

Aid dependency and political settlements in Afghanistan

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Question

Produce an annotated bibliography of recent literature on aid dependency in Afghanistan and the degree to which declining international aid could be an existential threat to the (already fragile) political settlement.

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1. Overview

Afghanistan is highly aid dependent. Aid dependency is defined as when aid comprises around 10% of GDP and when in the absence of aid the state fails to perform many of its core functions (Bizhan, 2018b, p. 1016). The World Bank (2018) estimates that international aid currently comprises 40% of Afghanistan's GDP. Afghanistan is dependent on international aid to maintain state functions (Strand et al., 2017, p. 46).

Aid dependency has a number of features and consequences for Afghanistan, including:

- The Afghan national budget is split into an operating budget (e.g. salaries) and a development budget. Donors have contributed to both. International aid has been delivered both on-budget (through the Afghan government's budgetary processes and national systems) and off-budget (disbursed directly by donors to NGOs etc. who implement their projects). Donors have used off-budget aid mechanisms due to concerns about state weakness and corruption, and because of the need to deliver quick results post-2001.
- Off-budget aid has had unintended consequences: Bizhan (2018b) argues that there has been an over-reliance on off-budget aid, which has created a parallel public sector, fiscally larger than the permanent public sector, unintentionally undermining the development of permanent state institutions, the private sector, and in some cases state legitimacy (Bizhan, 2018 state fragility, p. 36).
- Development aid has largely been focused on short-term objectives, which has hampered progress in the medium to long-term (Bizhan, 2018b).
- A large fiscal gap: Bryd (2018) argues that the fiscal gap, which can only be bridged by international aid is the most important macroeconomic problem facing Afghanistan and it is likely to continue for the foreseeable future (p. 8 & p. 3). Afghanistan's current account is only in credit because of large international aid flows (World Bank, 2018).
- Delivery of public services: international aid has expanded public services, particularly in health and education. However, some of these services, for example, basic health services, are still delivered by NGOs (Bizhan, 2018b). It is unclear whether, in the absence of international aid, the government would be able to provide these services.

Aid dependency is related to and interacts with a number of other challenges that affect Afghanistan's socio-economic development. These challenges include:

- A weak centralised state with low capacity, which affects the delivery of public services (Bizhan, 2018b, p. 21).
- Rising poverty and unemployment amidst a worsening security situation with civilian casualties at their highest levels since 2002 (ART Consulting, 2018, p. 7). In 2016, there were 11,418 civilian war deaths and injuries, compared to 5,969 in 2009 (Bizhan, 2018b, p. 25).
- A displacement crisis: more than 1.7 million Afghans are internally displaced and more than 2 million refugees have returned to Afghanistan (mainly from Pakistan and Iran) since 2015 (World Bank, 2018, p. 1).
- Ongoing drought conditions, which impact agricultural production, rural livelihoods and food insecurity (World Bank, 2018, p. 3).
- The protracted conflict and the peace process with the Taliban: this affects state legitimacy as the government's anti-insurgency strategy has been ineffective, causing people to lose faith in the government (Bizhan, 2018b, p. 25). It has also contributed to increasing out-migration (Bizhan, 2018b). The continuing insurgency hurts confidence,

investment and the development of the private sector, undermining job creation (IMF, 2018).

- Opium production: valued at approximately 20-30% of GDP (World Bank, 2018, p. 4). The opium trade has helped to fund the insurgency.
- Corruption is widespread, for example the think tank Integrity Watch Afghanistan estimated in 2014 that USD 1.9 billion was paid in bribes, the most common form of corruption (de Toledo Gomes, p. 517). Aid inflows have also contributed to corruption (Strand et al., 2017).

Donors have warned the Afghan government that aid levels will decline in the future (ART Consulting, 2018). Aid levels are expected to approximately halve by 2030 (reducing from 40% of GDP to 20%). There is consensus in the literature that Afghanistan is aid dependent and also that it is sensitive to changes in international aid. For example, analysts agree that the slowdown in economic growth in 2013-2015 was due to the combination of declining international aid, the drawdown of international forces and the 2014 Presidential election (see for example, Bryd, 2016).

The literature reviewed for this report agrees that continuing international aid is needed to protect the gains made in Afghanistan since 2002 (see for example, Ghiasy, 2017). This is due to the low resilience of the Afghan state, which makes its economy and political system highly sensitive to shocks (Bizhan, 2018b). Afghanistan is a fragile state and a number of reforms would be needed to help the state move towards self-reliance (Bizhan, 2018b; IMF, 2018). However, literature searches for this report were unable to identify any projections concerning the minimum level of international aid needed to sustain the state's ability to function.

Analysts have warned that declining international aid would be an existential threat to the Afghan state. Sinno (2015) predicts that the Afghan state will "last so long as money continues to flow to it from international donors, but it will likely unravel soon thereafter, the way the government of Najibullah did" (p. 1827). Other analysts are more tempered in their predictions but argue that Afghanistan will need international assistance for years or decades to come (see for example, Rubin, 2018).

Declining international aid from major donors, according to the sources reviewed for this report, could very likely result in the collapse of the Afghan government and increased insurgency, and possibly result in a relapse into civil war (Ghaisy, 2017, p. 23). Rubin (2018) argues that the international community needs to develop a new regional consensus involving the regional powers, for example China and India, whose economic development plans require stability in Afghanistan.

2. The nature of aid dependency

The World Bank (2018). *Afghanistan Development Update, August 2018*. The World Bank Group.

<http://documents.worldbank.org/curated/en/985851533222840038/pdf/129163-REVISED-AFG-Development-Update-Aug-2018-FINAL.pdf>

Afghanistan has experienced slow economic growth since 2014 due to reductions in international aid, the drawdown of international forces and a worsening security situation (p. 1). International aid declined from USD 12.5 billion in 2009 to USD 8.8 billion in 2015 (p. 2). Slow economic growth has been accompanied by a decline in living standards: the proportion of Afghans living in poverty has increased from 38% in 2011/12 to 55% in 2016/17 (p. 1). Food insecurity has also increased from 30% in 2011/12 to 45% in 2016/17 due to continuing drought conditions reducing wheat harvests (p. 27).

Economic growth: Conflict negatively impacted economic growth in 2017 and prospects for 2018 and beyond will be heavily influenced by political and security developments (p. 1). Risks to economic growth in 2018 include increasing election-related violence, declining business confidence and worsening drought conditions (p.1). The World Bank argues that these risks can be partly mitigated by sustained international aid and continuing government reform processes to assure investors that governance will not deteriorate like that it did in 2014 (p. 1).

Economic growth is projected to be 2.4% in 2018, 2.8% in 2019 and 3.6% by 2021 (p. 14). The World Bank argues growth will increase as drought conditions abate and confidence picks up (p. 14). However, with a population growth rate of 2.7%, higher rates of growth will be needed to significantly improve incomes and livelihoods (p. 11). 2018 growth predictions assume there will be additional international aid, which will result in a projected budget deficit of 0.4% (p. 14). On-budget donor aid is projected to reach 13.7% of GDP in 2018 (p. 14).

In order to expand investment and employment opportunities the Government needs to maintain services and build private sector confidence (p. 30). This will require continued sound macroeconomic and fiscal management, continued reform progress, and avoiding any repeat of the disruptive political transition that followed the 2014 elections.

The trade deficit: The trade deficit remained stable during 2017 at around 40% of GDP (p. 1). Increases in exports were offset by increases in food imports and higher energy costs (p. 1). The trade deficit was financed almost entirely by foreign aid inflows (p. 7). Consequently, the current account¹ remained in surplus at the end of 2017 at approximately 1.6% of GDP (p. 9). In the medium term (2019-2021) the current account balance will move into deficit as aid inflows decline, reaching a deficit of 4.1% of GDP by 2021 (p. 14). As the current account surplus narrows, foreign exchange reserves will begin to decline from 2019, but will still be at comfortable levels by the end of 2021 (p. 14).

The impact of international aid: Economic projections are highly sensitive to the level and modality of aid flows (p. 15). Grants to Afghanistan are currently estimated at around 40% of GDP (p. 15). External grants are currently relied on to finance more than half of budget expenditures and vital off-budget security and service delivery functions (p. 15). Aid levels are expected to approximately halve by 2030 (to around 20 percent of GDP) (p. 15).

The World Bank argue that any sudden reduction in aid levels below the current committed levels would have major implications for fiscal sustainability (p. 16). This is because the Government of Afghanistan is facing major upcoming expenditure pressures due to taking on increased responsibilities in the security sector and meeting the maintenance costs of donor-financed assets and infrastructure (p. 16). The amount of aid that is on-budget also needs to increase to help the Government meet these upcoming pressures without causing disruption or negative impacts for service delivery (p.16).

A number of sectors rely on international aid. For example, international donors have financed almost half of all education expenditures (p. 35). International aid contributions to education have declined since their peak in 2013 due to the worsening security situation, which has hampered service delivery (pp. 35-6). Donors have moved a high proportion of education funding on-budget: for example in 2013 nearly 50% of contributions went directly to projects, but in 2015, only 22% went directly, the rest was on-budget (p. 35).

¹ A country's current account (balance of payments) is an important indicator of economic health. It measures the inflow and outflow of goods including imports and exports, trade in services, investment income (including migrants remittances from abroad) and net transfers (including international aid).

Continuation of aid: The World Bank argues Afghanistan has faced impossible odds since 2014 and the drawdown of international forces and reductions in aid (p. 27). It argues that continued aid support is vital if the gains of the past 15 years are to be maintained and to avoid further deterioration of living conditions (p. 30). Continued aid support is vital for both service delivery and overall economic performance in an economy that remains heavily reliant on aid (p. 30).

The World Bank argues that increasing poverty and food insecurity as well as high population growth, low educational attainment and limited productive employment opportunities demonstrate the need to maintain progress and carefully manage the risks associated with the upcoming election period (p. 30).

The International Monetary Fund. (2018). *Islamic Republic of Afghanistan: Third Review under the Extended Credit Facility Arrangement and Request for Modification of Performance Criteria- Press Release and Staff Report*. The IMF.

<https://www.imf.org/en/Publications/CR/Issues/2018/05/29/Islamic-Republic-of-Afghanistan-Third-Review-Under-the-Extended-Credit-Facility-Arrangement-45897>

Sustained international aid is vital in the current context of security challenges and political uncertainties. A premature withdrawal of international aid would threaten fiscal sustainability and necessitate growth-reducing cuts in expenditure. A partial shift towards concessional lending to compensate for a decline in aid would have negative consequences, putting Afghanistan at risk of high debt distress and affecting growth and stability. Currently, Afghanistan's public debt is low and its debt sustainability hinges on continued ample grant inflows combined with sound policies and reforms, and improving security.

As of May 2018, when the report was written, the IMF argue donor support remains strong, encouraged by the government's continued reform efforts. Donor disbursements are in line with 2016 Warsaw and Brussels pledges from the Warsaw and Brussels, although the timing of disbursements has been somewhat unpredictable.

The IMF's assessment of the Afghan economy and trends is broadly similar to that of the World Bank (2018) outlined above. They argue that the overall fiscal balance including international aid has moved from zero in 2016 to a deficit of 0.6% of GDP in 2017. This was due to a 2.5% of GDP decline in operating grants. In the first 3 months of 2018, domestic revenues increased by 12% against the same period in 2017, supported by continued efforts to improve tax administration.

The IMF has revised its 2018 economic growth projection down to 2.5% from 3% as the outlook for growth remains subdued. This is due to the security situation affecting private sector confidence and a relatively dry winter which is likely to constrain agriculture (one of the few sources of economic growth). Growth will be lower than expected if the security situation worsens or aid declines as this will affect unemployment and poverty.

The IMF projects 5% growth by 2023, predicated on no significant deterioration in security, continued reforms and no adverse shocks to aid flows.

ART Consulting (2018). *Aid Effectiveness in Afghanistan*. ART Consulting: Kabul.

https://reliefweb.int/sites/reliefweb.int/files/resources/aid_effectiveness_in_afghanistan_march_2018_0.pdf

This research study commissioned by Oxfam and the Swedish Committee for Afghanistan focuses solely on development aid and does not include military aid. It argues that Afghanistan is financially dependent on international support (p. 7). In 2017/18 financial year 66% of the government's budget was funded by international aid (p. 7). Donors contributed to both the

government's operating budget and its development budget (including both discretionary and non-discretionary grants) (p. 7). Donors also gave money to Afghanistan off-budget i.e. disbursed through development partners, UN agencies and NGOs (p. 7). In 2016, 59% of international aid was on-budget (p. 17).

Afghanistan's top ten donors between 2011 and 2015, from highest amount to lowest were: the US, Japan, Germany, the UK, the EU, Australia, Canada, Norway, Sweden and Denmark (p. 25). The most commonly funded areas included: public services (e.g. education and health), economic infrastructure and services (e.g. energy and transport), humanitarian aid, production sector support (e.g. agriculture, construction and trade) (p. 28).

International aid has decreased at the same time as the security situation in Afghanistan has worsened: development aid fell from nearly USD 6.5 billion in 2010 to USD 4.2 billion in 2015 (p. 7). Donors have warned the Government of Afghanistan that aid flows will decrease in the coming years (p. 7). Consequently, ART Consulting argue that aid effectiveness is crucial if Afghanistan is to maintain its development path (p. 37).

Interviews conducted with government officials suggest that less money could mean more government ownership of the development agenda as fewer dollars will be directed off-budget (p. 37). Donors have channeled large proportions of international aid off-budget due to concerns about corruption and weak government systems, institutions and processes and their need to demonstrate effectiveness to their domestic constituencies (p. 38). The paradox is that donors need the Afghan system to be effective before channeling their aid through it, but international aid is partially being used to help build and strengthen government institutions, plans, strategies and policies (pp. 37-38).

ART Consulting argue that overall aid to Afghanistan does not need to increase but donors should prioritise longer-term planning and commitments in order to encourage financial stability (p. 39).

Bizhan, N. (2018). Aid and state-building, Part II: Afghanistan and Iraq, *Third World Quarterly*, 39 (5), 1014-1031.

<https://www.tandfonline.com/doi/pdf/10.1080/01436597.2018.1447369?needAccess=true>

Afghanistan is highly aid dependent and has relied on foreign military and economic assistance to finance state-building and development efforts (p. 1018). Between 2002 and 2010, over 50% of total military and development aid was allocated to the security sector (p. 1018). Aid contributed to economic growth and the expansion of public services, but it has not fostered effective state-building (p. 1014)². For example, the expansion of public services has not been balanced by the development of effective state institutions (p. 1020). The availability of aid has affected the structure and size of the state. For example, in 2004, donors envisioned a 70,000 strong army, however, after a resurgent Taliban, donors agreed to fund a force of 228,500 people with an estimated budget of USD 4.1 billion (p. 1019).

In 2001, Afghanistan was a failed state, weak, fragmented and unable to provide public services (p. 1016). Whilst many formal structures and some of the traditional practises of public administration remained in place, Afghanistan lacked human, financial and physical resources (p. 1017). International aid was needed until domestic institutions were built and the economy would produce enough surplus for sustaining the state-building project (p. 1017). However, donors' aid modalities had implications for state-building (p. 1017).

² Bizhan defines state-building as the creation of new government institutions and the strengthening of existing ones, with state capacity being the capability of the state to implement various policies and generate revenue (p. 1015)

Off-budget aid: Donors wanted quick results, consequently they disbursed large proportions of their aid off-budget (p. 1019). Between 2001 and 2010, 82% of total aid was off-budget (p. 1019). In addition donors also earmarked portions of on-budget aid for their purposes (p. 1019).

Off-budget aid paid higher wages to project employees than government employees (p. 1019). Whilst it helped to improve project implementation, it diverted resources that could have been used to strengthen government departments and increased transaction costs due to multi-level subcontracting (p. 1019). In some cases, such as the Provincial Reconstruction Teams (PRTs), it undermined state legitimacy (p. 1019). The PRTs worked with local communities directly to identify their needs and implement projects to meet these needs (p. 1019). This process bypassed local state institutions, undermining their legitimacy and their ties with the communities (p. 1019). Off-budget aid also became a source of corruption (p. 1019).

Between 2002 and 2010 the US and Japan channelled the majority of their funds off-budget, whilst the World Bank and the Asian Development Bank channelled their funds on-budget through trust funds (p. 1020). In 2010, following repeated demands from the government that a large proportion of aid should be delivered on-budget, donors agreed to channel at least 50% of their aid through the government budget or trust funds (p. 1020). Progress has differed between donors, with the US significantly lagging behind achievement of this target (p. 1020).

Parallel public sector: Off-budget aid created a parallel public sector that was fiscally bigger than the permanent state institutions and diverted much of the political and financial resources away from building effective state institutions (p. 1017). For example, donors established 35 autonomous project units across government ministries to deliver aid and implement projects (p. 1019). These structures implemented development agendas independent of the Afghan government (p. 1019). They also diverted political and financial resources from the state's permanent institutions (p. 1026).

Other challenges: Afghan politics is characterised by patronage and elite fragmentation with high levels of corruption: these also undermine the state-building project (p. 1018 & p.1024). These challenges combined with donors' short-term objectives induced Afghanistan's international aid regime (p. 1024). Delivering aid through parallel institutions to achieve short-term objectives in the face of state weakness may have been plausible, but it proved counter-productive in the long run as it damaged the state building process (p. 1024).

Bizhan, N. (2016). *A Path to Self-Reliance for Afghanistan*. Opinion Piece.

<https://www.project-syndicate.org/commentary/brussels-conference-on-afghanistan-aid-by-nematullah-bizhan-2016-10#paragraphId=9fd10b70beed48e7bffed368a7ebcd48>

Afghanistan is aid dependent. Estimated public expenditure for 2017-2021 is USD 60 billion. However, there is an average annual financing gap of 74%, which the government is relying on international aid to meet.

Bizhan recommends a number of steps to help Afghanistan move towards self-reliance, including the improved delivery and allocation of aid, governance reforms and smart investments. Donors need to channel aid towards investment in programmes with longer-term objectives. While some short-term measures are needed to enhance stability, their impact will quickly fade without long-term programmes aimed at building institutions and laying the foundation for a dynamic economy.

Bizhan recommends prioritising investments in education and health and in job-creating sectors including agriculture. Only 3% of the aid spend between 2002 and 2010 went on education and he argues this is reflected in the fact that 40% of primary and lower-secondary school age children are not in school. Whilst more than half of the total aid spend has supported the security sector, the security situation has worsened since the departure of international combat troops.

Bizhan argues that 75% of donor aid should be on-budget in order to make the state fiscally larger than the private sector in terms of public service delivery. However, in order for this strategy to work he argues the government must improve its public service delivery, including boosting the quality of its civil service and freeing it from political pressures. The government also needs to tackle corruption and patronage, improve accountability and increase government revenues by continuing to reform and strengthen the tax system.

Bizhan, N. (2018b). *Building Legitimacy and State Capacity in Protracted Fragility: The Case of Afghanistan*. Commission on State Fragility, Growth and Development.

<https://www.theigc.org/wp-content/uploads/2018/04/afghanistan-report-v3.pdf>

This report was prepared as part of the LSE-Oxford Commission on State Fragility, Growth and Development launched in March 2017 to guide policy to address state fragility. It argues that Afghanistan exhibits a number of signs of state fragility including: a deficit of government legitimacy, weak fiscal and legal capabilities, and low resilience to political, security and economic shocks (p. 4). The security and political shocks of 2009 and 2014 were significant setbacks and increased the risk of Afghanistan's collapse into a failed state (p. 4).

Afghanistan faces a number of social-economic challenges predicated on underlying state fragility (pp. 5-6). These include: aid dependency, the opium trade, corruption, insurgency and migration (both refugees and internally displaced persons) (p. 6). Aid dependence has implications for state legitimacy and resilience. It has improved public service delivery, but its modalities mean that the government might struggle to sustain services in the future (pp. 19-20). For example, basic health services have been subcontracted to NGOs, which has increased the cost of the service (pp. 19-20).

State Legitimacy: Off-budget aid improved service delivery and implementation but it also reduced the pressure to reform public institutions (p. 12). In the case of the PRTs, outlined above, the legitimacy of local state institutions was undermined as communities directly negotiated with the donors' agents (p. 12). Whilst governance practises especially in the area of public financial management improved, these improvements did not significantly reduce corruption (p. 12). International aid modalities shifted the balance of power in favour of the donors as they had fiscal leverage over both government and societal actors: both needed to negotiate for funding and report on individual projects (p. 13).

Security and economic outcomes have major impacts on public confidence (p.14). The deterioration of security in 2005 and 2014 adversely affected the public's positive perceptions (p. 14). In a 2016 Asia Foundation survey, only 29% of 100,000 respondents said they thought Afghanistan was heading in the right direction, compared to 58% in 2013 (p. 14). Electoral processes and corruption also undermined state legitimacy (pp. 9-10 & p. 11). Corruption is once one of the biggest problems facing Afghanistan: a 2012 UN survey found that half of Afghan citizens have paid a bribe whilst requesting a public service, with bribes to officials amounting to USD 3.9 billion (p. 11).

Building state capacity: despite improvements since 2002, the Afghan state is weak as evidenced by its low fiscal, legal and coercive capacities (p. 15). Indicators of state weakness include:

- Aid dependency: in the 2017/18 fiscal year, development and military aid funded 61% of the national budget (p. 15).
- The budget execution rate: 43% between 2002 and 2010, and 20% in the first 6 months of the 2017/18 fiscal year (p. 15).
- Tax revenues as a share of GDP: 10% in 2015 (up from 4% in 2004) (p. 16).

Donor and government strategies to provide public goods and increase state capacity included:

- **Technical assistance:** externally hired and funded international and national staff working with civilian ministries. This was largely ineffective (p. 16).
- **Outsourcing government functions:** Some government functions were also fully or partially outsourced post-2001 to the private sector (p. 17). After building initial capacity, some of these functions, e.g. procurement, were restored to the state (p. 17). However, others including delivery of basic health services continued to be delivered by NGOs (p. 17).
- **Off-budget aid:** delivered by private companies and NGOs. The amount of aid disbursed through the parallel public sector was larger than the government's public sector and poorly aligned with national and local priorities (p. 17). Trust Funds, such as the World Bank's Afghanistan Reconstruction Trust Fund, were an effective intermediate approach, channelled through the government but funding the private sector or NGOs to implement projects (p. 17).
- **Direct intervention in building state capacity:** Government departments and ministries with direct exposure to donors significantly improved (p. 18). But, within key ministries capacity varies as does its sustainability (p. 18). For example, in the case of the Ministry of Finance, the General Directorate of Budget has improved³, but the Directorates of Revenues and Customs have not due to corruption and nepotism (p. 18).

These tactics, particularly off-budget aid and buying capacity, had short-time horizons and adverse implications for state capacity in the long-term (p. 17). Adverse implications include: fragmenting public administration; creating islands of inefficiency; increasing transaction costs; reducing attractiveness of government positions for capable candidates; and diverting financial and political resources from strengthening state institutions (p. 17).

Low Resilience: The Afghan state lacks resilience and has low cushions against shocks (p. 33). Due to Afghanistan's high aid dependence, aid shocks impact macroeconomic and political stability (p. 34). Aid dependency has resulted in weak political cushions to shocks: the government has been preoccupied with donors due to the need to sustain aid flows (p. 34). Consequently, it has neglected domestic priorities (p. 34). Weak state capacity and deficit of legitimacy have also increased the country's vulnerability to political and economic shocks (p. 35).

The security and political shocks of 2009 and 2014 were significant setbacks for the Afghan state (p. 5). In 2009, additional troops and aid stabilised the security situation somewhat (p. 5). Bizhan refers to 2014 as a triple transition due to the combination of the drawdown of international forces, a disputed presidential election and reduced international aid, which increased the risk of state collapse (p. 5 & pp. 24-25). Government and donors' measures to stabilise the situation included: modest increases in aid, delaying the complete withdrawal of US troops and the establishment of the National Unity Government (NUG) (p.4).

Some analysts (see for example, Sinno 2015, below) have compared 2014 to the period after the USSR collapse when the cessation of Soviet military and economic aid in 1991, resulted in regime collapse in Afghanistan (p. 33). Bizhan argues that whilst the situation in Afghanistan in 2014 was quite different, the government, donors and citizens were concerned about the risk of armed conflict and political chaos: earlier experiences helped to ignite an early warning (p. 33).

Bizhan argues that the 2014 Presidential elections increased the risk of a relapse into civil war (p. 33). Elections are a source of political instability and societal division due to the nature of Afghanistan's political system and the existence of an inefficient electoral administration (p. 34).

³ However, it is the line ministries that execute the budget (p. 18).

Patronage, elite fragmentation and a lack of checks and balances have also increased the risks of internal shocks (p. 33).

Recommendations: Bizhan recommends a number of policy options to help Afghanistan move away from state fragility. These include: reforming the electoral system, tackling corruption, continuing tax reforms, defragmenting state institutions and integrating the parallel public sector created by donors (p. 38). The defragmentation process requires the bulk of international aid to be on-budget so that it is fully aligned with local priorities and increases the pressure to reform state institutions and improve governance practices (p.38). On-budget aid, combined with an emphasis on using local companies and domestic products for service delivery could create jobs and incentivise private sector development (p. 39). State legitimacy, economic growth and security will be endangered if the state cannot provide basic services and protect citizens (p. 37). Consequently, it is imperative to prioritise building state capacity (p. 37).

Byrd, W. A. (2016). What Can Be Done to Revive Afghanistan's Economy?, United States Institute of Peace Special Report

<https://www.usip.org/publications/2016/02/what-can-be-done-revive-afghanistans-economy>

Similar to other analysts, Bryd argues that changes in international expenditures due to the drawdown of international forces were a major negative demand shock to the Afghan economy (p. 2). This resulted in a sharp economic downturn with low economic growth (p. 2). Other contributing factors to slow economic growth between 2013 and 2015 were: the NUG and political infighting (which compounded uncertainty and contributed to weak demand and investment) and capital and human flight (which already significant, mushroomed during this period) (p. 2).

The fiscal gap: Bryd argues that the fiscal crisis is the most urgent macroeconomic problem facing Afghanistan for the foreseeable future (p. 8 & p. 3). The fiscal gap, which can only be bridged by international aid, is partly attributed to the high cost of the Afghan National Security Forces (p. 3).

In 2014, declining Afghan government revenues and expenditure pressures led to a budgetary shortfall (USD 537 million according to the government), severe cash flow problems and arrears of around USD 200 million on government contracts and other payments (p. 8). Donors provided USD 190 million in response to the government's emergency request for aid, but the fiscal situation has continued to be tight (p. 8).

Bryd recommends three strategies for tackling the fiscal gap:

- **Increasing government revenues**, for example through new tax measures and reducing corruption (p. 8);
- **Economising and restructuring expenditures in favour of higher-priority spending.** The government and donors are currently working to restructure expenditures toward higher-priority programs that can deliver more timely results (p. 8);
- **Government borrowing:** the Afghan government currently has a no-overdraft policy (i.e. the Ministry of Finance's deposits at the central bank, Da Afghanistan Bank, are not allowed to enter negative figures). Bryd argues that in the current situation this policy could be a harmful contractionary force that could worsen the macroeconomic situation (p. 8). In current circumstances, modest government borrowing, limited to no more than 2% of GDP, and sourced domestically (e.g. borrowing from Da Afghanistan Bank directly or selling bonds to the public) could have a stimulative effect on the economy (pp. 8-9).

Economic growth: Even in the absence of further potential shocks including the breakdown of the NUG, further weakening of the Afghan army, major, sustained gains by the Taliban and natural disasters, economic growth can be expected to remain very low (p. 2). Bryd argues that

there are no sources of economic demand that will come anywhere near to financially offsetting the negative demand shock of declining military expenditures and aid (pp. 4-5).

Measures that could stimulate economic growth in the near-term include: increasing overall demand, shifting demand away from imports to domestic production, and encouraging repatriation and investment of the potentially billions of dollars of private Afghan capital held abroad (p. 3 & p. 5). To realise these strategies political leadership, better government functioning, increasing confidence in the future and tackling the level of violence are needed (p. 3 & p. 5).

Bryd argues that in the short-term the government should follow a focused economic agenda (p. 11). This would mean limiting the number of initiatives to a handful of priority areas and avoiding accelerating extractives exploitation, rapidly privatizing too many public enterprises or trying to quickly reduce opium cultivation (this would harm local livelihoods and could increase support for the Taliban) (p. 11). Corruption is so entrenched that a comprehensive anti-corruption strategy could be counterproductive (p. 9). Consequently, Bryd recommends a narrow, concentrated anticorruption agenda focused on area where corruption significantly impacts many people's daily lives (e.g. border crossings, the Customs Department) and areas where anticorruption measures could improve confidence in the government, domestically and internationally (e.g. asset declarations for senior officials) (pp. 9-10).

In light of the immediate economic pressure and in order to revive demand, restore confidence and build the government's credibility in the near term donors should focus support on selected job and income-generation programmes, particularly in the larger cities as opposed to rural development programmes (p. 13). Donors should also reallocate and front load aid, work with the government to review and ruthlessly restructure portfolios of donor-funded projects, encourage the government to respond in a unified manner more in line with the urgency of the situation, and fund high-level expertise and technical inputs as needed to strengthen the government's economic management and to design innovative programmes (p. 13).

de Toledo Gomes, A. (2017) Statebuilding and the Politics of Budgeting in Afghanistan. *Journal of Intervention and Statebuilding*, 11(4), 511-528.

<https://doi.org/10.1080/17502977.2017.1341369>

Aid dependency hinders statebuilding in Afghanistan (p. 511). A considerable number of studies have scrutinized the impacts of aid dependency and share similar conclusions (p. 511):

- Aid delivery is not predictable, which means ordinary payments and development projects are always at risk: this weakens state capacity for service delivery (p. 512).
- Rent payments in Afghanistan help recipients to avoid any revenue bargaining process, as they negotiate preferentially with foreign donors with the aim of gaining access to aid and capital, therefore creating no fiscal bond between the government and the people (p. 512).

Some analysts have argued that the Afghan state is upheld by international aid and struggles to project its authority throughout the territory (p. 514). The US and other donors focused reconstruction efforts on security institutions and fostered control of international agents over their projects (p. 514). At the same time national and local actors were pressing for local ownership (p. 514). As local figures such as warlords were a challenge to the statebuilding project, the focus was on creating a strong central state to control these actors (p. 514). Consequently, efforts to rebuild state institutions attempted to reconcile the tension between international assistance and local ownership as well as create a central government capable of centralizing power (p. 514).

President Karzai centralized revenue collection and created the new national budget negotiated with foreign actors (p. 514). The core budget is split into an operational budget (e.g. salaries largely financed through domestic revenues e.g. taxes) and a development budget (development projects and reconstruction co-financed by the government, donors and multilateral funds) (pp. 514-5). In 2015, 71.1% of the budget was funded by foreign aid (p. 515). Almost USD 4.36 billion was committed to different projects, but only 85.6% of these commitments were disbursed (p. 515).

The external budget (off-budget aid) became an instrument of direct control, which could be used to impose conditions and even determine how resources should be spent (p. 517). Off-budget aid is difficult to track and often varies year on year (p. 516). For example, USAID contracts accredited US firms to run their projects, who in turn subcontract to local companies, thus obscuring whether funds are spent as intended (pp. 516-17).

De Toledo Gomes argues that this budget structure was justified on the grounds of the government's lack of absorptive capacity to manage funds and the existence of widespread corruption (p. 517). In order to effectively spend foreign aid an administrative infrastructure was needed that was missing in Afghanistan, so NGOs and consultants were employed to manage the money flow (p. 517).

Persistent aid dependency and the centralised nature of the Afghan state have a number of consequences:

- **Implementation of government development priorities depends on donors and their agendas** as the bulk of development funds are not raised directly by the government or made available to them (p. 518). As the budget is the outcome of a bargaining process between international actors and the Afghan government, it results in centre-periphery relations that leave little room for subnational administration units to operate (pp. 519-20). In terms of centre-province relations the rules for allocation, transfer and use of resources are still unclear (p. 520).
- **Budget execution is low**, in 2015, only 50.8% of the development budget was executed (p. 518). This could be due to the highly centralized nature of the ministries in Kabul, which slows budget flow to the provinces, the low administrative capacity of Afghan institutions, and a decrease in economic activity due to insecurities in the transition period (p. 518). Low budget execution means public goods, services and resources do not reach the people, opening more opportunities for tribal and patronage networks to extend their influences based on the distribution of selective benefits to groups and individuals (p. 520).
- **A weak centralized state system coexists with informal networks of power** (p. 519). There is a lack of state presence in the provinces (p. 519). However, there is a strong provincial governor system and governors are responsible for coordinating central government activity in the province; informally they are entitled to intervene in expenditure approvals and political appointments (p. 519).
- **Impacts on output legitimacy in the provinces** due to the lack of services provided by the central government. For example, between 2010 and 2014, the number of development projects in the provinces was greatly reduced (for example by 80% in Nangahar Province) (p. 519). The government stated this was due to security and political uncertainties, however, it affects state legitimacy (p. 519).

Strand, A., Borchgrevink, K., & Harpviken, K., B., (2017). *Afghanistan: A Political Economy Analysis*. Norwegian Institute of International Affairs.

https://brage.bibsys.no/xmlui/bitstream/handle/11250/2470515/NUPI_rapport_Afghanistan_Strand_Borchgrevink_BergHarpviken.pdf?sequence=2

This report was commissioned by the Norwegian Ministry of Foreign Affairs. Strand et al. argue that Afghanistan is extremely aid dependent (p. 17). High foreign aid security expenditures limit (equivalent to 25% of GDP in 2014) limit the fiscal space for civilian development and operation spending (p. 17). The Afghan security systems are totally dependent on international aid (p. 27).

International aid can be a stabilizing influence, but it will not resolve the governance and development challenges imposed by internal Afghan elite politics, including elite capture, competing networks within government and the role of the illicit economy (p. 20). The formal Afghan state apparatus is totally dependent on international economic support to maintain its functions, pay salaries and deliver public services (p. 45). A semi-informal state is partly embedded in the formal state for protection, but supplements its exploitation of state resources and positions with income from the illicit economy (p. 45). An informal state exists in parallel with the formal state and is represented by the Taliban and other militant groups and relies on the illicit economy (p. 45).

Strand et al. argue that the fall in economic growth in 2014 was influenced by several factors other than the reduction in external funding (p. 16). These include the youth bulge, high dependence ratios (half the population are under 15), the majority of the population live in rural areas with the highest concentration of poverty, and, high levels of corruption (pp. 15-17). High levels of corruption reduce the value and impact of development assistance, the functioning of and trust in the police and judiciary and lead to large differences between the extremely rich and the poor (p. 17).

Strand et al. argue that the World Bank and other observers agree that the ongoing conflict is the foremost constraint on Afghanistan's development and has broader implications for the economy and society (p. 17). Nearly four decades of protracted conflict have resulted in weakened government institutions and severe social and ethnic cleavages (p. 17). There are fracture lines within society on ethnic and tribal identities, rural versus urban divides, and beliefs about the changing role of women (p. 17). The ongoing armed conflict threatens personal safety and also public service delivery and private investment (p. 17). Future economic development will depend on reaching a settlement to the ongoing conflict (p. 16). Agriculture remains the main source of real GDP growth, employment and subsistence for the Afghan population (p. 16).

Willner-Reid, M. (2018). Competition in the Aid Marketplace in Afghanistan: Mercenaries, Missionaries and Misfits. *Asian Survey*.

<https://as.ucpress.edu/content/ucpas/58/6/1016.full.pdf>

The national Afghan NGO sector is highly aligned with the funding priorities of the international community and act as service providers, relying on international funding, as opposed to being autonomously occurring citizens' initiatives. Pay structures in national NGOs are generally higher than in local businesses making NGO formation an attractive market proposition.

The Afghan government is in constant competition with other actors, particularly donors, to control the aid agenda. Consequently, the government seeks to maximize on-budget and the amount of aid that is aligned with national priorities. Willner-Reid argues that the government is increasingly viewing UN agencies in competitive terms as they take on broader implementation roles and it is pushing the UN to focus on advisory and capacity building functions. Willner-Reid refers to how some academic commentators have argued that reliance on the NGO sector for public service delivery risks undermining the Afghan state. NGOs can also be seen as a competitor for donors' aid resources.

Within the Afghan government, line ministries require funding in order to fulfil their objectives: this can translate into competition between ministries, who rely on their ability to convince either central government or the donors to fund them. There are suspicions within the government that

donors exploit this competition to ensure buy-in from line ministries for their programmes, to the detriment of centrally-defined national priorities.

Willner-Reid argues that accountability structures for aid can create incentives for donors to prioritise their responsibilities over collective action goals. For example, the Provincial Reconstruction Teams (PRTs) system, which operated until 2014. Under this system lead donors were given responsibility for coordinating all activities (civilian and military) in their designated province. Consequently, donors prioritised provincial development, for which they were accountable, over national-level outcomes. Under this system donors would often resist pressure from the government and other donors to re-allocate funding from their province to areas where it may be more needed.

3. Degree to which international aid could be an existential threat to the political settlement

Sinno, A. (2015). Partisan intervention and the transformation of Afghanistan's civil war. *American Historical Review*, 120, 1811–1828.

<https://academic-oup-com.ezproxye.bham.ac.uk/ahr/article/120/5/1811/2581573>

Sinno argues that the Afghan state is a fragile institutional actor and predicts civil war will continue once most or all of the Coalition forces withdraw (p. 1812). He argues that Coalition actions have merely extended the 1992-2001 civil war instead of terminating it decisively in favour of the anti-Taliban forces (p. 1827).

Sinno argues that the Afghan state will “last so long as money continues to flow to it from international donors, but it will likely unravel soon thereafter, the way the government of Najibullah did” (p. 1827). The Najibullah regime resisted the Mujahideen for 6 months after Soviet aid ended in 1991 (p. 1827). The regime's institutions either disbanded, split along ethnic lines or became independent militias (p. 1827).

Sinno argues that whilst the lessons of history are not deterministic, Afghanistan seems to be heading toward a conflict that is curiously similar to the pre-Coalition civil war (p. 1827). Ethnic and regional networks similar to those in 1991 are at work in post-Coalition Afghan institutions and many of their members are allied with militant organizations, including the Taliban (p. 1827). He predicts officials “will defect in droves” once the merits of defections outweigh the material gains that accompany regime affiliation (p. 1827). The Coalition will leave behind predatory and unruly warlords in Pashtun areas, which Sinno predicts will increase Pashtun civilians' desire for the Taliban to return; however, the Taliban's return will be slow enough that minority organizations will be able to prepare to fight them (p. 1827). He outlines how former Northern Alliance leaders began expanding their militias and formed a new alliance in 2011, in preparation for the 2014 US withdrawal (p. 1827).

Aid modalities have also affected institution building (p. 1820). Sinno, similar to a number of other authors, cites the creation of a parallel civil service and its impacts (p. 1820). These include:

- creating non-cohesive institutions with fault lines between employees and consultants;
- fragmented institutional cultures and dysfunctional operations;
- increases in corruption as state employees used requesting bribes and stealing institutional resources as ways to make up the differences between their and the consultants' pay;

- the lack of institutional cohesion encouraged all stakeholders to maximize profits instead of investing in the institutions they were building and, encouraged the consolidation of destructive rival patronage networks as alternative ways to provide some safety and certainty in an otherwise chaotic institutional environment (pp. 1820-21).

Sinno argues that the Coalition members have also impeded their own state-building efforts by financing local Afghan militias, for example, by hiring them as security contractors (p. 1819). This has increased insecurity and weakened state influence (p. 1819). For example, it has allowed local militias and their leaders to reduce state penetration into their areas and co-opt state institutions by purchasing Afghan National Police or other government positions to further increase their influence (p. 1820).

William Maley (2016) Afghanistan on a knife-edge. *Global Affairs*, 2(1), 57-68.

<https://doi.org/10.1080/23340460.2016.1159865>

Maley argues that years of foreign aid have left an ambiguous legacy (p. 59). He labels the slowdown in economic growth in 2014 as 'almost inevitable' and states it negatively affected Afghan families by reducing incomes (p. 59).

Maley argues that Sinno's (2015) warning, outlined above, highlights the importance of continuing aid to Afghanistan. An unravelling of the Afghan state would reconstitute the very conditions that provided a nurturing environment for al-Qaeda in the second half of the 1990s, and risk inspiring radical groups in Pakistan to attempt further terrorist attacks in India, with the risk of escalating conflict in a highly combustible region (p. 64).

Maley argues that public perception affects political developments (p. 64). For example, the discontinuation of Soviet aid to the Najibullah regime in 1991 contributed to its demise in two ways: one, it deprived the regime of the material resources needed to purchase the loyalty of key local powerholders; and, two, it made Najibullah look like a likely loser in the eyes of ordinary Afghans (p. 65). Momentum is extremely important in Afghan political life and a serious loss of momentum creates major challenges for a ruler (p. 65). Consequently, a range of simultaneous setbacks for the government could push Afghanistan beyond a tipping point, with a whole range of social groups, unenthusiastic about the Taliban, switching sides because of the growing conviction that the fall of Kabul was likely (p. 65). The wider world can help to avert this danger by committing in both word and deed to protecting the current dispensation (p. 65).

State legitimacy and economic development are also affected by corruption, opium cultivation, the worsening security situation (including along ethnic and sectarian lines), and increasing numbers of refugees (pp. 59- 60). Maley argues that a government that cannot provide a minimal level of security for its citizens is unlikely to secure or retain a high level of legitimacy (p. 59). Increasing refugees could undermine investor confidence, affecting economic growth (p. 60).

Directorate-General for External Policies, Policy Department (2017). *Afghanistan: Challenges and perspectives until 2020*. Brussels: European Parliament

[http://www.europarl.europa.eu/RegData/etudes/STUD/2017/578033/EXPO_STU\(2017\)578033_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2017/578033/EXPO_STU(2017)578033_EN.pdf)

This report summarises the proceedings of a November 2016 workshop organized by the European Parliament's Committee on Foreign Affairs, the Committee on Development and the Delegation for relations with Afghanistan. Three of the workshop's presentations, outlined below, are relevant to the issue of aid dependency in Afghanistan.

***Political challenges and perspectives 2016-2019* by Richard Ghiasy, Stockholm International Peace Research Institute:** Ghiasy argues that the EU will need to continue

supporting Afghanistan politically and financially for the foreseeable future (p. 23). Failure to do so, especially if other major donors also reduce their support, would, very likely, result in (a) the collapse of the NUG, (b) an increase in the number of military defeats suffered by the Afghan government at the hands of the armed opposition, (c) a rise in military fractionalisation, and (d) possibly a relapse by Afghanistan into some degree of civil war (p. 23). Consequently, EU expectations on delivery, impact of aid and NUG effectiveness should be set at a low (and therefore realistic) level (p. 23).

The international community's continued political and financial support is pivotal to Afghanistan's stability (p. 19). Afghanistan is experiencing simultaneous and mutually reinforcing political, socio-economic and security crises (p. 19). Challenges include a lack of political and electoral reform implementation, the fragmentation of the NUG, corruption, a lack of economic development and the security situation (pp. 9-10). The prospects for an immediate peace settlement are slight (p. 19).

Ghiassy predicts that President Ghani is unlikely to be re-elected in 2019, but the NUG may avoid full-scale collapse (p. 10). However, it will continue to be ineffective at providing public services, developing the economy and achieving a peace settlement (p. 10). The ongoing security situation will continue to hamper investment, regional economic development initiatives and absorb the government's attention and resources (p. 10). The illicit economy will continue to flourish and the lure of radical, violent Islam and migration will remain strong (p. 10). In these circumstances, Afghanistan will continue to pose a security threat for the international community and the growing tendency to migrate to the EU will continue (p. 24).

An Afghan path to peace and development, by Dr Arne Strand, Director of the U4 Anti-Corruption Resource Centre at the Chr. Michelsen Institute: Donors have to be prepared to provide development aid even after a peace is reached in Afghanistan (p. 16). Sustained donor engagement and funding will also be needed to achieve the Afghan government's ambitious Afghan National Peace and Development Framework 2017-2021 (p. 32).

Successful implementation of the Framework requires reduced conflict and violence, improved governance and continuing international aid (p. 32). Contextual challenges influencing implementation include: the security situation, the weak economy, internal displacement, returnees, urbanization, and a fragmented administration with limited implementation capabilities (p. 32). The youth bulge (60% of the population is under 26 and 400,000 youths enter the labour market annually) is both a challenge and an opportunity (p. 16). Agriculture and rural development will be crucial as 70% of the population rely on rural income (p. 16).

Presentation by Pierre Amilhat, Director for Development, Coordination – Asia, Central Asia, Middle East/Gulf and Pacific, DG DEVCO, European Commission: The international community's support for Afghanistan remains an essential condition for growth (p. 17). Important economic and social gains were put at risk in 2014, with increasing levels of poverty and unemployment, heightened security risks and violence, an erosion of public services provision and strong migration pressures (p. 17).

A legacy of weak institutions still undermines the delivery of social services, and deters private sector investment with limited access to physical capital (p. 17). Achieving higher growth will require more efforts by the Afghan government and the international community but also more cooperation with regional neighbours, especially for exporting industries (p. 17).

The Afghan government faces a budgetary challenge: 45% of the national budget is used for security purposes, the rest is spent on obligatory expenditure (e.g. salaries), which leaves an extremely small margin for action (p. 18). Consequently more donor aid must be on-budget (p. 18). The Afghan government needs more room to manoeuvre and the government must be in charge of their own development and build its capacity (p. 18).

Rubin, B. (2018). Is Afghanistan Ready for Peace? How Great Powers Can End the War. *Foreign Affairs*

<https://www.foreignaffairs.com/articles/afghanistan/2018-07-30/afghanistan-ready-peace>

Rubin argues that Afghanistan will need financial and security assistance for decades. In order to achieve the relative stability needed for Afghanistan to reduce its external dependence on the US, a new regional consensus will be needed.

Afghanistan suffers from a combination of inter-ethnic tension and geopolitical rivalry (including the United States, Russia, India, Pakistan and Iran). Rubin argues that in the past similar combinations have led to state collapse and civil war, however, currently, alternative outcomes are possible. This is due to regional and global powers perceiving a much greater cost to continued conflict in Afghanistan than they did in 1992.

India and China's economic development plans and regional strategies (for example, China's Belt and Road Initiative), as well as concerns about the threat of terrorism, require stability in Afghanistan. India, Afghanistan and Iran are cooperating to develop the Iranian port of Chabahar and link it by road and rail to Afghanistan and then to a north-south corridor through Central Asia, sponsored by India and Russia. China and India have also discussed building a railroad across northern Afghanistan to link the Belt and Road to Chabahar.

Rubin argues that these actions, as well as recent discussions between China, Iran, Pakistan and Russia about taking coordinated steps against ISIS terrorism in Afghanistan, may mean that the regional powers have deepened their understanding of the real threat posed by Afghanistan's dependence on the US. He argues that the threat is not that the US will use Afghan military bases to threaten other states in the region, but that the US will tire of its efforts to maintain stability in Afghanistan and withdraw, leaving the region with a challenge it is ill prepared to face.

Rubin argues that transition in Afghanistan will require the assistance of the UN, and the Shanghai Cooperation Organization (SCO) (Russia, China, India and Pakistan are members and Iran and Afghanistan are observers). The US could assist a redesigned military force to help implement a peace agreement and counterterrorism strategy in partnership with the UN and the SCO. This arrangement would help to restrain Pakistan's support for the Taliban and would be held together by mutual interests in economic cooperation and connectivity.

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