constraints remain challenging and need to be addressed

World Bank, *TRANSITION IN AFGHANISTAN LOOKING BEYOND 2014*, November 21, 2011, p. 20

## **The Afghan Response: Requesting More Than Will Ever Come**

The Afghan government acknowledged the risks inherent in such dependence at the Bonn Conference in late November 2011, and outlined a potential Transition plan for the Afghan civil sector in broad terms,<sup>35</sup>

Afghanistan's fiscal gap is significant, and unless it is addressed the good work of the past ten years will come undone. The Government and the World Bank have examined the financial position of Afghanistan as it moves beyond Transition and the results, shared in the joint World Bank - Government report, show that even under ideal conditions the Government will not be able to cover spending pressures. In the preparation of this document Government closely examined the costs associated with delivery of its planned strategy. It used the same economic models as the World Bank, but made slight modifications in the fiscal assumptions.

Government chose to exercise additional restraint on forecast spending on recurrent costs, incorporated modest increases in minerals related revenue and invested the proceeds indevelopment. The primary difference between World Bank and MoF models is that the MoF forecasts continued projections to the future, to understand what would be required to achieve sustainability.

This internal analysis has not been independently reviewed by donors, but calculates the estimated cost of continued non-security related on-budget development through the NPP framework is equal to 14% of GDP in 2015, with an estimated 9% of GDP coming through off-budget channels. The total cost of security is 26% of GDP. The civilian wage bill, O&M and other recurrent non-security Government costs is equal to 13% of GDP. The total forecast for required on budget spending is therefore equal to 53% of GDP in 2015 and 62% when projected off-budget development spending is considered. Substantial funding cuts in any of these areas undermine our ability to achieve our shared goal of a secure, sustainable Afghanistan.

Included in these estimates are the costs of absorbing the results of more than ten years of generous external budget assistance programs. Of the estimated \$57 billion spent on Afghan reconstruction only \$6 billion has been channeled through the national development budget, with the full ownership of Government. In spite of this, the Government will ultimately need to absorb, utilize and maintain much of this infrastructure. It realizes that it must face difficult decisions about which assets can be accepted. Further, Government will inherit funding responsibility for externally funded technical advisors that are essential to the delivery of donor-funded programs. Long-term success in Afghanistan requires that the anticipated shortfall in security and development spending be met.

...The Government's strategy to address this involves a re-commitment by the Afghan Government to economic growth, key reforms and increased efficiency in revenue mobilization. The IMF forecasts that Afghanistan will collect \$2.0 billion in revenue in fiscal 2011-12, corresponding to just over 11% of GDP. By fiscal 2016 we believe that a 15% revenue to GDP ratio is achievable. This is comparable to Nepal (15.7%), the Philippines (13.4%), and Sri Lanka (14.6%) and well above many other post-conflict, least developed nations where data is collected. Succeeding would mean that the Government would collect \$4.4 billion in 2016, and would reflect an average revenue growth rate from 2009 of more than 30%.

### ***Concepts Not Plans***

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<sup>35</sup> *Towards a Self-Sustaining Afghanistan, An Economic Transition Strategy*. Government of the Islamic Republic of Afghanistan, and dated November 29, 2011.

It is important to note, however, that the Afghan government did not provide a clear plan for using aid and for Afghan economic development, and did not address the future shape and costs of the ANSF – which have been by far the most expensive aspect of donor aid to date. It instead focused on the past hopes of the Afghan national development plans and its National Priority Plans (NPPs), although it stated that the status of such efforts was highly uncertain, warned that aid costs might rise, and it made no attempt to assess their impact on the Afghan economy,<sup>36</sup>

More than 60% of development activities in the NPPs are currently underway. They are 35% funded with existing, programmed money. The unfunded portions of the NPPs are aligned with donor priorities, reflect the experience of the donor community shared with us in extensive consultations and are already being considered for funding by our partners. The NPPs are our national priorities and will form the basis of government programming well beyond Transition, implemented in a way that is sustainable with available resources...Analysis of the long-term costs of continuing implementation of these programs is ongoing.

...We anticipate a gradual reduction in capital spending and a shift toward increased program operation costs, but with only small decreases in funding requirements over time. The exception to this trend is the creation of physical infrastructure. Here, capital costs are anticipated to rise once program planning phases are complete and construction begins. This corresponds to the phased completion of transport corridors envisioned in the National Resource Corridor Program and the New Silk Road vision.

### ***Promises of Reform from a Decade-Long Non-Reformer***

The Afghan government did call for reforms to strengthen outside and domestic investment, although it again tactically assume a high level of security in 2014 and success in reform,

The Government's strategy to address this involves a re-commitment by the Afghan Government to economic growth, key reforms and increased efficiency in revenue mobilization. The IMF forecasts that Afghanistan will collect \$2.0 billion in revenue in fiscal 2011–12, corresponding to just over 11% of GDP. By fiscal 2016 we believe that a 15% revenue to GDP ratio is achievable. This is comparable to Nepal (15.7%), the Philippines (13.4%), and Sri Lanka (14.6%) and well above many other post-conflict, least developed nations where data is collected. Succeeding would mean that the Government would collect \$4.4 billion in 2016, and would reflect an average revenue growth rate from 2009 of more than 30%.

To achieve this, the Government has committed to an aggressive program of efficiency and reform, agreed with the IMF on November 14th, 2011. The key elements of this program include

- measures to increase the efficiency of our customs and revenue departments,
- expanding the Government's ability to enforce the Afghan tax law,
- improved governance of our state-owned enterprises and corporations, including strong measures for the elimination of subsidies, and clear time-bound plans to turn over non-essential functions to the private sector,
- increase capacity and an improved institutional framework to respond to economic crime,
- implementation of a series of reforms to strengthen the financial sector, ensuring access to capital for legitimate investors, and

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<sup>36</sup> *Towards a Self-Sustaining Afghanistan, An Economic Transition Strategy*. Government of the Islamic Republic of Afghanistan, and dated November 29, 2011.

– a phased implementation of a value-added tax providing for tax efficiency and a more progressive, pro-poor taxation.

The impact of private sector investment in Afghanistan's extractive industries is forecast to have a substantial impact on government revenues. Though the challenges of producing an accurate forecast of mineral related revenue cannot be overstated, optimistic scenarios predict that from 2016 annual receipts could reach more than \$1.5 billion per year and grow to more than \$3 billion by 2026. Though Government will continue to aggressively pursue this potential revenue, it has taken a more conservative approach to revenue planning.

Beginning in 2016, internal estimates forecast revenue contribution of \$500 million per year and grow steadily afterwards. This combined with increases in efficiency in tax and customs would push our revenue to GDP ratio to an estimated 21% by 2030. These estimates forecast minerals-related revenues to grow at an annualized rate of 17% per year between 2016 and 2030. Achieving this scenario would require a significant positive change in security and the Afghan business climate leading to increases in direct local investment. In addition to the measures described in this paper the Government re-commits itself to the principle of transparent, responsible use of mineral sector revenues.

### ***The Oliver Twist Approach to Transition: "More. Please."***

The basic Afghan response, however, was to call for more aid. President Karzai requested some \$10 billion a year through 2030 for a program that set ambitious goals for both security and development, called for equally ambitious reforms and improvements in governance, and called for the Afghan government to achieve full independence from outside support in 2030.<sup>37</sup>

- By 2015 Afghanistan will have taken over full responsibility for its own security, and will be leading development initiatives and processes with the confidence to make critical foundational investments that will lead to economic growth and fiscal sustainability.
- By 2025 Afghanistan will have eliminated its dependency on international assistance for funding to non-security sectors and will only receive support consistent with all other least developed nations. A robust and growing extractive industries sector will have developed. Through effective development and, improved delivery of Government services, the root causes of insurgency will be reduced and, in consultation with international partners, plans will have been put in place to reduce the size of the ANSF.
- By 2030 Afghanistan will be funding a professional, highly effective ANSF. Achievements in development and governance will see Afghanistan emerge as a model of a democratic, developing Islamic nations [sic].

The increases in revenue were very ambitious. They called for revenues to rise from \$2.0 billion in revenue in fiscal 2011–12, corresponding to just over 11% of GDP, to \$4.4 billion, or 15% by 2016, an average annual revenue growth rate from 2009 of more than 30%. The requirement for outside aid was described as follows,<sup>38</sup>

Based on our initial analysis we must look to donors to finance approximately 47% of GDP or approximately \$10 billion in 2015. At first glance, this figure may look enormous. However, it

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<sup>37</sup> The details were provided in a separate paper circulated in addition to the President's statement entitled, *Towards a Self-Sustaining Afghanistan, An Economic Transition Strategy*. It was issued by the Government of the Islamic Republic of Afghanistan, and dated November 29, 2011.

<sup>38</sup> *Towards a Self-Sustaining Afghanistan, An Economic Transition Strategy*. Government of the Islamic Republic of Afghanistan, and dated November 29, 2011.

reflects a 40% reduction from current aid levels, and it is expected to decline over time. The Government takes the challenge donors will face in maintaining this level of assistance seriously, but notes that when compared to the current spending of the International Community it is small. The current estimated cost of the international military presence in Afghanistan is \$140 billion per year; 7% of total 2011 security costs is sufficient to fund the entire gap. This cost savings can facilitate Afghanistan's passage to a future that is not aid-dependent. A long-term funding commitment by the International Community, declining over time and ending in 2030, would provide the necessary stability in financing to allow Afghanistan to arrive at a stable and prosperous future.... Based on current analysis the Government of Afghanistan believes it will be necessary for the donor community to fund the cost of the Afghan security forces through 2025.

To be successful, this financial support should be defined in two categories: security assistance and non-security assistance.

***Security assistance.*** Based on current analysis the Government of Afghanistan believes it will be necessary for the donor community to fund the cost of the Afghan security forces through 2025. The Government will continue to contribute to the recurrent cost of maintaining the security forces. The Government commits to work closely with the International Community to develop strategies to reduce the number of troops, and their recurrent maintenance costs.

***Non-Security assistance.*** We ask the International Community to work with Government to implement the NPPs in a manner that creates conditions where strong economic growth is enabled and the root causes of insurgency are diminished. Donor funds will used to achieve the commitments laid-out in this document and to achieve our shared goals of improved public financial management, reduced vulnerability to corruption, broad political and institutional reform, improved public service delivery, a strong enabling environment for growth, and direct poverty reduction.

These Afghan requirements for future aid are valid to the extent they reflect the very real requirements described in the World Bank and other donor studies, At the same time, they seem to be based on assumptions about future security, the pace of reform and improvement in governance, increases in economic development and activity, and increases in government revenue that are optimistic to the point of being unrealistic. As a result, they almost certainly understate the level of outside aid needed to achieve Afghan goals. Aid levels of roughly \$120 billion over the entire period are almost certainly too low to both cover the cost of funding the ANSF during Transition and beyond, and give Afghanistan the resources to cope with the loss of US and ISAF military spending during 2012-2014 and the probable cuts in donor civil aid.

## **Why Mismanaging Transition Could Create Even Worse Conditions for Post Transition Stability**

Gross economic impacts are also only part of the story. The agricultural part of the Afghan economy would be extremely vulnerable to weather problems during this period. Some 30-45% of its GDP comes from agriculture, and a drought in 2008 reduced overall GDP growth from 10% to 5%.

This is particularly important because narcotics output continues to increase – and some 10% continues to go to insurgents and up to 70% goes to distributors and criminal networks. In spite of the relatively high price for wheat and some other crops, marketing and distribution are improving very slowly at the national level, and they will remain high-risk crops relative to drugs well beyond 2014.<sup>39</sup>

### ***Security Problems and Regional Impacts***

As has been pointed out earlier, cuts in spending will hit the hardest in the least secure areas. ISAF and US Embassy estimates indicate that more than three quarters of US assistance goes to the Southeast, and Southwest – the largely Pashtun – provinces. These are also the areas that receive most of the military spending that is actually spent in Afghanistan (the World Bank estimated that external aid to Helmand totaled \$350 per person in 2010). At the same time, sensitive urban centers also get “disproportionate” spending. The Kabul district got \$480 million of \$850 million in US aid disbursements during the 4<sup>th</sup> quarter of 2010 to the third quarter of 2011.

As has been stressed throughout this analysis, much will depend on how serious the security threat is in 2014 and beyond. Some working estimates indicate that the total annual budget deficit could easily reach 20-25% by 2014 – and 25-30% by 2021 if Afghanistan funds the ANSF and its security efforts at the necessary level, but there are no estimates that focus on regional and district impacts.

The previous analysis of tactical trends warns, however, that it is unlikely that US, other ISAF forces, and the ANSF can secure enough of the 81 critical terrain districts, and 41 districts of interest, that are the focus of the current ISAF strategy. It is equally unlikely that Pakistan will be fully secure in its border areas, fully cooperate with the Afghan government, and give Afghan development high priority.

This is particularly important in the case of combat areas. Some working studies indicate that some 80% of the total mix of aid and military spending go to conflict areas in the south and east of Afghanistan. In many cases, such aid is tailored to immediate operations and not to lasting development.

In these areas, aid is managed by PRTs and military forces, and not through the Afghan government. Removing outside forces and civil-military aid teams will impact far more

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<sup>39</sup> Alissa J. Rubin, *In Afghanistan, Poppy Growing Proves Resilient*, New York Times, January 2, 2012, p. A1, A8; Discussions with US and German experts

heavily on such combat districts than the country as a whole. It could potentially lead large numbers of armed men to react to cuts in funding and support, and it is questionable whether the Afghan government will be able to cope.

### ***The Impact of Demographics***

The problems in Transition planning are not simply a lack of accurate population data. Most Transition models do not account for demographic factors that the World Bank and US working studies have shown will be critical. While none of the numbers quoted in such studies are reliable, the broad trends in such data almost certainly are:<sup>40</sup>

- **Growth:** With a current population of about 29-31 million, population growth will be roughly 2.5% annually.
  - US Census Bureau estimates that the Afghan population has grown from 8.2 million in 1950 to 26.1 million in 2010 in spite of 30 years of crisis and war.
  - Growth is estimated to reach 32.6 million in 2015, 36.6 million in 2025, and 41.1 million in 2035.
- **Urbanization:**
  - About 76% of the population lives in rural areas with an annual urbanization rate of 5.4% due in large part to job availability and internal displacements.
  - Note: Kabul's population is about 3 million (500,000 during the Taliban era).
- **Unemployment:**
  - With a labor force of 15 million people, unemployment will increase from its current level of about 35-40% (31% in agriculture, 26% in industry, 43% in services).
  - The World Bank estimated in November 2011 that unemployment and especially underemployment in Afghanistan—respectively estimated at 8% and 48%—are already high, even with today's rapid economic growth. Roughly 6–10% of the working population has benefited from aid-financed job opportunities, most of these in short-term employment. Declining aid, therefore, can be expected to exacerbate underemployment levels (with fewer casual labor opportunities and lower pay for skilled employees).<sup>41</sup>
  - Almost 43% of the population is under 15 years of age, leading to a bulge in employable people.
  - The lack of jobs, resulting from slowing economic growth, will cause flight from Afghanistan.
  - Annual population growth will outpace job creation.
  - Best case for full implementation of the "New Silk Road" and other new aid efforts is creating 150,000 jobs over next three years.
  - CIA estimates annual increases in labor force may outpace best-case impact of NSR over three years. 2010 Estimate is growth of 392,116 males and 370,295 females

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<sup>40</sup> World Bank, *Transition in Afghanistan: Looking Beyond 2014, Executive Summary*, November 2011, p. 2.

<sup>41</sup> World Bank, *Transition in Afghanistan: Looking Beyond 2014, Executive Summary*, November 2011, p. 2.

- **Literacy:** 28% literacy of population over 15 years of age (43% male, 12.6% female)

Even these estimates tacitly assume that there is no increase in the negative economic impacts of the insurgency and civil violence following US and ISAF withdrawal. They ignore the impact on drug production, and the behavior of criminal networks and large numbers of armed men who will suddenly be unemployed. *There is a clear need to do far more to assess the impact of given levels of aid and spending on the fact that Afghanistan is still at war, has hundreds of thousands of armed fighters, and faces an unstable Pakistan and insurgent sanctuaries that seem all too likely to survive transition.*

### ***The Human Impact of “Transition” on a Sub-Subsistence Economy***

It is equally important to give gross econometrics a human dimension. Some aid reporting implies Afghanistan has begun to move towards broadly based, stable development. As has been shown earlier, the UN WFP provides a far more realistic picture of the fact that, absent significant external aid, many Afghans still live below the subsistence level.<sup>42</sup>

The WFP also notes that aid cuts are already having a major human impact: “Starting this month, WFP is cutting school meals, food-for-training activities and food-for-work programs in about half of Afghanistan’s 34 provinces. WFP hopes to resume these activities in the near future if funding becomes available. WFP, which is 100 percent voluntarily funded, had originally planned to feed more than 7 million people in Afghanistan in 2011, but a shortage of donor funds means the agency will now only reach about 3.8 million people this year.”<sup>43</sup>

These reports are supported by the recent reports of the UN Secretary General and by the CIA World Factbook, which states:

Despite the progress of the past few years, Afghanistan is extremely poor, landlocked, and highly dependent on foreign aid, agriculture, and trade with neighboring countries. Much of the population continues to suffer from shortages of housing, clean water, electricity, medical care, and jobs. Criminality, insecurity, weak governance, and the Afghan Government's inability to extend rule of law to all parts of the country pose challenges to future economic growth. Afghanistan's living standards are among the lowest in the world. While the international community remains committed to Afghanistan's development, pledging over \$67 billion at four donors' conferences since 2002, the Government of Afghanistan will need to overcome a number of challenges, including low revenue collection, anemic job creation, high levels of corruption, weak government capacity, and poor public infrastructure.<sup>44</sup>

While such data are as uncertain as all the other data on the country, the CIA has never revised its estimate that indicates at least a third of the population is unemployed and lives below the poverty line.<sup>45</sup> Moreover, no meaningful estimates now exist of the

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<sup>42</sup> UN World Food Program, [ww.wfp.org/countries/Afghanistan/Overview](http://www.wfp.org/countries/Afghanistan/Overview)

<sup>43</sup> <http://www.wfp.org/news/news-release/wfp-support-hungry-afghans-hit-funding-shortfalls>

<sup>44</sup> <https://www.cia.gov/library/publications/the-world-factbook/geos/af.html>

<sup>45</sup> <https://www.cia.gov/library/publications/the-world-factbook/geos/af.html>

number of internally displaced persons and the number of Afghans driven into marginal, urban-based lives by security problems, water issues, and population growth.

## **Narcotics, the Grey and Black Economy, Power Brokers, Criminal Networks. And Transition Flight**

The failure to try to estimate, and analyze, the impact of corruption, criminal gangs, and narcotics on the Afghan economy is one of the most critical areas of incompetent and dishonest economic analysis, and a major problem for Transition. Capital flight is already a problem, but Transition is almost certain to trigger a major wave of new narcotics growing, push power brokers and officials into even higher levels of corruption, and strengthen the ties between organized criminal gangs, the police, and various officials.

It does not make sense to assume that Transition is going to encourage broader reform of the economy in ways that allow planners to ignore the impact of narcotics, the gray and black economies, the roles of power brokers and criminal networks, and the inevitable flight on some rich Afghans and Afghan capital out of the country.

There will be obvious incentives for Afghans to seek larger earnings from narcotics, and there already are some shifts in this direction. The UN Office on Drugs and Crime (UNODC) reported on October 11, 2011, that:<sup>46</sup>

Opium poppy-crop cultivation in Afghanistan reached 131,000 hectares in 2011, 7 per cent higher than in 2010, due to insecurity and high prices, said the *2011 Afghan Opium Survey* released by the Ministry of Counter Narcotics (MCN) and the United Nations Office on Drugs and Crime (UNODC). "The Afghan Opium Survey 2011 sends a strong message that we cannot afford to be lethargic in the face of this problem. A strong commitment from both national and international partners is needed," said the Executive Director of UNODC, Yury Fedotov.

Farmers responding to the Survey cited economic hardship and lucrative prices as the main reasons for opium cultivation. In 2011, 78 per cent of cultivation was concentrated in Helmand, Kandahar, Uruzgan, Day Kundi and Zabul provinces in the south, and 17 per cent in Farrah, Badghis, Nimroz provinces in the west, which include the most insecure provinces in the country. This confirms the link between insecurity and opium cultivation observed since 2007.

...In 2010, opium yields fell sharply due to a poppy blight, which was a major factor behind the price rise. In 2011, however, yields were back to around 45 kg per hectare, potentially raising opium production to 5,800 tons - up 61 per cent from 3600 tons produced in 2010. Buoyed by higher speculative prices arising from volatile security conditions, the farm-gate income of opium farmers rose markedly. With dry opium costing 43 per cent more today than in 2010, the total farm gate value of opium production is set to increase by 133 per cent: from \$605 million to \$1,407 million in 2011.

The final 2011 UNODC estimate of narcotics activity in 2011 is summarized in **Figure Twenty-Six**. Somewhat amusingly, it presents yet another – and very different – estimate of the total size of the Afghan GDP. What is far more important is that the UNODC

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<sup>46</sup> <http://www.unodc.org/afghanistan/en/october/2011/opium-production-in-afghanistan-shows-increase.html>. The full details can be found in UNDOC, *Afghanistan Survey 2011, Summary Findings*, October 2011

survey reveals a projected increase in narcotics production in 2011, and the UNODC estimate for 2012 indicates that this level is likely to be as high in 2012.<sup>47</sup> The text in the final UNODC report for 2011 notes that,<sup>48</sup>

In 2011, several troubling trends emerged. The foremost was the dramatic increase in the value of the opium economy. In 2010, major opium-cultivation areas were affected by plant diseases that led to a large yield reduction (29.2 kg/ha). In 2011, opium yields were back to “normal” levels of 44.5 kg/ha. When compared to 2010, opium production increased by 61% from 3,600 mt in 2010 to 5,800 mt in 2011. However, as with other scarce commodities, the greatly reduced supply of fresh opium from the 2010 harvest time triggered a spectacular rise in opium prices.

Between 2009 and 2010, dry opium prices at harvest time increased to US\$ 169/kg from US\$ 64 in 2009, a jump of 164%. This increase continued until the first quarter of 2011 when prices began to level off. Between 2010 and 2011, dry opium prices at harvest time increased to US\$ 241 from US\$ 169/kg, a jump of 43%. Not surprisingly, this significant increase in 2011 opium prices and production resulted in a 133% increase in the farm-gate value of opium production compared to 2010.

The farm-gate value of opium amounted to US\$ 1.4 billion, about 9% of the GDP estimate for 2011. While the farm-gate value was expected to be higher than 2010 when opium production was affected by plant diseases, the 2011 farm-gate value far exceeded levels reached in other years with similar or higher opium production due to higher opium prices. Similarly, in 2011, the gross per-hectare income from opium cultivation (US\$ 10,700) reached levels not observed since 2003.

When considering potential income from the opium production for the Afghan economy, numbers are striking, as well. The potential export value of opiates amounts to US\$ 2.4 billion or 15% of GDP; the domestic market worth about 1% of this year’s GDP. These amounts cannot be easily substituted by other economic activities. Opium is therefore a significant part of the Afghan economy and provides considerable funding to the insurgency and fuels corruption.

This situation presents a worrying possibility, given that farmers surveyed in 2011 cited the high sale price as the most important reason (59%) for cultivating opium poppy in 2011. The high level of opium prices in 2011 continues to provide a strong incentive to plant opium in the upcoming poppy season. In 2011, the ratio between gross income from opium and wheat, the main crop cultivated in the same agricultural season as opium, was 11:1, the most unfavorable ratio for wheat since 2003.

This high opium price, however, may not last long. A similar phenomenon was observed in 2004 when opium production fell due to disease and prices rose. The price hike then was relatively short-lived, lasting less than a year. Another disquieting development in 2011 was the 7% increase since 2010 in the total area devoted to opium cultivation in Afghanistan. In statistical terms, this change was not significant and may rather indicate a stable situation. However, it is worrying to note that opium cultivation in Afghanistan has not seen any major decline since 2009. Afghanistan continues to account for just under two-thirds of global opium cultivation.

The increase in 2011 in the number of provinces growing opium is also unsettling. In 2011, 17 provinces grew poppy compared to 14 in 2010. Furthermore, the number of provinces that remained poppy-free (17) decreased by 3 compared to 2010 (20). Kapisa in the Eastern region, Baghlan and Faryab provinces in the Northern region lost their poppy-free status in 2011.

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<sup>47</sup> UNDOC, Opium Survey 2012, Opium Risk Assessment for all Regions (Phase 1&2), April 2012, pp. 2-3.

<sup>48</sup> Source: UNDOC, Afghanistan Opium Survey, 2011, October 2011, pp. 5-6.

Ninety-five per cent of the Afghanistan cultivation took place in nine provinces in the Southern and Western regions - the most insecure provinces in the country. Most of the districts in these regions were inaccessible to the United Nations and NGOs. This strong link between insecurity and opium cultivation confirms that the less secure areas are the most likely to grow opium. Thus, Hilmand, one of the most dangerous provinces in the country remains the single largest opium-cultivating province, growing almost half of all opium in Afghanistan (48%).

Opium cultivation in Hilmand province decreased by 3% in 2011. While at the province level, this indicates a stable situation in statistical terms, diverging trends were observed within the province. The central part of Hilmand (Marja, Lashkargah (Provincial Center), Nawa-i-Barukzayi and Garm Ser districts) witnessed a massive reduction in opium cultivation, mainly due to the implementation of comprehensive counter-narcotics strategies by the Ministry of Counter Narcotics and the Governor of Hilmand province. The district of Marja south of Nad Ali district, which witnessed very strong cultivation in the past, had negligible cultivation this year. Similarly, North of Garm Ser district markedly reduced its opium cultivation this year. However, the strong reduction in the opium cultivation in central Hilmand did not compensate for the increase in cultivation in northern and southern areas of Hilmand province. Strong increases in opium cultivation were observed in some regions. In the Central region, North-eastern and Western region, cultivation increased by 45%, 55% and 12% respectively. In the Eastern region there was a dramatic increase of 276% (719 hectares in 2010 to 2,700 hectares in 2011) in Nangarhar province where, due to tough resistance from anti-government elements (AGE), proper eradication did not take place and cultivation increased. There was also an increase of poppy cultivation in the Northern region where two provinces namely Baghlan and Faryab lost their poppy-free status in 2011. In the Southern region, opium poppy cultivation remained at about the 2010 level (+2%).

One positive change in 2011 concerns opium eradication. The hostile security situation continued for eradication campaigns as most opium cultivation was confined to the Southern and Western provinces which are affected by insurgency and organized crime groups. However, the total hectares of opium fields eradicated increased in 2011 by 65%, from 2,316 hectares in 2010 to 3,810 hectares in 2011. But, as eradication increased in 2011, so too did the number of security incidents during the Governor-led eradication (GLE) in 2011, GLE teams were attacked 48 times compared to 12 times in 2010. Fortunately, however, there were fewer deaths in 2011. Twenty eradication-campaign-related fatalities were reported in 2011 (mostly of policemen) compared to 28 such fatalities in 2010.

These UNODC data are a warning that reveal a major ongoing problem in the entire counternarcotics effort may not survive Transition. Not only is there no clear evidence that ten years of effort will produce a meaningful reduction in output after Transition, the UNODC analysis indicates that even in an Afghan economy driven by vast flows of aid and military spending, narco-trafficking is estimated to account for some 15-16% of the GDP in 2011.

This estimate of export value is far more important in understanding the impact of Transition than estimates of the value of farm gate prices – particularly since the percentage of the total GDP is likely to rise sharply as the direct and indirect impacts of military and aid spending decline.

Farm gate prices are somewhat useful in estimating the value of narcotics vs. other crops – although such comparisons are of very questionable value given the fact that farmers can often grow both, the economics of narcotics are shaped by narcotraffickers and their pressure and investment in farmers, and the legal risks in growing narcotics have to be balanced against the more demanding water and climate conditions for other groups. It is absurd, however, to measure the farm gate value of the crop against the total GDP. The value of the narcotics industry is determined largely by the value added during the series

of transactions and processing that occur beyond the farm gate. Farm gate prices are meaningless as a measure of the importance of narcotics to the Afghan economy.

Similarly, it is dishonest and misleading to ignore the economic and practical impact of narcotics on the broader pattern of corruption in the Afghan police, justice system, and Afghan officials; and the strong ties that often exist between power brokers, officials, police-justice officials, other forms of criminal gangs, and narco-traffickers. The failure to conduct such analysis may suit the politics of organizations like the World Bank, but it is just as dishonest as talking about shifting funds from direct aid to control by the Afghan central government without talking about the scale of waste and corruption and real world ability to absorb and use the money. It represents a fundamental lack of professional integrity on the part of any organization that does so.

Furthermore, any meaningful Transition planning must look at the problem of capital flight. It does not take much vision to calculate what will happen to narcotics, criminal networks, and corruption if the Afghan economy is driven towards recession or depression as part of the Transition process. Moreover, power brokers may well shift to a regional and ethnic effort to exploit aid, and the gray and black portions of the economy to their benefit. It is also all too likely that many Afghans will not stay and invest, they will take their wealth and leave the country.

*Figure Twenty-Six: The Continuing Importance of a Domestic Narco-Economy*

	2010	Change on 2010	2011
Net opium poppy cultivation (after eradication) in % of global cultivation*	123,000 ha (104,000-145,000) 63%	+7%	131,000 ha (109,000-155,000) 63%
Number of poppy-free provinces <sup>2</sup>	20	-3	17
Number of provinces affected by poppy cultivation	14	+3	17
Eradication	2,316 ha	+65%	3,810 ha
Weighted average opium yield **	29.2 kg/ha	+52%	44.5 kg/ha
Potential production of opium <sup>3</sup> ** in % of global production*	3,600 mt (3,000-4,200) 74%	+61%	5,800 mt (4,800-6,800) 82%
Average farm-gate price (weighted by production) of fresh opium at harvest time	US\$ 128/kg	+41%	US\$ 180/kg
Average farm-gate price (weighted by production) of dry opium at harvest time	US\$ 169/kg	+43%	US\$ 241/kg
Current GDP <sup>4</sup>	US\$ 12.7 billion		US\$ 16.3 billion
Total farm-gate value of opium production in % of GDP	US\$ 0.6 billion 5%	+133%	US\$ 1.4 billion 9%
Potential gross export value of opiates in % of GDP	US\$ 1.4 billion (0.9-2.1 billion) 11%	+79%	US\$ 2.6 billion (2.1-3.4 billion) 16%
Potential net export value of opiates in % of GDP	US\$ 1.2 billion (0.6-2.0 billion) 9%		US\$ 2.4 billion (2.1-2.9 billion) 15%
Farmers' gross income from opium per ha <sup>5</sup>	US\$ 4,900	+118%	US\$ 10,700
Farmers' net income from opium per ha	US\$ 2,900	+121%	US\$ 6,400
Ratio of farmers' gross (net) income from wheat to opium	1:6 (1:4)		1:11 (1:8)

\* Based on provisional estimates for some countries and regions.

\*\* Refers to oven-dry opium.

<sup>1</sup> Numbers in brackets indicate the upper and lower bounds of the estimation range.

<sup>2</sup> Poppy-free provinces are those that are estimated to have less than 100 ha of opium cultivation.

<sup>3</sup> The 2010 opium production estimate takes into account the impact of disease on opium yield by combining different approaches. This introduces an additional uncertainty that, however, could not be expressed in statistical terms.

<sup>4</sup> Nominal GDP of the respective year. Source: Government of Afghanistan, Central Statistical Office.

<sup>5</sup> Income figures are indicative only as they do not include all expenditure and income components associated with opium cultivation.

Source: UNDOC, Afghanistan Opium Survey, 2011, October 2011, p. 2.

## **The US, ISAF, and Afghanistan Cannot Rely on Mines and the “New Silk Road” for Transition**

Both the Afghan government and outside organizations and donor governments put far too much faith in development goals whose potential importance to Transition has been sharply exaggerated. Transition cannot be successful if it relies on either mining income or a set of projects called the “New Silk Road.”

### ***A Mining Option for the Future, Not for Transition***

The mining option has long-term benefits, but saying that Afghanistan has \$900 billion to \$1.4 trillion worth of resources in the ground says nothing about what can be done during Transition as short and mid-term gains are likely to be limited. A stable, secure Afghanistan with improved lines of communication may be able to generate a major increase in mining revenues over time. The resources shown in **Figure Twenty-Seven** have significant mid to long-term potential – although similar estimates have grossly exaggerated real-world commercial potential in past cases.

The practical problem is that Afghanistan is not stable, is not secure, and does not have the lines of communication required for large-scale rapid investment at the level required. Nor can it physically create major mine output and earnings in the short period of time necessary for Transition.

Working studies of the potential of the Afghan mining industry warn that growth will be slow, and Russia, China, the US, and Europe are likely to be cautious about investment. An analysis of the prospects for Afghan mining found that the entire sector now accounts for less than 1% of GDP, with public revenues of only \$32 million in 2010. Quarries of construction materials account for virtually all employment – tens of thousands of Afghans – while the employment impact of mines like Aynak – which require investments of billions of dollars and 5 to 10 years to develop – is negligible.

The near term increase in earnings from all extractive industries would total around \$20-\$25 million by 2016. Even assuming full security and rapid investment and development, the maximum increase by 2020 would be around 90,000 jobs (mostly indirect) and \$500 million in added national income.

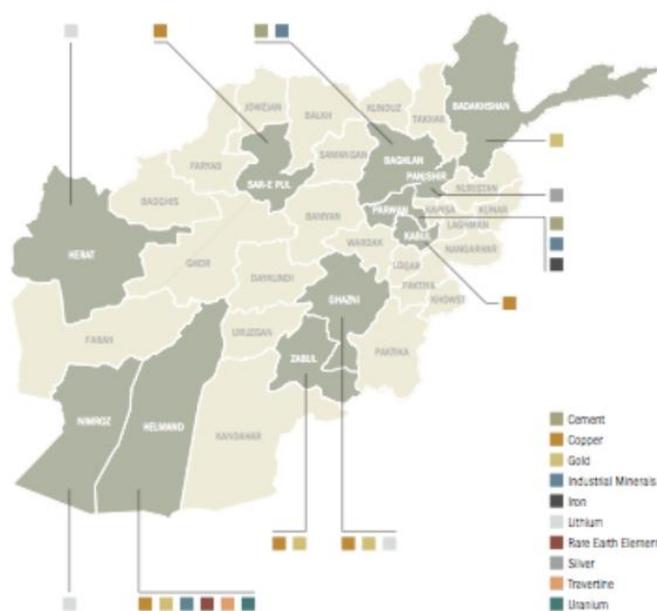
It will take 10-20 years of steady investment and development on the ground to have a major impact, although important progress could be made in 5-10 years in peaceful and stable areas if Afghanistan can create an investment climate attractive to outside investors. Afghanistan currently ranks 167<sup>th</sup> out of 183 countries in the World Bank’s 2011 index for ease of doing business, and ranks worst in the world for protecting investors and trading across borders.

*Figure Twenty-Seven: Hopes for a “Rich” Future are Not a Plan: Mining Potential*

MINERAL RESOURCES (NON-FUEL): ESTIMATED POTENTIAL GROSS IN-PLACE VALUE, DECEMBER 2009		
Mineral (non-fuel)	Amount (Tonnes)	Value (\$ Billions)
Iron	1,490,944,000	420.85
Copper	40,895,800	274.00
Niobium	3,500,000	81.20
Cobalt	600,000	50.82
Gold	685	25.00
Molybdenum	724,010	23.89
Rare earth elements	1,400,000	7.41
Asbestos	13,365,563	6.32
Silver	9,067	5.34
Potash	27,513,690	5.09
Aluminum	2,290,175	4.43
Graphite	1,055,223	0.67
Lapis lazuli	1,300	0.65
Fluorite/fluorspar	8,791,000	0.64
Phosphorus	6,200,000	0.58
Lead and zinc	243,900	0.55
Mercury	32,234	0.50
Strontium	329,100	0.41
Sulfur	6,450,000	0.23
Talc	1,250,000	0.16
Magnetite	31,200	0.16
Kaolin	—	0.05
<b>Total Estimated Value</b>		<b>908.95</b>

Note: — = not available.  
 Source: DoD, TFBSO, "Afghan Economic Sovereignty: Establishing a Viable Nation," 6/14/2010, p. 5.

POTENTIAL RESOURCES IN 11 PROVINCES



Note: Potential resources identified during TFBSO visits.  
 Source: DOD/TFBSO, response to SIGAR data call, 7/14/2010.

MINERAL RESOURCES (FUEL): ESTIMATES OF POTENTIAL CURRENT VALUE			
Resource	Primary Location	Quantity	Potential Value (Billions)
Crude oil	Afghan-Tajik Basin	1,596 billion barrels	\$123.2 (at \$77.19/barrel)
Natural gas	Amu Darya Basin	15,687 billion cubic feet	\$56.3 (at \$3.59/MMBtu)
Natural gas liquids	Amu Darya Basin	562 million barrels	\$43.4 (at \$77.19/barrel)
<b>Total</b>			<b>\$222.9</b>

Source: SIGAR, Quarterly Report, July 2010, pp. 102-103

***The “New Silk Road” is a Poor Cover, Even for an Exit Strategy***

Unfortunately, some experts have rushed forward to promote a concept called the “New Silk Road” without adequate analysis, and in ways that suggest they are far more interested in finding a political cover for a rapid exit than a credible approach to reducing the problems of Transition.

There is nothing wrong with the concept of building up lines of communication and transport to both develop the Afghan economy and create regional development. Preliminary studies, however, provide a clear warning that even extremely favorable assumptions indicate the “New Silk Road” has no practical prospect of dealing with the near and perhaps mid-term problems of Transition.

A study entitled “Afghanistan & Regional Economic Cooperation, Economic Impact Assessment” (Phase I, June 7, 2011) illustrates the challenges involved in making such analyses:

- It assumes a state of peace, effective and relatively honest governance, and the ability to implement projects without criminal or political interference. None of these assumptions seem credible until well after 2014, if then. (See p. vii, 56, 64-65) the study summarizes other critical limitations on p. 11
- The study examines 15 tangible projects and five sets of improvements and reforms in government (p. ii). Many of the 15 projects have no plan or cost benefit analysis as of yet. The five projects involving government require major improvements in governance, legal reforms, reductions in corruption, and levels of security and stability that are highly unlikely to exist. (pp. 50-55.).
- The study does note the need for future critical path analysis (p vii), but uses timescales (p. 8) that sometimes are extraordinarily optimistic, particularly given the fact that five of the 15 tangible projects are not yet scoped to the point where meaningful scheduling and cost benefit analysis is possible.
- It is not possible from the study to clearly determine benefits for Afghanistan versus benefits for outside workers, investors, and countries (p. vi, 2-4).
- The study recognizes that the success of a number of projects is dependent on cooperation from neighboring governments and their development policies but does not analyze whether this is the case in critical countries like Pakistan – where it does not seem to be Pakistani policy (e.g. p. 5, 63).
- Estimates of job creation are uncertain, and generally involve large multipliers of indirect impacts based on examples drawn from other countries, most of which seem to have been more developed, stable, and peaceful (pp. 7, 10). The benefits are reported in terms of jobs created within five years and after five years, although there are now at most three years to Transition. If one looks at the details, only 148,988 new jobs would be created even with these assumptions within three years, and the maximum of 824,709 jobs shown for “5+ years” could take 10-15 years to create (p. vi and see individual project analyses).
- These issues are critical, because the study notes that (p. 7) investments need to add 100,000-200,000 new jobs to the economy each year if the unemployment rate is to reduce well below the 35% mark where it is currently stuck. However, CIA World Factbook reports 392,116 males and 370,295 females reached job age in 2010. The US census bureau estimates a population increase from 32.6 million in 2015 to 36.6 million in 2020 – which means an increase of roughly 4 million during the five years in the study estimate versus creation of 824,709 under best case assumptions.
- The study claims significant increases in national per capita income without supporting analysis of the entire Afghan economy, demographics, or economic trends other than the activity in the New Silk Road (pp. vi, 10, 58, Annex 2).
- The Economic Internal Rate of Return (12%) only finds “the projects would be viable under market based financial conditions, and this assessment seems to ignore corruption, problems in government capacity, and security risks in assessing rates of return (pp. v, 56, 59-60).

A CENTCOM summary of some of the key data involved is shown in **Figure Twenty-Eight**. USCENTCOM recognizes the need for extensive additional analysis to determine the cost-benefit of such concepts, and the new timeline and funding conditions created by Transition. It sets forth the following needs for planning and analysis:

- Human terrain analysis of PIPs.
- Assist the Afghan government to complete an Afghan rail plan.
- Expand map and gap analysis.
- Economic consequences of the provincial Transition.
- Assess the economic impact of the drawdown on the Afghan economy.

*Figure Twenty-Eight: USCENTCOM Summary Data on the New Silk Road*

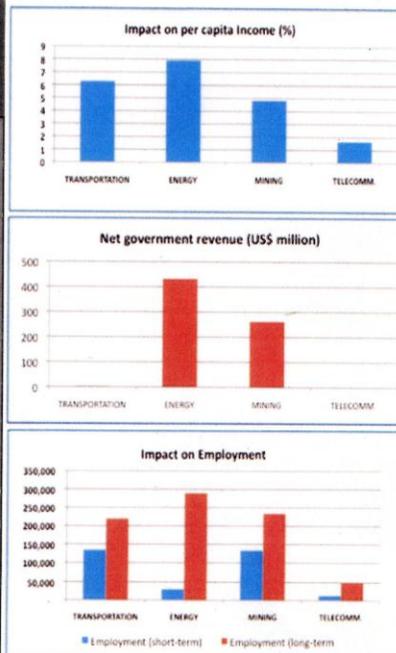
**Costs**

- NSR is not new, it is already underway.
- The NSR is composed of 81 projects costing \$47.2 billion.
- \$10.0 billion has been spent or committed.
- \$28.3 billion in rail, gas pipeline, and mining projects lend themselves to private sector investment.
- Two of the remaining unfunded projects, large hydroelectric projects, valued at \$5.8 billion, won't be started until late in this decade.
- The unfunded balance \$4.3 billion.

**The Solution: Reliance on private sector investors, encouraging U.S. allies to invest more heavily and focusing on projects that only support trans-regional trade.**

**Key Projects**

SRI Priority Investment Projects	EIRR (%)	JOBS		GDP (% per yr)
		1-3 YRS	3+ YRS	
Project 5. Kabul-Jalabad-Peshawar Expressway	25.0	8,770	6,069	0.10
Project 4. Afghanistan North-South Corridor	21.6	2,721	9,838	0.22%
Project 15. Fiber Optic Ring	19.5	--	64,233	4.30%
Project 1. Afghan Ring Road Completion	18.3	1,296	10,309	0.52
Project 7. Afghanistan-Pakistan Rail Links	18.0	16,758	103,060	2.41%
Project 11. TAPI	16.8			
Project 2. Salang Tunnel Rehabilitation and By-pass	16.0			
Project 10. CASA 1000	15.6	--	131,577	3.3%
Project 14a. Aynak Copper Mine	13.7	38,289	179,126	2.7%
Project 14b. Hajigak Iron Ore Mine	13.7	38,287	110,737	2.1%
Project 8. Sherkhan Bandar to Herat Rail Line	13.3	38,477	172,249	3.01%
Project 9. Sheberghan Gas Fields Development	13.1	4,443	107,412	5.14%
Project 13a. Kokcha Multi-Purpose Dam	12.9	--	75,609	1.9%
Project 13b. Kunar Basin Hydropower	12.9	--	--	--
Project 12. Southern/Northern Electrical System	--	--	--	--



Source: USCENTCOM, August 2011

## **ANSF Development as a Steadily More Uncertain Element of Transition**

ISAF and its training mission, National Training Mission Afghanistan (NTM-A), did make major progress in developing the Afghan forces after 2009, and some aspects of this progress have accelerated over time. As **Figure Twenty-Nine** shows, it may be possible to expand the different elements of the ANSF to over 352,000 men during the period of Transition. This is uncertain, however, given the current problems with attrition and AWOLs shown in **Figure Twenty-Nine**, the lack of suitable numbers of expert outside trainers, and the uncertainty as to whether the funding will be available to field so large a mix of military and police forces for any length of time.

In any case, successful Transition will also depend more on creating a force that is affordable and effective than one that is large. Current plans talk about a force of 230,000 and a budget reduced to around \$4.1 billion a year, but it is not clear such plans will be put into practice, how the current force goals will be adjusted, what budget will actually be available, and how much the Afghan government can spend of its own revenues. The security situation remains unpredictable, as do the challenges posed by peace negotiations, and the police effort presents special problems both because of corruption and because it is being developed without a matching real-world justice system and Afghan government presence in the field.

It is unclear whether the US and its allies are willing to fully fund the necessary development and support effort through 2014 and for as long as it takes after this time to achieve lasting security and stability – a truly massive funding effort that so far has dominated total aid expenditures in Afghanistan.

### ***Transition and the Regular Armed Forces***

Unless far more progress is made towards a real peace than now seems likely, a successful Transition will be equally dependent on major training and partnering efforts that last well beyond 2014 and possibly to 2020. This will be critical to give Afghan forces quality as well as quantity, limit the impact of corruption and power brokers, create an Afghan Air Force that is not scheduled to have even basic force size and equipment before 2016, and give the Afghan Army the time necessary build up its overall structure, command and control capability, infrastructure and sustainment capability, maintenance and other services.

The *Department of Defense Report on Progress Toward Security and Stability in Afghanistan* for October 30, 2011 makes it clear that there are still many limitations to the force development effort for the Afghan Army and Air Force:<sup>49</sup>

- Even with this progress, the growth and development of the ANSF continues to face challenges, including attrition above target levels in the ANA and some elements of the ANP, leadership

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<sup>49</sup> [http://www.defense.gov/pubs/pdfs/October\\_2011\\_Section\\_1230\\_Report.pdf](http://www.defense.gov/pubs/pdfs/October_2011_Section_1230_Report.pdf)

- deficits, and capability limitations in the areas of staff planning, management, logistics, and procurement. The ANSF continues to require enabling support, including air (both transport and close air support), logistics, ISR, and medical, from coalition resources to perform at the level necessary to produce the security effects required for Transition. The influence of criminal patronage networks on the ANSF also continues to pose a threat to stability and the Transition process. Further, the drawdown of U.S. and international forces increases the risk of a shortfall of operational partnering resources, which could reduce the ANSF-ISAF operational partnership and may impede ANSF development (p. 4).
- Successful Transition of the lead for security responsibilities to the ANSF is heavily dependent on a healthy, sustained partnering and advising relationship. These security assistance relationships create the conditions by which ANA and ANP forces can develop and become effective in defeating the insurgency, providing security for the local population, and fostering legitimacy for the Afghan Government. These relationships provide the ANSF with the ability to operate in a complex, counterinsurgency environment while also providing operational space and timing to man, equip, and absorb critical training. As the ANSF continues to grow and the U.S. and coalition forces begin to draw down, the gap between the requirements for partnering and available resources will grow. This gap threatens to undermine force development and may pose a risk to the Transition process. As a result, IJC is currently reviewing all partnering relationships to align with projected force levels and ensure resources are used to the greatest effect in the areas where they are most needed. As of September 30, 2011, there are seven critical shortfalls for the ANA and 88 shortfalls in the ANP in focus districts (31 AUP [Afghan Uniformed Police], 22 ANCOP [Afghan National Civil Order Police], and 35 ABP [Afghan Border Police]). These shortfalls do not account for U.S. forces departing theater without backfills due to the ongoing surge recovery, and shortfalls are expected to increase as U.S. and coalition forces continue to draw down (p. 40).
  - As of September 2011, the MoD is assessed as requiring some coalition assistance to accomplish its mission (a rating of CM-2B, a status it achieved in October 2010). Overall, NTM-A [NATO Training Mission Afghanistan]/CSTC-A [Combined Security Transition Command Afghanistan] anticipates the MoD moving to CM-1B by early 2013, with full Transition of most offices and functions to CM-1A by mid-2014 (p. 16).
  - Although progress is being observed and assessed in a number of areas across the MoI, challenges remain that must be addressed. Civil service reform, both in personnel management and pay, is a recurring deficiency, both in the MoI and the MoD. The September 3, 2011 Ministerial Development Board recommended that Public Affairs be held in the CM-1B testing phase until civilian pay reform is achieved. The MoI Civil Service Department remains behind schedule largely because it lacks a permanent director and empowerment to effect change, as well as adequate office space, logistical support, office equipment and Internet connectivity needed to accomplish its basic functions. The Civil Service Department also requires support from the MoI senior leadership to implement the Afghan Government Public Administration Reform Law and to include conversion to the reformed pay scale. A strong partnership with provincial governors is required to improve hiring at the provincial level. The challenges surrounding civil service reform have already impeded Public Affairs' advancement and could obstruct overall MoI capacity, progress, and sustainment (p. 18).
  - Shortfalls in the institutional trainer requirements set forth in the CJSOR [Combined Joint Statement of Requirements] still exist and continue to impede the growth and development of the ANSF. CJSOR v11.0 is the current document supporting trainer requirements. As of the end of the reporting period, the shortfall in institutional trainers is 485, a decrease of 255 from the March 2011 shortfall of 740, with 1,816 deployed trainers currently in-place against the total requirement of 2,778. The United States currently sources 1,331 non-CJSOR trainer positions. In order to temporarily address the NATO CJSOR shortfall and fill the U.S.-sourced non-CJSOR requirements as quickly as possible, the United States has implemented a series of requests for information from other coalition partners, including unit-based sourcing solutions to address short-term training needs. (p. 19-20).

- In order to maintain the accuracy of personnel figures, NTM-A/CSTC-A continues to review and revise the end-strength reporting process. During the reporting period, this constant review process highlighted a failure to report training attrition, which has resulted in a large discrepancy between actual and reported ANA end-strength numbers. After agreeing upon an accurate end strength for September, NTM-A and ANA leadership implemented new policies and procedures to ensure training base attrition is accurately reported in the future. Strong leadership within the ANA Recruiting Command (ANAREC) and effective and mature processing within National Army Volunteer Centers, which induct recruits into the ANA, has enabled adjustments to current recruiting plans in order to prevent delays in achieving the objective end-strength levels. NTMA/CSTC-A continues to work closely with and support the ANA in rectifying manning issues to ensure growth to the JCMB-endorsed ANA end-strength goal of 195,000 personnel by the end of October 2012 (p. 22).
- Although recruiting and retention are continuing at a strong pace, if the high levels of attrition seen during this reporting period continue, there is a risk that the ANA will not be able to sustain the recruitment and training costs currently incurred to achieve the October 2012 growth goal. Historic trends show that attrition is seasonal, rising in the fall and winter and declining in the spring. The main causes of attrition in the ANA are poor leadership and accountability, separation from family, denial of leave or poor leave management, high operational tempo, and ineffective deterrence against soldiers going absent without leave (AWOL) (p. 22). Nevertheless, President Karzai issued a decree in April 2011 renewing the policy of amnesty for AWOL officers, NCOs, and soldiers who return to their units voluntarily until March 2012. This extension has the potential to impede the ANA's ability to decrease attrition.
- The ANA is projected to still have only 57,600 NCOs to meet a requirement of 71,900 in November 2012.
- The AAF's [Afghan Air Force] long-term development strategy includes the creation of an air force that can support the needs of the ANSF and the Afghan Government by 2016. This force will be capable of Presidential airlift, air mobility, rotary and fixed-wing close air support, casualty evacuation, and aerial reconnaissance. The AAF also plans to be able to sustain its capacity through indigenous training institutions, including a complete education and training infrastructure. The air fleet will consist of a mix of Russian and Western airframes. Afghan airmen will operate in accordance with NATO procedures, and will be able to support the Afghan Government effectively by employing all of the instruments of COIN airpower. This plan, however, is ambitious, and is indicative of the tension between Afghan Government aspirations, necessity, and affordability (pp. 31-32).
- In August 2011, the total number of reporting ANA units in the field increased to 204, and the number of units achieving an operational effectiveness rating of "Effective with Assistance" or higher was sustained at 147; alternatively, 37 units (18 percent) of fielded ANA units are in the lowest assessment categories, "Developing" or "Established," due to an inability to perform their mission or the immaturity of a newly-fielded unit. Even the ANA's highest-rated *kandak*, 2<sup>nd</sup> *kandak*, 2nd Brigade, 205th Corps, which achieved the rating of "Independent," remains dependent on ISAF for combat support and combat enablers. In locations without a large ISAF footprint, the ANA has exhibited little improvement and there is little reporting on their operational strengths and weaknesses. These units are typically located in the west and far northeast regions (p. 43).

Given the state of the ANA at the end of 2011, it is far from clear that the US, other donors, and the Afghan government can create the kind of army called for in current plans with the resources that will be available, that the current force goals can be met with the necessary quality, that enough outside trainers and partners will be available, and that the Afghan government can deal with the economic impact of funding such a force and its civil and police needs.

- This is critical to every aspect of the economics of Transition because there are direct links

between the capability of the ANA and the ability to secure traffic across the Pakistani border, and along critical roads like the Afghan ring road that circulates the country. Most Transition planning tacitly assumes that Afghanistan will be broadly secure at the end of 2014, and that there will be enough security to allow development and the relatively secure flow of trade. There is little evidence to date that such an assumption will be valid, and it seems even less likely if the US, other donors, and the Afghan government cannot create an effective Army.

### ***Transition and the Police Forces***

The aforementioned 2011 *Department of Defense Report on Progress Toward Security and Stability in Afghanistan* makes it clear there are even more serious limitations to the development effort for the various Afghan police forces:

- Despite indicating positive developments in ANP force generation, NTM-A recently determined that 3,940 officers and 6,733 patrolmen were filling NCO billets; large numbers of officers and patrolmen placed against vacant NCO positions overstates the development of the NCO ranks. Removing officers and patrolmen from NCO-designated positions would result in an actual officer strength at 102 percent, patrolmen strength at 113 percent, and NCO-assigned strength at 66.7 percent against authorized positions. NTM-A and IJC, along with ANP leadership, will focus on growing the NCO corps by 12,700 in order to close this gap (p. 34).
- Untrained patrolmen remain the biggest challenge for the AUP and NTM-A/CSTC-A, and the MoI continues to push the recruiting base in order to ensure all available training seats are used. As of September 2011, the AUP had a total of 11,919 untrained patrolmen and NCOs. AUP attrition remains the lowest of all police pillars at 1.3 percent, and has consistently remained below the monthly attrition objective of 1.4 percent for the last 11 months (November 2010 - September 2011) (p. 36).
- As of September 2011, the Afghan Border Police (ABP) end strength was 20,852 personnel. The ABP remains on schedule to meet all growth objectives for officers and patrolmen, but remains short of NCOs, with only 3,800 of an assigned total of 5,600. This shortfall, as well as the shortfall of untrained patrolmen, remains the primary focus for training efforts.
- Although overall attrition in the ANP has remained near target levels for the past year, high attrition continues to challenge the ANCOP in particular, which has experienced an annual attrition rate of 33.8 percent; although this has decreased significantly from 120 percent annual rate in November of 2009, it remains above the accepted rate for long-term sustainment of the force. As a national police force rotating from outside areas, it has avoided the corruption that was once seen in other police pillars. Although ANCOP units' effectiveness initially suffered from runaway attrition that stemmed largely from extended deployments and high operations tempo, the adoption of a 12-week recovery and retraining period between deployments has improved this situation.
- Building a capable and sustainable ANP depends on acquiring the equipment necessary to support the three basic police functions: shoot, move, and communicate. Accordingly, significant equipment uplift for the ANP began during the reporting period, which is expected to increase the ANP's on-hand equipment to approximately 80 percent by the spring of 2012. Despite progress, however, the ANP remains underequipped as a result of fielding challenges. Due to these shortages, the MoI has developed fielding priorities based on operational requirements. To address the delay in processing supply/equipment requests, the MoI Material Management Center established a Customer Care Center in April 2011. This single point-of-entry clearinghouse for supply/equipment requests has been a success, significantly reducing response times (pp. 37-38).
- The ANP's logistics system remains particularly limited, both in facility development and in assigned and trained logistics personnel. The biggest challenge in developing logistics support to the ANP is the hiring and training of civilian personnel, as civilians make up 50 percent of the logistics workforce. Civilian hiring will continue to be a challenge until the MoI institutes civil service reforms (p. 38).

- The ANP has demonstrated improvement in its ability to conduct limited, independent policing operations and to coordinate operations with other ANSF elements. These improvements are largely attributable to a number of exogenous factors, including low insurgent threat levels in the given operating environment and ISAF enablers. ISAF mentor reporting shows that the majority of ANP units still rely heavily on coalition assistance, especially in contested areas. As with the ANA, the operational performance of ANP units is also suffering from U.S. and coalition force reductions. Each of the three ANP pillars saw an increase in the number of units that were not assessed due to recently-fielded units that are not reporting or not partnered due to lack of available coalition forces. Within the ABP, 11 of the 12 units were not assessed due to long standing partnering shortages. Additionally, four ANCOP *kandaks* located throughout theater were not assessed. Finally, within the AUP in key terrain districts, 17 of the 22 units not assessed were in RC-C (p. 45).
- Currently, the MoI Force Readiness Report is the Afghan system for reporting ANP data. Unfortunately, at this time, the report only focuses on the statistics for personnel and equipment: shoot, move and communicate. There are no ratings associated with the data and no commander's assessment or narrative comments to describe issues and challenges. The positive aspect of the report is that the MoI collects, aggregates, and builds its own reporting products with minimal coalition oversight (p. 46).

Even if these problems did not exist, the entire police development effort would be limited by the lack of progress in governance, creating the other elements of rule of law, and the permeating climate of corruption, interference by power brokers, and the impact of criminal networks. Moreover, political pressure is already growing that can divide the ANSF by ethnicity and may be a prelude to post withdrawal power struggles.

Moreover, corruption is endemic within the police, as is the abuse of power and extortion. The current unclassified readiness and capability assessment systems being used to show progress within the ANP are virtually meaningless since they do not assess the integrity of police units. Worse, unclassified reporting does not indicate the scale of police coverage in any given district, or show whether the other elements of governance and the justice system are present, and whether there are detention facilities. No unclassified effort is made to assess areas where the police (and sometimes Army) do not interfere with insurgent operations or have de facto arrangements that allow both to operate in ways that affect commerce and transportation.

The present system for reporting on progress in the police is almost solely oriented towards force generation and support of counterinsurgency. The system that ISAF uses to assess the ANP (which is nearly identical to the ANA assessment system) overstates the capabilities of the police, because it focuses on manning, equipping, and training – instead of focusing on more important factors such as corruption, loyalty, and the functioning of the justice system. The ANP is essentially being trained to become a light paramilitary COIN force, with little in the way of traditional police training. In most areas, the police are not linked to a functioning justice system at all.

These are not casual issues since they too affect every aspect of the Afghan economy. Moreover, the present separation of the police development effort from matching efforts to improve governance and the rule of law creates another set of problems. Police forces cannot operate in a vacuum. They need a successful government presence and popular governance to win the support of the people and support for their justice efforts. There must be prompt justice of a kind the people accept and find fair enough to support or

tolerate. Incarceration must set acceptable standards and jails must not become training and indoctrination facilities for insurgents and criminal networks.

### *Is Successful Transition still possible for the ANSF?*

It should be stressed that the problems in the ANSF might well be solvable with time, advisors, and funds. **Figure Thirty** shows, however, that past funding levels which were planned to be available to support the force goals shown in **Figure Twenty-Nine** have already proved to be unsustainable in today's political and budget climate, while the race to withdraw US and allied forces is already underway.

NTM-A and ISAF have already taken steps to adapt to the new timescale and funding levels they face, but they have not yet openly changed force goals that are highly ambitious, may be unfundable after 2014, and stress the entire system.

This leaves three options:

- Fund and support the ANSF plan in something approaching its current character for as long as it takes to defeat the insurgents, if – as now seems almost totally unlikely – this proves possible.
- Act immediately to reshape the ANSF plan to create more realistic goals and costs without false optimism, and seek Congressional and Allied support for a smaller, cheaper, and still effective force.
- Go on to force NTM-A and ISAF to downsize resources while keeping the current force goals, and create a hollow force that will be unsustainable after Transition – repeating the mistake made in Vietnam on a very different level.

So far, the official choice seems to be option one. It is an effort to go to the total force strength called for in current plans with less focus on force quality and future affordability. As noted earlier, however, the US and other governments are discussing ISAF plans that call for a force of only 230,000. They are also examining major cuts in pre-Transition spending and cuts in post-Transition spending to \$4.1 billion a year – versus the \$7-9 billion called for in early 2011. It is not clear exactly what this force would look like, and the US is simultaneously seeking to cut the US share of the spending from around 80% to 25%.

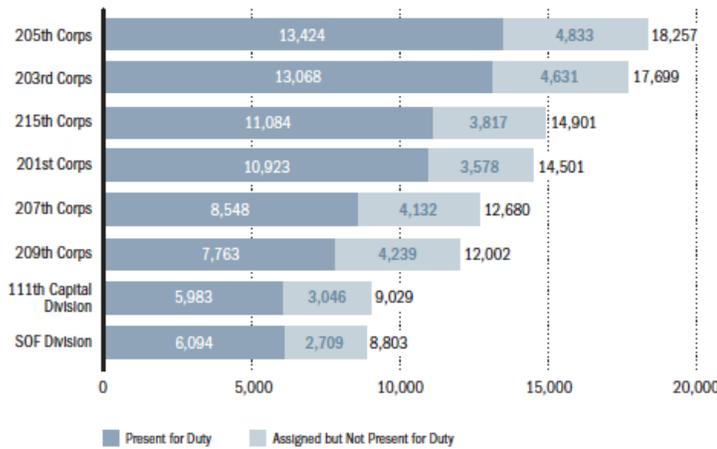
The economics of Transition depend on a successful Transition to an Afghan lead in security. The worst possible option is to create an Afghan force that can last through 2014, but becomes a dysfunctional façade once most US and allied troops are gone. Keeping US and ISAF force levels high to 2014, preparing the ANSF as if it would have continuing support in funds and advisors, and then leaving it unsupported would repeat the mistakes of Vietnam in turning potential success into abandonment and Afghan defeat.

Accordingly, one of the acid tests of any economic plan for Transition is that it addresses the future of the ANSF in explicit terms and ways that are practical and properly funded. As is the case with every element of Transition, there is no point in succeeding in one part of Transition if a plan cannot be funded and executed that deals with all of the problems in Transition.

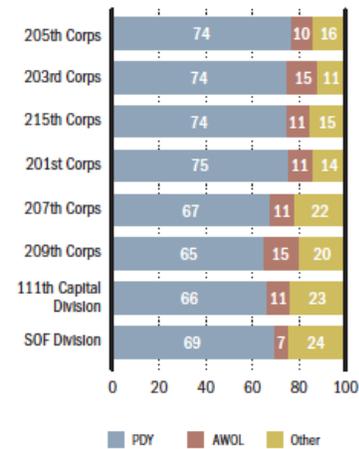
Figure Twenty-Nine: ANSF Forces and Force Goals – Part One

ANSF FORCE STRENGTH AGAINST TARGET GOALS			
Priority	Targets	Status This Quarter	Change Since Last Quarter
Afghan National Army	171,600 troops by 10/2011 195,000 troops by 10/2012	176,354 personnel (as of 11/2011)	+7,278
Afghan National Police	134,000 personnel by 10/2011 157,000 personnel by 10/2012	143,797 personnel (as of 12/2011)	+7,675

ANA PERSONNEL STRENGTH, SELECTED COMPONENTS, ON NOVEMBER 25, 2011



ANA PERSONNEL PRESENCE, SELECTED COMPONENTS, ON NOVEMBER 25, 2011 (PERCENT)



ANP FORCE STRENGTH, DECEMBER 2011

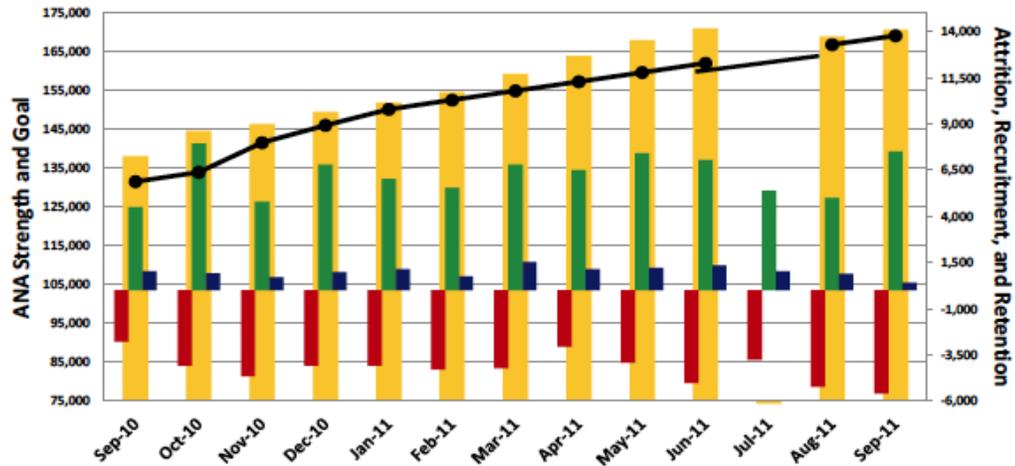
	Authorized (Tashkil)	Assigned to Tashkil Positions	Not Assigned to Tashkil Positions
ANP (Total Strength: 143,797)	138,121 <sup>a</sup>	135,957	7,840 <sup>c</sup>
<b>Breakdown By ANP Component</b>			
AUP	80,275	80,718	—
ABP	23,086	21,203	—
ANCOP	13,678	15,540	—
Other Units	21,082 <sup>b</sup>	18,496 <sup>b</sup>	—

Note: AUP = Afghan Uniform Police. ABP = Afghan Border Police. ANCOP = Afghan National CMI Order Police. — = not available.  
 a. Includes authorized AUP, ABP and ANCOP personnel in addition to authorized personnel for MoI headquarters, anti-crime, training, counter-narcotics, traffic, medical, intelligence, and fire units.  
 b. Includes personnel authorized for or assigned to MoI headquarters, anti-crime, training, counter-narcotics, traffic, medical, intelligence, and fire units.  
 c. Students enrolled in initial entry training programs.

Source: SIGAR, Quarterly Report, July 2010, pp. 92-93, and Quarterly Report, January 30, 2012, p. 72, 74, 80

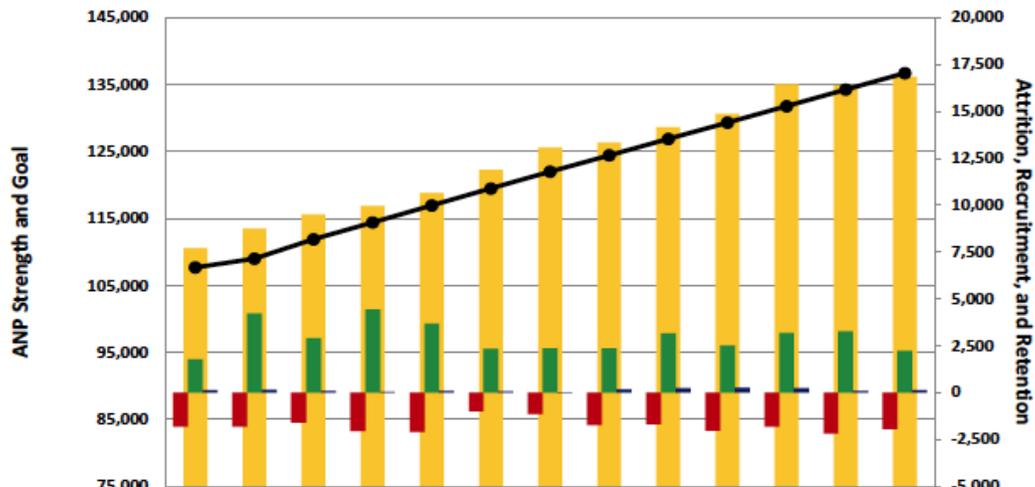
Figure Twenty-Nine: ANSF Forces and Force Goals – Part Two

ANP End-Strength (September 2010 – September 2011)



	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11
Actual	138,164	144,638	146,352	149,553	152,034	154,614	159,363	164,003	168,037	171,050	0	169,076	170,781
Attrition	-2,781	-4,082	-4,649	-4,085	-4,075	-4,295	-4,213	-3,045	-3,935	-5,027	-3,766	-5,219	-5,574
Recruitment	4,500	7,956	4,800	6,815	6,018	5,540	6,819	6,500	7,435	7,050	5,393	4,997	7,513
Retention	1,030	912	709	993	1,139	750	1,524	1,140	1,208	1,351	1,037	903	419
Goal	131,600	134,000	141,637	146,115	150,242	152,615	154,988	157,361	159,734	162,100		166,900	169,200

ANP End-Strength (September 2010 – September 2011)



	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11
Actual	110,559	113,472	115,584	116,856	118,812	122,219	125,589	126,291	128,622	130,622	135,029	134,865	136,122
Attrition	-1,809	-1,809	-1,620	-2,056	-2,108	-1,004	-1,160	-1,730	-1,693	-2,043	-1,813	-2,186	-1,954
Recruitment	1,767	4,214	2,892	4,429	3,673	2,336	2,362	2,362	3,164	2,508	3,167	3,254	2,230
Retention	113	153	93	54	75	60	27	179	233	251	237	90	117
Goal	107,689	109,000	111,885	114,414	116,943	119,471	122,000	124,440	126,880	129,321	131,760	134,257	136,708

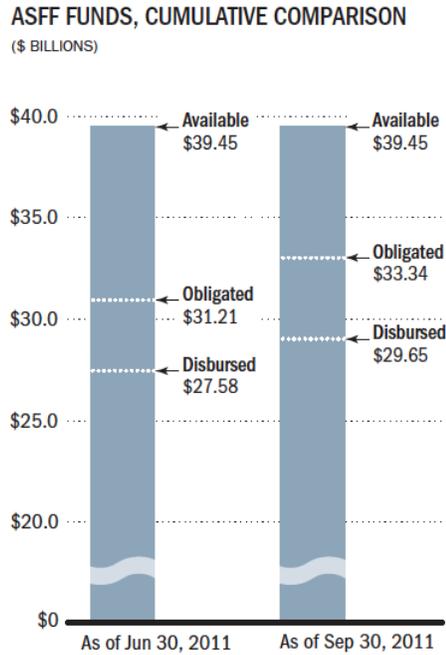
Source: Department of Defense, *Report on Progress Toward Security and Stability in Afghanistan*, October 2011, pp., 23 and 35.

*Figure Thirty: ANSF Funding Levels: Past and Projected*

**Past and Current Spending on ANSF**



Note: Numbers affected by rounding.  
Sources: DoD, response to SIGAR data call, 10/17/2011; P.L. 112-10, 4/15/2011.



Note: Numbers affected by rounding.  
Sources: DoD, response to SIGAR data call, 10/17/2011; P.L. 112-10, 4/15/2011.

**Pre-Transition Plans for ANSF Aid Spending During 2013-2024**

<b>PROJECTED ANSF EXPENDITURES, 2008/09–2023/24</b>				
	2008/09 <sup>a</sup>	2013/14	2018/19	2023/24
<b>Expenditures by Security Force (\$ BILLIONS)</b>				
ANA <sup>b</sup>	\$3.2	\$3.8	\$5.0	\$6.5
ANP <sup>c</sup>	\$1.5	\$1.7	\$2.1	\$2.7
<b>Total</b>	<b>\$4.7</b>	<b>\$5.5</b>	<b>\$7.1</b>	<b>\$9.2</b>
<b>Expenditures Relative to Revenues (PERCENT)</b>				
ANSF Expenditures as a Share of Projected GIRoA Domestic Revenues	449%	270%	195%	154%

Notes: Numbers affected by rounding. Includes operating and investment expenditures.  
 a. Estimated actual.  
 b. World Bank Manpower Level Assumptions: ANA strength increases to 240,000 by 2012/13; ANP strength increases to 160,000 by 2013/14. These differ from the troop levels agreed to at the January 2010 London Conference, which were 171,600 for the ANA and 134,000 for the ANP by October 2011.  
 c. Macroeconomic assumptions: Afghanistan's long-term GDP growth rate averages 6% annually; inflation decreases to 3% in 2012/13 and beyond; GIRoA domestic revenue rises to 13% of GDP by 2028/29.  
 Sources: World Bank/DfID, "Afghanistan Public Expenditure Review 2010: Security Sector," pp. 23–24; DoD, "Report on Progress Toward Security and Stability in Afghanistan," 4/2010, pp. 104, 115.

Source: SIGAR, Quarterly Report, July 2010, pp. 92-93, and Quarterly Report, October 2011, p. 48

***The Problem of the Afghan “Local Police”***

The ANA and ANP, however, are only part of the story. There are other Afghan forces that present funding and security challenges that affect the post-Transition Afghan economy. ISAF has made real progress in selected areas in combining efforts to create local police that respond to the regular police and government, and where the creation of such security forces is part of a broader effort to create civil governance and economic aid efforts.

The Afghan Local Police are one of these forces. SIGAR reports that the ALP had 10,594 members as of December 31, 2011. ALP members operated at 150 sites; mentored by the Combined Joint Special Operations Task Force (CJSOTF-A) and ISAF Regional Commands East and Southwest. The goal was to provide a total of 30,000 members in 99 districts, and in the ALP headquarters in Kabul, by 2014. CSTC-A and CFSOCC-A had obligated \$37.9 million of Afghan Security Forces Fund (ASFF) funds to support the ALP and cover its salaries as of December 31, 2011.<sup>50</sup>

As US official reporting indicates, this effort goes far beyond simply creating a militia, and potentially offers a key way to address the critical Transition problems in providing effective security and reasons to be loyal to the central government at the local and district levels.<sup>51</sup>

The Combined Joint Special Operations Task Force – Afghanistan (CJSOTF-A) began conducting Village Stability Operations (VSO) in February 2010. VSO is a bottom-up COIN initiative that establishes security areas around rural villages to promote local governance and development. VSO uses Afghan and ISAF Special Operations Forces embedded in the community full-time to help improve security, governance, and development in more remote areas of Afghanistan where the ANSF and ISAF have a limited presence.

Each VSO consists of a 12-man team that embeds in a village and regularly engages local Afghans, enabling a level of situational awareness and trust otherwise unattainable. VSO teams are supported by a Village Stability Platform (VSP), which includes a range of enablers and supporting elements. Along with medical, air, civil affairs, and military information teams, VSPs also include units focused on linking the district and provincial levels of governance and development to the national government. Further, Provincial

...Augmentation Teams, in partnership with Provincial Reconstruction Teams, help VSPs to build local governance and improve development. In districts with VSO, Afghan satisfaction with access to essential services has uniformly increased over the last three months. Further, analysis of attack levels before and after a VSP is established indicates, after a brief increase in insurgent attacks, a steady improvement in security conditions throughout the community. The VSO initiative has resulted in such noticeable improvements in security, governance, and development that Taliban senior leaders have identified the VSO initiative as a significant threat to their objectives.

Significant success has prompted the program to expand. The VSO initiative began with five VSPs covering 1,000 square kilometers; as of this report, CJSOTF-A has 6,000 personnel in 103 locations throughout Afghanistan, covering approximately 23,500 square kilometers. To support this growth, the VSO initiative now supplements Special Forces with conventional forces.

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<sup>50</sup> SIGAR, *Quarterly Report*, January 2012, p. 83.

<sup>51</sup> Department of Defense, *Report on Progress Towards Security and Stability in Afghanistan*, October 30, 2011, pp. 66-67

Currently, the 1-16th Infantry and the 1st/505th Parachute Infantry Regiment are augmenting Combined Forces Special Operations Component Command – Afghanistan (CFSOCC-A) presence to enable the expansion of VSO sites across the country.

There were more than 48 operational Afghan local police sites, and more than 50 additional sites pending, at the end of 2011: <sup>52</sup>

Established in August 2010 by President Karzai, the Afghan Local Police (ALP) program is part of the VSO initiative. ALP is a village-focused MoI initiative that complements ISAF's COIN strategy by training local Afghans in rural areas to defend their communities against threats from insurgents and other illegally-armed groups. The ALP program is a complementary component to the VSO program; although not all VSO sites have ALP units, all ALP units are a part of an existing VSO site. In the latter phases of a VSO, village elders may, through a *shura*, elect to establish an ALP unit.

These prospective ALP sites are validated by the MoI, which conducts an evaluation and officially approves the district for ALP development. A district is considered officially validated when the Afghan Government officials meet with the local officials to formally agree that the given district demonstrates both a need and a desire for an ALP unit. The MoI has approved 100 districts for ALP units as of September 2011; of those, 48 districts have been validated by their district *shura* and collectively represent a force of about 8,100 ALP. In conjunction with counsel from U.S. Special Operation Forces and IJC, the Afghan Government has authorized an ALP end-strength of 30,000 patrolmen.

The MoI requires ALP candidates to be 18-45 years of age. They must be nominated by local community *shuras*, vetted by the MoI, and biometrically-enrolled in the ALP program. Weapons must be registered in order for the ALP unit to receive the MoI funding provided for authorized program positions. ALP members sign one-year service contracts, work part-time, and are paid approximately 60 percent of the basic salary for an ANP patrolman. Upon termination of their respective contracts or of the ALP unit, qualified members are eligible for integration into the ANP.

...U.S. Special Operations Forces currently conduct a three-week ALP training program that introduces basic security and policing skills...As a purely defensive force, ALP units are not equipped for offensive operations nor are they permitted to grow beyond the size in their *tashkil*, which amounts to approximately 30 patrolmen per village and 300 per district. ALP patrolmen have detention but not arrest authority, and conduct investigations under the direct supervision of the Deputy District Chief of Police.

Despite these limitations, ALP units have proven effective in disrupting insurgent activities by denying them safe havens and limiting their freedom of movement; the improved security enables development and governance projects for the community...Each ALP unit coordinates its operations extensively with the ANSF, coalition forces, local *shuras*, and Afghan Government officials, which helps build and strengthen the link between local governance and the central government. The units are also overseen by the village *shura* that originally sponsored them, as well as U.S. Special Operations Forces. This extensive oversight by both Afghan and coalition members helps to ensure ALP operations are effective and conducted in accordance with Afghan law.

The ALP program continues to increase in strength and effectiveness, and the ALP have proven to be a significant threat to the insurgency in key areas throughout Afghanistan. In response to this, insurgents have engaged in intimidation campaigns and targeted assassinations against ALP members and their families. These attacks have largely failed to intimidate ALP forces and local

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<sup>52</sup> Department of Defense, *Report on Progress Towards Security and Stability in Afghanistan*, October 30, 2011, pp. 66-67

communities, which continue to defend their villages effectively against insurgent attacks.

The ALP add to the cost of Afghan forces, and they cannot be set up and maintained without a major presence from highly-skilled Special Operations Forces (SOF), military, and aid workers in the field. The history of similar forces is also one of relatively rapid collapse when that presence (and money) leaves and all of the problems in governance, local corruption, and local custom return. They also have already led to extensive unofficial “copycat” units that are abusive, corrupt, and tied to local power brokers.

As the Department of Defense Reports,<sup>53</sup>

Despite its significant success, the ALP program faces a number of challenges. The program is heavily dependent on Special Operations Forces for training, mentorship, and oversight. The approved expansion to 30,000 ALP patrolmen will likely strain the capacity of the coalition Special Operations Forces in Afghanistan, and may require additional conventional forces in order to adequately support projected ALP growth.

Further, the proliferation of independent, non-sanctioned militias outside the VSO framework threatens to undermine the legitimacy and progress of the ALP program. Although limited in number, these unauthorized groups exacerbate the concern that the ALP program risks empowering local strongmen who will either use the ALP program to incorporate their own militias into the government structure, or will brand their militias under the ALP title to further their own illegal interests. Illegally-armed militias in Kunduz Province, for example, posing as ALP patrolmen, have been collecting illegal taxes and have engaged in a number of armed conflicts with other local groups, degrading local security conditions and fostering negative perceptions of the ALP program. Also during the reporting period, a Human Rights Watch report accused some ALP units of abusive practices. ISAF has undertaken to investigate these allegations. The ALP is also challenged by ethnic tensions; although *shuras* are largely effective in ensuring fair tribal and ethnic representation in ALP units, some units actively resist recruiting certain ethnicities, which can create significant ethnic tension in rural villages

President Karzai has reinforced these Transition problems, as well as the problems created by the ethnic divisions within Afghanistan by disbanding another force called the Critical Infrastructure Police that was set up by ISAF in Afghanistan’s four northern (and largely non-Pashtun) Balkh, Kunduz, Jowzjan and Faryab provinces. Elements of these forces were certainly corrupt and supported northern leaders like the governor of Balkh Province that had little loyalty to Karzai. They had some 1,200-1,700 members per provinces and were paid as much to not extort the population as to give it security. Nevertheless, the net effect was to compound ethnic tensions – particularly as Karzai did little to deal with the corruption and abuses of regular and local police that were Pashtun or more directly under his control.<sup>54</sup>

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<sup>53</sup> Department of Defense, *Report on Progress Towards Security and Stability in Afghanistan*, October 30, 2011, pp. 66-67. For further reporting, see David Alexander, *Afghan security contractor oversight poor: Senate report*, Reuters, [Washington](#), Fri Oct 8, 2010 6:58am EDT; Ray Rivera, *Obstacles Hinder Formation of Afghan Security Force, Report Says*, New York Times, November 1, 2011; and Congressional Research Service, *Wartime Contracting in Afghanistan: Analysis and Issues for Congress* <http://www.scribd.com/doc/73041739/Wartime-Contracting-in-Afghanistan-11142011>.

<sup>54</sup> Matthew Rosenberg and Alissa J. Rubin, *Afghanistan to Disband Irregular Police Force Set Up Under NATO*, New York Times, December 26, 2011.

### ***Private Security Contractors and the Afghan Public Protection Force***

President Karzai has created another, potentially greater problem for the economics of Transition by trying to rush the disbandment of private security forces in ways that seem more oriented toward enhancing his power over security contracting and key aspects of government, military, and aid spending than security. ***Figure Thirty-One shows that just the portion working for the Department of Defense totaled 20,375 in the fall of 2011. They have been*** responsible for securing ISAF sites and convoys, diplomatic and non-governmental organization personnel, and development projects. ISAF and diplomatic missions, along with their development partners, employed some 34,000 contract security guards from Private Security Companies (PSCs), of which some 93 percent were Afghans.<sup>55</sup>

***Figure Thirty-One: Private Security Personnel Working for the Department of Defense in Afghanistan***

	<b>As of 7/7/2011 PSC Contractors</b>	<b>As of 12/9/2011 PSC Contractors</b>	<b>5-Month Difference PSC Contractors</b>
U.S. citizens	693	570	-123
Third-country nationals	1,282	897	-385
Afghan nationals	13,330	18,908	+5,578
<b>Total</b>	<b>15,305</b>	<b>20,375</b>	<b>+5,070</b>

Source: SIGAR, Quarterly Report, January 2012, p. 84.

No one doubts that private forces have been a problem, but so is setting impossible standards for replacing them and putting security functions into the hands of new, corrupt, and incapable central government forces. The Department of Defense reported that,<sup>56</sup>

By 2010...many PSCs were operating outside of Afghan law and customs as well as U.S. Government requirements, and PSC performance was often marked by poor discipline and safety. As a result, President Karzai issued Presidential Decree 62 in August 2010 directing many PSCs to be disbanded by December 2010 and replaced by the Afghan Public Protection Force (APPF). ...Although the decree included exceptions for Embassies and diplomatic personnel, it soon became clear that the APPF could not adequately replace PSCs in such a short time period. In order to allow time for the APPF to develop, the Afghan Government, together with the international community and ISAF, developed a 12-month bridging strategy for the further implementation of Decree 62.

The strategy is divided into categories to address the three distinct types of PSC operations: diplomatic, development, and ISAF. Diplomatic entities are exempt from Presidential Decrees and associated regulations applicable to PSCs. In contrast, at the conclusion of the bridging period, development entities and ISAF are expected to contract for their security services through the

<sup>55</sup> Department of Defense, *Report on Progress Towards Security and Stability in Afghanistan*, October 30, 2011, pp. 66-67

<sup>56</sup> Department of Defense, *Report on Progress Towards Security and Stability in Afghanistan*, October 30, 2011, pp. 66-67

APPF. The 12-month bridging period began on March 22, 2011, and terminates on March 20, 2012. At the end of this period, as determined by its capacity and capability, the APPF will increasingly assume responsibilities, in priority order, for the security of ISAF and ANSF construction sites and for ISAF bases. In the event the APPF does not possess the capacity or capability to assume this responsibility, there is a conditions-based extension in the bridging strategy to allow PSCs to continue to provide services for an additional 12 months. The bridging strategy also called for disbanding seven PSCs due to close ties with Afghan officials. During June and July 2011, ISAF replaced all contracts held by these seven PSCs, which included 34 contracts and nearly 4,000 guards.

Of the 46 remaining PSCs, 43 PSCs have renewed licenses and have been certified as compliant, while the remaining three continue to work with the MoI to become relicensed. All remaining PSCs, however, barring the extension of the current bridging strategy, will be disbanded by March 2012, with the exception of those PSCs providing security services to diplomatic activities, which will continue to operate indefinitely.

...ISAF and the U.S. Embassy are assisting the MoI to develop the management and command and control necessary for the APPF to meet the needs of the coalition and the international community. The APPF currently has a guard force of approximately 6,400, and is expected to integrate approximately 14,000 guards who are expected to Transition from existing PSCs to the APPF, while also generating additional forces of no fewer than 11,000 guards. In total, approximately 25,000 guards will be required by 2012 in order to support ISAF and implementing partner security requirements.

Key observations from the initial assessment indicated that the APPF was unable: 1) to execute and maintain the business operations necessary to remain a viable and solvent business; 2) to man (recruit, vet, train), pay, equip, deploy, and sustain guard forces to meet contract requirements; 3) to negotiate and establish legal and enforceable contracts with customers for security services; 4) to command and control security operations across Afghanistan; 5) to meet the requirements of the bridging strategy. Additionally, the APPF has not created an operational State-Owned Entity to support business operations essential to manage and execute contracted security services.

In sum, the APPF is not on track to assume the responsibilities for security services performed by PSCs, which, barring the extension of the current bridging strategy, are projected to be disbanded on March 20, 2012. Combined planning efforts are ongoing to resolve the identified issues in a timeframe that is consistent with President Karzai's original directive.

A study by ISAF and the Afghan Interior Ministry, reported in November 2011, found a whole new range of problems, and that 63 of 166 "essential" measures of the government's ability to recruit, train and sustain the guard force could not be attained at all and less than a third could be completely attained.<sup>57</sup> A report in the *New York Times*, based on reading the study, found that the MoI program "has no money available to procure necessary supplies and equipment." It also found that the training center was not teaching leadership skills and could not generate enough guards to meet the forecasted demand. It also found that the MoI failed to provide the seed money — about \$10 million — to prop up a state-owned business to run the program. The program had already failed to supply personnel and equipment for some of its contracts, the report said. Its authors concluded that the police protection force "is not on track" to assume the responsibilities of the private security companies by March.

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<sup>57</sup> Ray Rivera, *Obstacles Hinder Formation of Afghan Security Force, Report Says*, *New York Times*, November 1, 2011

An official working for Gen. John R. Allen, the commander of NATO forces in Afghanistan, stated on background that, “It’s become a top priority because if it doesn’t work, everything grinds to a halt...If it isn’t sorted out, everyone will pull out because they don’t want some fly-by-night security protecting them.”

A SIGAR report in January 2012 found similar problems with the entire APPF effort:

As noted in previous SIGAR quarterly reports, in August 2010, President Karzai had decreed that all national and international PSCs would be disbanded by the end of the year. Instead, the MoI announced in December 2010 that PSCs could continue to operate with new restrictions that would prevent them from conducting actions that fall within the authority of Afghan law enforcement agencies.

In March 2011, the Afghan government released its bridging strategy for Transitioning the lead on security from PSCs to the APPF. This strategy allowed PSCs that were licensed by the MoI and had agreed to certain staffing limitations to operate and perform security for diplomatic and ISAF projects; however, PSCs that perform security services for development and humanitarian projects were to be replaced by the APPF by March 2012.

In September 2011, the MoI, ISAF, and representatives of the U.S. Embassy Kabul completed a six-month assessment of the effectiveness of the bridging strategy and the capacity of the APPF, according to DoD. Specifically, the assessment reviewed whether the APPF will be able to effectively manage and provide security to ISAF and ANSF construction sites and ISAF bases at the end of the

bridging period. According to the assessment, the APPF was unable to carry out a number of tasks:

- Execute and maintain the business operations necessary to remain a viable and solvent business.
- Recruit, vet, train, pay, equip, deploy, and sustain guard forces to meet contract requirements.
- Negotiate and establish legal and enforceable contracts with customers for security services.
- Command and control security operations across Afghanistan.
- Meet the requirements of the bridging strategy. In addition, the APPF had not created a functioning state-owned entity to support the business operations that are essential to manage and execute contracted security services.

As of December 31, 2011, the APPF had 6,558 personnel, according to CSTC-A. Of those, 5,624 were assigned and present for duty—221 on the LOTFA [Law and Order Trust Fund for Afghanistan] tashkil (funded through the LOTFA) and 5,403 on the MoI tashkil. According to CSTC-A, all LOTFA-funded assigned APPF personnel are trained; however, training data for personnel on the MoI tashkil was not available, specifically for those assigned to security contracts. CSTC-A assumes that all APPF personnel on the MoI tashkil are trained either through ANP courses, the APPF training center, or through on-the-job training.

According to CSTC-A, the MoI is in the process of expanding the LOTFA tashkil to meet the requirements associated with the implementation of Presidential Decree 62. That decree, which President Karzai issued in August 2010, placed the responsibility for the provision of security services under the direct authority and oversight of the Afghan government through the APPF. PSCs previously provided these services.

Pending approval, the expanded tashkil is expected to authorize billets for 516 uniformed APPF members—including staff for the APPF Training Center and operational staff—to provide the expertise needed to provide security services to the international development community and

ISAF. The MoI is also expected to add billets for 130 civilians to support business operations within the APPF.

Replacing one existing problematic force with far inferior forces that are even more subject to corruption, presents many more problems for outside and domestic investors and companies, and makes basic security functions uncertain in what is still a war zone at government expense. This scarcely seems an aid to Transition.

### ***Making Security Force Planning a Key Part of the Economics of Transition***

The problems involved in sharpening and funding the complex mix of Afghan army, regular police, local police forces, militias, and contract or APPF security forces would be less important if they did not coincide so directly with efforts to create a broad Transition to ANSF security operations far more quickly than previously planned. The fact is, however, that the Transition to reliance on Afghan forces now has to be much quicker than US, ISAF, and NTM-A planners counted on even a year ago, and will have far less outside funding.

Moreover, the success of every element of the Afghan security forces is essential to creating a secure enough climate for the Afghan economy to function and develop, and to create significant outside investment. It is also an essential part of any successful Transition plan to sustain aid and economic advisory activity in the field as US and ISAF forces are withdrawn and aid workers and PRTs are removed.

This means that plans to deal with the civil aspects of Transition in the Afghan economy must be integrated with plans to develop the ANSF. They must also take explicit account of the probable level of security in given areas as outside military and aid workers depart, as well as who can provide security for domestic and internal ventures. There are few prospects of anything approaching local security in much of Afghanistan until long after 2014 – barring some “peace” arrangement that gives insurgents de facto control over high threat areas. No aid or economic plan that ignores the facts that the nation is at war and that key areas are likely to remain so long after 2014, has either practical value or credibility.

## **Conclusions**

There are massive political, security, and governance challenges in making an effective form of Transition. As stated in the introduction to this paper, the economic aspects of Transition are only one of a complex set of problems that must be addressed to bring any degrees of lasting security and stability to Afghanistan. This does not mean, however, that the economic aspects can be addressed with the carelessness and negligence that they have received to date.

### ***The Afghans Need Real World Goals and Help***

Studies by the World Bank and Afghan government -- and ongoing studies by the IMF, the US, and key European governments -- show that Transition requires major levels of continuing aid to avoid triggering major security and stability problems. This does not mean, however, that the Afghan government can realistically count on the kind of aid levels it has requested to date.

President Karzai requested some \$10 billion a year through 2025 at the Bonn Conference on November 30, 2011. He requested this aid to fund a program that sets ambitious goals for both security and development, called for equally ambitious reforms and improvements in governance, and called for the Afghan government to achieve full independence from outside support in 2030:<sup>58</sup>

- By 2015 Afghanistan will have taken over full responsibility for its own security, and will be leading development initiatives and processes with the confidence to make critical foundational investments that will lead to economic growth and fiscal sustainability.
- By 2025 Afghanistan will have eliminated its dependency on international assistance for funding to non-security sectors and will only receive support consistent with all other least developed nations. A robust and growing extractive industries sector will have developed. Through effective development and, improved delivery of Government services, the root causes of insurgency will be reduced and, in consultation with international partners, plans will have been put in place to reduce the size of the ANSF.
- By 2030 Afghanistan will be funding a professional, highly effective ANSF. Achievements in development and governance will see Afghanistan emerge as a model of a democratic, developing Islamic nations.

The Afghan government stated that meeting its goals requires some \$120 billion in aid over the period through 2025. This level of aid, however, is almost certainly too high to be credible, and many of the Afghan promises of reform in governance and to remove the economic barriers to growth and development are extremely unlikely to be kept.

### ***US and European Realities***

Regardless of what donor countries have said in the past, say at the coming Chicago Conference, or say in future conferences, it is nearly certain that the Afghan government cannot obtain the level of aid it requested at the Bonn Conference, particularly over a period that extends so far beyond 2014.

As has been shown earlier, many US and European actions have already begun to look like a cover for an exit strategy from Afghanistan. Military spending is already dropping sharply and will drop again in FY2013. Development aid from US, the largest aid donor, dropped from \$3.5 billion in FY2010 to about \$2 billion in FY2011. Aid to support democracy, governance and civil society dropped by more than 50%, and from \$231 million to \$93 million. Aid for "rule of law" dropped from \$43 million to \$16 million.<sup>59</sup>

Other countries are cutting their civil and military aid programs, and some NGOs are already having to eliminate key programs or withdraw from the country.<sup>60</sup>

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<sup>58</sup> The details were provided in a separate paper circulated in addition to the President's statement entitled, *Towards a Self-Sustaining Afghanistan, An Economic Transition Strategy. It was issued by the Government of the Islamic Republic of Afghanistan*, and dated November 29, 2011.

<sup>59</sup> Julian Borger, *Afghanistan conference promises support after troop withdrawal*, The Guardian, 5 December, 2011, <http://www.guardian.co.uk/world/2011/dec/05/afghanistan-conference-support-troop-withdrawal>.

<sup>60</sup> Julian Borger, *Afghanistan conference promises support after troop withdrawal*, The Guardian, 5 December, 2011, <http://www.guardian.co.uk/world/2011/dec/05/afghanistan-conference-support-troop-withdrawal>.

The first step in adequate economic Transition planning, therefore, is to be far more realistic about probable aid resources. There is a clear need for a coordinated effort by the US and other donors to determine what level of civil and military aid is credible over time, to coordinate as much as possible, and to work with the Afghan government to give it a more realistic basis for planning. Both Afghan aid requests and outside pledges need to be brought to more realistic levels, and plans need to be made which reflect these realities.

The US and other current donors also need to avoid trying to turn to other powers as “solutions” for their own unwillingness to spend. Pakistan has no money. Russia, China, and Iran seem remarkably unlikely to support either Afghan government hopes or the US and Europe in funding Transition. The US and its allies also need to be more honest about describing conferences as a form of success when only results on the ground actually count. Louise Hancock, Oxfam's Afghanistan policy officer described the Bonn conference as follows: “It's been another conference of flowery speeches: big on rhetoric and short on substance.”<sup>61</sup>

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[withdrawal](#); Rod Norland, *Aid Agencies in Afghanistan Fear Reversals* New York Times, December 6, 2011, p. A1; Steven Lee Myers and Rod Norland, *Afghans Say Assistance Will Be Needed for Years*, New York Times, December 6, 2011. P. A14.

<sup>61</sup> <http://www.oxfam.org/en/pressroom/reactions/oxfams-reaction-2011-bonn-conference-afghanistan>.

### ***Prospects for Transition in Afghanistan: The Problem of Resources***

The second step is to develop detailed plans for both the civil and military aspects of Transition that reflect a far more realistic assessment of the Afghan economy, the limits to Afghan civil governance, and the need to fund effective and affordable Afghan national security forces.

Even with the best and most realistic plans, Transition will not be easy and may well fail to produce a stable Afghanistan. Nevertheless, it seems likely that more realistic goals and funding plans could accomplish a great deal. For all of the problems listed in this analysis; US, IMF, and World Bank working studies do seem to indicate that continuing flows of affordable and carefully focused US and European aid could lead to a stable Transition. However, such a Transition would be incumbent upon the war making progress in defeating the insurgents at the political as well as military level, the Afghan forces becoming effective enough to replace the US and ISAF in most of the country, Afghanistan achieving enough political stability with reductions in corruption, Afghan governance improving at reasonable levels, and insurgent sanctuaries and Pakistan's actions in Afghanistan not growing worse and having a crippling impact.

There is little time, however, in which to make a credible start in becoming far more realistic about the Afghan economy, the impact of cuts in military and aid spending, and how best to handle the phase-down of aid and military spending while focusing on the limited assets the Afghan government and economy will have after 2014. Time and money cannot continue to be wasted at anything near the current levels.

Goals need to be far more modest, and the US and Europe must begin to act immediately. There are less than three years left before Transition in 2014, and there are no magic bullets that offer rapid growth and prospects for stability before 2020. This means creating a meaningful action plan that Congress, the media, area experts, and the American people can debate and commit themselves to supporting no later than Congressional approval of the FY2013 US budget. If President Obama cannot provide such a plan within several months, and then win the support necessary to implement it, any hope of salvaging lasting success in the war will vanish.

Even in an election year, there will be a need for a level of honesty and integrity that so far has been sadly lacking in most Transition planning.

Mobilizing US and European support for the war and continued aid and support to Afghanistan is already a critical issue. It is also an issue where success will depend largely on the US. If the US is to have any hope of bringing its European allies along at the required level of effort, it must show them – and Afghanistan and Pakistan – that it has the domestic support to act.

The risks and issues in dealing with Afghanistan's political, security, and economic problems cannot continue to be ignored or "spun" in presenting Transition plans to the US Congress and public or to the legislatures and publics of other donor countries. They require a level of transparency, integrity, and professionalism that can rebuild the trust necessary to earn public support.

