The Afghan War in 2013
Meeting the Challenges of Transition

VOLUME II
Afghan Economics and Outside Aid

AUTHOR
Anthony H. Cordesman
with assistance from Bryan Gold and Ashley Hess
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# Table of Contents

**EXECUTIVE SUMMARY** ................................................................. VIII
Continued Aid and Economic Stability as Key Threats to a Successful Transition ........ viii
The Need to Focus on the Afghan War Fatigue ................................................................. ix
The Need for Credible Economic and Aid Plans, Credible Resources, and Transparency ... ix
Time Is Another Key Threat ....................................................................................................... x
Planning on the Basis of Economic Realism ............................................................................. xi

Restructure Economic Aid to Reflect the Fact Afghans Will Need Aid for Economic Stability During Transition More Than for Development ........................................................... xii
Create an Effective and Coordinated International Effort ............................................................ xiii
Shift Governance Aid to Deal with the Realities of a Flawed Afghan Political System
But Hold the Afghan Government Accountable Where This Is Critical to Transition ....... xiii
Accept the Reality That the “New Silk Road” and Regional Development May Benefit Afghanistan After 2020, But Offer No Practical Basis of Support for Transition ........................................... xv
Prepare to Shift Economic Aid from Development to Stability .............................................. xv

**ECONOMIC AND AID CHALLENGES** ........................................ 1
Real World vs. “Mythical-macro” Economics: There Are No Reliable Macroeconomic Data on Afghanistan ................................................................. 2
No Reliable GDP or GDP Per Capita Data ............................................................................. 2
It Is Absurd and Dishonest to Treat Outside Military and Aid Spending as GDP Growth ...... 6
The Uncertain Forces Driving the Afghan GDP ....................................................................... 6
Per Capita Income Data Provide Only the Roughest Warnings ........................................... 10
Population Data Is Similarly Uncertain and Used with Equal Analytic Dishonesty .......... 16
How Many Afghans and Where? No One Knows ................................................................. 17
Making Up More Detailed Numbers by Model and Guessestimate ....................................... 17
Taking a Guess at Some Key Population Trends Affecting Every Element of Development and Transition ................................................................. 19
Without Credible Baseline Data, More Sophisticated Breakouts Become Impossible .......... 22

**AID SPENDING AND EFFECTIVENESS** ..................................... 25
Past Spending, Current Spending Rates, and Spending as a Percent of Total Aid Funds Are Not a Measure of Merit, and Never Will Be .................................................................................. 25
There Are No Accurate Data on the Total Size of the International Aid Effort .................. 26
The Totals for All International Aid Are Equally Unreliable and Fail to Provide Any
Meaningful Measure of Progress .............................................................................................. 33

**THE US AS A CASE STUDY** ......................................................... 42
The US as a Case Study and a Warning .................................................................................. 42
The Unknown Impact of Coming US Cuts in Spending ......................................................... 45
Look at the Trends in US Aid vs. Total Spending .................................................................. 48

**TRYING TO ESTIMATE AFGHAN ABILITY TO GENERATE REVENUES** ........................................................................ 57
The Lack of Meaningful Transition Data on the Sources of Afghan Government Domestic Revenues ....................................................................................................................... 57
Afghan Investment and Future Sources of Revenue ................................................................. 64
SPEND, NOT BUILD (AND THEN STOP SPENDING)? ....................... 67  
A New “Great Game”? .............................................................................67  
The Problem of Sustaining Aid Levels .....................................................67  
Unaffordable “Needs” and the Rush for the Exits .......................................69  
Building on a Weak Foundation ................................................................70  

DEALING WITH A CRIPPLING AFGHAN DEPENDENCE ON OUTSIDE SPENDING ................................................................. 77  
World Bank Estimates of Dependence on Outside Spending ....................77  
Department of Defense Comments on Dependence ..........................................77  
General Accountability Office Estimate of Aid Dependence .......................82  
The Risks in Cutting Outside Spending ....................................................87  
The Afghan Response: Requesting More Than Will Ever Come ...............90  
Concepts Not Plans ...................................................................................91  
Promises of Reform from a Decade-Long Non-Reformer .........................91  
The Oliver Twist Approach to Transition: “More. Please.” .......................92  
Creating an Aid and Afghan Budget Crisis by 2014: The Year Troops Leave and a Presidential Election Is Supposed to Be Held ...........................................93  
  *World Bank, CRS, and SIGAR Warnings* ........................................94  
An Impossible Financing Gap in Aid? ....................................................95  

DEALING WITH THE PRESSURES OF A GLOBAL ECONOMIC CRISIS AND DONOR FATIGUE .......................................................... 97  
A Long History of Unmet Pledges and Real-World Abandonment ...............97  
The Tokyo Conference ...........................................................................98  
  *Hope and Uncertainty* ........................................................................98  
  *The Operational Realities* ...................................................................99  
  *No Basis for Meaningful Planning* ....................................................101  
If Reality Intervenes .............................................................................101  
Afghan Problems versus Outside “Pledges” ...............................................102  
Trying to Make Aid Work as PRTs Are Eliminated and with Inadequate US, European, Donor, and UN Structures .............................................104  

The Death of the Afghan Compact and Development Plan .......................106  
The US, ISAF, and Afghanistan Cannot Rely on Mines and the “New Silk Road” for Transition ........................................................................108  
A Mining Option for the Future, Not for Transition ....................................108  
The “New Silk Road” Is a Poor Cover, Even for an Exit Strategy ................111  

THE NEED TO FOCUS AID ON KEY AREAS AFFECTING KEY SECTORS, REGIONS, AND DEMOGRAPHIC PRESSURES THAT WILL SHAPE POST-TRANSITION STABILITY.............. 114  
Agriculture .............................................................................................114  
The Service Sector ..................................................................................115  
Mining and Narcotics .............................................................................115  
Security Problems and Regional Impacts ..................................................116  
Demographics and Economic Stability .....................................................116
The Human Impact of “Transition” on a Sub-Subsistence Economy ........................................................119
Employment ...........................................................................................................................................119
Poverty, Food Issues, and the UN World Food Program ..............................................................................121
Refugees, Displaced Persons, and Poverty .................................................................................................123

NARCOTICS, THE GRAY AND BLACK ECONOMY, POWER BROKERS, CRIMINAL NETWORKS, AND TRANSITION
FLIGHT .......................................................................................................................................................128
Reverting to a Narco-Economy .................................................................................................................128
Rising Area Under Cultivation Even in Helmand and Other Areas in the South and
Rebirth of Taliban Influence .........................................................................................................................129
Reality vs. Anti-Narcotics Claims of Progress .............................................................................................132
Narcotics, Criminal Networks, Leadership Flight, and the ANSF .............................................................133
Narco-Corruption as a Critical Part of Afghan Economic and Transition ..................................................136

ESTIMATING THE REAL-WORLD ECONOMIC CHALLENGES OF TRANSITION ..........................143
Dodging the Worst Case, But the Bad Case Is Bad Enough ........................................................................143

MEETING THE ECONOMIC AND AID CHALLENGES OF TRANSITION ........................................154
The Need to Focus on the Afghan War Fatigue .........................................................................................155
The Need for Credible Economic and Aid Plans, Credible Resources, and Transparency .......................155
Time Is Another Key Threat .......................................................................................................................156
Planning on the Basis of Economic Realism ...............................................................................................157
Restructure Economic Aid to Reflect the Fact Afghans Will Need Aid for Economic
Stability During Transition More Than for Development ...........................................................................158
Create an Effective and Coordinated International Effort ........................................................................158
Shift Governance Aid to Deal with the Realities of a Flawed Afghan Political System
But Hold the Afghan Government Accountable Where This Is Critical to Transition .........................159
Accept the Reality That the “New Silk Road” and Regional Development May Benefit
Afghanistan After 2020, But Offer No Practical Basis of Support for Transition ....................................161
Prepare to Shift Economic Aid from Development to Stability .................................................................161
Table of Figures

Figure 1: Baseline Economic and Demographic Statistics – Part One .................................4
Figure 1: Baseline Economic and Demographic Statistics – Part Two ..............................5
Figure 2: Trends in the Afghan GDP: 2002/2003-2010/2011 – Part One ...........................8
Figure 2: Trends in the Afghan GDP: 2002/2003-2010/2011 – Part Two ..........................9
Figure 3: Immense Demographic Pressure Regardless of a Range of Estimates for Total Population from 26-35 Million .................................................................................21
Figure 4: CRS Estimate of International Aid Commitments to Afghanistan: 2002-2011 ..........................................................................................................................29
Figure 5: CRS Estimate of Major Non-US Pledges for Afghanistan: 2002-2012 ($ in Millions) ........................................................................................................................................30
Figure 6: Afghan/UNDP Ranking of Donor Countries, Detailing Aid Commitments and Disbursements: 2002-2011 ........................................................................................................31
Figure 7: International Aid Donor Contributions to UNDP Effort in Afghanistan: 2008-2012 ........................................................................................................................................32
Figure 8: External Assistance Pledged, Committed, and Disbursed: 2002-2011 ................36
Figure 9: Aid vs. GDP Trends in Afghanistan ($ in Billions and Percent) ............................37
Figure 10: Aid Money Expenditures by Functional Area – Part One .................................38
Figure 10: Aid Money Expenditures by Functional Area – Part Two ................................39
Figure 11: Donor Assistance ..............................................................................................40
Figure 12: Future International Aid Contributions for Afghanistan: 2012-2017 ..................40
Figure 13: Afghan Finance Ministry Estimate Predictability of Aid: 2012-2014 ..................41
Figure 14: US Spending on the War in Afghanistan: FY2002-2013 – Part One ...............43
Figure 14: US Spending on the War in Afghanistan: FY2002-2013 – Part Two ...............44
Figure 15: DoD Budget Request for Spending on the Afghan War in FY2013 .................46
Figure 16: Post Crisis Aid – Killing the Golden Goose as Soon as Possible ....................47
Figure 17: CRS Estimate of US Spending in Afghanistan, Total Obligations for Major Programs: FY 2001-2011 ($ in Millions) ..................................................................................50
Figure 18: SIGAR Estimates of Total US Military and Civil Aid Spending: FY2000 – FY2012 (January 30, 2013) – Part One ..........................................................51
Figure 18: SIGAR Estimates of Total US Military and Civil Aid Spending: FY2000 – FY2012 (January 30, 2013) – Part Two ..........................................................52
Figure 19: SIGAR Estimates of Indicators of Spending Inside and Outside Afghanistan – Spending on ANSF: FY2004-FY2012 (January 30, 2013) – Part One ..........53
Figure 19: SIGAR Estimates of Indicators of Spending Inside and Outside Afghanistan – Spending on ANSF: FY2004-FY2012 (January 30, 2013) – Part Two ........54
Figure 19: SIGAR Estimates of Indicators of Spending Inside and Outside Afghanistan – Spending on ANSF: FY2004-FY2012 (January 30, 2013) – Part Three ....55
Figure 20: SIGAR Estimate of Key Economic Aid, Narcotics, and Civil Justice Spending: FY2004-FY2012 ........................................................................................................56
Figure 21: World Bank Estimate of Afghan Sources of Total Foreign and Domestic Spending: 2010-2011 (in $ Millions) ..................................................................................61
Figure 22: World Bank Estimate of Afghan Sources of Domestic Revenue: 2011-2012 .........................................................................................................................62
Figure 23: USAID Disbursements per Capita, 2010 ................................................................63
Executive Summary

Continued Aid and Economic Stability as Key Threats to a Successful Transition

Developing even minimal security and stability requires Afghan, US, and allied planners to approach economics and the full range of civil and military aid activities in ways that recognize the need for US and allied realism about the necessity of serious military and civil aid well beyond 2014 and a continuing commitment to working with the Afghan government.

The coming cuts in military and development spending, which have long driven the growth of Afghanistan’s fragile economy, pose a critical challenge for US, allied, and donor policy. An updated World Bank analysis of the economic situation in Afghanistan – and the impact of aid – raises the following issues:1

- Most GDP growth in recent years has come from agriculture and rainfall, not from aid or outside spending.
- But, aid and military spending have equaled some 90% of market GDP.
- Aid alone, less military spending, has equaled 40% of GDP.
- 75-95% of aid that goes through the Government of the Islamic Republic of Afghanistan (GIRoA) budget stays in country, versus 10-25% for off-budget aid.
- But, only 12% of aid to date went through GIRoA, versus a future goal of 50% of aid to be managed and spent by GIRoA in spite of critical budget execution, management, and corruption problems.
- Moreover, aid and military spending in Afghanistan has been high enough to vastly exceed absorption capacity, produce immense waste, distort the economy, and do much to corrupt Afghan society and the government.
- While only 6-10% of the population has been significantly affected by aid and military spending, this percentage represents the leading civil and security elite. Cuts will affect the government, market business sector, political leaders and power brokers, and civil service. This is the elite that drives security and stability, and spending cuts are already hurting this elite.
- Serious security problems and spending cuts could drive Afghanistan into recession and produce a serious crisis in stability and security.
- Even the 4-6% growth case that would occur with sufficient aid, security, and good rainfall will fall below the level needed for development and stability, and politics could produce negative growth.
- Unemployment (8%) and underemployment (48%) total 56% of the labor force, and the economy is under constant pressure from additions to the work force coming from a very young and rapidly growing population.
- Spending cuts pose a critical problem for the budget. Government revenues may be able to rise from 11% of GDP to 27% in 2020-2021 with good governance and security, but Afghanistan will need outside financing equal to 43% of its GDP through 2020-2021.

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• Afghanistan would have to spend 17.5% of GDP on security if the cost is limited to $4.1 billion a year.

• A financing gap of 40% of the GDP will exist in 2014-2015. The gap will still be 25% in 2020-2021 even if mining and other capital investment is high and security, economic reform, and all pledges come through. Key uncertainties exist about the economic status of internally displaced persons, the impact of urban population pressures, and infrastructure issues like road repair.

• The agricultural sector faces major challenges from dependence on rainfall, the impact of the narco-economy, and a lack of cold storage, food processing, market access, and transportation. One Afghan official claimed that 60% of food rots or is lost on the way to market.

• Outside spending cuts will push the agricultural sector towards opium and cannabis, benefiting crime lords and creating problems for farmers in terms of load dependence at a time of acute population pressure on the land.

**The Need to Focus on the Afghan War Fatigue**

Afghanistan must convince donors that they can work through the central, provincial, and local governments in ways in which aid money is actually used to benefit the people and bring economic stability. It must have outside support to focus on reforming its own economy and reducing government barriers to development.

Regardless of official rhetoric, public opinion polls in the US and most ISAF countries show little support for the war or serious aid spending, and some countries are already cutting aid and reducing their troop levels earlier than planned. Much of the aid effort in the field will be cut from 2013 onwards as ISAF troops depart, and the lead time to implement new or more effective programs in Afghanistan often requires 11-18 months to put major changes into action.

There is little time left to set forth a clear program to deal with Transition. There is well under two years remaining before most US and ISAF forces are gone and their military spending in Afghanistan goes with them.

**The Need for Credible Economic and Aid Plans, Credible Resources, and Transparency**

All of these issues highlight the need for a new approach to the war, one that highlights the need for credible civil and military spending plans that have a far greater degree of honesty and transparency. So far, there are no credible public plans for either the economic or military aid aspects of Transition.

In spite of the claims of success and token aid pledges that came out of the largely symbolic conferences in Chicago and Tokyo, there is no open-source evidence that the US and ISAF have really reversed insurgent momentum in Afghanistan or created conditions where tactical victories will have lasting strategic meaning. Possibly more importantly than military victories, the civil effort lags far behind the military effort. While there have been some successes in some aspects of Afghan governance and development, they are so limited and fragile they may well not survive beyond 2015.

The political and bureaucratic barriers to dealing with these realities are all too clear, but the US, other ISAF countries, donor countries, and the Afghan government still need to do what they can to develop detailed plans for 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.

These efforts should:

- Create an honest baseline of reporting and trend analysis based on the political nature of the war and net assessment of each side, while explicitly addressing uncertainty and the need for parametric analysis.
- Create credible civil and military plans for affordable levels of aid, and make both publicly transparent in an effort to win US and international support on a credible and sustainable basis.
- Focus on stability during the key period of Transition from 2013 to 2016, not development. Look at worst-case risks. Address issues like security, corruption, narco-economics, and capital flight.
- Make aid “conditional” in ways that are tied to the actual level of progress in Afghan politics, force development, and use of economic aid.
- Work with the ANSF and GIRoA to focus military and aid resources on holding key populated areas while securing those other areas where the Afghan central government and/or key Afghan leaders and factions are strong enough to hold and have sufficient popular support to sustain their position. This will sometimes mean devolving power back to regional and local leaders on their terms – and then using aid and security assistance to support them – when this offers a practical way of providing some form of effective governance and security. It means backing Afghan leaders who are actually effective even if this means “doing it their way,” rather than setting unrealistic standards or backing the central government where it cannot lead or be effective.
- Phase down aid and outside military support during 2015-2018 with careful attention to how Afghan forces actually perform in the field and real-world time schedules for effective action.
- Move towards self-funding in as carefully planned a manner as possible. Rapid cuts will kill the chances of successful ANSF development and create economic and political instability. Throwing money at the problem in ways that waste and corrupt, setting goals Afghans don’t want and can’t achieve, losing sight of priorities by focusing on projects rather than national needs, and ignoring both the inevitable cuts in outside funding and the need for self-sustainment have been immensely destructive aspects of the civil and military efforts throughout the war. Repeating them during the most critical phase of Transition is a recipe for failure.
- Finally, accept the fact that the Afghan insurgency may drag on indefinitely and that it is certain to have de facto control over some parts of the country after 2014; this is a fact the US, its allies, and aid donors must be prepared to live with.

Time Is Another Key Threat

There is little time 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.

There are less than two years left before Transition in 2014, and there are no magic bullets that offer rapid growth and prospects for stability before 2020. This means it is necessary to create 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 FY2014 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.
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.

**Planning on the Basis of Economic Realism**

A successful Transition will require both Afghans and donors to take a realistic look at the economic impact of cuts in military and aid spending, Afghanistan’s real-world level of per capita income, gross inequities in economic distribution, and the need for internal economic reform as a substitute for high levels of aid and outside investment.

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

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 the US, the largest aid donor, dropped from $3.5 billion in FY2010 to about $2.3 billion in FY2012. Aid to support democracy, governance and civil society dropped by more than 50%, from $231 million to $93 million. Aid for "rule of law" dropped from $43 million to $16 million.\(^2\)

Other countries are cutting their civil and military aid programs, and some NGOs are already eliminating key programs or withdrawing from the country.\(^3\) Unfortunately, the time lag between US appropriations and disbursements – and allied pledges and actual spending – will make the impact of such cuts even worse during Transition. The past increases in appropriations and pledges and the spending impact in Afghanistan of the surge or peak in US forces mean actual disbursements peaked in 2011 and 2012, sharply increasing the problems of coming spending cuts in 2013-2015.

Moreover, the US and other current donors 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 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

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conference as follows: “It’s been another conference of flowery speeches: big on rhetoric and short on substance.”4

Restructure Economic Aid to Reflect the Fact Afghans Will Need Aid for Economic Stability During Transition More Than for Development

Although there are no reliable estimates of the economics of Transition, the “guesstimates” that do exist make it clear that both Afghan military and civil efforts face major funding problems. Studies by the World Bank and Afghan government – and working studies by the International Monetary Fund (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 Hamid 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, while also calling for equally ambitious reforms and improvements in governance as well as for the Afghan government to achieve full independence from outside support in 2030:5

- 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 nation.

The Afghan government stated that meeting its goals will require some $120 billion in aid 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. At the Tokyo conference in July 2012, international donors pledged less than $4 billion per year through 2016, and it is highly likely that much of this pledged funding will never reach Afghanistan.

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5 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, Government of the Islamic Republic of Afghanistan, November 29, 2011.
Create an Effective and Coordinated International Effort

While national tensions have so far crippled any unified UN or other effort to fully coordinate national aid, there is a clear need to create an effective international body to replace the UN Assistance Mission in Afghanistan (UNAMA). Someone needs to help manage the transition from national and NGO aid that is largely spent outside the GIRoA budget and control to an effective Afghan-planned and -managed aid effort.

This body should have a mandate that gives it real power to work with the Afghan government and key Afghan factions at the regional and local levels to actually coordinate development planning and spending, while also working to find ways to ensure it actually reaches the Afghan people and meets their needs.

The weaknesses and corruption in the Afghan central government are not fixable before 2014 or in the medium-term thereafter. Cutbacks in Provincial Reconstruction Teams (PRTs), NGO presence, and aid staffs will further complicate the problem. The money that remains cannot be effective if it continues to be spent on a donor nation-by-donor nation, NGO-by-NGO, and compartmentalized into military and civilian basis. There is a desperate need for coordination, reform, and for someone and some organization to be in charge of the overall planning and management for the aid effort. There is a desperate need for expanding the realism and depth of the World Bank effort and for creating a UN body that can actually do its task.

The obvious need is to either reform or abolish UNAMA and create a UN body that can actually do the job or give the World Bank a major role in the field, and use international conferences to get donor states to both coordinate aid and spending and regulate NGOs.

An effort to coordinate aid was made at the Tokyo conference. It does not take much vision or many visits to Afghanistan, however, to predict that no real coordination will take place, that UNAMA will continue to be a dysfunctional mess, and that even the US internal effort will remain a poorly planned and coordinated mix of “golden silos” in which the talk of integrated civil-military efforts never goes beyond concepts to reality.

Shift Governance Aid to Deal with the Realities of a Flawed Afghan Political System But Hold the Afghan Government Accountable Where This Is Critical to Transition

Governance aid will need major restructuring. The US, its allies, and other donor states seem bound to ignore the lessons most colonial governments learned after far longer periods of nation-building. Cultures and political systems are remarkably resilient, and while they seldom return to the past, they do quickly change to reflect local values, some elements of tradition, and local power.

Transition cannot be based on the illusion of perfect elections, reliance on the presidency and central government, the emergence of some form of Afghan consensus and unity, an end to corruption, an end to power brokers, rigid adherence to a largely foreign draft constitution, or the sudden sharing of money and power effectively with provinces and districts.

Transition must focus on “Afghanistan as good as can actually get,” and this Afghanistan is decades away from these goals – if it ever does emerge – and the task now is to get through the 2014 election with some form of credibility and effective national leadership,
strong provincial leadership, and ensuring leadership in key districts that is workable on Afghan terms.

There are areas, however, where the US and its allies will need to make aid and support conditional on Afghan progress, and where it should be clear that Afghan failures will mean an end to outside support. These include credible plans to:

- Hold a 2014 election that is honest and open enough to win a reasonable degree of public support. Given the lead times involved, this plan should have already existed and been made public.

- Hold the Afghan central government accountable for the more critical reforms that it pledged at Tokyo and in the paper it circulated at Bonn. This should not involve a search for new anti-corruption bodies, more prosecutions, and more scapegoats.

- Create a focused effort on enforcing enough fiscal responsibility and accountability to limit waste and fraud to more reasonable levels, and tie funding flows to actual progress.

- Make it clear to Karzai, his successor, and all senior Afghan politicians that the US commitment to the war is conditional on their performance in key areas vital to the success of Transition. The US and its allies should make it clear that they have an exit strategy for Afghanistan if its leaders fail their people and do not work towards some form of strategic success, and make it clear they will act accordingly. This effort should, however, be narrowly focused only on essential aspects of Transition.

- Press for enough reform to make the Afghan legislature less of a corrupt and obstructive body. These steps require a far more focused and better planned and managed effort that is dependent on the understanding that the US and its allies have continuing strategic interests in Afghanistan, but scarcely vital ones or ones they cannot walk away from. It requires the US and its allies to take a hard line when it is functional and to avoid confrontation when it is not. It requires Afghans to clearly understand that they will be held accountable for their own actions: future successes or failures will be their own.

- Make it equally clear to Karzai and future presidents that outside aid and support to the central government – and to them personally – will be dependent on keeping effective ministers and provincial/district governors and removing corrupt and ineffective ones.

- It may be too late, but the US should at least press for sufficient political reform to produce stability and security in key provinces and districts. These reforms should be aimed at facilitating elected representation and enabling localities to raise and control their own funds.

- Push for reforms that allow provinces, key cities, and districts to control and raise their own funds; strengthen local assemblies; and create more representative government at the regional and local levels. The gross over-centralization of power, control of money, and appointment of key officials makes the present constitution and power structure a source of aid and comfort to the insurgency.

- Tolerating moderate levels of corruption and the abuse of power must remain an ongoing reality, but the US, its allies, and donors should publicly out grossly corrupt governors, senior commanders, and power brokers and make it clear they will not resume funding until these figures are gone and stay gone. Control of money, not anti-corruption bodies and prosecution, should be the key.

At the same time, if the central government does not succeed, the US and its allies should be prepared to accept a major weakening of the central government and support the de facto division of the parts of the country along regional, ethnic, and sectarian lines. Power brokers and warlords are scarcely desirable, but neither is a total collapse or failure at the center.
Accept the Reality That the “New Silk Road” and Regional Development May Benefit Afghanistan After 2020, But Offer No Practical Basis of Support for Transition

The fifth step is for the US to stop talking about economic miracles and instead focus on getting the aid necessary to ease the Afghan government and people through the coming cuts in military spending and aid. As World Bank studies in early 2013 make all too clear, no credible case exists for the New Silk Road or major revenues from mining until 2021 or beyond. As such, they should be dropped from all US policy and planning efforts.6

This does not mean that objective mid- and long-term economic development studies and plans are not needed. They should not, however, be contract studies to please given policies. Creating a dedicated section within a World Bank planning effort – tied to some counterpart group in the Afghan government – that is transparent and subject to peer review could prove to be of great value over time and especially in the period beyond 2015-2017.

Prepare to Shift Economic Aid from Development to Stability

The sixth step, and perhaps the most important for the period between 2014 and 1017, is to prepare to shift economic aid away from development projects and to help Afghanistan achieve economic stability if the cuts in military spending and overall aid trigger a serious recession, create problems in popular support for the government, or affect the elite (that has benefited from aid and spending and that effectively lead the country and represents its armed elite).

The data on the economy, military spending, and the impact of aid are so bad that it is not possible to predict the impact of coming cuts – a problem compounded by the inability to predict how serious these cuts will be and how much of a backlog of existing unspent aid will actually be spent in country over the next few years. The risks involved, however, are too great to ignore.

Far more realistic risk analysis is need almost immediately and must then continue throughout the next half decade. Scenarios need to include the full range of problems and risks. Plans need be created to rapidly shift funding to meet urgent employment and economic stability needs. Simply hoping or assuming no crisis will occur is not a meaningful form of planning.

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Economic and Aid Challenges

There is no clear way to assign a priority to Afghan political stability and governance, Afghan economic stability, or Afghan security. All three represent critical elements of Transition. What is clear is that the quality of Afghan leadership, political unity, and governance cannot be given precedence over the other two elements of this “triad.” The stability of the Afghan economy, government expenditures, and the flow of outside aid will be as important, so will security and the development of the Afghan National Security Forces (ANSF), and all will be dependent on outside aid for a successful Transition.

This means the US and other outside planners must now be far more honest in addressing problems like the internal ethnic and sectarian divisions with Afghanistan, corruption, power brokers, warlords, narcotics, and capital flight. They need to be honest about the deep divisions outside “Kabulstan” and the problems that weaken support for the central government. They need to accept the fact that some form of regionalism may become the de facto price of unity.

They need to deal with the fact that peace negotiations with the Taliban and other insurgents may mean giving them local power, a major role in the central government, or only succeed at the cost of making lasting strategic relations with the US impossible. They may also find that the insurgents only engage in peace negotiations as a form of political warfare by other means.

The story is different in the case of Afghan aid and economics. The flow of military spending and aid has come to dominate the market sector of Afghan GDP and vastly exceed Afghanistan’s ability to raise internal revenues. The central government probably cannot function or survive without outside civil and economic aid at levels that can provide it with popular support and economic stability well beyond 2017. It cannot possibly fund effective ANSF unless the US and outside donor nations foot most of the bill.

At present, however, far too much of the outside effort at the national, international organization, and NGO level lives in a state of denial. They make unrealistic estimates of future development options that focus on massive changes in areas like mining and regional cooperation. They use macro-economic indicators that have no real validity or application to Afghan society. They use data with no credible source or definition to claim progress that has not occurred.

As a World Bank study issued in 2013 notes, ⁷

…[A]s is well known, collecting reliable data on Afghanistan is extremely difficult. Moreover, much of the information that is available is subject to large margins of uncertainty and often problems of incompleteness, incomparability, and so on. Data are frequently changed and updated. Collecting and triangulating data on issues such as jobs, aid inflows, and security costs have posed major challenges...

Far too few governmental studies – especially those by the US Agency for International Development (USAID) and the US State Department – meet even minimum professional

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standards in estimating these uncertainties, carry out parametric analysis of uncertainty, using data in ways that are relevant, or defining key terms. Moreover, they use macroeconomic data and make claims about the impact of aid that ignore:

- The scale of waste, corruption, and the impact of a decade of spending that went far beyond Afghan absorption capability, leading to massive capital transfers outside the country and a distortion of virtually every market-driven aspect of the economy.
- The economics of power brokers, narcotics, and criminal networks.
- Full-scale risk analysis in looking at the impact of coming cuts in spending, while ignoring the economic realities of why given elements and districts do or do not support the central government.
- The fact Afghanistan is at war and security is likely to be a major problem long beyond the end of 2014.

The answer is far more honest assessment and plans, a focus on what is actually needed and possible, an equal focus on the affordable and politically credible, and year-by-year commitments to plans that actually suit Afghan conditions and needs.

**Real World vs. “Mythical-macro” Economics: There Are No Reliable Macroeconomic Data on Afghanistan**

The first step in making these changes 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, International Monetary Fund (IMF), UN Assistance Mission in Afghanistan (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.

There is nothing honest – or that has the slightest analytic validity – about implying that rises in GDP growth and per capita income that are actually driven by good rainfall and increased agricultural output – coupled with a flood of aid and military spending – represent real growth or self-sustainable increases in personal income. There is nothing honest or analytically valid in their willingness to parrot back unreliable Afghan estimates for improvements in medical care and education. In fact, the overall failure of international organizations and governments to honestly address the sources and quality of data have become both an international disgrace and a major barrier to effective planning and assessment.

Again, according to the World Bank, “it is well known that collecting reliable data on Afghanistan is extremely difficult. Moreover, much of the information that is available is subject to large margins of uncertainty, as well as often problems of incompleteness, incomparability, etc. Data are frequently changed and updated. Collecting and triangulating data on issues such as jobs, aid inflows, and security costs has posed a major challenge…”

**No Reliable GDP or GDP Per Capita Data**

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Figure 1 compares the most basic macroeconomic data on Afghanistan using some of the primary sources now being used in Transition planning and shows how one set of these data can affect other aspects of how Afghan stability and security are assessed.

The data on market value GDP are relatively consistent but largely because they use the same methodology, one that seems to ignore key factors like narcotics and corruption/capital outflow. The data on GDP in purchasing power parity (PPP) terms differ radically from each other and from the market data.

GDP figures used by the World Bank, IMF, Central Intelligence Agency (CIA), State Department, Afghan Central Statistics Organization (CSO), and the UN all appear to be based on the same IMF/World Bank estimates and CSO. While there are some discrepancies between the market-oriented GDP figures from these various sources, this is likely due to one of the following three factors:

- Calculations using different Afghani to US dollar exchange rates.
- Attempts to shift GDP calculations from the Afghan to the Western calendar year.
- GDP revisions shift figures for any particular year either upward or downward in the months following the initial data report; this process is common to all countries and creates differences in data depending on the date of publication.

Unfortunately, no source provides more than a marginally credible breakdown of GDP by sector, district, or province, or shows it has a credible basis for estimating the GDP in either market or PPP terms. It is unclear how the standard methodologies for calculating GDP provided in the 2008 System of National Accounts recommended by the UN and World Bank can credibly be applied towards an economy distorted by external spending, corruption, and the black market.

Given these difficulties, it is noteworthy that such precise GDP numbers are provided without any indication of the percentage of uncertainty involved.

Figure 1 also shows that the PPP adjusted estimates of GDP figures can be nearly 70% higher than the figures for GDP calculated at market exchange rates. These estimates make per capita income estimates totally uncertain. Even if one ignores the major differences in population estimates, the PPP GDP estimates suggest that future decreases in aid reaching the Afghan people will have a disproportionate effect, given that a dollar spent – or not spent – in Afghanistan could have purchased roughly 1.7 times the amount of goods that same dollar could purchase in the US.

Furthermore, the far greater problems in estimating economic data from the years of Taliban rule and civil war prior to 2001 make it difficult to make meaningful economic trend and growth estimates or comparisons relative to these time periods. The trend data on economics are particularly suspicious because it is unclear if there is any valid base point to be used in calculating such trends. In fact, many estimates are actively dishonest exercises in “spin” in that they are using 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.
**Figure 1: Baseline Economic and Demographic Statistics – Part One**

<table>
<thead>
<tr>
<th>Estimates</th>
<th>Population (M)</th>
<th>GDP (US$) Market/Real</th>
<th>GDP (US$) PPP/Nominal</th>
<th>GDP per-Capita (US$)</th>
</tr>
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<tbody>
<tr>
<td>Afghan Central Statistics Organization(^{10})</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>US Census Bureau IDB(^{19})</td>
<td>31.108 (2013)</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>


\(^{11}\) The figure was originally given as 903,990 billion Afghanis. Currency conversions from Afghanis to US dollars are calculated at the World Bank’s reported average exchange rate for 2011-2012 of 47.8 Afs to $1USD.

\(^{12}\) The year 2011 roughly corresponds to the Afghan year 1390 (March 21\(^{st}\) 2011 to March 20\(^{th}\) 2012) that is used in official Afghan government statistics.


Figure 1: Baseline Economic and Demographic Statistics – Part Two

GAO Statistical Overview of Afghanistan

It Is Absurd and Dishonest to Treat Outside Military and Aid Spending as GDP Growth

This does not mean there has not been real progress in Afghanistan since the fall of the Taliban, even if one ignores the fact that much of the economic growth has been driven more by agriculture, rainfall, and increased narcotic revenues. However, many of the so-called “improvements” in other areas can be traced to unsustainable levels of external military and aid spending – often under conditions about which it is impossible to know what weight the trend analysis actually assigns to the impact of outside spending versus the impact of the fall of the Taliban and the impact of agriculture.

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.

A combination of outside aid and military spending has driven the growth of the Afghan economy and has totaled at least 7-11 times the revenue-earning power of the Afghan government. The kind of “positive” reporting that has focused on uncertain estimates of GDP growth has been decoupled from reality to the point that it ignores the real-world risks in Afghanistan’s prospects for Transition, both what will happen as this spending is cut and the human factors involved.

The Uncertain Forces Driving the Afghan GDP

The World Bank has been far more explicit about the uncertainties involved in estimates of the GDP growth and their cause.20

Afghanistan’s economy has grown rapidly since 2001: real GDP has increased at 9 percent a year, though with wide year-to-year fluctuations largely caused by agriculture’s volatility… Recovery from more than two decades of conflict and destruction, which left Afghanistan one of the poorest countries in the world, as well as a severe drought in the late 1990s, was a dominant factor in the initial post-2001 years. Growth has remained high in subsequent years— higher than in almost any other low-income post conflict country.

Services have contributed most strongly—and steadily—to growth, driven largely by consumption fueled by extraordinarily high aid in recent years. For services, communications and transport, followed by government services, have been the most important sources of growth, and for industry, construction has been the main source. Mining’s contribution has been marginal, but it has good potential.

Agriculture remains important for its continued large share in the economy and for its provision of livelihoods to the majority of the rural population. Private consumption has contributed to the growth of aggregate demand in every year since 2005/06, with private investment playing a relatively small role. Through 2025, growth is expected to be much slower, according to simulations of the transition’s impact with a general equilibrium model (for more on the model, visit http://www.worldbank.org/mams). The model uses projections based on different assumptions, including security, aid volumes and modalities, sources of growth, and investment climate…

The importance of agriculture – where the fluctuations from year to year are driven largely by rain and global prices for wheat and opium – is also shown in the trend and sectoral analysis in Figure 2.

This seems to be as good a picture of the trends in the Afghan GDP as is currently available. However, it is not clear that the World Bank analysis has a credible basis for assessing the level of Afghan dependence on agriculture versus the impact of massive displacement of the Afghan population into urban areas and the impact of population growth on other sectors.

Furthermore, it is unclear how credible figures could have been collected from those districts controlled not by the government but by insurgents, an area including large parts of Paktika, Zabul, Kunar, Nuristan, and other provinces. Moreover, it is unclear how anyone can estimate the direct and secondary impacts of aid and military spending – given the difficulties in knowing what portion of money is really staying in Afghanistan and the impact of aid and military imports in shaping indirect GDP growth.
Figure 2: Trends in the Afghan GDP: 2002/2003-2010/2011 – Part One

Real and Agricultural Growth

Sector Growth Rates

Sector Shares in GDP in Percent

Figure 2: Trends in the Afghan GDP: 2002/2003-2010/2011 – Part Two

Per Capita Income Data Provide Only the Roughest Warnings

These problems in estimating the GDP make any estimates of increases in Afghan per capita income even more speculative and illustrate the almost constant analytic dishonesty of many international organizations, NGOs, and governmental structures like USAID and the US State Department in making claims about progress in health and education that have no basis in reliable population data and which are almost universally selected to imply that aid has produced exaggerated benefits. No reputable organization ignores gross uncertainty in its estimates or fails to provide parametric analysis when gross uncertainty exists.

The problems involved become clear from even a brief review of other sources, even if one ignores the massive uncertainties in Afghanistan’s population data discussed in the following section. For example, the CIA estimated in early 2013 that the Afghan GDP per capita was only $1,000 in 2011, which ranked a dismal 217th in the world. The CIA also warned that,21 Afghanistan's economy is recovering from decades of conflict. The economy has improved significantly since the fall of the Taliban regime in 2001 largely because of the infusion of international assistance, the recovery of the agricultural sector, and service sector growth. Despite the progress of the past few years, Afghanistan is extremely poor, landlocked, and highly dependent on foreign aid. 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 difficulty in extending 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 nine donors' conferences between 2003-10, 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.

Once again, sources sharply disagree. For example, the Afghan CSO calculated GDP per capita of $629 in 2010-2011, which suddenly leaped to $715 in 2011-2012 – evidently because of higher disbursements in aid and military spending and a low estimate of population growth.22 The UN put GDP per capita at $586 in 2011.23 The IMF estimated GDP per capita in current prices at $620 in 2012, and the per capita income in PPP terms at $993.24 The World Bank estimated gross national income per capita at only $470 in 2011, using the Atlas method.25 This makes the CIA estimate of Afghan per-capita income roughly 2.1 times the World Bank estimate – which may be a result of different

methods and definitions, but highlights the need for any reputable reporting on progress in Afghanistan to explicitly explain and validate the use of statistical data and show the range of uncertainty in other sources.26

This clearly highlights the failure of international organizations and US agencies like USAID to examine the validity of any of the progress numbers they use – including data on education, medical care, and the numbers of Afghans affected – which makes it impossible to trust any aspect of their statistics.

Nevertheless, most outside agencies do agree that the CIA is correct in drawing broad conclusions about Afghanistan’s real-world economic problems. For example, the World Bank warned in its May 2012 evaluations of Afghan prospects for Transition that,27

> Afghanistan remains one of the world’s least developed countries, with a per capita gross domestic product (GDP) of only $528 in 2010-11. More than a third of the population live below the poverty line, more than half are vulnerable and at serious risk of falling into poverty, and three-quarters are illiterate. Additionally, political uncertainty and insecurity could undermine Afghanistan’s transition and development prospects.

The large aid inflows that have benefited Afghanistan have also brought problems. Aid has underpinned much of the progress since 2001—including that in key services, infrastructure, and government administration—but it has also been linked to corruption, poor aid effectiveness, and weakened governance. Aid is estimated to be $15.7 billion—about the same as the size of the GDP in fiscal year 2011.

Despite the large volume of aid, most international spending “on” Afghanistan is not spent “in” Afghanistan, as it leaves the economy through imports, expatriated profits of contractors, and outward remittances. Other countries’ experience shows that the impact of large aid reductions on economic growth may be less than expected. The main issue is how to manage this change, mitigate impacts, and put aid and spending on a more sustainable path.

Key questions about Afghanistan’s growth relate to its sources and sustainability. Even taking into account the stagnation of real GDP during the previous 25 years of conflict and the subsequent post-conflict economic rebound, growth—especially in the latter part of the past decade—appears to have been stimulated by enormous inflows of aid and international military spending. Afghanistan has become an extreme outlier in its dependence on aid. Trends in aid dependence are downward for all three groups of comparator countries. Strong performers on average have initially higher aid dependency ratios, but steeper declines than the other two groups, partly reflecting more rapid economic growth.

… Political uncertainty and insecurity could undermine Afghanistan’s transition and development. International experience demonstrates that violence and especially protracted internal insurgency are extremely damaging to development, and that political stability and consolidation are key ingredients of transitions to peaceful development. This underlines the importance of reaching a peaceful solution to the Taliban insurgency, and the need for political consolidation particularly in the run-up to the next election cycle. (The presidential election is to be held in 2014, and

parliamentary elections in 2015.) But if there is worsening insecurity and increasing uncertainty about longer-term stability, Afghanistan’s development prospects will be harmed.

Political consolidation is not the only pressing issue that needs to be tackled. Afghanistan’s political economy over the past 10 years has been shaped by large inflows of aid, which provided benefits to various groups from the associated rents and contracts. Given these distortions, returning to a more “normal” economy with much lower aid inflows will not be easy and will require continued and concerted international support.

Afghanistan’s political elite will need to rise above short-termism, factionalized politics, widespread patronage, and corruption and more consistently pursue a medium- to longer-term national agenda. This will require political consolidation and a broad-based coalition for peace and reconciliation. And the international community will need to move beyond viewing transition just in security terms, as a way to exit, and start seeing it as an opportunity to enhance the coherence and effectiveness of its assistance and pursue realistic developmental objectives over the longer term.

There is much that both partners can do to make transition more likely to succeed from the broader and longer-term perspective taken here. While challenging, the fiscal, government capacity, service delivery, economic, and poverty dimensions of transition can be managed, provided that the overall security and political context of transition (including the regional environment faced by Afghanistan) is conducive.

…A gradual fall in aid might be beneficial in the long term as it would reduce distortions in the economy caused by the extraordinarily high levels of aid in the past. A rapid decline could, however, lead to major macroeconomic instability and serious socioeconomic consequences. Future aid flows need to be carefully programmed to allow the economy to adjust to new opportunities for growth from mining (especially), agriculture, and services.

Making aid more effective can mitigate some of the negative impact of the fall in aid. Raising the local content of aid could do this, through shifting more aid on budget and increasing opportunities for local vendors to participate in aid contracts.

Rather than declining aid, however, deteriorating security and governance are likely the largest risks to the economic outlook. Efforts to sustain or improve security—as well as to bolster the legitimacy of the state—will remain of utmost importance.

The Independent Evaluation Group of the World Bank warned in its 2013 evaluation of the progress in Afghanistan’s economy during 2002-2011 that,28

Despite gains in building a stable central government, Afghanistan remains fragile and dependent on the international community. President Karzai won a second five-year term as president in the 2009 election, but the results were disputed and accepted somewhat reluctantly. The constitution also provides for elected provincial, district, and village councils. While provincial councils held elections in 2005 and 2009, they are still seeking to find effective roles in securing provincial development, and district and village councils have not yet been elected or established.

…The government has taken steps to lay the foundation for economic stability and growth, despite a very difficult security situation and the challenges associated with building political and economic institutions. Economic activity has been robust, with real gross domestic product (GDP) growth averaging more than 10 percent annually over the past five years. Revenue collection increased to 11 percent of GDP in 2010/11 from 8 percent in 2008/09.

However, current revenue covers only about two-thirds of central government operating expenditures and less than 20 percent of total public spending. Inflation has been rising, and confidence in the banking sector has been low since the collapse of Kabul Bank in September 2010. Security spending rose by 1.3 percent of GDP, while non-security spending dropped by 0.7

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percent of GDP from 2009/10 to 2010/11, as recruitment for the Afghan National Army grew by over 30 percent. The operating budget deficit, excluding grants, remained broadly stable at 4 percent of GDP, but development spending fell by 1.7 percent of GDP, and budget execution rates remain low, due to capacity constraints, difficulties in public financial management, and a worsening security situation (IMF 2011).

The World Bank also provided another analysis in the spring of 2013 that documented many real positive trends since 2001, but put them in an honest perspective lacking in so many exaggerated official claims of progress:29

Afghanistan is one of the poorest countries in the world. In 2010 gross domestic product (GDP) was US$15.9 billion (excluding opium production), after nearly a decade of strong growth. With an estimated population of 30.6 million, the country has a per capita GDP of US$528. In spite of encouraging progress, social indicators are still dismal (and suggest wide gender gaps): 36 percent of people are poor, and about 75 percent of the population is illiterate. (p. 47)

...Key social indicators, including life expectancy and maternal mortality, have improved markedly (admittedly from an extremely low base), and women are participating more in the economy. Yet in other respects, particularly governance and institution building, the country has fared less well, and many indicators have worsened in recent years. Afghanistan remains one of the world’s least developed countries, with a per capita gross domestic product (GDP) of only US$528 in 2010/11. More than one-third of the population lives below the poverty line, more than half are vulnerable and at serious risk of falling into poverty, and three-quarters are illiterate.

The large aid inflows that have benefited Afghanistan have also brought problems. Aid has underpinned much of the progress since 2001—including that in key services, infrastructure, and government administration—but it has also been linked to corruption, fragmented and parallel delivery systems, poor aid effectiveness, and weakened governance. Reflecting steep increases after 2005, civilian aid and spending on the Afghan National Security Forces in 2010/11 (together, “aid”) came to an estimated US$15.7 billion—about the same as GDP... Although the bulk was security spending, civilian aid is estimated at more than US$6 billion a year, or nearly 40 percent of GDP. Such aid dependency is almost unique (only a few smaller economies, such as Liberia and West Bank and Gaza, have on occasion received more aid per capita). (p. 1-2)

...On the basis of limited available data, unemployment and underemployment are estimated at 8 percent and 48 percent, respectively, even with current rapid economic growth. Weakening labor markets during the transition could worsen the jobs outlook, affecting household incomes and possibly other aspects of the transition.

The direct employment impact of aid, while significant, does not seem to be excessively large. An estimated 6–10 percent of the working population has benefited from aid-financed job opportunities, most of them short term (less than six months)... US$500 million decline in aid delivered outside Afghanistan’s budget could directly affect 11,000–18,000 six-month jobs. It may also worsen underemployment and reduce household incomes (because of fewer casual labor opportunities and lower pay for skilled employees) rather than lead to much higher open unemployment. The impact will be greater in conflict-affected provinces (which have received much more aid per capita) and in urban centers. A gradual decline in aid would mute the employment impact, allowing labor markets to adjust and the security, mining, and civilian public sectors to grow and partly offset aid-related job losses.

Slower economic growth and the associated employment effects are expected to increase poverty, but aid reductions would probably not markedly affect it, because higher donor spending—particularly the massive stabilization-oriented expenditures in some of the more insecure and conflict-affected provinces—appears to have only modestly affected poverty. This effect was

identified through a comparison of three groups of provinces, grouped by the sum of per capita government and donor spending in 2007/08: low (< US$100), medium (US$100–200), and high (> US$200). Comparing changes between 2005 and 2008 (the only years with comparable household survey data) in the medium and high-spending provinces with changes in the low-spending provinces showed that the high-spending group registered a very modest gain in monthly per capita food consumption: Af 110, equivalent to about US$2.20 only. (p. 8-9)

…Development spending represents only 26 percent of the education budget, which is largely taken up by teachers’ payroll costs financed through the operating budget, leaving nonwage O&M grossly underfunded. This underprovision makes sustaining investments in infrastructure and maintaining student enrollments difficult, given deferred maintenance of school buildings and shortages of basic supplies. Required O&M for the education sector in 2010/11 is estimated at US$170 million, against a budget allocation of only US$38 million… By 2014 this requirement is expected to increase to US$235 million. Budgetary and administrative reforms in the Ministry of Education will be required to ensure that any additional O&M allocation is made available to schools.

Health service delivery depends much more on the development than the operating budget. Unlike education, primary health services are delivered mainly by nongovernmental organizations (NGOs), which are contracted by the Ministry of Public Health and funded by a few donors through the development and external budgets. Some 72 percent of the core budget is financed through the development budget. Any significant drop in external funding of the development budget would therefore pose a serious threat to health services.

Funding for agriculture and rural livelihood activities is largely through the development budget. As in health, interventions in this sector are primarily implemented by NGOs and financed through the development and external budgets. Apart from the National Solidarity Program (NSP), most projects are small and funded by a single donor, but their great number translates into a large overall budget. 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. (p. 16-17)

…[P]rojections suggest that, under reasonably favorable baseline projections, real GDP growth may fall from 9 percent a year in 2000–10 to 5–6 percent over 2011–18. Given Afghanistan’s annual population growth of 2.8 percent, there would be limited increases in average per capita incomes, continuing high underemployment, and little progress in reducing poverty. Only growth at the upper range of plausible scenarios would enable Afghanistan to significantly reduce poverty and increase average per capita incomes. For example, with real GDP growth of 6 percent a year, average per capita income—currently among the lowest in the world at US$528—would take 22 years to double, about a generation. (p. 18; also see pages 68-69)

…Economic growth would be even lower under less favorable scenarios. Growth projections are based on assumptions (scenarios) related mainly to security sources of growth, aid levels, and changes in the investment climate. If the assumptions in the less favorable scenarios come to pass—for example, if agriculture performance is poor, major mining investments (Aynak for copper and Hajigak for iron ore) do not materialize, or aid declines precipitously over the period—then growth could drop to 3–4 percent a year. Deteriorating security and governance would lead to even lower or possibly negative economic growth. (p. 18-19)

…According to the NRVA 2007/08, 66.5 percent of those in the working-age population (16 years and older) participated in the labor market. Only about 6.8 percent of the population could be considered unemployed in 2009 based on the conventional definition of the term. However, the relatively low level of open unemployment is counterbalanced by the severity of underemployment: more than 48 percent of those employed work fewer than 35 hours a week, on average.

…Underemployment is particularly widespread in rural areas and among the self-employed, including day laborers and family workers, who make up about 77 percent of the workforce. (pp. 61-62)
The Ministry of Finance reported that, in 2010, some 6,647 people working outside the civil service in nonsecurity ministries received salaries or salary top-ups financed by donors. The International Security Assistance Force registers 60,000–80,000 Afghans directly employed through military-related contracting agencies. However, information on the length of employment is not available, and double counting may possibly cause errors. The USAID, depending on the source, estimates 31,600–60,000 jobs created through its own contracts, but whether these numbers include second-round effects (jobs created indirectly through aid money) is unclear. U.S. Central Command (US-CENTCOM) reports that U.S.-financed contracts employed 34,200–78,500 Afghans, including contracts issued by the USAID and military agencies (US-CENTCOM July 2008–January 2011).

Nongovernmental organizations are believed to employ about 16,600 Afghans. Much uncertainty exists even over direct employment through aid contracts. Taking employment numbers reported by aid agencies, the number of jobs created is around 410,000. Using the methodology applied by the Peace Dividend Trust (Heady et al. 2011), estimates for jobs lasting six months and financed through off-budget aid range roughly between 312,000 and 620,000, depending on local-content assumptions. Including the number of beneficiaries in the civil service, this methodology suggests that 6.5–10 percent of the working population benefited, in one form or another, from employment created or sustained by aid in 2010. (p. 62-63)

Underemployment will rise because the activities affected by declining financial inflows (services, construction) are relatively labor intensive. Roughly 6–10 percent of the working population has benefited from aid-financed jobs, though most are short term. So declining aid can be expected to heighten underemployment (with fewer casual labor opportunities and lower pay for skilled employees), even if unemployment is not greatly affected. The adverse impact of lower economic growth on employment is likely to be much larger than the direct employment impact of declining aid, making the slowing of economic growth a concern during transition.

Lower aid and public spending will affect some groups more than others. Aid has not been evenly spread across the country. Because of donors’ choices and the predominant role of stabilization and military spending, conflict-affected provinces have received much higher per capita aid than more peaceful (and often poorer) provinces. As a result, the slowdown in aid will be felt more acutely in conflict-affected provinces and urban centers. If aid declines gradually so that it can be partly offset by growth of the mining and civilian public sectors, the impact could be softened and spread over time, allowing labor markets more time to adjust. (p. 19)

Life expectancy in Afghanistan has been rising steadily...at a rate similar to the average for middle performers but slower than for strong performers, but starting from a very low base in 2001. At 48 years, life expectancy remains well below the averages for comparator groups—indeed, below most countries except some in Sub-Saharan Africa affected by high rates of HIV/AIDS. Internationally, life expectancy increased significantly, on average, for strong performers and middle performers but stagnated or declined for weak performers.

Afghanistan has only slowly reduced the under-five mortality rate over the past decade, according to the World Development Indicators...This situation contrasts with that of the strongly performing comparator countries, which generally had sharp declines, whereas middle performers had a slowly declining trend (but better than Afghanistan’s). Weak performers had a rising trend. Thus, Afghanistan has been falling further behind the better-performing comparator countries for under-five mortality. (p. 34)

Growth in Afghanistan is volatile, mainly because of the economy’s heavy reliance on agriculture, which in 2010/11 contributed 23.3 percent of total value added. Agricultural production is particularly susceptible to the weather. During 2003/04–2010/11 annual real agricultural growth ranged from 22 percent contraction to 45 percent expansion...and the sector accounted for between one-quarter and one-third of GDP. Absorbing 60 percent of the working population, agriculture is by far the largest employer, so rural development will remain crucial in sustaining growth.
Agriculture will remain a very important source of income and growth for many years. The illicit production of opium still overshadows agriculture, accounting for nearly half of overall agricultural production but on a much smaller portion of arable land... According to 2011 estimates from the United Nations Office on Drugs and Crime, the farm gate value of opium is 8 percent of GDP, and its overall contribution to GDP (including distribution) is believed to be around one-third.

Mining makes a marginal contribution to GDP—less than 0.5 percent during the 2000s—but could potentially take off in the future. Afghanistan has substantial untapped mineral deposits.... Two large investments in copper deposits in Aynak (near Kabul) and iron deposits in Hajigak (Bamyan province), in 2010 and 2011, could be the first step toward realizing this potential. (p. 51-52)

...Most aid (both civilian aid and security assistance), including the amount contracted in country, has a low domestic economic content, limiting its effect on the economy. Much aid either never comes in or flows directly out through contracting with international providers of goods and services, imports, and the expatriation of profits. A study by the Peace Dividend Trust (Bontjer, Holt, and Angle 2009) suggests that the domestic content from trust funds and budget support is around 70–80 percent, and only 35–50 percent and 10–20 percent, respectively, for local and international contracts, resulting in an overall local effect from donor aid of 38 percent. In other words, only 38 cents of every aid dollar spent in Afghanistan actually reaches the economy through direct salary payments, household transfers, or purchase of local goods and services. This study, however, did not consider security spending. The domestic content of aggregated aid flows is estimated at only about 14–25 percent...

...US$2.2 billion to US$4 billion of aid may have stayed in the country in 2010/11. To calculate this figure, the methodology applied by the Peace Dividend Trust (Bontjer, Holt, and Angle 2009) was modified and a combination of data collection, focus group interviews, and assumptions was used. (p. 55)

It is important to understand there is nothing “worst case” about such analyses. The World Bank made these estimates under conditions where its status as a client of the Afghan government meant it had to largely ignore key factors like a lack of reliable data on the effectiveness of aid, the impact of waste and corruption, the impact of capital and capacity flight, welfare, and the impact of continuing power struggles and declines in security. It focused on development, not stability and the security and political impact of transition.

These methods may be appropriate in a World Bank study focused on economic development, but they are not a suitable basis for risk analysis in the broader sense or for assessing the impact of key issues like what will happen to the governance, economic, and security elites that will be far more heavily impacted than the average Afghan, but will largely determine the nation’s future stability and security.

Population Data Is Similarly Uncertain and Used with Equal Analytic Dishonesty

The economics of Transition are driven as much by demographic pressures as by the underlying nature of the Afghan economy. Figure 1 showed sharp variations in total population data even though different organizations tend to borrow from the same uncertain sources in the absence of any meaningful census. The Afghan data differ significantly from the data used by outside sources. This lack of reliable data creates another set of major uncertainties – easily reaching a 30% margin of error or more – and Figure 3 shows how serious the differences in the estimates of future growth can become over time.
How Many Afghans and Where? No One Knows

The acute limits to – or failure of – the 1979 census supervised by the Soviet Union and never completed, had led most sources to reduce the original estimate of roughly 33-34 million Afghans used in the past. However, a few experts still seem to believe that more recent figures are a major undercount.

The differences in population data are illustrated by the following different estimates:

- The US Census Bureau provides the estimate reflecting the massive population growth shown in Figure 3 and also projects the population as rising to 32.6 million in 2015, 41.1 million in 2025, and 63.8 million in 2050.30

- The CIA estimated the total population at a similar 30.4 million as of mid-2012.31 It also estimates the population as being very young, with 43.2% of the population in the 0-14 age group, 21.6% at 15-24 years, and 28.9% at 25-54 years. The total numbers of Afghans reaching age 16 in 2010 include 392,116 males and 370,295 females. Uncertain as such figures are, this is an incredible burden on a sub-subsistence economy in terms of job generation, housing, and productivity gain, and sharply exceed the job growth benefits of even very optimistic economic growth estimates in studies done for the “New Silk Road.”

- The UN estimate of the trend in population growth shows the Afghan population rising from 8.1 million in 1950 to 9.6 million in 1960, 12 million in 1970, 14.2 million in 1980, 13.0 million in 1990, 22.1 million in 2000, and 31.4 million for 2010. The projections include a wide range of growth figures depending on different assumptions, and only one projection is shown in Figure 3. The UN projects the population as rising in the medium variant case to 42.1 million in 2020, 53.3 million in 2030, 64.8 million in 2040, and 76.3 million in 2050.32

- The World Bank shows a very similar growth rate but estimates the Afghan population as rising from under 10 million in 1960, to 12 million in 1970, over 15 million in 1980, 19 million in 1990, 26 million in 2000, and between 35 to 36 million for 2011.33

- The Afghan CSO estimate for 2011-2012 was a total population of 24.987 million – 12.78 million males and 12.21 million females.34 This is only 70% of the World Bank estimate, 88% of the UN estimate, and roughly 85% of the CIA/Census Bureau estimate.

It seems likely that any current estimate could have at least a 15% to 25% margin of error.

Making Up More Detailed Numbers by Model and Guesstimate

A new demographic survey has resulted in a recent downward revision of the Afghan fertility rate, from 6.6 offspring per woman to 5.1.35 Fertility rates underpin population

---

33 Public Data, The World Bank, January 17, 2013, http://www.google.com/publicdata/explore?ds=d5bncppjof8f9&met_y=sp_pop_totl&idim=country:AFG&dl=en&hl=en&q=afghan%20population%20trends#t=type%3Dl%26strail%3Dfalse%26bcs%3Dd%26nslm%3Dh%26met_y%3Dsp_pop_totl%26scale_y%3Dlin%26ind_y%3Dfalse%26rdim%3Dregion%26idim%3Dcountry:AFG%26ifdim%3Dregion%26hl%3Den_US%26dl%3Den%26ind%3Dfalse.
growth; the discrepancy between the recent measurements and prior estimates indicates
that the Afghan population may in fact be even lower than the current range of population
estimates suggests.

It is unclear that correct figures for the total population would even matter given the acute
differences in security, ethnicity, the economy, and dependence on drug markets that
affect the Afghan population. This is particularly the case 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 moved much of their income outside the country. While nothing
approaching a Gini 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 instead benefited a tiny fraction of the Afghan elites – as well as
outside contractors and fundraisers.

The Afghan CSO does provide a breakout of population by sex by province and district
for the settled population and distinguishes between rural and urban areas in each sub-
category. 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 population numbers more
accurately, and its high estimate is just a little over 80% of the estimate used by most
outside sources. As is the case with every aspect of the economic 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 with massive numbers of citizens living
outside the country due to war and/or economic pressure, while many others are located
in remote rural areas or in urban slums. Furthermore, the Afghan government is denied
access to many rural villages by insurgents, particularly in the south and east of the
country.

The end result is that the CSO – and the 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

http://www.economist.com/blogs/feastandfamine/2012/06/demography; the CIA World Factbook reports a
2012 fertility rate of 5.64; *The World Factbook [Total Fertility Rate]*, Central Intelligence Agency,
37 See the Afghan census methodology data in the CSO web page – http://cso.gov.af/en – and in UN
Statistics Division web page, 2010 *World Population and Housing Census Programme*, UN Statistics
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 Afghan Ministry of Education data on students do not credibly track with the number of schools or data on teachers, nor does it 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 many active schools there 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 further problem that most surveys claim at best 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, a process in which the collector is effectively paid 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.

**Taking a Guess at Some Key Population Trends Affecting Every Element of Development and Transition**

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.38

The following guesstimates illustrate some of the “factoids” and trends involved – many of which contradict the data from other studies quoted earlier:40

**Growth**

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• Population growth is unlikely to drop below 2.5% annually.

Urbanization
• About 75% of the population lives in rural areas with an annual urbanization rate of 5-6%, 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).
• Almost 43% of the population is under 15 years of age, leading to a near-future bulge in employable people.
• The lack of jobs, due in large part to slowing economic growth, will cause flight from Afghanistan.
• Annual population growth will outpace job creation.
• The best case for full implementation of the “New Silk Road” (NSR) and other new aid efforts is creating 150,000 jobs over next three years.
• The CIA estimates annual increases in labor force may outpace best-case impact of NSR over three years: the estimate of growth in 2010 was 392,116 males and 370,295 females.
• An estimated 28% literacy among the 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, based on the facts that Afghanistan is still at war, has hundreds of thousands of armed fighters, faces an unstable Pakistan, and continues to have insurgent sanctuaries; all of these issues seem likely to survive Transition.
Figure 3: Immense Demographic Pressure Regardless of a Range of Estimates for Total Population from 26-35 Million

US Census Bureau Estimate

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<tr>
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<td>12,431,15,044</td>
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<td>22,461,26,335</td>
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<td>-1.9</td>
<td>-3.5</td>
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<td>-3.4</td>
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<td>-2.4</td>
<td>-2.2</td>
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<tr>
<td>Total fertility rate (births per woman)</td>
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<td>8.0</td>
<td>8.0</td>
<td>6.4</td>
<td>5.9</td>
<td>5.6</td>
<td>5.3</td>
<td>4.8</td>
<td>4.3</td>
<td>3.9</td>
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<td>NA</td>
<td>47</td>
<td>54</td>
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<td>51</td>
<td>42</td>
<td>40</td>
<td>39</td>
<td>39</td>
<td>37</td>
<td>34</td>
<td>30</td>
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<td>Births (in thousands)</td>
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<td>739</td>
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<td>1,158</td>
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<td>47</td>
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<td>50</td>
<td>51</td>
<td>53</td>
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<td>Infant mortality rate (per 1,000 births)</td>
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<td>191</td>
<td>168</td>
<td>157</td>
<td>147</td>
<td>137</td>
<td>128</td>
<td>115</td>
<td>104</td>
<td>94</td>
<td>84</td>
<td>65</td>
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<td>220</td>
<td>205</td>
<td>187</td>
<td>179</td>
<td>169</td>
<td>151</td>
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<td>119</td>
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<td>Crude death rate (per 1,000 population)</td>
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<td>11</td>
<td>10</td>
<td>9.8</td>
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<td>356</td>
<td>408</td>
<td>434</td>
<td>456</td>
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<tr>
<td>Net migration rate (per 1,000 population)</td>
<td>NA</td>
<td>NA</td>
<td>-82</td>
<td>-51</td>
<td>-34</td>
<td>-19</td>
<td>-9</td>
<td>-3</td>
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<td>248</td>
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United Nations Estimate

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<tr>
<td>Total</td>
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<td>21,765,0</td>
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<td>5,2</td>
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<td>23,1</td>
<td>78,8</td>
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<td>90 - 94</td>
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<td>12,4</td>
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<td>18,1</td>
<td>18,1</td>
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<td>5,2</td>
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Without Credible Baseline Data, More Sophisticated Breakouts Become Impossible

All of these uncertainties reinforce the problems in estimating the impact of Transition on stability and security in terms of certain critical portions of the population. Even in areas where progress has certainly been made, the economic and population data are too unreliable to know what levels of progress have actually occurred or how volatile it will be during Transition.

If virtually all economic and population data are in conflict and lack a credible source, so do any estimates of key indicators like the figures for children in school or Afghans with access to health care. It is also clear that the combination of problems in both economic and population data present special problems in estimating the impact of Transition on stability and security in a country the United Nations Development Program (UNDP) ranks 172nd out of 187 nations in the Human Development Index, and the CIA estimates a per capita income ranking of 217th out of 228 countries.39

There is no clear basis for knowing the impact of coming cuts on the poorest elements of the population or those that seem to be largely excluded from the direct impact of military and aid spending. There is no credible basis for making an estimate of how much military and aid money actually is being spent in Afghanistan – as distinguished from being spent on Afghanistan – and knowing where it goes and what the impact of coming cuts will be.

What is clear is that stability depends to some degree on the urban poor, several million internally displaced persons, and the agricultural sector. Far too much of the data being generated assume that military and aid spending had only a limited impact on a nation of subsistence farmers, “self-employed” workers in urbanized areas, and semi-feudal poor farmers/share croppers/migratory workers tied to the drug economy. As noted earlier, the World Bank did look at several of these issues, but its work makes it clear how limited many key data are.

The World Bank also assume there will be no significant crises in security, a failed election and/or political turmoil, capital and capacity flight, an increased shift to a narco-economy, or more abusive corruption – risks that are all too real.

Afghanistan remains at war, a conflict that has already had a massive impact on the poorer population and pushed many into urban areas. It faces a separate set of dangers posed by the highly cyclical nature of Afghan agriculture. If the rains do not come during critical periods of Transition, this will be is a serious issue in a country where the CIA guesses only 12% of the total land is arable, only 6% is currently cultivated, and farmers are critically dependent on adequate rainfall.

Moreover, almost all economic analysis of this sector of the population ignores the special problems affecting large numbers of the poorest urban underemployed, migratory workers, and tenant farmers.

The UN World Food Program (WFP) warns that Afghanistan may actually be a subsistence economy. Its webpage 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.

The WFP fed more than 6.5 million people in 2010. In 2012 it warned that, “In northern Afghanistan, WFP 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 WFP is correct, this is more than 10% of the entire population, and the winter of 2011/2012 is scarcely exceptional.

The WFP set its 2012 requirement at roughly $487 million to feed 7,597,600 Afghans, nearly 30% of the population, 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 averages for the country.

In early 2013, its webpage noted that, With more than half of all children under five suffering from stunting, chronic undernutrition is a big problem in Afghanistan. A new partnership between WFP, the Global Alliance for Improved Nutrition (GAIN), Afghanistan’s Ministry of Public Health and the Khalifa Bin Zayed Al Nahyan Foundation (KBZF) aims to reach 15 million Afghans with more nutritious food…

The World Bank may well be right in indicating that many – and perhaps most – Afghans may have gotten so little from more than a decade of aid and military spending that massive cutbacks in such spending will have far less impact than might otherwise be the case. However, the WFP analysis warns that a very real risk exists that any impact – direct or trickle down – may have been critical in the large subsistence or sub-subsistence section of the Afghan economy and that continued food aid – much of which flows through Iran – may be critical to Afghan stability.

However, the apparent gap between the WFP analysis and most aid-oriented studies also reinforces the previous warnings that any economic models – or Transition recommendations – that are based on available figures are suspect at best. Several sources of detailed data on Afghanistan do 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

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civil war for more than three decades. The fact that such data are generated, however, in no way makes them reliable or useful.

The Afghan CSO’s detailed estimates of the activity within the Afghan economy provide a further illustration of this point. The CSO figures for the annual components driving the estimate of GDP show a sharp annual fluctuation for the years between 2005 and 2012. 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.

At the same time, the World Bank estimate of the role of growth in services and construction shown in Figure 2 raises a different set of sectoral stability concerns. These are areas in which the secondary or trickle-down effects of outside military and aid spending in country may have played a critical role in the current Afghan economy as well as those in which the coming cuts will have a key 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.

Neither UNAMA nor the Afghan CSO is able to make useful estimates of total aid spending – in part because countries simply do not report such expenditures. UNAMA does prepare 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. Furthermore, there are no reliable estimates of overall aid spending, how such spending is allocated, the actual level of spending in the different areas of Afghanistan, or given activities with various economic impacts. Moreover, UNAMA does not list or provide a single report on aid activity on its web page, leaving such reporting to be done by the UNDP, World Bank, and other organizations.

The situation is also no better – and sometimes worse – when one attempts an assessment of aid impacts donor-by-donor or program-by-program. In most cases, there are no credible estimates of the benefits of such activities other than their cost. Furthermore, it is difficult, if not impossible, to know what portion of the cost of most such programs is actually spent within Afghanistan, let alone what impact a given program has had on different economic sectors.

There sometimes are province-level reports on aid that include trends and total spending. These data may sometimes provide a basis for calculating what aid actors’ work was where, how aid levels have changed over time, and what types of projects have been a major focus. In general, however, both the World Bank and Afghan experts warn that such data can be grossly inaccurate unless they are based on clearly defined sources and methods – something lacking in virtually all such reporting.

Most important for a security and stability viewpoint, the data on external spending – like the overall data on the Afghan economy – do not provide an adequate basis for understanding how given levels of aid will impact other key parts of the Afghan economy like the ANSF, Afghan government, urban economic elites, and key ethnic and sectarian groups. It is these segments of the Afghan population that are going to be the drivers of Afghan political and security stability during Transition. As a result, any international effort targeting aid to ensure stability as nations cut their military spending and aid
efforts will have to be ad hoc and reactive to events and problems after they occur or gather serious momentum.

Aid Spending and Effectiveness

Civil and military aid is only one part of the outside spending in Afghanistan that will be affected by Transition, and spending by US and other ISAF forces in country has also had an impact on the Afghan economy. What is also clear, however, is that if virtually all combat troops leave Afghanistan by the end of 2014, the combination of military and civil aid spending during 2014 to at least 2018 will be critical.

As a result, the success of Transition depends heavily on whether the US, individual European states, and major outside aid donors meet the pledges made at the Chicago and Tokyo Conferences, the way in which the money flows into Afghanistan and the Afghan national budget, and how well and honestly that money is spent. These are all areas where no clear plans yet exist, the past history of spending and effectiveness has been poor, and donor fatigue and Afghan political instability and corruption combine to create major risks.

Past Spending, Current Spending Rates, and Spending as a Percent of Total Aid Funds Are Not a Measure of Merit, and Never Will Be

As the previously discussed World Bank studies have shown, there is no practical way to provide accurate data for the flow of military and civil aid that has actually reached – and stayed in – Afghanistan, or to measure the flow of military spending in country by the US military and the militaries of other countries. Most countries do not collect these data and none provide detailed reporting on their websites that make accurate estimates possible.

Moreover, when countries do report on spending, it is invariably on total funds committed and never on actual spending in Afghanistan. It is also not in ways that make it clear how much money actually went into the Afghan economy or stayed in country versus flowing out via contractors, imports, and Afghan officials moving money to outside accounts. No country or international organization seems to have accounting and reporting tools that make such data available.

A World Bank estimate made in the spring of 2013 notes,44

Spending “on” Afghanistan does not equal spending “in” Afghanistan. Cumulative U.S. spending for the Afghanistan mission is estimated to be as high as US$444 billion. The U.S. Department of Defense appropriated US$118.6 billion in 2011 alone (Belasco 2011). The sheer size of U.S. spending on Afghanistan has led many to assume that military withdrawal will affect the economy quite negatively. However, military spending by the United States (and other countries) finances the salaries of military personnel, investments in weapons equipment and systems, sustainment, logistics and research of international forces, and operations contracted and paid for outside the country. Although it indirectly benefits Afghanistan’s economy by supporting security, the direct positive effect on poorer households appears to be limited. The impact of its withdrawal is therefore likely to be muted.

Most aid (both civilian aid and security assistance), including the amount contracted in country, has a low domestic economic content, limiting its effect on the economy. Much aid either never

comes in or flows directly out through contracting with international providers of goods and services, imports, and the expatriation of profits. A study by the Peace Dividend Trust (Bontjer, Holt, and Angle 2009) suggests that the domestic content from trust funds and budget support is around 70–80 percent, and only 35–50 percent and 10–20 percent, respectively, for local and international contracts, resulting in an overall local effect from donor aid of 38 percent. In other words, only 38 cents of every aid dollar spent in Afghanistan actually reaches the economy through direct salary payments, household transfers, or purchase of local goods and services.

This study, however, did not consider security spending. The domestic content of aggregated aid flows is estimated at only about 14–25 percent… US$2.2 billion to US$4 billion of aid may have stayed in the country in 2010/11. To calculate this figure, the methodology applied by the Peace Dividend Trust (Bontjer, Holt, and Angle 2009) was modified and a combination of data collection, focus group interviews, and assumptions was used.

The inability to measure actual spending in country is compounded by a lack of any systematic economic analysis to justify the spending in any given area or aid and its resulting effectiveness — although some superficial reporting ties estimators of Afghan progress to aid without any credible chain of cause and effect.

Another critical side effect of this problem is reporting by some aid agencies, military aid donors, and NGOs that borders on the absurd. The size and rate of spending is made a measure of effectiveness. No organization with any analytic or professional integrity will make spending a measure of effectiveness — particularly in a country with such limited absorption capacity and rampant corruption. Even in developed countries, the ability of a government to actually spend money has never been a measure of effectiveness or merit.

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

**There Are No Accurate 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 never been given the support by donor countries that would allow it to succeed 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.

Even a brief comparison of current sources shows that the data available on country, major NGO, and international organization aid contributions do not agree and instead often differ in definition and timing in ways that are not explained and make the source lack credibility. **Figure 4 to Figure 6** provide just a few examples of the difference in country-by-country reporting. In some cases, for example, countries are shown as spending less during 2002-2012 than 2002-2011.

A broader review of country-by-country data show that it is almost impossible to clearly distinguish aid that did or did not go through the Afghan government, was or was not reported to the UN, figures that represented real spending and actual disbursements, figures that reported actual but unobligated commitments, and pledges.

Some countries are shown in some lists and not in others. Pledges sometimes sharply exceed spending, but it is unclear that much of the reporting on spending is actual spending, as opposed to pledges or commitments.

Civil and military aid are mixed together in unexplained ways, and there is no reporting on military spending in Afghanistan by ISAF forces on ISAF forces that was not aid. There is no way to know what aid money was actually spent in Afghanistan and then remitted by foreign contractors – much less the money sent out of the country by Afghans without affecting the Afghan economy, or money that was stolen later and sent out of country as it moved down the chain. Some estimates go as high as 40%, but there are no real data or methodologies to validate such claims and no case studies or surveys to help provide such data.

- **Figures 10 and 11** provide a Congressional Research Service (CRS) estimate of aid spending for pledges through 2011 and 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 that the US has been the only member of NATO/ISAF actively involved in Pakistan and is the major donor of aid to that country.

  These data 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 5** 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.

  At the same time, a close examination of the data on other donors in **Figures 10 and 11** show some countries like Australia, Canada, Denmark, France, China, Japan, India, Iran, Italy, Japan, Pakistan, and Taiwan are counted in one set of figures but not in another – partly because the Pairs Conference totals excluded many states. Saudi Arabia, the Netherlands, Switzerland, etc., are said to have pledged less during 2002-2012 than during 2002-2011, and so on.

  **Figure 6** shows a similar country-by-country estimate by UNDP, and it disagrees in many details with the US estimates used by the CRS. The differences between **Figure 5** and **Figures 10 to 11** are striking for Japan, Britain/UK, Pakistan, Saudi Arabia, Sweden, the UAE, and the UN, and significant for Australia, Canada, Finland, Iran, Italy, Norway, Spain, and the World Bank. Some donors like the Agha Khan development network appear on this list that are ignored on the US lists.

  Moreover, **Figure 6** provides another rough indication of the difference between commitments/pledges and actual spending. The figures presented are scarcely reliable, and once again, are totals and not actual spending in Afghanistan. After ten years and on the edge of Transition, disbursements were only 82% of commitments.
It is far from clear that Afghanistan has the ability to absorb anything like the disbursements that did occur – much less the total commitments. It is readily apparent from studies like the McMasters review of contracting in Afghanistan and various UN and country studies that aid was often so poorly planned and managed that it greatly exceeded Afghan ability to absorb the money and had an intensely corrupting impact on Afghan officials and the Afghan business sector. This, however, is far more a warning about the lack of competence and integrity in the donor effort than a reflection on the Afghans.

- **Figure 7** shows the amount of aid money reported by UNDP. This is almost exclusively civil aid and provides a warning of a different kind. It is a tiny fraction of total aid. Moreover, it provides a symbol of a much broader problem.

The incompetence and corruption of the Afghan central government has led donors to bypass the government and provide aid directly in the field or at the urban, district, and provincial levels. As is discussed in detail later in this analysis, US reporting in January 2013 by SIGAR and in December 2012 by the Department of Defense (DoD) strongly indicates that the Afghan government will not be able to do much better through 2014 – much less be able to honestly manage even 50% of the total aid flow.

This has severely limited the role UNAMA and UNDP can and could 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, why documents like the UNDP program for 2010-2013 have stayed conceptual, and why they never laid out specific programs or program goals.\(^\text{45}\)

But bypassing both the Afghan government and UNDP, and the lack of any effective UNAMA effort to plan and coordinate the overall aid effort, created a chaotic structure of individual national and NGO efforts with minimal coordination. This included very high rotation rates for aid terms, a serious lack of in-country expertise, no clear contract management effort, no meaningful measures of effectiveness, and often little effort to seriously consult the Afghans involved. In short, national donor efforts often took a broken Afghan process and broke it further.

Figure 4: CRS Estimate of International Aid Commitments to Afghanistan: 2002-2011

(Pledges Through 2011, as of March 2010, in $US Millions)

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


Note: Figures include funds pledged at April 2009 NATO summit and Japan’s October 2009 pledge of $5 billion over the next five years.
Figure 5: CRS Estimate of Major Non-US Pledges for Afghanistan: 2002-2012 ($ in Millions)

<table>
<thead>
<tr>
<th>Country</th>
<th>Pledges (in Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>13,150</td>
</tr>
<tr>
<td>European Union</td>
<td>2,880</td>
</tr>
<tr>
<td>Germany</td>
<td>2,680</td>
</tr>
<tr>
<td>Asian Development Bank</td>
<td>2,270</td>
</tr>
<tr>
<td>Britain</td>
<td>2,220</td>
</tr>
<tr>
<td>World Bank</td>
<td>2,140</td>
</tr>
<tr>
<td>India</td>
<td>1,515</td>
</tr>
<tr>
<td>Canada</td>
<td>1,255</td>
</tr>
<tr>
<td>Iran</td>
<td>1,000</td>
</tr>
<tr>
<td>Netherlands</td>
<td>775</td>
</tr>
<tr>
<td>Norway</td>
<td>745</td>
</tr>
<tr>
<td>Australia</td>
<td>645</td>
</tr>
<tr>
<td>Italy</td>
<td>645</td>
</tr>
<tr>
<td>Sweden</td>
<td>635</td>
</tr>
<tr>
<td>United Nations</td>
<td>445</td>
</tr>
<tr>
<td>Denmark</td>
<td>435</td>
</tr>
<tr>
<td>France</td>
<td>320</td>
</tr>
<tr>
<td>China</td>
<td>255</td>
</tr>
<tr>
<td>Spain</td>
<td>220</td>
</tr>
<tr>
<td>Turkey</td>
<td>210</td>
</tr>
<tr>
<td>Finland</td>
<td>160</td>
</tr>
<tr>
<td>Russia</td>
<td>150</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>140</td>
</tr>
<tr>
<td>UAE</td>
<td>135</td>
</tr>
<tr>
<td>Switzerland</td>
<td>120</td>
</tr>
<tr>
<td>South Korea</td>
<td>115</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>105</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$24,900</strong></td>
</tr>
<tr>
<td><em>(includes donors of under $100 million, not listed)</em></td>
<td><em>(of which $19,700 disbursed—about 80%)</em></td>
</tr>
</tbody>
</table>


Notes: Figure for Japan includes $5 billion pledged in 2008 (over five years) to fund Afghan National Police salaries and funds pledged at the July 8, 2012, Tokyo donors conference. Figures for Germany included $550 million pledged (over four years) at that meeting. Table includes donors of over $100 million only.
Figure 6: Afghan/UNDP Ranking of Donor Countries, Detailing Aid Commitments and Disbursements: 2002-2011

<table>
<thead>
<tr>
<th>Rank</th>
<th>Donor</th>
<th>2002-2011 Commitment</th>
<th>2002-2011 Disbursement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United States of America</td>
<td>57,383</td>
<td>47,524</td>
</tr>
<tr>
<td>2</td>
<td>Japan</td>
<td>3,821</td>
<td>3,821</td>
</tr>
<tr>
<td>3</td>
<td>European Union/European Commission</td>
<td>3,077</td>
<td>2,816</td>
</tr>
<tr>
<td>4</td>
<td>United Kingdom</td>
<td>2,574</td>
<td>2,578</td>
</tr>
<tr>
<td>5</td>
<td>Germany</td>
<td>2,435</td>
<td>978</td>
</tr>
<tr>
<td>6</td>
<td>Asian Development Bank</td>
<td>2,400</td>
<td>1,129</td>
</tr>
<tr>
<td>7</td>
<td>World Bank</td>
<td>2,378</td>
<td>1,852</td>
</tr>
<tr>
<td>8</td>
<td>India</td>
<td>1,588</td>
<td>759</td>
</tr>
<tr>
<td>9</td>
<td>Canada</td>
<td>1,371</td>
<td>1,371</td>
</tr>
<tr>
<td>10</td>
<td>Netherlands</td>
<td>1,109</td>
<td>1,110</td>
</tr>
<tr>
<td>11</td>
<td>Australia</td>
<td>953</td>
<td>806</td>
</tr>
<tr>
<td>12</td>
<td>Norway</td>
<td>852</td>
<td>712</td>
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<tr>
<td>13</td>
<td>Sweden</td>
<td>736</td>
<td>736</td>
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<tr>
<td>14</td>
<td>Italy</td>
<td>697</td>
<td>589</td>
</tr>
<tr>
<td>15</td>
<td>Denmark</td>
<td>503</td>
<td>503</td>
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<tr>
<td>16</td>
<td>United Nations</td>
<td>446</td>
<td>182</td>
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<tr>
<td>17</td>
<td>Iran</td>
<td>399</td>
<td>367</td>
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<tr>
<td>18</td>
<td>France</td>
<td>376</td>
<td>199</td>
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<tr>
<td>19</td>
<td>Turkey</td>
<td>226</td>
<td>193</td>
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<tr>
<td>20</td>
<td>Spain</td>
<td>220</td>
<td>194</td>
</tr>
<tr>
<td>21</td>
<td>Finland</td>
<td>178</td>
<td>178</td>
</tr>
<tr>
<td>22</td>
<td>United Arab Emirates</td>
<td>169</td>
<td>151</td>
</tr>
<tr>
<td>23</td>
<td>Russian Fed</td>
<td>151</td>
<td>147</td>
</tr>
<tr>
<td>24</td>
<td>Aga Khan Development Network</td>
<td>140</td>
<td>140</td>
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<tr>
<td>25</td>
<td>Saudi Arabia</td>
<td>140</td>
<td>103</td>
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<td>26</td>
<td>China</td>
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<td>27</td>
<td>Switzerland</td>
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<td>120</td>
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<td>28</td>
<td>South Korea</td>
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<tr>
<td>29</td>
<td>Czech Republic</td>
<td>111</td>
<td>105</td>
</tr>
<tr>
<td>30</td>
<td>Islamic Development Bank</td>
<td>77</td>
<td>24</td>
</tr>
<tr>
<td>31</td>
<td>Belgium</td>
<td>61</td>
<td>57</td>
</tr>
<tr>
<td>32</td>
<td>New Zealand</td>
<td>40</td>
<td>40</td>
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<td>33</td>
<td>Poland</td>
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<td>34</td>
<td>Ireland</td>
<td>22</td>
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<td>35</td>
<td>Kuwait</td>
<td>19</td>
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<tr>
<td>36</td>
<td>Luxembourg</td>
<td>12</td>
<td>11</td>
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<tr>
<td>37</td>
<td>Hungary</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>38</td>
<td>Lithuania</td>
<td>5</td>
<td>5</td>
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<tr>
<td>39</td>
<td>Austria</td>
<td>5</td>
<td>5</td>
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<td>40</td>
<td>Pakistan</td>
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<td>41</td>
<td>Brunei</td>
<td>4</td>
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<td>42</td>
<td>Greece</td>
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<td>43</td>
<td>Singapore</td>
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<td>44</td>
<td>Estonia</td>
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<tr>
<td>45</td>
<td>Portugal</td>
<td>1</td>
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Total: 85,116 69,723

Figure 7: International Aid Donor Contributions to UNDP Effort in Afghanistan: 2008-2012

<table>
<thead>
<tr>
<th>Donor Name</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
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<td>UNESCO</td>
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<td>3,964,783</td>
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<td>3,964,783</td>
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<tr>
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<td>2,000,000</td>
<td>2,000,000</td>
<td>2,000,000</td>
<td>2,000,000</td>
<td>2,000,000</td>
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<tr>
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<td>150,000</td>
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<tr>
<td>Government of Croatia</td>
<td>50,000</td>
<td></td>
<td></td>
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<td>50,000</td>
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<tr>
<td>Government of Denmark</td>
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<td>1,869,351</td>
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<td></td>
<td></td>
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<td>Government of United Kingdom</td>
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<td>IYABA, Kabul</td>
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<td>AG. Espanola de Cooperacion IN</td>
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<td>24,932,574</td>
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<td>DEPT FOR ART &amp; INTL TRADE G</td>
<td>10,166,109</td>
<td>23,234,640</td>
<td>8,899,705</td>
<td>12,337,397</td>
<td>51,038,150</td>
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<td>4,175,637</td>
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<td></td>
<td>59,100,000</td>
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<tr>
<td>UNDP AS A A FOR JP PASS THROUGH</td>
<td>2,500,000</td>
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<td>Australian Agency for Internatl</td>
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<td>225,610</td>
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<td></td>
<td>6,528,598</td>
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</table>

The Totals for All International Aid Are Equally Unreliable and Fail to Provide Any Meaningful Measure of Progress

The next series of figures summarize estimates of total outside aid and help confirm the previous net assessments and warnings.

- Figure 8 again highlights the gap between pledges, commitments, and disbursements. Disbursements were less than 60% of pledges after a decade of aid efforts.

- Figure 9 shows a rough estimate of the total flow of aid from 2002/2003 to 2010/2011 and its size relative to the Afghan GDP. It should now be obvious that this estimate is not much more than a rough guesstimate, does not measure the flow of aid that actually impacts the Afghan economy, and uses a totally untrustworthy estimate of the Afghan GDP. It also again does not include in-country military spending on ISAF forces and does not seem to reflect anything like the total flow of aid to the ANSF.

- Experts like Ken Katzman may overstate dependence on outside funding when they say it accounts for some 95% of the GDP. However, even low-end estimates from officials in the US Export-Import (EXIM) Bank indicate it must account for over 40% and that almost all of the growth in the GDP as defined in market terms has been driven by outside expenditures and not development. Even if there was a credible statistical base for an estimate of the total Afghan GDP in either market or PPP terms, it still would be meaningless to quote per capita income statistics when sources like the Afghan CSO, CIA, State, World Bank, IMF, and UN produce estimates of the population varying between 26 and 36 million.

- The fact remains, however, that these grossly uncertain sets of estimates represented state-of-the-art transition planning at the time they were issued, and no better data have been provided since. It also is almost certainly broadly correct in showing just how dishonest it is to talk about Afghan GDP growth as if it were development driven—rather than driven by the vast flow of military and aid spending—and how difficult it will be for the Afghan government and economy to absorb the coming cuts in spending.

- It is also important to point out that the argument that cuts in military spending and aid will have limited impact on Afghans caught up in an agricultural subsistence economy ignores key driving variables:
  - First, other US data show that much of the military and aid spending has been spent in the field and in low-income and rural areas;
  - Second, much of it has gone to local police forces and militia who are armed and where cuts in funding can have serious security and political impacts;
  - Third, such money has been heavily concentrated in high-risk and combat areas where cuts can do most to further reduce loyalty to the central government;
  - Fourth, corruption and capital outflow may disproportionally affect elites, but public opinion surveys show is all too perceptible nationally;
  - Finally, mapping of areas of drug cultivation show that many areas already depend heavily on drug money, and cuts in aid will increase this dependence significantly.

- Figure 10 provides a reasonable guesstimate of how much of the aid money has gone to security. It is a warning of both the limited impact aid can have on Afghan development and how seriously cuts in aid can simultaneously impact both the Afghan economy and Afghan security.

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• **Figure 11** shows both how little overall aid has actually gone through the Afghan government to date and that this still has accounted for much of the Afghan budget. This presents critical problems in terms of Afghan ability to generate revenues from within Afghanistan – issues discussed later in this report.

• **Figure 12** shows a rough estimate of the various national pledges to support Afghanistan from 2012 through Transition in 2015 and beyond. If these pledges are met, the Afghan government will remain largely dependent on outside development aid for basic funding. If they are not, it will not be able to spend in ways that secure the economy and public support needs at a time when the number of major donors as well as their pledges is dropping.

• **Figure 13** provides a warning of Afghan perceptions of the uncertainties in future flows of aid. The Afghan estimate seems to deliberately imply a crisis level of cuts that will almost certainly not occur, but it is clear how deeply worried and uncertain the Afghan government has become.

Reporting by the US Special Inspector General for Afghanistan Reconstruction (SIGAR) provides additional insight into the problems that both the overall international effort and the Afghan government now face after years in which much of the total flow of aid funds bypassed GIRoA entirely and went directly to projects and programs that it did not control. The July 2012 SIGAR report says, 47

> The largest share of international contributions to the Afghan operational and development budgets comes through the ARTF. From 2002 to June 20, 2012, the World Bank reported that 33 donors had pledged approximately $6.10 billion, of which nearly $5.70 billion had been paid in. According to the World Bank, donors have pledged approximately $930.36 million to the ARTF for the Afghan fiscal year—solar year 1391—that runs from March 1, 2011, to December 31, 2012 (when it will shift to a January 1 start date).

As of June 20, 2012, the United States had paid in approximately $1.74 billion. The United States and the United Kingdom are the two biggest donors to the ARTF, together contributing approximately 48.1% of its total funding...

Contributions to the ARTF are divided into two funding channels—the Recurrent Cost (RC) Window and the Investment Window. As of June 20, 2012, according to the World Bank, nearly $2.50 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 June 20, 2012, according to the World Bank, more than $2.18 billion had been committed for projects funded through the Investment Window, of which more than $1.61 billion had been disbursed. The World Bank reported 19 active projects with a combined commitment value of more than $1.12 billion, of which approximately $611.66 million had been disbursed.

The updated January 2013 SIGAR report has updated figures for the US aid effort, 48

> ...From 2002 to December 20, 2012, the World Bank reported that 33 donors had pledged nearly $6.18 billion, of which more than $6.11 billion had been paid in. According to the World Bank, donors have pledged nearly $1.01 billion to the ARTF for the Afghan fiscal year—solar year 1391—that ran from March 21, 2012 to December 20, 2012 (when the Afghan fiscal year shifted to a December 21 start date)...

---


...As of December 20, 2012, the United States had paid in more than $1.74 billion. The United States and the United Kingdom are the two biggest donors to the ARTF, together contributing nearly 47% of its total funding...

...Contributions to the ARTF are divided into two funding channels—the Recurrent Cost (RC) Window and the Investment Window. As of December 20, 2012, according to the World Bank, more than $2.67 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 adequate 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 20, 2012, according to the World Bank, nearly $2.61 billion had been committed for projects funded through the Investment Window, of which nearly $1.87 billion had been disbursed. The World Bank reported active projects with a combined commitment value of nearly $1.56 billion, of which approximately $819.46 million had been disbursed...

A total of $6.11 billion is scarcely small, but it is only 10% of the total $57.1 billion estimated for aid spending earlier.49 This also shows that international aid has not been as forthcoming as Afghan needs require and that in six months, from July 2012 to January 2013, pledged funding levels barely increased.

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“Since 2002, the entire amount of pledges for Afghanistan as of July 2012 stands at $119 billion, which includes $16 billion announced in support of development by the Development Partners (DPs) at the Tokyo Ministerial Conference in July 2012 and $14 billion announced at the Chicago NATO Summit in May 2012 to support security. As of December 2011, the entire amount of external assistance committed to Afghanistan stands at $85 billion, of which a total of $70 billion has been disbursed. The recently announced pledges increase the total volume of pledges from $89 billion to $119 billion.”

Figure 9: Aid vs. GDP Trends in Afghanistan ($ in Billions and Percent)

World Bank Estimate

“Our 10-year analysis of data (2001-2010) indicates that on average 51% of aid money has been invested in security. Therefore, it is no surprise to see that a huge portion (68%) of external assistance, disbursed in the year 2011, was allocated to finance security expenditures. Our analysis indicates that the US provided the highest amount of external resources in support of security (95%) in 2011, followed by Japan (3%) and the EU (1%), whilst the remaining 1% came from other DPs. According to the SIGAR report of January 2012, in the year 2011, the US DoD appropriated a total amount of $24.4 billion in support of the Afghanistan National Security Forces, of which $10.8 billion was committed, and $8.4 billion was disbursed.”

Figure 10 Aid Money Expenditures by Functional Area – Part Two

GAO estimate of US Aid 2002-2012

- $56.9 billion, more than two-thirds of the allotments, were provided to support Afghanistan’s security in areas such as the development of Afghan army and police forces and counternarcotics efforts.

- $20.6 billion, a quarter of the allotments, were provided to support governance and development efforts such as the construction of roads and schools.

- $2.1 billion, the remainder of the allotments, were provided for humanitarian assistance.

Figure 11: Donor Assistance

(US$ millions, unless otherwise indicated)

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<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Civilian aid</td>
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<td>1,350</td>
<td>2,188</td>
<td>2,675</td>
<td>3,542</td>
<td>5,262</td>
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<td>Security-related aid</td>
<td>988</td>
<td>1,905</td>
<td>7,028</td>
<td>2,750</td>
<td>5,470</td>
<td>8,594</td>
</tr>
<tr>
<td>On-budget support</td>
<td>720</td>
<td>717</td>
<td>1,059</td>
<td>1,024</td>
<td>1,275</td>
<td>1,886</td>
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<tr>
<td>Total</td>
<td>4,124</td>
<td>3,972</td>
<td>10,284</td>
<td>6,440</td>
<td>10,686</td>
<td>15,742</td>
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<tr>
<td>Percentage of GDP</td>
<td>66</td>
<td>56</td>
<td>118</td>
<td>61</td>
<td>86</td>
<td>98</td>
</tr>
</tbody>
</table>


Figure 12: Future International Aid Contributions for Afghanistan: 2012-2017

Future International Aid Contributions for Afghanistan

- Denmark (2010-2013)
- Australia (2012-2017)
- UK (2012-2017)
- Canada (2014-2017)
- Canada (2011-2014)
- Australia (2015/16-2019/20)
- India (2012-2016)
- Germany (2012-2016)
- Japan (2012-2016)
- EU (2012-2016)
- Asian Development Bank (2012-2016)
- United States (2012 Authorized)
- United States (FY13 Request)

Figure 13: Afghan Finance Ministry Estimate Predictability of Aid: 2012-2014

The US as a Case Study

The US not only dominates the future flow of aid, it acts as a case study that helps highlight the issues in planning the civil, economic, and security assistance aspects 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 given aid activity, does not validate requirements for aid, and does not measure actual cash flow or how it is allocated. Nor does the US provide any meaningful measures of effectiveness in terms of the overall benefits of a given program and its impact on the Afghan economy or 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, but most analyses use extremely uncertain and undefined data, often lacking any clear relationship to US aid efforts or provision of credible trend lines.\(^{50}\)

The US as a Case Study and a Warning

The CRS provides an estimate of total US aid and military spending in Figure 14. The estimates in Figure 14 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 spent 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 authorizations for each of the 2011 and 2012 fiscal years alone were 7 times the total World Bank estimate of the Afghan GDP for 2010-2011. There is no way to reliably estimate the Afghan GDP during the period from 2002-2012, but it seems likely that the US spent over four times as much on the war during this period as the combined total of Afghan GDP over 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 this was only a little over 6% of total military spending. If one looks at the entire war – from FY2001-FY2012 – the US DoD spent $523.5 billion on the war, while State/USAID spent $29.4 billion, or less than 6% of military spending.

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

**Figure 14: US Spending on the War in Afghanistan: FY2002-2013 – Part One**

CRS Estimate of Total Cost of War: 2002-2011

<table>
<thead>
<tr>
<th>Operation and Funding Source</th>
<th>FY02</th>
<th>FY03</th>
<th>FY04</th>
<th>FY05</th>
<th>FY06</th>
<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
<th>FY10</th>
<th>FY211</th>
<th>CRA P.L.</th>
<th>FY2012 Request</th>
<th>Cum. Enacted FY2001-FY2011</th>
<th>Cum. Total w/FY2011 CRA &amp;FY2012 Request</th>
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<td><strong>DOD</strong></td>
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<td>14.3</td>
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<td><strong>State/USAID</strong></td>
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<td>0.7</td>
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<td>1.1</td>
<td>1.9</td>
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<td>2.1</td>
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<td><strong>Total Afghanistan</strong></td>
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<td>14.7</td>
<td>14.6</td>
<td>20.8</td>
<td>19.0</td>
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<td>118.6</td>
<td>113.7</td>
<td>443.5</td>
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**Overseas Contingency Operations (OCO)**

| Spending Memorandum: 1
| Discretionary Cap Adjustment: 2
| Department of Defense
| Operation Enduring Freedom
| Operation New Dawn / Iraq
| Subtotal, Department of Defense 3
| Department of State and U.S. Agency for International Development
| (USAID) 4
| Iraq
| Afghanistan
| Pakistan and Other
| Subtotal, Department of State and USAID
| Other International Agencies
| Subtotal, Department of State, USAID, and Other International Agencies
| Department of Justice
| Total, Discretionary budget authority

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<td>11,203</td>
<td>8,245</td>
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<td>159,405</td>
<td>126,544</td>
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Figure 14: US Spending on the War in Afghanistan: FY2002-2013 – Part Two

GAO Estimate of Cost of Aid: 2002-2013

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<td>$14,654</td>
<td>$13,859</td>
<td>$79,657</td>
<td>$9,747</td>
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</table>

Source: GAO analysis of Departments of Defense, Justice, and State data.

*INCLE = International Narcotics Control and Law Enforcement. FMF = Foreign Military Financing. Other international affairs security includes International Military Education and Training (IMET); Nonproliferation, Antiterrorism, Demining, and Related Programs (NADR); and Voluntary Peacekeeping (PKO) funds.

*ESF = Economic Support Fund. Other international affairs governance and development includes Development Assistance (DA); Global Health and Child Survival (GHCS); Treasury Technical Assistance; and International Organizations and Programs funds.

*Governance assistance includes Migration and Refugee Assistance (MRA); Emergency Refugee and Migration Assistance (ERMA); International Disaster Assistance (IDA); Transition Initiatives; Food for Education/Food for Progress; U.S. food assistance programs authorized through Title I (Food for Progress) and Title II (Food for Peace) of the Food for Peace Act (also known as P.L. 480); the Bill Emerson Humanitarian Trust; and section 416(b) food aid funds.


*CERP = Commander’s Emergency Response Program. AIF = Afghanistan Infrastructure Fund. Other Department of Defense governance and development include Task Force for Business and Stability Operations (TFBSO) and Afghanistan Freedom Support Act (AFSA) funds.

The Unknown Impact of Coming US Cuts in Spending

The US began to make major cuts in civil aid and military spending even before the timing of the current Transition effort had been decided. Figure 15 shows the President’s budget request for DoD spending on the war in FY2013.

Figure 15 only hints at the further cuts in spending that will take place in the key Transition year of FY2014 and beyond. 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 that of FY2010. The State/USAID budget request for the war in FY2013 is also roughly 75% of the FY2012 figure.

Once again, it must be stressed that there is no way to know how much of the money in these figures has actually been spent in Afghanistan and what impact these funds have had on the Afghan economy. This not only is true of civil aid, where much of the money was spent outside Afghanistan, but also military aid on programs such as the ANSF, Afghanistan Infrastructure Fund (AIF), and Commander’s Emergency Response Program (CERP) funds.

This aid involves a significant outflow of money by contractors even in narrowly focused programs like 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.” Moreover, no meaningful US estimate exists on the amount of money for military operations by US forces that was actually spent in country, nor is it reflected in any public tables.

The coming scale of cuts in US spending is not clear, largely because of delays in submitting the FY2014 budget request. However, the funding request for the ANSF – an area where much of the money is spent in country – dropped by 49% between FY2012 and FY2013. US officials have also said that far more serious cuts will come after FY2014, and that the US goal is for the total spending to drop to between $4.1 and $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.

Finally, there are some grim historical precedents about the validity of strategic commitments and pledges over time. The US abolished most of its planned aid to the Iraqi police between 2001 and the end of 2012, as well as much of its planned aid to the Army. More generally, Figure 16 shows just how precipitously US aid has been cut after past crises.

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**Figure 15: DoD Budget Request for Spending on the Afghan War in FY2013**

![Graph showing trends in OCO funding and OCO troop levels](image)

*Afghan data is for Operation ENDURING FREEDOM. Iraq data is for Operation IRAQI FREEDOM and Operation NEW DAWN, and Iraq activities.

**FY 2012 number ($115B) includes $0.6B of rescissions that were applicable to FY 2010 OCO appropriations.

***U.S. forces deployed in Iraq only for the first quarter of FY 2012.

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<th>Category</th>
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<td>Force Protection</td>
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<tr>
<td>Improvised Explosive Devices (IED) Decontamination</td>
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<td>Military Intelligence Program (MIP) (Includes ISR)</td>
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<td>Afghanistan Security Forces Fund (ASFF)</td>
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<td>Afghanistan Infrastructure Fund (AIF)*</td>
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<td>Commander's Emergency Response Program (CERP)*</td>
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<td>0.4</td>
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<td>Support for Coalition Forces</td>
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<td>Equipment Reset</td>
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<td>Military Construction</td>
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<tr>
<td>Temporary End Strength</td>
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<tr>
<td>Non-DoD Classified</td>
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</tr>
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<td>Non-war/Other*</td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>115.7</strong></td>
<td><strong>88.5</strong></td>
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<tr>
<td>Rescissions**</td>
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<tr>
<td><strong>Total including Rescissions</strong></td>
<td><strong>115.1</strong></td>
<td><strong>88.5</strong></td>
</tr>
</tbody>
</table>

* 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 2016 OCO appropriations.

Source: *FY2013 Budget Overview*, Department of Defense, February 2012, p. 6-1 and 6-3.
Figure 16: Post Crisis Aid – Killing the Golden Goose as Soon as Possible

Development Assistance Levels Before and After Troop Reductions

Following the withdrawal or significant reduction in troop levels, Iraq, Kosovo, Haiti, and Bosnia saw significant decreases in development assistance levels.

Source: United States Agency for International Development.
Look at the Trends in US Aid vs. Total Spending

Figures 23 to 26 provide a more detailed picture of the trend in US economic and civil aid versus security spending, and it is clear just how much security and building up the central government has cost when compared with other aspects of development. SIGAR notes that as of July 30, 2012, the US had appropriated nearly $89.48 billion for relief and reconstruction in Afghanistan since FY2002.

- $52.15 billion for security
- $22.34 billion for governance and development
- $6 billion for counter-narcotics efforts
- $2.37 billion for humanitarian aid
- $6.62 billion for oversight and operations

The January 2013 report contains updated data but continues to show that little has changed in the past 6 months in regard to Afghanistan aid. As of December 31, 2012, $89.77 billion has been appropriated since FY2002, and the report breaks down the specifics as follows:

- $52.15 billion for security
- $22.39 billion for governance and development
- $6.15 billion for counter-narcotics efforts
- $2.44 billion for humanitarian aid
- $6.64 billion for oversight and operations

The figures that follow provide both a more detailed breakdown of how aid has been spent and a clearer picture of how much spending only ramped up after the conflict transformed into a serious civil war and the Afghan government got into deep trouble. It also shows how erratic many of the patterns in US aid spending have been, which is part of the reason why the ANSF is not ready for Transition.

- Figure 17 shows a CRS estimate of the US aid authorized during the period before the “surge” in US forces funding took effect. It makes an interesting contrast to the sharp rise in US aid in the years that followed.

- Figure 18 uses data taken from SIGAR’s January 2013 report and shows just how much of the US aid effort during FY2000-FY2012 was military: $56.81 billion out of a total of $88.76, with roughly 65% coming from the DoD.

The bulk of the military aid money was allocated to Afghan forces: $49.63 billion, or roughly 88%, of $56.81 billion in military aid, and roughly 57% of the civil-military total of $88.76 billion.

USAID received a total of $15.05 billion, or roughly 17%. State received $5.58 billion for counternarcotics, and six other agencies combined received $13.31 billion or roughly 15%.

- Figure 19 shows total spending on the ANSF. It is important to note that much of this spending for goods and services involves services and imports from outside Afghanistan. But 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.
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 (LOFTA). SIGAR reports that the UNDP administers the LOTFA to pay Afghan National Police (ANP) salaries and build the capacity of the Ministry of Interior. Since 2002, donors had pledged nearly $2.20 billion to the LOTFA, of which more than $2.12 billion had been paid in as of September 30, 2011.52

The LOTFA’s sixth support phase spanned from January 1, 2011, to March 31, 2013. In the 21 months since Phase VI began, the UNDP had transferred nearly $955.75 million from the LOTFA to the Afghan government to cover ANP and Central Prisons Directorate staff remunerations and an additional $17.90 million for capacity development and other LOTFA initiatives. As of September 30, 2012, donors had committed more than $1.12 billion to the LOTFA for Phase VI. Of that amount, the United States had committed nearly $425.92 million, and Japan had committed nearly $476.62 million. Their combined commitments made up more than 80% of LOTFA Phase VI commitments. The United States has contributed nearly $897.74 million to the LOTFA since the fund’s inception.

According to the updated report in January 2013, donors have slightly increased their pledges to $2.65 billion, and the fund has received $2.57 billion.53

- **Figure 20** provides a breakdown of the key trends in US civil aid spending. It is striking that major cuts have already been made in annual spending in key areas and programs like the Economic Support Fund (ESF). This will somewhat reduce the impact of further cuts made during Transition and after 2014, but will be 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 effects 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 the probable reversion to narcotics as well as the 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 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.

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**Figure 17: CRS Estimate of US Spending in Afghanistan, Total Obligations for Major Programs: FY 2001-2011 ($ in Millions)**

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<th>Security Related Programs (mostly DOD funds)</th>
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<td>Afghan National Security Forces (incl. FMF, and DOD ANSFF)</td>
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<td>Commander Emergency Response Program (CERP)</td>
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<td>Karzai Protection (NADR funds)</td>
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<td>Counter-Narcotics (INCLE, DOD, DEA)</td>
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<td>Other, incl de-mining operations (Halo Trust, other contractors)</td>
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<td>International Military Education and Training Funds (IMET)</td>
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<td>Defense article drawdown/DOD Infrastructure Fund/Business Task Force</td>
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<th>Humanitarian-Related Programs</th>
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<td>Food Aid (USDA and USAID: P.L. 480 Title I and II; Food for Progress, 416(b), Food for Education)</td>
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<tr>
<td>Migration and Refugee aid (including emergency)</td>
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<td>Debt Relief for Afghan government</td>
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<tr>
<td>Disaster Relief (IDA)</td>
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**USAID Development Funding: Economic Support Funds (ESF) and Development Assistance (DA)**

| Afghan government budget support | 255 |
| Democracy (Including election support) | 1,400 |
| Afghan Reconstruction Trust Fund (for National Solidarity Program, etc) | 1,690 |

| Rule of Law and Human Rights (not incl. some INCLE funds) | 187 |
| Roads | 2,148 |
| Power/Electricity | 1,921 |
| Education | 795 |
| Health Sector | 930 |
| Water | 120 |
| Agriculture | 1,025 |
| PRT projects (development and local governance) | 1,234 |
| Private Sector Development/Econ. Growth (incl cash-for-work) | 1,122 |
| Alternative Development/Livelihoods | 1,020 |

**Other Aid:**

| Child Survival and Health | 554 |
| Commodity Credit Corporation (CCC) | 26 |
| Treasury Technical Assistance | 3.5 |

| Total (including minor amounts not included in table) | 67,672 |

Figure 18: SIGAR Estimates of Total US Military and Civil Aid Spending: FY2000 – FY2012 (January 30, 2013) – Part One

US Funds Supporting Afghanistan Reconstruction Efforts ($ in billions)

**Funding Sources (Total: $88.76)**

- ASFF: Afghanistan Security Forces Fund
- CERP: Commander's Emergency Response Program
- AIF: Afghan 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

**AGENCIES**

- **Department of Defense (DoD)**: $56.81
- **USAID**: $15.05
- **Department of State (State)**: $3.59
- **Distributed to Multiple Agencies**: $13.31

**Notes:** Numbers have been rounded.

* Multiple agencies include DoD, State, DoJ, USAID, Treasury, and USAID.


**Cumulative Appropriations by Funding Category, as of December 31, 2012 ($ in billions)**

Figure 18: SIGAR Estimates of Total US Military and Civil Aid Spending: FY2000 – FY2012 (January 30, 2013) – Part Two

Appropriations by Fiscal Year and Funding Category (in billions and percentages)

Figure 19: SIGAR Estimates of Indicators of Spending Inside and Outside Afghanistan – Spending on ANSF: FY2004-FY2012 (January 30, 2013) – Part One

Figure 19: SIGAR Estimates of Indicators of Spending Inside and Outside Afghanistan – Spending on ANSF: FY2004-FY2012 (January 30, 2013) – Part Two

Figure 19: SIGAR Estimates of Indicators of Spending Inside and Outside Afghanistan – Spending on ANSF: FY2004-FY2012 (January 30, 2013) – Part Three

Figure 20: SIGAR Estimate of Key Economic Aid, Narcotics, and Civil Justice Spending: FY2004-FY2012

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 have been ten years of failure in which even the most credible working estimate, which in itself is 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.

This is particularly true if key studies become politicized. For example, the World Bank study quoted in many government reports had to be written putting the Afghan government in a positive light. It did not examine security scenarios or issues in realistic detail. It did not examine bad, much less worst, cases. It did not take narcotics and criminal networks, the risk of the country fracturing into ethnic and sectarian power groups, the impact of corruption, and capital flight into account. It did not model the impact of coming funding cuts by sector or region. It stated an inability to estimate military spending in country, but no follow-up analysis has yet publicly addressed the problem of improving the data.

Unfortunately, there is no better way 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 the preceding figures.

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

Most attempts to measure Afghan 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 the critical problems in planning the economics of Transition are reflected in the “guesstimates” in Figures 27 to 29.54

- Figure 21 provides a typical estimate of the level of outside spending as a percentage of Afghan government revenues. The basic problem with this estimate is that there is no accurate way to know how much outside military and aid spending actually contributed directly and indirectly to Afghan revenues.

• **Figure 22** provides a rough breakdown and “snapshot” 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 ignores 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 that is needed far more often in Transition planning:^55

**Although domestic revenues have grown at 20 percent, operating expenditures have been rising at 27 percent per year for the past three years.** The operating budget is likely 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 Afghan National Army (ANA) and Afghan National Police (ANP) 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 billion was channeled through the core budget and was under the control of the government’s formal Public Financial Management 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.

**The disbursement of the development budget has flattened out over the 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 the Ministry of Rural Rehabilitation and Development (MRRD), a program that accounts for 17 percent 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.

3) 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.

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

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weaknesses the budget execution rate is not a very adequate predictor for absorption capacity of the Government.

An updated version of this report released in October 2012 looked at various aspects of Transition in Afghanistan: 56

The outlook for 2012 and 2013 is favorable. Due to the good harvesting season and favorable weather conditions, 2012 will be a year of above-average agricultural output, likely pushing economic growth to over 10 percent. The following year, donor funding and development projects will continue to drive the demand for construction, transportation and distribution services. In 2013, mining will begin to contribute more noticeably to growth with the start of oil production in Amu Darya. Assuming that agricultural output reverts to its historic average, economic growth might fall back to around 7 percent.

In the next 2-3 years, however, political and security uncertainties of the transition period are likely to take a toll on business confidence. This could result in trade interruptions and a possible postponement of already-low levels of private investment. The upcoming Presidential elections in 2014 might further compound the security situation and potentially delay planned reforms.

In the medium term, economic growth is expected to wind down as aid declines during the transition and transformation phase. The withdrawal of international troops is associated with a decline in security, and possibly, civilian aid. Projections suggest that even with favorable assumptions, real GDP growth may fall from the average of 9 percent per year experienced over the past decade to 4-6 percent for 2011-2018. Given Afghanistan's annual population growth of 2.8 percent, 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 upper level of the range of plausible scenarios would enable Afghanistan to meaningfully reduce poverty and achieve higher per-capita incomes. For example, with real GDP growth of 6 percent per year, average per-capita income - currently one of the world's lowest, at US$528 dollars - would take 22 years, or about a generation, to double.

Economic growth would be even lower under less favorable scenarios. The World Bank's growth projections up to 2014 and beyond, to 2022, 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 materialize - if, for example, agricultural performance is poor, major mining investments (Aynak for copper and Hajigak for iron ore) do not materialize, and if aid declines precipitously in the period - then growth could drop to 3-4 percent. 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 that is actually spent within Afghanistan, and channeling as much as possible through the Afghan Budget.

The impact of transition might be uneven across provinces. 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 is likely to be felt more acutely in the conflict-affected areas and in urban centers, most likely through a loss of wage-labor opportunities as military bases and provincial reconstruction teams (PRTs) close. At present, with seven out of 30 PRTs closed, the available analysis and data do not suggest any significant impact, or, it might be too small to influence (available) economic aggregates. Nevertheless, there are considerable political economy risks that deserve continuous attention.

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Transition may have a substantial balance of payment effect. Projections of exchange-rate behavior show a depreciation of the exchange rate. By 2025 the Afghani is projected to have lost nearly 20 percent of its 2010 value. This may be surprising given the expected capital inflows associated with the mining expansion. However, the decline in aid outflows will outweigh the expected capital inflows from mining, particularly in the years soon after 2014, since mining activities are expected to begin only in 2016/2017. Only in the case of major expansion of both the mining and agricultural sector does the model predict a net appreciation.

Substantial risks may also arise from rising fiscal financing needs. Ongoing analysis projects revenues to reach more than 16 percent of GOP by fiscal 2022 (from current levels of 11 percent). However, expenditures are expected to grow much faster. Total government spending could reach up to 39 percent of GDP over the next ten years and could potentially rise even higher during many of the intervening years. The increase in expenditure is largely a result of rising security spending for both O&M and wages for the army and police, which are currently funded by donors outside of the budget. But it will also be driven by non-security spending, which will increase as results of additional O&M liabilities associated with the handover of donor-built assets and with a rising government payroll, as the pay and grading (P&G) reform is completed and some additional expenditure is taken on to develop a senior civil service cadre at higher wages. Security spending is projected to be more than 15.2 percent of GDP in fiscal 2022 (about as much as total projected domestic revenue in that year), the civilian wage bill 4.8 percent, the civilian non-wage O&M bill 7.2 percent.

However, donors have committed to cover the financing gap. The July 2012 donor meeting in Tokyo pledged US$16 billion in development aid for Afghanistan over the next four years. Donors further committed to placing 50 percent of aid on budget and having 80 percent aligned with the National Priority Programs. Together with earlier pledges on the security side, annual aid would amount to about US$8 billion - divided roughly equally between civil and security aid. This should, in principle, be sufficient to cover the projected gap and allow the authorities to accelerate progress towards achieving the UN's Millennium Development Goals and other infrastructure targets. However, these funds will be subject to conditionality, as disbursements will depend on implementing the action plan agreed in the Tokyo Mutual Accountability Framework...

The Tokyo Mutual Accountability Framework

The TMAF covers five critical areas of engagement, in each of which both the government and international community have set out goals and indicators of progress. The five areas are:

a) Representational Democracy and Equitable Elections, including presidential and parliamentary elections in 2014 and 2015.

b) Governance, Rule of law and Human Rights, covering the enforcement of laws and action plans for the protection of women and children as improved corruption control.

c) Integrity of Public Finance and Commercial Banking, including timely implementation of the IMF supported program, the PFM action plan as well as the Anti-Money Laundering and Combating Terrorism Financing action plan.

d) Government Revenues, Budget Execution and Sub-National Governance, including enactment of a legal framework to implement the sub-national Governance policy, and development of a sub-national budgeting process.

e) Inclusive and Sustained Growth and Development, comprising strengthening of the investment climate, WTO accession and greater regional integration.

Moreover, there is a major security aspect of this issue. 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 – most of the financing coming from the US. As of June 2012, the US began 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.

No more realistic figures have been made public since that time, and the justification for the $4.1 billion estimate was little more than an analytic guess designed to cut past spending to a minimum without any serious consideration of how the cost and capability of given elements of the ANSF would evolve.

The $4.1 billion total may be a more credible and sustainable figure in funding terms, but it cannot reflect the conditions that will emerge from 2014 onwards. This figure represents the real risk that Afghanistan cannot sustain the forces it needs, nor it is tied to an ongoing debate over whether and when the current force goal of 352,000 should be downsized to 228,500. This figure also ignores the impact of having 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 (ALP) 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 in Figure 23. 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 21: World Bank Estimate of Afghan Sources of Total Foreign and Domestic Spending: 2010-2011 (in $ Millions)**

Figure 22: World Bank Estimate of Afghan Sources of Domestic Revenue: 2011-2012

Afghan Sources of Revenue: 2010/2011

Customs Revenue: 2010/2011

Total Revenue by Province: 2010/2011


Note: 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 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, not the reflection of the indirect effects of massive outside spending.

Here again, the World Bank provides a useful warning, as does its analysis in Figure 24, which shows that Afghanistan often ranks last in providing the peacetime conditions for investment (and new government revenue generation) in a region already notoriously bad in creating an environment conducive to outside and market-driven domestic investment.57

Given the security situation, 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. At a firm-level, Afghan businesses are restrained by red tape, lack of policy predictability, and corruption. Afghanistan’s regulatory framework is relatively well ranked on two indicators – Starting a Business (25th) and Paying Taxes (53rd). However, it is ranked last (183rd) on three indicators – Protecting Investors, Trading across Borders and Closing a Business (see table below). In order to address and enhance Afghanistan’s business environment the Ministry of Commerce and Industries launched an initiative in December 2010 aimed at making improvements in these areas.

One year later, financial sector development is still clouded by the implications of the Kabul Bank crisis. The crisis highlighted the limited capacity of the Central Bank to effectively supervise the banking sector and enforce regulations. The IMF is therefore discussing with the authorities a satisfactory resolution of the problem as a critical threshold for the establishment of an Extended Credit Facility. As of October 2011, no final agreement on a new program was reached, however, progress on the implementation of the resolution plan moved considerably and recent developments suggest there could be a program in place over the coming months. Donors have begun to fund again the ARTF investment window in the short-term and are expected to return to more normal contributions once the agreement with the IMF is in place.

Measures to strengthen the health of the financial sector are underway. The Afghan authorities have been in intensive discussions with the international community on priority steps to stabilize the banking sector and lay foundations for a broad banking sector reform. The key short term priorities are: (i) resolving the Kabul Bank issues and (ii) strengthening banking supervision to re-establish confidence in the health of the banking sector and avoid similar crises in the future. In this context, the IMF is providing technical assistance on the resolution of Kabul Bank’s problems. The UK Department for International Development (DFID) and the World Bank are financing audits across the banking system. USAID is providing renewed support to the Central Bank via its new Financial Access for Investing in the Development of Afghanistan (FAIDA) project, notably on mobile banking. As part of the World Bank Financial Sector Rapid Response Project, approved in August 2011, measures will be taken to modernize the national payment system which is currently dominated by Kabul Bank.

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, especially in the long term. 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 these are needed most.

Figure 24: World Bank Estimate of Doing Business Indicators, Regional Comparison: 2012 and 2013 – Part One

2012 Regional Comparison (by rank)

Figure 24: World Bank Estimate of Doing Business Indicators, Regional Comparison: 2012 and 2013 – Part Two

2013 Regional Comparison (by rank)

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 key unless some truly miraculous peace settlement changes the entire course of the war. 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 that the US, its allies, and donor states face during Transition. In the real world, the success of Transition will depend on the US, Europe, and other existing partner countries that already have forces or donate significant aid to Afghanistan.

A New “Great Game”?  

Relations between Afghanistan and regional powers have been improving in recent years. Links with Pakistan have historically been troubled by Pakistan’s role in supporting the insurgents in Afghanistan – particularly its ties to the Taliban. For instance, the Taliban’s Quetta Shura functions in the Baluchistan province of Pakistan with little prohibition or effective counter-action by the Pakistani government, while the Taliban Peshawar Shura has functioned in the North West Frontier Province. The Haqqani network is also reported to be tied to the Pakistani Directorate for Inter-Services Intelligence (ISI). Pakistan has recently been signaling that it would like to be more active in the reconciliation process. In particular, the post-President Perez Musharraf period has seen an improvement in relations. Both President Hamid Karzai and the Pakistani President Asif Zardari have visited the other’s capital, signing a joint declaration against terrorism in 2009. Government ministers and both presidents visited Washington together in 2009, and tripartite meetings took place in 2011. After several high-level Afghan visits to Pakistan in late 2012, Pakistan released 26 Taliban figures in favor of reconciliation.

The withdrawal of NATO forces in Afghanistan has been facilitated by Pakistan’s reopening of supply routes that connect the two countries – providing the alliance easy access to the Port of Karachi. In February 2012, President Karzai and President Zardari met in the UK with British Prime Minister David Cameron, and the two countries set the stage for facilitating talks with the Taliban as well as a possible Afghanistan-Pakistan “…agreement strengthening ties on economic and security issues, including trade and border management…”

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Despite these steps toward improved relations, there is still uneasiness in bilateral ties. In March 2012, a statement made by a prominent Pakistani cleric was perceived in Afghanistan as advocating suicide bombings in Afghanistan—bringing criticism from President Karzai and opening the rift in Afghanistan-Pakistan relations.63

Relations with India have also been improving, especially in terms of economic aid and activities. India’s Prime Minister Manmohan Singh visited Afghanistan in 2011 and the two countries announced a “Strategic Partnership,” with President Karzai visiting India in October 2011 to sign the pact. An agreement later that year resulted in India assisting in the training of ANSF personnel. However, India has focused more on investment and economic development, as opposed to military and security deployments.64

India is reported to have offered roughly $2 billion in assistance to Afghanistan—mainly to support Afghan infrastructure development. As of June 2012, about half of that amount had been invested. A key source of Indian investment could be the possible development of rail infrastructure connecting Afghanistan and the Iranian port of Chabahar, which would help facilitate Indian extraction and transportation of the roughly $3 trillion in iron believed to be in Afghanistan.65 In addition to the benefits that could come from iron extraction, it is reported that India may be pursuing such endeavors to “reduce Pakistan’s influence and logistical leverage.”66

Other steps toward strengthening India-Afghanistan relations include steps taken toward a Preferential Trade Agreement (PTA) and the establishment of a $50 million line of credit for export-import banks as well as working on “building human capital.”67 Looking forward, it is believed that as aid levels from the West decline in the years ahead, India could become a major provider of assistance to Afghanistan.68

Russia has also become more economically involved in Afghanistan; it is reported to be investing $1 billion in infrastructure and electrical capacity construction. President Karzai’s January 2011 visit to Moscow led to an agreement for Russia to continue stalled Soviet occupation-era construction projects, such as tunnels, hydroelectric facilities, and a university.69

Furthermore, China also appears to be increasing its presence in Afghanistan, especially in minerals and resource investment. In September 2012, a Chinese government official

signed security and economic agreements during a trip to Afghanistan, including provisions to fund, equip, and train the ANP.\textsuperscript{70}

Two major Chinese investments in Afghanistan are the Aynak copper mine and oil and gas exploration in the Amu Darya River Basin. The Aynak deal involves two firms from China and is considered to be the most substantial outside investment ever made in Afghanistan – worth over $4 billion. It could lead to as many as 5,000 jobs and further infrastructure development within Afghanistan.\textsuperscript{71}

Oil and gas exploration and drilling has been permitted for the China National Petroleum Company at the Amu Darya River Basin – giving China’s oil industry access to up to 87 million barrels of Afghan oil and providing for the creation of Afghanistan’s only refinery by mid-decade.\textsuperscript{72} There is also talk of possibly developing a roadway to connect Afghanistan and China.\textsuperscript{73}

However promising these developments might be, it is unlikely that these and other regional powers will commit to being involved in Afghanistan to a significant degree in a post-2014 situation. Western donors and forces will continue to be extensively relied upon for development, security, and aid. Moreover, instability in Afghanistan and the resurgence of radical Islamist leadership in the country could jeopardize the investments that have already been made and may deter future investment – especially in infrastructure, vulnerable assets, projects in unstable provinces, and plans that require large teams in-country that may be susceptible to attack.

\textbf{The Problem of Sustaining Aid Levels}

The success of US, European, and donor efforts is highly uncertain. As Figures 31 and 32 show, Transition is coming after aid has already peaked, and at a time when 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 25 shows that the US “surge” in aid workers during 2009-2010 was at token levels compared to the roughly 15,000 USAID personnel assigned during the War in Vietnam. The surge has been hindered by the fact that staffing levels are temporary and most of the support was never truly involved in fieldwork. The US Provincial Reconstruction Teams (PRTs) and their security are due to leave the field in most areas,

shrinking to just five areas no later than the end of 2014. In practice, the entire ISAF PRT system may shrink to a fraction of its current level before the end of 2014.

For all the crippling weaknesses in the quality of data and methodology, completed and ongoing studies by the World Bank, the IMF, the US, and key European governments are almost certainly correct in showing 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.\(^{74}\) 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 cover the cost of funding the ANSF during Transition and beyond and at the same time provide Afghanistan the resources to cope with the loss of US and ISAF military spending and the probable cuts in civil aid.

Many US and European actions have already begun to look like a cover for an exit strategy from Afghanistan. Development aid from the US, the largest aid donor, dropped from $3.5 billion in FY2011 to about $2.3 billion in FY2012. Funding for the Economic Support Fund (ESF) – the largest element of US economic aid – went from a peak of $3.4 billion in FY2010 to $2.1 billion in FY2011, $1.8 billion in FY2012, and a request for $1.8 billion in FY2013.\(^ {75}\) Funding for the Afghan Security Forces Fund (ASFF) – the largest element of US military aid – went from only $5.6 billion in FY2009 to $9.2 billion in FY2010, peaked at $11.0 billion in FY2011, and then dropped to $10.2 billion in FY2012 with a request for only $5.7 billion in FY2013 – reflecting a boom and bust cycle in ANSF development that is a clear warning of how unstable the overall program has been and remains.\(^ {76}\) Sequestration has delayed the US budget request for FY2014 and has made it more difficult to predict future US aid or ANSF spending.

At the same time, aid to support democracy, governance, and civil society dropped by more than 50%, from $231 million to $93 million. Aid for “rule of law” dropped from $43 million to $16 million.\(^ {77}\) Many aid agencies and NGOs are already making major cuts in their programs, and some have already eliminated programs or have withdrawn from the country.\(^ {78}\) According to the January 2013 SIGAR report, the requested FY2013

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budget provides $9.66 billion for Afghan reconstruction, a decrease of roughly $7 billion from FY2012 appropriations. ANSF funds have similarly been cut in the FY2013 request:80

- $5.7 billion for the Afghan Security Forces Fund (ASFF) – a 48% decrease from FY2012 appropriations
- $240 million for ANA and ANP infrastructure – a 90% decrease from FY 2012
- $362 million for ANA and ANP equipment and transportation – a 83% decrease from FY 2012
- $1.32 billion for ANA and ANP training and operations – a 28% decrease
- $3.8 billion for ANA and ANP sustainment – a 20% decrease

However, there have been some increases in several individual programs:81

- Commanders Emergency Response Program – $425 million, a 6% increase
- Counternarcotics – $405 million, a 6% increase
- Task Force for Business and Stability Operations – $179 million, a 19% increase
- Economic Support Fund (Department of State) – $1.8 billion, a .7% increase ($811 million base, $1 billion OCO)
- International Narcotics Control and Law Enforcement (Department of State) – $600 million, an 85% increase

While former US Secretary of State Hillary Clinton joined her European colleagues in pledging continued aid at the Bonn Conference in December 2011, there were no concrete long-term pledges made. 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 ISAF forces depart, spending which totaled $4.3 billion for direct US military contracts with Afghans in FY2011 and was only a small portion of total US military spending in the country. 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

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Louise Hancock, Oxfam's Afghanistan policy officer, put it, “It’s been another conference of flowery speeches: big on rhetoric and short on substance.”

**Building on a Weak Foundation**

The problem since 2001 has been a US, allied, and UN effort that has contained little or no real-world capacity for nation building on the scale required, failing 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 interests and regional competition. The US 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.

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83 Oxfam’s reaction to the 2011 Bonn Conference on Afghanistan, Oxfam, December 5, 2011.  
Figure 25: The Slow and Limited Surge of USAID Through FY2012 – Part One

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

Figure 25: The Slow and Limited Surge of USAID Through FY2012 – Part Two

Figure 25: The Slow and Limited Surge of USAID Through FY2012 – Part Three


**U.S. FOREIGN ASSISTANCE TO AFGHANISTAN, FY 2002–11**

* Approximation of USAID-appropriated foreign assistance from the Development Assistance, ESF and GHCS accounts. Includes foreign assistance funds that USAID transfers to other agencies to carry out foreign assistance objectives. Does not include humanitarian assistance to Afghanistan, which has totaled approximately $1.8 billion from FY 2002 to present.

Figure 26: Ongoing US Government Assistance to Afghanistan in June 2012

Dealing with a Crippling Afghan Dependence on Outside Spending

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, drawn from sources of uncertain credibility. They report spending as if spending levels are a measure of effectiveness and rarely make an attempt to tie such spending to its effectiveness.

**World Bank Estimates of 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 targeted towards Afghanistan is not actually spent in country as aid, instead returning to the donor countries.84

One key problem is the lack of an ongoing effort to acquire realistic data and make it public. A World Bank study conducted in November 2011 produced different results from those shown earlier, finding that some $15.7 billion worth of aid went to Afghanistan in 2010/2011, and $13.8 billion of this total was spent outside the Afghan national budget. It also estimated that only 10-15% of the $8.6 billion in external security aid and 20-25% of the $5.2 billion civilian aid was actually spent in country.85

Figure 27 shows a working estimate of total Afghan dependence on outside spending dating back to the spring of 2011. According to the World Bank, Afghanistan is an “extreme outlier in terms of dependence on aid.”86 Yet, as has been touched upon earlier, the November 2011 World Bank study did not fully examine the risks of this dependence in an economy dependent on narcotics and corruption or in a context of post-2014 security levels, capital flight, or worst-case economic impacts. It did not attempt to look at the impact of military spending in addition to aid, estimating that the total Afghan national core budget was $3.8 billion, of which $1.9 billion was aid.

In particular, the World Bank study estimated that 90-95% of the security aid actually reached Afghanistan, while substantially less than 70% of the civil aid did so. The study stated,87

...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.

**Department of Defense Comments on Dependence**

The DoD has tried to be optimistic about the future of Afghanistan, but it warned at the end of 2012 that no real progress was occurring and that future stability and security continued to depend on the flow of outside aid:88

Collections of domestic revenue have improved steadily since 2009, and, as of August 28 in the current first year (SY 1391), are up by six percent compared to the same time period last year. The total domestic revenue reached roughly $950M for the first two quarters of the current fiscal year. Although revenue generation is on-track to exceed last year’s total revenue of $2 billion, it is projected to come in slightly below SY 1391 government targets, largely due to the shortened fiscal year.

New taxes and their administrative implementation are now underway, including new property taxes, customs tariffs, business taxes, and agriculture surplus taxes. Customs revenue on crossborder trade in Afghanistan has steadily and significantly increased over the past eight years; however, this year it has decreased slightly compared with last year due, in part, to border closures with Pakistan. In the future, customs revenues are expected to remain a major source of funding for government operations as trade increases in the region. As improved border management reduces corruption and the agencies responsible for implementing recent custom legislation and regulation become more capable, this targeted area of revenue generation should continue as a significant contributor to government revenue. Business taxes, however, will remain fairly low for the foreseeable future due to multiple issues, including the large informal economy, corruption, and the remoteness of sizable portions of the Afghan population.

The sectors with the most revenue-generating potential are agriculture, information communication technology, and extractive mining and hydrocarbons. Although revenue generated from the extractive industry remains fairly minimal, it did increase roughly 60 percent (as of August 28 in SY 1391), compared to the same period last year.

Despite measured progress in revenue generation, Afghanistan’s fiscal sustainability ratio (a measure of domestic revenues to operating expenses) is still one of the worst in the world.

Projected revenue for 2012 is expected to cover about 2/3 of the central government’s operating expenditures yet provides less than 20 percent of the total estimated public expenditures budget. In the first quarter of CY 2012, the fiscal sustainability ratio dropped below 60 percent, due to proportionally higher increases in operating expenses, but rebounded in the second quarter to approximately 80 percent.

Despite the improved fiscal sustainability ratio, economists remain concerned about Afghanistan’s fiscal sustainability as revenues are slightly below projections and government expenditures continue to increase. As Transition continues, the necessity to absorb additional expenditures for operations and maintenance (O&M) costs - as reconstruction/infrastructure projects are transferred to the Afghan government - will further strain the ability of government revenues to cover fixed operating costs.

However, some of these additional O&M costs are expected to be offset by anticipated savings from Civil Service reforms. Additional efficiencies are expected to produce cost saving results in contracting, financial systems management, increased budget planning, formulation, implementation, and monitoring, as well as more effective prioritization of spending. Capacity-development programs have been in place and continue to increase the capabilities of the government in these areas. As economic and infrastructure development and an improved business environment enable private sector industries to grow, a stable tax base will enable the government to become increasingly self-supporting.

In the medium term, the international community has pledged to provide assistance to help fill the fiscal gap between domestic public revenue and total public expenditures. At the July Tokyo

Conference, donors promised $16B in civil assistance through 2015; this amount is in addition to donor pledges made in the run up to the May NATO Summit, which were focused on security assistance of $3.6B and an Afghan commitment of $500M annually to support the Afghan police and military from 2015-2017. Together, these sums align with the World Bank’s baseline scenario of the levels of foreign assistance, roughly $8B annually, needed to fill the gap, although World Bank notes that this level of assistance will be needed well beyond 2015.

To increase aid effectiveness, international donors agreed that 50 percent of all aid pledged at Tokyo will be spent through the Afghan government budget, and that 80 percent of the aid will be directed to projects that are aligned with the Afghan government’s NPPs. This approach is in line with commitments made during the 2010 Kabul Process.

Revenue generation will only be beneficial in so far as the Afghan government has the capacity to spend its budget in prioritized areas effectively. Budget execution, while showing improvement from SY1389 to SY1390, continues to struggle to meet donor expectations, especially with regards to the development budget. For SY1390 (March 2011 – March 2012), the Afghan government executed 94 percent of its operating budget while the execution rate for the development budget rose from 39 percent in SY1389 to about 52 percent in SY1390. The development budget execution rate through July was 9.9 percent, two percentage point higher than last year; and the expenditure rate continued to increase slowly over the second quarter.

The operating budget execution rate was 10.6 percent in the first month of the Afghan fiscal year, 31.1 percent as of July, and remained slightly higher through the second quarter. Under the Tokyo Mutual Accountability Framework, the Afghan government is expected to improve its development budget execution rate to 75 percent by 2017. As donors look to increase on-budget funding to at least 50 percent, in accordance with pledges, the amount of funding that must be utilized will increase substantially over a short period and require the Afghan government to significantly, and potentially unsustainably, accelerate its spend rate.
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.

Figure 27: World Bank Estimate of the Crippling Dependence of Afghanistan on Outside Funding – Part Two

Aid Versus GDP Per Capita Comparison

**General Accountability Office Estimate of Aid Dependence**

As usual, there is only a limited correlation between estimates – even within the same organization – but the challenges involved are all too clear. The US General Accountability Office (GAO) has issued the somewhat different estimate of the level of aid dependence in Figure 28. The GAO report that provided the estimate stated that, \(^{89}\)

… [T]he U.S. government could not fully determine the overall extent to which its efforts had improved the Afghan government’s public financial management capacity because (1) U.S. agencies have reported mixed results; and (2) weaknesses in USAID’s performance management frameworks, such as lack of performance targets and data, prevent reliable assessments of its results.

Afghanistan’s domestic revenues funded about 10 percent of its estimated total public expenditures from 2006 to 2011. Domestic revenue grew from $0.6 billion to $2.0 billion from 2006 to 2011..., an increase of over 230 percent. At the same time, Afghanistan’s estimated total public expenditures grew from $5.8 billion to $17.4 billion, an increase of over 200 percent, maintaining a gap between revenues and expenditures.

Donors funded approximately 90 percent of Afghanistan’s estimated total public expenditures from 2006 to 2011, with the United States providing 64 percent of that amount...The United States funded an estimated 91 percent of Afghanistan’s total security expenditures and about 37 percent of Afghanistan’s total nonsecurity expenditures between 2006 to 2011. In numerous reports and congressional briefings, we have raised concerns about Afghanistan’s inability to fund planned government expenditures without foreign assistance and raised questions about the sustainability of U.S.-funded road, agriculture, and water infrastructure development projects, as well as Afghanistan’s ability to sustain its national security forces.

Donors funded, on average, 56 percent of Afghanistan’s on-budget expenditures and 100 percent of its off-budget expenditures. Between 2006 and 2011 about 79 percent of Afghanistan’s estimated $73 billion in total public expenditures were “off-budget”—that is, funded by the international community outside of the Afghan national budget, such as equipment for Afghan National Security Forces. The remaining expenditures were “on-budget”—that is, within the government’s budget and funded by domestic revenues and donor contributions. As a result, a majority of Afghanistan’s total public expenditures were outside the direct control of the Afghan government.

The international community has pledged to continue to support Afghanistan through 2017 if certain metrics regarding reform in Afghanistan are met. Given Afghanistan’s future revenue generation projections and expenditures, the country will likely continue to be reliant on the donor community through at least 2024. In July 2012, the international community committed to providing over $16 billion for Afghanistan’s economic development through 2015.

The Afghan problems in managing a far larger amount of aid on budget will be especially severe during 2013-2016 because of the “bow wave effect” of past aid funding. Total authorization of US aid funding rose from $39.59 billion in FY2006 to $98.15 billion (if one includes the FY2013 request) and averaged around $16 billion a year from FY2010 to FY2012 – before dropping to $9.66 billion in FY2013. No one in the US government has the faintest idea of how much of this money actually reached the Afghan economy in any form, although it is unlikely to have exceeded 30-40%.

The lag between authorization and disbursement means that the flow of US civil and economic aid that actually reaches the country is peaking at a time when Afghanistan has

to adapt to a coming crash in economic aid, since the international community has pledged a total of only $16 billion for 2012-2015.\textsuperscript{90} This creates a major incentive for Afghan officials to take as much money as possible during what SIGAR calls the “golden hour” and leave the country (the EXIM Bank has estimated that at least $3 to $6 billion has flowed out of Afghanistan in recent years). Other problems include the fact that SIGAR and the GAO have found that measures to control the integrity of spending and contracting have not been effective; furthermore, most PRTs and field efforts to control and evaluate the flow of money will be withdrawn well before the end of 2014.

Figure 28: GAO Estimates of Dependence of Afghanistan on Outside Funding – Part One

79% Dependence of Public Expenditures on Off-Budget Sources

<table>
<thead>
<tr>
<th>Solar year</th>
<th>On-budget</th>
<th>Off-budget</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$1.570</td>
<td>$3.951</td>
<td>$5.521</td>
</tr>
<tr>
<td>2007</td>
<td>$1.877</td>
<td>$7.926</td>
<td>$9.803</td>
</tr>
<tr>
<td>2008</td>
<td>$2.252</td>
<td>$9.333</td>
<td>$11.585</td>
</tr>
<tr>
<td>2009</td>
<td>$2.771</td>
<td>$10.409</td>
<td>$13.180</td>
</tr>
<tr>
<td>2010</td>
<td>$3.176</td>
<td>$11.151</td>
<td>$14.327</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$11.645</strong></td>
<td><strong>$42.770</strong></td>
<td><strong>$54.415</strong></td>
</tr>
</tbody>
</table>

Afghan Revenue as a Share of Expenditures

<table>
<thead>
<tr>
<th>Solar year</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>70%</td>
</tr>
<tr>
<td>2007</td>
<td>73%</td>
</tr>
<tr>
<td>2008</td>
<td>72%</td>
</tr>
<tr>
<td>2009</td>
<td>73%</td>
</tr>
<tr>
<td>2010</td>
<td>70%</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td><strong>70%</strong></td>
</tr>
</tbody>
</table>

Figure 28: GAO Estimates of Dependence of Afghanistan on Outside Funding – Part Two

Dependence on the US for 90% of Past Security Expenditures. Other donors have funded 4%; IRoA has only funded 6%.

<table>
<thead>
<tr>
<th>Solar year</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>GIRoA funded security expenditures</td>
<td>$0.284</td>
<td>$0.234</td>
<td>$0.280</td>
<td>$0.361</td>
<td>$0.354</td>
<td>$1.513</td>
</tr>
<tr>
<td>U.S. funded security expenditures</td>
<td>$1.452</td>
<td>$4.653</td>
<td>$5.073</td>
<td>$5.177</td>
<td>$5.840</td>
<td>$22.195</td>
</tr>
<tr>
<td>Other donor funded security expenditures</td>
<td>$0.053</td>
<td>$0.175</td>
<td>$0.148</td>
<td>$0.318</td>
<td>$0.339</td>
<td>$1.034</td>
</tr>
<tr>
<td>Total security</td>
<td>$1.789</td>
<td>$5.062</td>
<td>$5.502</td>
<td>$5.857</td>
<td>$6.533</td>
<td>$24.742</td>
</tr>
</tbody>
</table>

Dependence on the US for 39% of Past Security Expenditures. Other donors have funded 47%; GIRoA has only funded 14%.

Figure 28: GAO Estimates of Dependence of Afghanistan on Outside Funding – Part Three

Total Government Domestic Revenues

 Dependence on Foreign Aid for Current Budget

The Risks in Cutting Outside Spending

The problems in dealing with aid dependence and the economics of Transition involve a great deal more than the flow of aid. They involve major shifts in the amount of aid that must go through the Afghan budget at a time of political, military, and security instability for a government that cannot spend its current aid inflow on a timely basis and has little capacity to plan, spend, and manage with any effectiveness.

The World Bank warned in March 2011 that only about 30% of the Afghan budget was actually discretionary and that some 70% was non-discretionary carry forward and new expenditure.91

Afghanistan’s Ministry of Finance reported in the FY1390 (2011-2012) national budget that discretionary spending equaled approximately 25% of the budget, with the remaining 75% non-discretionary carry forward and new expenditure.92 These rigidities will further limit Afghan ability to respond to outside funding cuts as well as confront the Afghan government with major challenges in having to plan and manage for more aid within its budget. Some of these issues can be seen in Figures 29-31.

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91 The World Bank, March 14, 2011.
Figure 29: Aid as Percent of National Budget ($ in Millions)


Figure 30: Development vs. Operating Budget Spending: 2003-2011 ($ in Millions)

**Figure 31: On-Budget and Off-Budget Aid**

<table>
<thead>
<tr>
<th>Donor</th>
<th>On-budget</th>
<th>Off-budget</th>
<th>Donor</th>
<th>On-budget</th>
<th>Off-budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asian Dev. Bank</td>
<td>100%</td>
<td>0%</td>
<td>European Union</td>
<td>27%</td>
<td>73%</td>
</tr>
<tr>
<td>Isl. Development Bank</td>
<td>100%</td>
<td>0%</td>
<td>Norway</td>
<td>27%</td>
<td>73%</td>
</tr>
<tr>
<td>World Bank</td>
<td>100%</td>
<td>0%</td>
<td>Poland</td>
<td>17%</td>
<td>83%</td>
</tr>
<tr>
<td>Finland</td>
<td>67%</td>
<td>33%</td>
<td>United States</td>
<td>11%</td>
<td>89%</td>
</tr>
<tr>
<td>Australia</td>
<td>60%</td>
<td>40%</td>
<td>France</td>
<td>6%</td>
<td>94%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>58%</td>
<td>42%</td>
<td>India</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Denmark</td>
<td>53%</td>
<td>47%</td>
<td>New Zealand</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>46%</td>
<td>54%</td>
<td>Switzerland</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Japan</td>
<td>46%</td>
<td>54%</td>
<td>Turkey</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Italy</td>
<td>44%</td>
<td>56%</td>
<td>United Arab Emirates</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>Germany</td>
<td>36%</td>
<td>64%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Czech Republic</td>
<td>34%</td>
<td>66%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweden</td>
<td>29%</td>
<td>71%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Canada</td>
<td>28%</td>
<td>72%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The Afghan government, in turn, must accept the fact it will have to live with aid levels that may well not reach the Tokyo and Chicago pledges and that future aid is extremely unlikely to be increased beyond the level of the pledges outside countries have already made. It did acknowledge the risks inherent in its aid dependence at the Bonn Conference in late November 2011 and outlined a potential Transition plan for the Afghan civil sector in broad terms:\footnote{Towards a Self-Sustaining Afghanistan, An Economic Transition Strategy, Government of the Islamic Republic of Afghanistan, November 29, 2011.}

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 in development. The primary difference between World Bank and MoF [Ministry of Finance] 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.
**Concepts Not Plans**

It is also important that while the Afghan government did call for more aid during the conference than was pledged, it did not provide a clear plan for using that aid or for Afghan economic development. It also did not address the future shape and costs of the ANSF in its requests, although security aid has 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 made no attempt to assess their impact on the Afghan economy.\(^\text{94}\)

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 promise reforms that would encourage outside and domestic investment, although it assumed a high level of security in and beyond 2014 as well as quicker success in reform than seems likely.\(^\text{95}\)

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
− 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.”

Yet, it is important to stress that the main Afghan response was also to call for more aid than Afghanistan can get. President Karzai requested some $10 billion a year through 2030 for a program that set ambitious goals for both security and development, equally ambitious reforms and improvements in governance, and for the Afghan government to achieve full independence from outside support in 2030:96

- 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 also called for increases in revenue that were unrealistically ambitious. It called for revenues to rise from $2.0 billion in fiscal 2011–12, corresponding to just over 11% of GDP, to $4.4 billion, or 15% of GDP, by 2016, an average annual revenue growth rate from 2009 of more than 30%. The requirement for

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96 The details were provided in a separate paper circulated in addition to the President’s statement: Towards a Self-Sustaining Afghanistan, An Economic Transition Strategy, Government of the Islamic Republic of Afghanistan, November 29, 2011.
outside aid was described as follows.\footnote{Towards a Self-Sustaining Afghanistan, An Economic Transition Strategy, Government of the Islamic Republic of Afghanistan, November 29, 2011.}

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 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.

Some of these requirements for future aid are valid to the extent they reflect real requirements described in the World Bank and other donor studies. At the same time, it must be stressed that they are only valid to the extent the Afghan government makes good on its own efforts to provide future security, reform, improvements in governance, increases in economic development and activity, and increases in government revenue.

**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 issues 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 and rely fully on Afghan forces for its security.
World Bank, CRS, and SIGAR Warnings

The data and analysis available are now badly dated relative to the ongoing speed of Transition. However, the 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 – shown in Figure 32 provides at least some indication of the pressures involved.

Figure 32: World Bank Estimate That Domestic Revenues Are Projected to Increase, But Operating Spending Is Likely to Grow Faster

(Total budget expenditure and revenues)


The data in Figures 32 and 33 are affected by all the problems created by the inability to calculate domestic revenue sources and make credible future projections discussed earlier. Taken at face value, however, the World Bank estimates that: 98

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 World Bank analysis does estimate that Afghanistan’s domestic revenues would continue to rise, but also estimates that that operating costs would 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. Although the Afghan government collected 11% of Afghan GDP in revenue in 2011 (approximately $2 billion), up from 7.5% in 2008, the $15.7 billion in aid it received in 2010-2011 approximated nominal GDP.99

A CRS report provides somewhat different estimates and indicates that donor aid accounts for more than 90-95% of Afghanistan’s GDP; the US is estimated to have provided 62% of the aid, while other donors provided 28%.100 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 2011 dollars).

Other working-level studies indicated that foreign spending totaled some 40-75% of Afghan GDP in 2011. A joint World Bank-IMF report in June 2012 found that Afghanistan was not likely to be fiscally sustainable until at least 2032 and that there would be a $70 billion financing gap during Transition, from 2015-2024.101

A January 2013 SIGAR report also noted the problems in Afghan spending, especially after Transition:102

> Afghanistan’s fiscal sustainability ratio—domestic revenues versus operating expenses—is one of the lowest in the world, according to DoD. Domestic revenue in 2012 is estimated to cover only two-thirds of the government’s operating expenditures, and will comprise less than 20% of the public expenditures budget. The fiscal sustainability ratio will be further strained throughout the transition as Afghanistan takes on more reconstruction and infrastructure projects, and their associated fixed operations and maintenance costs

No one can currently predict just how serious the drop in outside spending will be by 2014 or in the years beyond, but estimates of the cut in current military spending in Afghanistan range from 70-90%.

**An Impossible Financing Gap in Aid?**

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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. According to the World Bank:103

The overall financing gap (before donor grants) is projected to increase sharply in the next several years and then stay very high for the rest of the decade. After peaking at more than 40 percent of GDP in 2014/15, the financing gap is projected to gradually decline when expected mining revenues materialize, reaching around 25 percent of GDP in 2021/22. This represents $7.3 billion in 2011 prices by 2021/22 and roughly $7.8 billion annually on average from 2014/15 to 2021/22. If domestic funding for security remains at 3 percent of GDP, the sector would account for somewhat more than half the overall financing gap (equivalent to 14.5 percent of GDP) and the civilian budget the rest (11 percent of GDP). Low-income countries receive, on average, around 9 percent of gross national income in non-security development assistance—Afghanistan would require close to three times this level for combined civilian and security assistance in 2021/22.

A World Bank estimate of these aid needs and the resulting funding gaps—subject to all of the critical uncertainties in data, methodology, and need analyzed earlier—raises the following issues:104

- **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 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

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- 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

**Dealing with the Pressures of a Global Economic Crisis and Donor Fatigue**

These problems are not solvable, however, unless the US and its allies are willing to sustain high levels of civil and security aid through 2014 and then fund very significant aid from 2015 to at least 2020 and more probably 2024. However, the lack of Afghan political progress, lack of increases in government capacity, lack of effective governance at the provincial and local levels, corruption, and reliance on power brokers make this questionable. It is easy to pledge and hard to spend, and “donor fatigue” and a desire to cease military and economic engagement present another kind of threat to Transition.

**A Long History of Unmet Pledges and Real-World Abandonment**

This level of consistent future aid and commitment seems highly questionable. The US and Europe are under intense pressure to cut any military and civil spending that does not help their own economies as soon as possible. Many donor countries have failed to meet their aid commitments since 2002, and Figure 16 provides an essential warning of how quickly donor fatigue has occurred in past crises.
A November 2011 World Bank study of future Afghan funding and aid needs provided much the same warnings:\(^{105}\)

- 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

**The Tokyo Conference**

Like the Bonn Conference in December 2011 and every other international conference on Afghanistan to date, the Tokyo Conference was an awkward mixture of hope, fantasy, and failure.

The Tokyo Conference provided some degree of conditional hope that the US and other donors would give Afghanistan substantial aid through 2015, including new pledges of support during Transition. At the same time, however, the meeting re-lived similar past aid provision fantasies that decouple such pledges from reality and spin the outcome of the conference as far more successful than is remotely real. More broadly, the conference failed to come to grips with any of the key threats to Transition and ignored the almost total lack of credible planning and coordination in the continuing aid effort.

**Hope and Uncertainty**

There were some hopeful aspects to Tokyo. The conference did lead to some $16 billion in pledges through 2015 and did create some momentum behind a sustained aid effort. Such an effort is sorely needed as Transition comes with increased responsibility – and thus costs – for the Afghan government, coupled with significant cuts in US and allied military spending.

At the same time, the pledges made at Tokyo were never linked to an analysis of economic conditions and aid needs that approached a worst-case analysis. They were not tied to realistic estimates of the future combat and security situations, they largely ignored the impacts of corruption and narcotics, and they did not address the current or future capacity of the Afghan government to absorb the aid or distribute it honestly and effectively.\(^{106}\)

The pledges only covered the period through 2015 and were “conditional” on the Afghan government making major reforms to fight corruption as well as ensuring an efficient and

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flexible use of aid. This reflected international donors’ frustration with the poor quality of Afghan governance, planning, management, and ability to operate in high-risk areas. While improvement in these areas will be critical to any hope for lasting security and stability as real Transition begins to take effect, it is unlikely that the Afghan government will be able to deliver more than modest reforms. Moreover, Tokyo left any follow-up conference to 2014 – too late to deal with any crises in the Transition process.

The Operational Realities

Even if one looks only at corruption and fiscal responsibility, the Afghan government has never met a single pledge to fight corruption, and even the most honest ministries have major problems in managing and executing any aspect of governance and economic development. President Karzai – who has never before made good on any pledges to reform and who will presumably leave office after the election in 2014 – made a long series of new commitments to reform, inviting each donor or nation individually to hold the Afghan government to account.

Press reports say that these conditions could affect some 20% of the aid pledges. This conditionality will be critical in a country whose governance is weak or absent and with a president who has undercut or cancelled every anticorruption effort in the past, given that such efforts could threaten many of his relatives and political allies.

The broader problem with these hopes is the uncertain ability of donors to deliver on their pledges. As has been analyzed in some detail earlier, nations often do not make good on even their short-term pledges, turn aid into loans, and tie aid to specific projects and priorities regardless of need.

Figure 33 provides another estimate of the trends in pledges before the Tokyo Conference. Even during the peak of international commitment to Afghanistan during 2002 and 2009, only 43.1% of the $62 billion in aid for reconstruction in Afghanistan pledged at donor conferences was actually disbursed to development projects and activities.

The most serious problem with the pledges from the Tokyo Conference, however, is that they are not tied to any credible assessment of actual requirements, plans for meeting them, or combined assessment of how to deal with the massive uncertainties in both the military and economic aspects of Transition.

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**Figure 33: Pledges and Disbursements: 2002-2009**

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<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>United States</td>
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<td>1.2</td>
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</tr>
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<td>Japan</td>
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</tr>
<tr>
<td>Iran (Islamic Republic of)*</td>
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<td>Russia*</td>
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<td>Switzerland</td>
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<td>0.1</td>
<td>0.1</td>
<td>102.9%</td>
</tr>
<tr>
<td>Multilateral agencies</td>
<td>5.3</td>
<td>4.0</td>
<td>2.7</td>
<td>50.6%</td>
</tr>
<tr>
<td>Others</td>
<td>5.9</td>
<td>3.3</td>
<td>0.7</td>
<td>12.3%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>62.0</strong></td>
<td><strong>46.1</strong></td>
<td><strong>26.7</strong></td>
<td><strong>43.1%</strong></td>
</tr>
</tbody>
</table>

No Basis for Meaningful Planning

The economic aid pledged per year and by country at Tokyo remains unclear, but it is clear that it fell far short of the average of $10 billion a year that Afghanistan requested at the Bonn Conference. Furthermore, the 70 donors at the Tokyo Conference never addressed the longer-term Afghan request for $120 billion through 2020.

If the total aid were allocated equally each year, the sum would be $4 billion annually (if all pledges are met for what may be the first time in history). However, estimates of Afghanistan’s need range from $6 billion a year, as estimated by the Afghan Central Bank and earlier estimates of some $7 billion by the World Bank before the 2011 Bonn Conference. All these estimates were somehow scaled down before the Tokyo Conference, although they do not include spending on the ANSF.

It is equally important in separating hope from fantasy to note that these aid figures are not tied to any economic assessment of the combined impact of the withdrawal of virtually all of ISAF from Afghanistan and ongoing cuts in past aid – aid which disbursement lags have caused to remain high through this calendar year but which will begin to fall significantly in FY2013.

If Reality Intervenes

It is difficult to estimate what portion of the pledged money will really be allocated each year by given governments, and how much will actually reach Afghans as ISAF troops withdraw, aid levels are cut, and administrative costs increase as a percentage of total aid actually spent. Donor overhead costs will almost certainly average at least 15-20%, and the Afghan government will impose its own overhead costs. Some worst-case estimates that include corruption indicate that an average of 40% of aid money never actually reaches Afghans or stays in Afghanistan.

No real mechanism was created for working with the Afghan government to develop effective procedures to assess and encourage reform, and the Tokyo Conference made no effort to assess UNAMA’s decade of failure in doing anything to effectively assess and coordinate international aid activity.

The Conference did not establish an effective framework for creating a combined plan for aid to Afghan governance, aid to the Afghan security forces, and aid to keep the Afghan economy functioning, given the massive military and aid spending cuts that will accompany Transition. It did not create a structure to develop effective analysis and plans, give any group like the World Bank formal responsibility, or appoint some meaningful form of aid coordinator.

The end results were images, rhetoric, and coordinating committees – not a coherent effort to assess and manage the aid effort as countries cut back on their aid staffs and field offices in Afghanistan, as the Afghan government is faced with growing needs for effective action at the provincial, district, and urban levels for which no credible plans existed to make the necessary capacity improvements.

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The December 2012 semi-annual report to Congress by the DoD could say little more about aid funding than repeat the content of the press releases issued during the two major international conferences in the spring and summer of 2012.110

On July 8, 2012, representatives from the Afghan government, international community, and civil society met in Tokyo to discuss the future development of Afghanistan. The Tokyo Conference was held to define the international community’s commitment to a Transformation Decade and for the government of Afghanistan to establish a clear reform plan. Participants issued a communiqué announcing the intent of the international community to provide $16B for Afghanistan’s development through 2015 and included a Mutual Accountability Framework (MAF) setting specific, measurable reform goals to improve Afghan governance and development performance. The United States pledged to request from Congress assistance levels at or near the levels of the last decade. Over the long term, Afghanistan and the international community pledged to increase the country’s self-reliance and gradually reduce assistance levels.

The Tokyo MAF established the mutual commitments and responsibilities for both the Afghan government and the international community (IC) to help sustain Afghanistan’s development gains of the last decade, improve the effectiveness of international assistance, steadily reduce Afghanistan’s reliance on international aid, and improve governance to maintain stability. Afghanistan’s performance in the five following major areas will be monitored: a) Representational Democracy and Equitable Elections; b) Governance, Rule of Law, and Human Rights; c) Integrity of Public Finance and Commercial Banking; d) Government Revenues, Budget Execution and Sub-National Governance; and e) Inclusive and Sustained Growth and Development. For its part, the international community committed to sustain financial support for Afghanistan’s economic development through the Transformation Decade, and reaffirmed its Kabul Conference Commitments to align 80 percent of aid with NPPs and channel 50 percent of 105 aid through the Afghan national budget. In addition, the international community agreed to work with the government of Afghanistan to improve the mechanisms for assistance delivery to better align with international principles of effective development.

Later in July, the Afghan government prepared a draft Tokyo Framework implementation plan to present to the international community. The paper was a positive step towards establishing the themes, goals, indicators, milestones, and responsible agencies necessary for implementing the commitments of the Tokyo Framework. After receiving input from international donors, the government of Afghanistan approved the implementation plan in late September and plans to present the final process, including specific milestones for each framework goal, at the October meeting of the Joint Coordination and Monitoring Board.

The participants agreed to follow-up meetings, which will take place at the ministerial level every two years and at the senior official level in alternate years. The level of progress will be monitored at more frequent intervals by the Afghan-UN-led Joint Coordination and Monitoring Board (JCMB). The first ministerial review of Tokyo Commitments will take place in London in 2014.

The United States, as well as NTM-A, continues to work through diplomatic channels and international organizations to encourage Allies and partners to continue providing assistance for the sustainment of the ANSF. At the May 2012 Chicago NATO Summit, NATO and ISAF Partner Nations made a political commitment to provide funding for ANSF sustainment after ISAF’s mandate ends in 2014. An enduring ANSF, as envisaged by the international community and the Afghan government, requires an estimated annual budget of approximately $4.1B. The Afghan government has agreed to provide roughly $500 million annually of the total cost, progressively increasing its share of financial responsibility for maintaining its security forces over time. Given Afghanistan’s current economic and fiscal constraints, the international community pledged to contribute the remaining amount for three years beginning in 2015.

Afghan Problems versus Outside “Pledges”


Despite measured progress in revenue generation, Afghanistan’s fiscal sustainability ratio (a measure of domestic revenues to operating expenses) is still one of the worst in the world. Projected revenue for 2012 is expected to cover about 2/3 of the central government’s operating expenditures yet provide less than 20 percent of the total estimated public expenditures budget. In the first quarter of CY 2012, the fiscal sustainability ratio dropped below 60 percent, due to proportionally higher increases in operating expenses, but rebounded in the second quarter to approximately 80 percent.

Despite the improved fiscal sustainability ratio, economists remain concerned about Afghanistan’s fiscal sustainability as revenues are slightly below projections and government expenditures continue to increase. As Transition continues, the necessity to absorb additional expenditures for operations and maintenance (O&M) costs – as reconstruction/infrastructure projects are transferred to the Afghan government – will further strain the ability of government revenues to cover fixed operating costs.

...In the medium term, the international community has pledged to provide assistance to help fill the fiscal gap between domestic public revenue and total public expenditures. At the July Tokyo Conference, donors promised $16B in civil assistance through 2015; this amount is in addition to donor pledges made in the run up to the May NATO Summit, which were focused on security assistance of $3.6B and an Afghan commitment of $500M annually to support the Afghan police and military from 2015-2017. Together, these sums align with the World Bank’s baseline scenario of the levels of foreign assistance, roughly $8B annually, needed to fill the gap, although World Bank notes that this level of assistance will be needed well beyond 2015.

...Revenue generation will only be beneficial in so far as the Afghan government has the capacity to spend its budget in prioritized areas effectively. Budget execution, while showing improvement from SY1389 to SY1390, continues to struggle to meet donor expectations, especially with regards to the development budget.

...Under the Tokyo Mutual Accountability Framework, the Afghan government is expected to improve its development budget execution rate to 75 percent by 2017. As donors look to increase on-budget funding to at least 50 percent, in accordance with pledges, the amount of funding that must be utilized will increase substantially over a short period and require the Afghan government to significantly, and potentially unsustainably, accelerate its spend rate.

Limited public financial management capacity remains one of the primary challenges hindering public sector program implementation and public service delivery. More specifically, the Afghan government cites capacity constraints at the national and sub-national levels; weak planning and budget formulation; donor earmarking of funds and funding delays; and communication challenges across ministries, donors, and sub-national entities as key challenges.

An additional long-term concern is the retention and integration of the externally funded Afghan “second civil service,” a cadre of skilled civil servants funded by international donors at a higher rate than the regular service in order to expand technical assistance and capacity in line ministries and, in some cases, to help execute donor-funded projects. Although the externally funded Afghan staff represents only roughly 3.9 percent of the total workforce, they account for an estimated 31.9 percent of total payroll costs, according to 2011 World Bank survey of eight key ministries and one agency. The Afghan government has little ability to absorb the cost of these higher salaries, which may jeopardize the transfer of valuable program management and service delivery competencies into the regular service.

None of these official sources came to grips with the need to provide real-world annual aid plans – plans that require constant dialogue and revision – or aid plans that deal with
challenges posed by corruption, power brokers, heavy dependence on a narco-economy, waste, or capital flight. Donors failed to address the lack of any coherent national-level aid planning by UNAMA or by “failed” agencies like USAID. With less than two years to go before the end of Transition in December 2014, they did not address the lack of coordination between donors and the Afghan central government, failures to control contractors, develop valid requirements for spending, or develop meaningful measures of effectiveness. More broadly, the discussions involved decouple the assessment of economic and development issues from an assessment of the current security situation and the current and probable capabilities of the ANSF.

Put simply, it is time to get real, to produce plans that can be trusted and actually implemented, tying together both civil and security needs. It is time to develop transparent and regular reporting on Afghan aid progress utilizing clear statements of key requirements and measures of effectiveness. The fact that aid has good intentions is not an excuse for continued incompetence.

**Trying to Make Aid Work as PRTs Are Eliminated and with Inadequate US, European, Donor, and UN Structures**

The “civilian surge” that was supposed to be part of the new US strategy has lagged, had uncertain organization and quality, and already faced funding cuts in FY2012. As has been touched upon earlier, an October 30, 2011, report by the DoD noted that major cuts were already being planned in key aspects of the civil effort like the PRTs: 112

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 countrywide 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.

SIGAR reports that the entire PRT effort will phase out before 2014 – which is a date long before the Afghan government will have the capacity it needs in the field: 113

The United States and its coalition partners had PRTs in 26 of Afghanistan’s 34 provinces at the

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beginning of 2012; the United States was in charge of 12 of them [Figure 34]. The Afghan government sees PRTs as parallel structures to local governments and wants them progressively disbanded as coalition forces turn over responsibility to the Afghan security forces. The first U.S.-operated PRT was scheduled to close as this report went to press. Transition plans call for all PRTs to be closed by the end of 2014. The United States is planning to have a reduced civilian presence after 2014 in Afghanistan to support a smaller development and security assistance program.

**Figure 34: The Fading Role of PRTs in Aid Activity in the Field**

*Where the PRTs were in early 2012*

The Need for Realism: The Death of the Afghan Compact and National Development Plan, the Limits to Mining, and the “New Silk Road” Fantasy

Whatever happens, current aid and development plans need to be recalibrated from the ground up if the Afghan government, the US, and other donors are to take a realistic approach to Transition.

The Death of the Afghan Compact and Development Plan

Moreover, more realistic goals need to be set to determine what level of security and stability can actually be reached to make “Afghan good enough” in the future. Figure 35 shows that the US has long abandoned any real-world hope that it, Europe, and other donors can finance the ambitious aid plans called for in the Afghan Compact and Afghan Development Plan, and did so early in 2011, long before the current budget crisis began to force major changes in US aid plans and increased the pace of US military 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 35: The Pre-Transition Crisis in Aid and Development Funding

Afghan Government’s Spending Expectations Inconsistent with Future Budget Restrictions

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

While many of Afghanistan’s economic and development prospects remain limited, there have been several regional meetings established that involve Afghanistan:114

- Summit meetings between Afghanistan, Pakistan, and Turkey; and between Iran, Afghanistan, and Pakistan. The latest Iran-Afghanistan-Pakistan meeting took place in Islamabad on February 16-17, 2012. The previous such meeting occurred in Tehran on June 25, 2011. The fifth of the Turkey-led meetings occurred on December 24, 2010.
- Turkey and UNAMA co-chair a “Regional Working Group” initiative, which organized the major meeting on Afghanistan in Istanbul on November 2, 2011. UNAMA also leads a “Kabul Silk Road” initiative to promote regional cooperation on Afghanistan.
- Russia has assembled two “quadrilateral summits,” the latest of which was on August 18, 2010, among Pakistan, Russia, Afghanistan, and Tajikistan, focused on counter-narcotics and anti-smuggling.
- The Regional Economic Cooperation Conference on Afghanistan, which was launched in 2005. It held its fifth meeting in Tajikistan on March 26-27, 2012.

Unfortunately, there is little near-term prospect that the countries in the region can overcome enough of the national, security, and political barriers to serious economic progress, and marginal improvement in cooperation at the local level will not help Afghanistan deal with its near-term problems in Transition. Improving rail links, pipelines, and power grids – along with investment and reductions in national barriers to trade – all have potential. But, they will not yield benefits in time to have a serious macroeconomic impact on the Afghan economy before 2018 under anything like current conditions. 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

Afghan’s national resources, especially mining, offer great longer-term potential for Afghanistan’s economic development. The problem is timing and whether mining can have a major impact on Transition during 2014 to 2018 or even by 2021. A World Bank report issued in the spring of 2013 makes it clear that this is very unlikely:115

Mining makes a marginal contribution to GDP—less than 0.5 percent during the 2000s—but could potentially take off in the future. Afghanistan has copper, gold, iron ore, and other minerals, as well as construction materials, dimensional stone and gemstones, coal, and hydrocarbons (mostly natural gas). Some of these resources were exploited in the 1970s and 1980s, but war, neglect, and paltry funding in the last two decades caused output to plummet far below potential. Mineral production is now limited to small coal operations, limestone, construction materials, and gemstones and dimensional stone.

This situation could change dramatically over the next few years. Many observers think mining has high potential, and some state that it will become important for growth in the near future and will lead economic growth over the longer term. Similar sentiments place very large numbers on the value of Afghanistan’s mineral resources—often well over a trillion dollars—for a country

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with a GDP in 2010 of only US$15.9 billion.

These “projections” have some element of truth but refer mainly to the value of minerals in the ground: they assume that the minerals are in large enough concentrations to be mined profitably and that the necessary infrastructure either will be available or can be built profitably to extract and sell them. Such prognoses may hold in the long run, as mining techniques improve, resources get scarcer, and the economy develops. But in the very short run, only two deposits are reasonably sure of being mined profitably: the copper deposit at Aynak, just 35 kilometers south of Kabul, and the iron ore deposit at Hajigak, in Bamyan province.

Partial equilibrium analysis shows that these two mines have the potential to generate substantial economic returns. The revenue from these two mines is estimated at US$322 million a year in 2011–15, primarily in signing bonuses, and over US$900 million per year, on average, until 2031. Opening 11 other mines... has the potential to increase revenue to around US$1 billion a year, on average, from 2012 through 2031.

Mining could eventually contribute 2–2.5 percent of GDP to domestic revenue (which stood at 11 percent of GDP in 2010/11) and add 2–3 percentage points to annual GDP growth, but the direct employment effect is expected to be relatively modest.

The resources shown in Figure 36 may have significant mid- to long-term potential if Afghanistan can deal with its security and transportation problems, and create a stable climate for large-scale outside investment, but they offer only very limited real-world commercial prospects in the short- to mid-term. Realistic estimates indicate that mining can only have major benefits after 2018 at the earliest.

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. A stable, secure Afghanistan with improved lines of communication may be able to generate a major increase in mining revenues over time. The practical near-term problems are the need for massive outside investment, the time it takes to make mines functional and profitable, the fact that Afghanistan is not stable or secure, and the fact that it does not have the lines of communication essential for large-scale rapid investment at the level required. It cannot 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, while 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 5-10 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 168th out of 185 countries in the World Bank’s June 2012 index for ease of doing business, and ranks worst in the world for protecting investors.

As the January 2013 SIGAR report warns,\textsuperscript{116}

With revenue-generating sectors such as mining in their infancy, agricultural output dependent on the weather, and demand for services correlated with the international presence, it remains uncertain whether Afghanistan can sustain economic development as U.S. and coalition forces withdraw by year-end 2014.

\textit{Figure 36: Hopes for a “Rich” Future Are Not a Plan: Mining Potential}

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\begin{figure}
\centering
\includegraphics[width=\textwidth]{mining_potential.png}
\caption{Hopes for a “Rich” Future Are Not a Plan: Mining Potential}
\end{figure}


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

Unfortunately, some experts have rushed forward to promote an another concept for rapid development during the Transition period called the “New Silk Road,” and have done so without objective analysis of its practicality or cost-benefit balance 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 develop both the Afghan economy and the region. However, the most recent studies, which are in themselves not very recent, 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 working study that has not been broadly circulated, entitled “Afghanistan & Regional Economic Cooperation, Economic Impact Assessment” (Phase I, June 7, 2011), illustrates the challenges involved in making such analyses and in the claims for near- to mid-term payoffs that can help stabilize Transition:

- 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.  

- The study examines 15 tangible projects and five sets of improvements and reforms in government. 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.

- The study does note the need for future critical path analysis, but uses timescales 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.

- 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.

- 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. 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.

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117 See Afghanistan & Regional Economic Cooperation, Economic Impact Assessment, June 7, 2011, p. vii, 56, 64-65; the study summarizes other critical limitations on p. 11.
119 Afghanistan & Regional Economic Cooperation, Economic Impact Assessment, June 7, 2011, p. vii, 8.
120 Afghanistan & Regional Economic Cooperation, Economic Impact Assessment, June 7, 2011, p. vi, 2-4.
121 Afghanistan & Regional Economic Cooperation, Economic Impact Assessment, June 7, 2011, p. v, 63.
122 Afghanistan & Regional Economic Cooperation, Economic Impact Assessment, June 7, 2011, p. vi, 7, 10, and see individual project analyses.
These issues are critical, because the study notes that investments need to add 100,000-200,000 new jobs to the economy each year if the unemployment rate is to be reduced well below the 35% mark where it is currently stuck. However, the 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.\textsuperscript{123}

- The Economic Internal Rate of Return (12%) only finds, “the projects would be viable under market based financial conditions,” an assessment which seems to ignore corruption, problems in government capacity, and security risks in assessing rates of return.\textsuperscript{124}

A US Central Command (CENTCOM) summary of some of the key data involved is shown in Figure 37. CENTCOM recognizes the need for extensive additional analysis to determine the costs and benefits of the New Silk Road and other such development concepts in the context of Transition. It sets forth the following needs for planning and analysis:

- Human terrain analysis of Public Investment Programs (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.

In practice, the “New Silk Road” seems to offer substantially less potential, even in the mid- to long-term, than mining. There are too many alternative routes to Afghanistan or that only pass through a small part of Afghanistan’s northwest region on the way to Central Asia. Other countries and routes offer lower risk and better access in terms of roads, rails, and pipelines. Existing investment in central Asia moves north to Russia, east to China, and west toward Europe. Pakistan has shown no interest in shaping economic development or its economic lines of communication through Afghanistan, and India-Pakistan tensions make Afghanistan an insecure route to an unstable South Asia. Someday, perhaps. In time for Transition, never.

\textsuperscript{123} \textit{Afghanistan & Regional Economic Cooperation, Economic Impact Assessment, June 7, 2011}, p. vi, 7, 10, 58, Annex 2.

\textsuperscript{124} \textit{Afghanistan & Regional Economic Cooperation, Economic Impact Assessment, June 7, 2011}, p. v, 56, 59-60.
Figure 37: USCENTCOM Summary Data on the New Silk Road (NSR)

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

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

Source: United States Central Command Briefing, August 2011.
The Need to Focus Aid on Key Areas Affecting Key Sectors, Regions, and Demographic Pressures That Will Shape Post-Transition Stability

For all the reasons described earlier, dealing with gross economic impacts is only part of the story. The Afghan government – as well as the US and other donors – also must do more to focus on key sectors, regions, and demographic pressures.

A World Bank assessment of sectoral growth issued in 2013 – but based on data collected in 2011 – summarized sectoral trends in terms that warned that agriculture was weather sensitive and that the other major sectors of growth were very sensitive to security and aid:125

The fastest-growing subsectors in services since 2003/04 have been Communications (66 percent annual average), financial and business services (26 percent), government services (20 percent), and transport (14 percent). Financial and business services still have only a marginal effect on services growth, however (considering the subsector’s growth and share in total services). The large share and strong growth of communications and transport, followed by government services, have been the main drivers of overall economic growth.

These subsectors, along with construction, are typically driven by the needs of post conflict reconstruction and high inflows of aid. Wholesale and retail trades also play an important role but mainly through their weight in total services rather than by strong growth.

Spending cuts could cripple much of the service sector – along with construction and transportation – that some estimates put as high as 50% of GDP. This would have a major impact on urban areas in particular, where political unrest and security problems are most likely to arise from a recession or lack of growth.

Agriculture

The importance of the agricultural sector is critical to the Afghan economy and stability, although US reporting on the Afghan economy pays little attention to the sectoral problems in the economy, while USAID has made claims of progress that border on specious nonsense. There is little analysis of the domestic and donor impact on other sectors of the economy, no credible data on how much of the population really is involved in agriculture (often estimated at 80%), no analysis of the cyclical impact of the climate tied to estimates of actual development, nor a decoupling of narcotics from legal crops.126

Once again, it is important to stress that the agricultural sector of the Afghan economy is extremely vulnerable to weather problems. Uncertain as they are, some estimates report that 30-45% of GDP comes from agriculture, and a drought in 2008 reduced overall GDP growth from 5-10%.

The World Bank estimates that,\textsuperscript{127} Agriculture contracted in 2010/11 because of bad weather, lowering overall growth by 1.5 percent. Agricultural value added has declined as a share of GDP over the last decade. Industry accounts for 26 percent of GDP: construction growth is still relatively strong, thereby feeding growth in manufacturing through demand for building materials. Contributions from mining are almost negligible but are expected to surge over the next decade...Growth in Afghanistan is volatile, mainly because of the economy’s heavy reliance on agriculture, which in 2010/11 contributed 23.3 percent of total value added. Agricultural production is particularly susceptible to the weather. During 2003/04–2010/11 annual real agricultural growth ranged from 22 percent contraction to 45 percent expansion (see figure 2.3), and the sector accounted for between one-quarter and one-third of GDP. Absorbing 60 percent of the working population, agriculture is by far the largest employer, so rural development will remain crucial in sustaining growth.

Agriculture will remain a very important source of income and growth for many years. The illicit production of opium still overshadows agriculture, accounting for nearly half of overall agricultural production but on a much smaller portion of arable land...

The Service Sector

Spending cuts could cripple much of the service sector – especially construction and transportation – that now account for some 50\% of GDP. This would have a major impact on urban areas, where political unrest and security problems are most likely to arise from a recession or lack of growth.

These other sectoral changes are particularly important because narcotics output continues to increase – 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 several other crops, marketing and distribution are improving only very slowly at the national level, and they will remain high-risk crops relative to drugs well beyond 2014.\textsuperscript{128}

Mining and Narcotics

The role of mining and narcotics is discussed elsewhere, but it is important to keep them in a broader perspective.\textsuperscript{129}

Mining makes a marginal contribution to GDP—less than 0.5 percent during the 2000s—but could potentially take off in the future. Afghanistan has substantial untapped mineral deposits... Two large investments in copper deposits in Aynak (near Kabul) and iron deposits in Hajigak (Bamyan province), in 2010 and 2011, could be the first step toward realizing this potential.

Narcotics are a different story. While such numbers are highly uncertain and controversial, some estimates indicate that some 10\% of the ultimate net profits from the street sale of narcotics continues to go to insurgents and up to 70\% goes to distributors and criminal networks.

In contrast with its assessment of the importance of mining to the Afghan economy, the World Bank’s assessment of narcotics reports, “According to 2011 estimates from the United Nations Office on Drugs and Crime, the farm gate value of opium is 8 percent of

GDP, and its overall contribution to GDP (including distribution) is believed to be around one-third.\textsuperscript{130}

\textbf{Security Problems and Regional Impacts}

There is an equal need to determine the degree to which cuts in spending will hit hardest in the least secure areas and affect the groups most sensitive to Transition. The State Department has taken what seems to be a very different view from the World Bank. It has reported that more than one-half of US assistance from 2009-2011 went to the largely Pashtun southern and eastern provinces.\textsuperscript{131} 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 from the fourth quarter of 2010 to the third quarter of 2011.

There are no credible unclassified estimates that focus on the regional- and district-level impacts of the economics of Transition. It is now clear, however, that the US, other ISAF forces, and the ANSF cannot 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 any more secure in its border areas, will fully cooperate with the Afghan government, or will give Afghan development high priority.

Several working studies indicate that some 80% of the total mix of aid and military spending goes 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 has been managed largely by PRTs and military forces, not through the Afghan government. Removing outside forces and civil-military aid teams will impact such combat districts far more heavily 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 would be able to cope.

\textbf{Demographics and Economic Stability}

Another key factor that will impact both the national and sectoral levels is that most Transition models do not account for demographic factors such as population growth and an extremely young, dependent population, both of which World Bank and US working studies have shown will be critical.

The basic issues involved have been addressed earlier in this analysis, but the US Census Bureau and UN estimates of these trends are almost certainly correct in warning about the levels of demographic pressure involved. While the previous analysis has made it all too clear that none of the numbers being quoted in such studies are reliable, the broad trends in such data almost certainly are:

- \textbf{Growth:} With a current population of about 29-31 million, population growth will be roughly 2.5% annually.


\textsuperscript{131} \cite{EvaluationU.S.ForeignAssistancetoAfghanistan}
The US Census Bureau estimates that the Afghan population has grown from 8.2 million in 1950 to 29.1 million in 2010 in spite of 30 years of crisis and war.\textsuperscript{132}

Growth is estimated to reach 32.6 million in 2015, 36.6 million in 2020, and 41.1 million in 2025.\textsuperscript{133}

The fertility rate is estimated to drop from 8.0 in 2000 to 5.9 in 2020 and 2.8 in 2050.\textsuperscript{134}

The UN estimates that the Afghan population grew from 8.2 million in 1950 to 21.8 million in. Growth is estimated to reach 45.2 million in 2015, 36.6 million in 2020, and 72.3 million in 2025.\textsuperscript{135}

The CIA estimates the total population was 30.4 million in July 2012.\textsuperscript{136} Some 42% were 14 years of age or younger. The median age was 17.9 years.\textsuperscript{137}

The Afghan Central Statistics Office estimates the total settled population at 25,500 million in 2012-2013.\textsuperscript{138} The Afghan Central Statistics Office estimates the total population of Helmand at 879,000 or 3% of the total. It estimates the total population of Kandahar at 1.2 million, Herat at 1.8 million, Balkh at 1.2 million, Nangarhar at 1.4 million, and Ghazni at 1.2 million.\textsuperscript{139}

**Urbanization:**

The Afghan Central Statistics Office estimates the total settled population had 19.4 million (76\%) in rural areas in 2012-2013, and 6.1 million (24\%) in urban areas.\textsuperscript{140}

The CIA estimates about 77\% of the population lives in rural areas with an annual urbanization rate of 5.4\% due in large part to job availability and rural instability.\textsuperscript{141}

Kabul’s population is about 3.3 million (compared to an estimated 500,000 in early 2001). The Afghan Central Statistics Office estimates the urban population of Kabul is estimated at 3.3 million or 54\% of the settled urban population and 13\% of the settled total.\textsuperscript{142}

**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 CIA estimates that 392,116 males and 370,295 women reached adult working age in 2010. These totals will be at least 11% higher in 2015.

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).”

Almost 43% of the population is under 15 years of age, which will result in a sustained long-term expansion of the labor force.

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 the next three years.

Annual increases in the labor force will far outpace even the best-case scenario job gains from the New Silk Road strategy over three years. The World Bank estimates that the Afghan labor force has grown annually by over 300,000 people per year since 2007.

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

These data and estimates also tacitly assume that there will be 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, the behavior of criminal networks, and the 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.

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

It is equally important to consider the human dimension of these developments. Some aid reporting implies Afghanistan has begun to move towards broadly based, stable development. The reality is totally different

Employment

There are no reliable data on unemployment and underemployment in Afghanistan, but the World Bank has at least provided a well-structured guesstimate: ¹⁴⁶

The impact of transition on employment is very difficult to assess because labor statistics are scarce. Most data come from only three sources: the National Risk and Vulnerability Assessment (NRVA) 2007/08; a national labor survey from 2005; and a survey on urban labor markets conducted in 2007 by the Ministry of Labor and Social Affairs, Martyrs and Disabled. All have major limitations and are inconclusive on the relationship between aid and employment. Poor data are worsened by the general lack of systemic employment information among donors.

According to the NRVA 2007/08, 66.5 percent of those in the working-age population (16 years and older) participated in the labor market. Only about 6.8 percent of the population could be considered unemployed in 2009 based on the conventional definition of the term.

However, the relatively low level of open unemployment is counterbalanced by the severity of underemployment: more than 48 percent of those employed work fewer than 35 hours a week, on average. Underemployment is particularly widespread in rural areas and among the self-employed, including day laborers and family workers, who make up about 77 percent of the workforce.

Employment patterns vary greatly across provinces, but two main patterns emerge. First, regardless of any apparent relationship with the size of the labor force, unemployment rates in conflict provinces are lower than in nonconflict provinces and, in the majority of them, lower than the national average. Second, only four conflict provinces show both low unemployment and underemployment rates. Conflict provinces seem to exhibit marginally higher underemployment than nonconflict provinces… A likely explanation for these patterns is that job opportunities created by PRTs, including “workfare” programs, might have helped change the status of workers previously categorized as unemployed, but many of these jobs are likely to be casual and short term in nature.

How many jobs aid has created remains unclear, partly because the data are widely scattered and difficult to interpret. Because most aid-financed activities are tendered out, information on recruitment and salaries is held by the winning contractor, who has no obligation to give it to the contracting donor. On the donors’ part, efforts to survey employment across contracts face multiple classification problems because many of the jobs are short term, lasting no longer than the contract.

A study by the Peace Dividend Trust (Heady et al. 2011), which surveyed 146 local businesses that won aid-financed contracts in 2006–11, found that the average length of a contract was six months and that more than half the jobs lasted less time. But it also found that efforts to improve local sourcing led businesses to retain some workers they employed: 58 percent of businesses that won an aid-financed contract ended the assignment with more employees than they started with. The study’s authors conclude that the contracts, which had a total value of US$1.1 billion, created roughly the equivalent of 118,000 jobs for six months.

The Ministry of Finance reported that, in 2010, some 6,647 people working outside the civil service in nonsecurity ministries received salaries or salary top-ups financed by donors. The International Security Assistance Force registers 60,000–80,000 Afghans directly employed through military-related contracting agencies. However, information on the length of employment

is not available, and double counting may possibly cause errors. The USAID, depending on the source, estimates 31,600–60,000 jobs created through its own contracts, but whether these numbers include second-round effects (jobs created indirectly through aid money) is unclear. U.S. Central Command (USCENTCOM) reports that U.S.-financed contracts employed 34,200–78,500 Afghans, including contracts issued by the USAID and military agencies (USCENTCOM July 2008–January 2011). Nongovernmental organizations are believed to employ about 16,600 Afghans. Much uncertainty exists even over direct employment through aid contracts.

Taking employment numbers reported by aid agencies, the number of jobs created is around 410,000. Using the methodology applied by the Peace Dividend Trust (Heady et al. 2011), estimates for jobs lasting six months and financed through off-budget aid range roughly between 312,000 and 620,000, depending on local-content assumptions. Including the number of beneficiaries in the civil service, this methodology suggests that 6.5–10 percent of the working population benefited, in one form or another, from employment created or sustained by aid in 2010.

Because of the nature and type of donor involvement in Afghanistan, much of the security-related and civilian aid has been allotted to construction and services, in particular transport and logistics, retail, and maintenance and repair. In U.S. contractual spending alone, these two sectors account for over 75 percent... We therefore expect the employment impact from a decline in foreign spending to be most pronounced in these sectors. What happens to employment when aid declines? Several effects are possible:

- Assuming a gradual decline in aid, the employment impact is expected to be limited. Unless aid is phased out very abruptly, the employment impact will be felt slowly. Applying the same methodology as above, a decline of, for example, US$0.5 billion in (off-budget) aid would affect 11,000–18,000 jobs (on a six-month basis). This is less than 0.2 percent of the current working population and a number that could be absorbed by other emerging economic activities. The Aynak and Hajigak mines, for instance, are expected to directly produce more than 20,000 jobs annually in 2016–22, in the same sectors where aid spending is now concentrated.

- The public sector will likely absorb part of the employment impact. Contingent on continued budget support and fiscal space, the government’s reform intentions are geared toward expanding the public sector: the head counts of the Afghan National Army and Afghan National Police are expected to increase by 21 percent from current levels by the end of 2012, some 10,000 teachers are expected to be hired annually, and the government wishes to attract up to 2,000 skilled Afghans from the “second civil service”... into the regular civil service over the next five years. This activity could mitigate the negative impact, which will occur mainly in the private sector.

- As in the following poverty analysis, the employment effects will be uneven among provinces. Because most jobs were created in provinces that received higher aid flows, the conflict-affected provinces will bear the brunt of the impact as the transition unfolds, because off-budget provincial aid allocations will likely decline faster than those through the core budget.

- Urban centers are likely to be harder hit than rural areas, because construction and services (the most vulnerable sectors) are more important there: they account for 64 percent of the working population in urban areas but only 24 percent in rural areas...

The employment impact will aggravate underemployment rather than show through in unemployment. Because many jobs created by aid are casual, these will probably be the first ones to go when the international troops withdraw and PRTs are dissolved. But because many people involved in daily labor or the casual food or cash-for-work programs also work in agriculture, the transition will more likely lead to higher underemployment and lower household income rather than to higher unemployment. A similar effect might materialize for skilled, high-wage earners who hold (high-paying) jobs in donor projects. They are more likely to find other jobs in the expanding regular civil service, though at lower wages.
Poverty, Food Issues, and the UN World Food Program

The poverty data on Afghanistan are extremely weak and date back to uncertain surveys in 2005 and 2008. The World Bank does make some estimates that aid and military spending have had little impact of the per capita income of most Afghans, even in high-income areas or those areas that received heavy aid spending.\textsuperscript{147}

Higher provincial spending appears to have only a modest relationship with development outcomes, even after controlling for conflict…On average, higher per capita provincial spending is associated with lower food poverty and with higher per capita food consumption and child immunization…But only the relationship between per capita spending and change in food poverty is statistically significant, at 10 percent; that between provincial spending and change in enrollment (among children ages 6–12) is statistically insignificant and slightly negative.

More systematic analysis of the data also points toward only a modest effect of higher spending on development outcomes. To further understand this issue, we use the difference-in-difference approach to calculate the change in development outcomes. High-spending provinces have witnessed a 15 percentage point net decline (compared with low-spending provinces) in food poverty between 2005 and 2008… But the gain in per capita food consumption is modest for high-spending provinces—a statistically insignificant increase of only Af 71 a month (equivalent to about US$1.40) associated with additional per capita spending of at least US$200.

The UN World Food Programme (WFP) warns that – absent significant external aid – many Afghans will still live below the subsistence level.\textsuperscript{148} The WFP notes that aid cuts are already having a major human impact. As noted on the organization’s website,\textsuperscript{149}

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 [2011].

And, as has been described earlier, those pressures are confirmed by the recent reports of the UN Secretary General and the CIA World Factbook, which states:\textsuperscript{150}

Despite the progress of the past few years, Afghanistan is extremely poor, landlocked, and highly dependent on foreign aid. 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 difficulty in extending 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 nine donors' conferences between 2003-10, 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.

While any 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

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and lives below the poverty line. Moreover, no meaningful estimates now exist of the number of internally displaced persons and the number of Afghans driven into marginal, urban-based lives by security problems, water issues, and population growth.

The UN World Food Program (WFP) has not released a fully updated risk assessment for Afghanistan since 2008, but it has provided updated findings in its 2011-2012 risk assessment. Preliminary findings from the 2011/2012 National Risk and Vulnerability Assessment (NRVA) indicate that 7.6 million people are food insecure nationally, consuming below 2,100 kcal/person/day. Of these, 2.1 million are very severely food-insecure (less than 1,500 kcal/person/day) and another 2.4 million are severely food-insecure (1,500-1,800 kcal/person/day).

The overall prevalence of food insecurity in Afghanistan is little changed compared with the 2007/2008 NRVA (31 percent in 2007/2008 to 30 percent in 2011/2012), with a slight improvement in rural areas (from 32 to 29 percent) and slight deterioration in urban areas (from 31 to 33 percent). The main characteristics of food-insecure households are that they: are headed by women; have more than 10 people; are returnees, IDPs or those affected by natural disasters; and rely on seasonal migration, wage labor or borrowing as the principal source of income.

Cereal production for 2012 is 6.32 million mt, the second-highest level in 35 years, implying that Afghanistan will be 94 percent self-sufficient for cereals. The large cereal harvest and good pasture conditions are expected to increase 2012 livestock production by 5 percent. However, improved food production at national level will not guarantee improved food security in all areas. Although prices are below August 2011 levels for wheat (-10 percent) and wheat flour (-5 percent), the current global wheat price increase could potentially affect domestic markets due to trade linking Afghanistan to regional markets. While markets are generally well-developed, integrated and competitive, the challenges of physical and economic access (poor infrastructure and limited livelihood opportunities), inadequate food utilization, instability due to conflict, and recurrent natural disasters will remain, especially in the most remote areas.

Afghanistan’s infant and maternal mortality are among the highest in the world. The most recent national survey showed 61 percent of children under 5 were stunted (chronically malnourished), 39 percent underweight and 7 percent were wasted (acutely malnourished). District-level surveys in 2011 have found global acute malnutrition (GAM) up to 17 percent, considered a “critical” nutrition situation. One-third of childhood mortality is caused by acute and chronic (stunting) malnutrition. One-fifth of Afghan women of child-bearing age are underweight.

Afghanistan suffers from recurring, mainly localized natural disasters, with droughts (such as in 2011), floods, earthquakes and extreme weather. These shocks contribute to reduced agricultural production, increased acute food insecurity, and further erode the development of sustainable and diversified livelihood systems.

This assessment raises similar concerns as those contained in the 2007-2008 National Risk and Vulnerability Assessment:

The 2007-2008 National Risk and Vulnerability Assessment (NRVA) found that 7.4 million people – nearly a third of the population – are unable to get enough food to live active, healthy lives. Another 8.5 million people, or 37 percent, are on the borderline of food insecurity. Around 400,000 people each year are seriously affected by natural disasters, such as droughts, floods, earthquakes or extreme weather conditions.

Based on a report published in August 2012, the WFP reported that 7.6 million Afghans (30%) are food insecure, with approximately 6.5 million receiving food from the WFP in 2010. The organization recently initiated a new program that aims to affect 15 million Afghans:154

Afghanistan’s Ministry of Public Health, the Khalifa Bin Zayed Al Nahyan Foundation (KBZF), the Global Alliance for Improved Nutrition (GAIN) and the World Food Programme (WFP) have launched a partnership that will reach approximately 15 million Afghans with nutritionally fortified wheat flour, vegetable oil and ghee. The partnership aims to reduce the prevalence of vitamin and mineral deficiencies among the general population and vulnerable groups such as children under five and women of reproductive age, through a project supporting the Government’s Nutrition Action Framework to address malnutrition.

Unfortunately, the need for food aid has remained as decoupled from most analyses of the economics of Transition as the impact of urban migration and the refugee and displaced persons problem. For a successful Transition to help the most vulnerable, the US, its allies, and the rest of the world need an updated National Risk and Vulnerability Assessment, the full findings of which have yet to be published.

As of February 2013, the number of people that the WFP plans on assisting has dropped significantly to 2,639,473.155 But this number – and the reason why it has dropped so dramatically – is not explained by the WFP. The reduction could be due to anything from fewer Afghans needing aid, decreased security making it impossible to reach the needy, a reduction in donations, or any number of other reasons.

More generally, there is no fully credible assessment of current Afghan poverty levels or of the number and distribution of Afghan poor who are dependent enough on aid and the flow of outside money to the market sector of the economy to be impacted by the coming cuts in military spending and aid.

Refugees, Displaced Persons, and Poverty

There are other major problems that are not addressed in the Transition studies made public to date, such as the impact of decades of conflict and economic disruption on externally and internally displaced persons or the broader issue of income distribution and poverty. A rough picture of the estimated Afghan refugee population can be found in Figure 38.

Pakistan and Iran have increasingly signaled that they want Afghan refugees to go back to Afghanistan. There is no way to estimate how serious Pakistani and Iranian efforts will


be or whether their timing will coincide with the worst economic pressure in Transition. Pakistan and Iran also do not have a reliable count of Afghan refugees, though UNHCR reports that the two countries together have approximately 2.7 million. Recent estimates indicate that there are over 1.6 million Afghan refugees registered in Pakistan alone, with another 1.8 million unregistered.

Registered refugees have been issued special identity cards that allow them to stay in Pakistan, but the cards were set to expire on December 31, 2012. On December 12, 2012, Prime Minister Ashraf announced that the cards would remain valid through June 2013, though there are growing reports of harassment. The Prime Minister also tasked a cabinet committee to develop a strategy for handling refugees after the extension expires in June 2013. Iran also houses a large Afghan refugee population, estimated at 1.07 million in 2010, more recently dropping to approximately 840,200. Iran, in partnership with UNHCR, provides the refugees with access to education, free primary health care, and eligibility for work permits. However, the refugees are an intense strain on the Iranian economy, particularly given the pressure of U.S. and international sanctions. Since 2005, Iranian President Ahmadinejad has stepped up the forcible repatriation of Afghan refugees, often with little advance indication. One report indicates that about 50,000 Afghans were expelled from Iran in May 2007. Afghan officials report that Iran returned as many as 160,000 Afghan refugees between March 2010 and February 2011. For those not forced out, movement within Iran is restricted and Afghans are banned from certain public areas.

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158 Alex Rodriguez, “Pakistan Weary of Hosting Millions of Afghan Refugees, Caught in conflicting agendas, they may soon face deportation,” Los Angeles Times, September 10, 2012, p. 3.
Engineer Shaukatullah, Pakistan's Minister of States and Frontier Regions, estimated that 109,383 Afghan refugees returned to Afghanistan from Pakistan and Iran in 2010, with the number of returning refugees dropping to 52,096 in 2011. Another 42,000 Afghan refugees returned in the first eight months of 2012, but these rates of return are offset by the 83,000 children born to Afghan refugees each year.\textsuperscript{166}

SIGAR reports that while the Iranian government has threatened mass deportations, these have yet to occur and do not seem imminent. Instead, many refugees have returned to Afghanistan due to the Western economic sanctions, decline in the value of the Iranian currency, and Iranian economic recession. The deportations that have happened seem to be of illegal migrants, not registered refugees.\textsuperscript{167}

According to UNHCR, 3.8 million registered Afghans have returned home since March 2002.\textsuperscript{168} These returns are already presenting problems for Transition, as Afghan officials are ill-equipped to deal with the humanitarian burden and sometimes accuse refugees as a destabilizing tool.\textsuperscript{169} The capacity of Afghanistan to absorb the returning refugees, especially given the weak economy and continuing Taliban insurgency, is unclear. The treatment of Afghan refugees in Iran has often caused anti-Iranian protests in Afghanistan, including five in a two-week period in May 2010, one of which took place outside the Iranian consulate in Jalalabad.\textsuperscript{170}

UNHCR reported that as of mid-2012 there were an estimated 425,000 internally displaced persons (IDPs) in Afghanistan and another 951,167 with uncertain status, creating an internal “population of concern” totaling 1,548,374. It put the number of refugees outside the country at 2,664,436 and the total mix of internal and external refugees and displaced poor at 4,248,193.\textsuperscript{171} Updated numbers for January 2013 show that IDPs have remained the same, and UNHCR planning for 2013 envisions a total of 547,550 IDPs.

One US report noted that,\textsuperscript{172}

Beyond economic and security issues, the status of Afghan refugees in Iran continues to be a contentious issue between Iran and Afghanistan. Approximately three million Afghan refugees currently reside in Iran, only one-third of which are registered with the United Nations High Commission for Refugees. In order to limit the impact of unregistered refugees on the economy and infrastructure, Iran has focused much of its forced repatriation on unregistered refugees. Current deportation rates range from 17,000 to 25,000 people per month. With little progress

\textsuperscript{166} Alex Rodriguez, “Pakistan Weary of Hosting Millions of Afghan Refugees, Caught in conflicting agendas, they may soon face deportation,” \textit{Los Angeles Times}, September 10, 2012, p. 3.


being made between the two countries on the status of the refugees and the rate of repatriation, the Afghan Ministry of Refugees and Repatriation has begun planning for the full repatriation of undocumented Afghans living in Iran at a rate of 50,000 per month.

The 1230 Report issued by the DoD in December 2012 detailed similar concerns:\(^{173}\)

Beyond economic and security issues, the protracted Afghan refugee situation continues to be a contentious issue between Iran and Afghanistan. Approximately one million registered Afghan refugees and about an estimated 1.4 million undocumented Afghan economic migrants (nonrefugees) currently reside in Iran. Economic pressures and the Iranian government’s discontinuation of subsidies on basic goods and services has led to a rise in the repatriation of Afghan refugees since 2011, but during this reporting period, Iran has not forcibly expelled or returned registered refugees. The deportation of undocumented Afghans continues, though at a reduced pace compared to previous years.

More generally, UNHCR warned in February 2013 that,\(^{174}\)

More than 5.7 million refugees have voluntarily repatriated to Afghanistan in the last 10 years, of whom more than 4.6 million were assisted to do so by UNHCR. Nonetheless, some 2.7 million Afghans continue to live in exile in neighboring countries. An international conference in Geneva in May 2012 brought the Governments of the Islamic Republics of Afghanistan, Iran and Pakistan, UNHCR and donors together to endorse a Solutions Strategy for Afghan Refugees, which aims to pursue voluntary repatriation, sustainable reintegration and assistance to host countries.

The security situation in Afghanistan continues to be volatile, and obtaining humanitarian access to many areas remains impossible. The lack of security continues to be the main cause of displacement. UNHCR estimates that as of mid-2012, some 425,000 Afghans were internally displaced. UNHCR pursues innovative practices to gain access to people of concern, track population movements and provide assistance to the vulnerable through a network of partners throughout the country.

Returning refugees struggle to achieve sustainable reintegration, which is defined as reaching parity with local community members. UNHCR is currently conducting community surveys in high-return areas, where the initial indications are that returnees have specific vulnerabilities. Protection monitoring to understand the return environment and confirm the voluntariness of returns is also critical.

During the last three years, internal displacement has increased significantly in Afghanistan. Securing access and providing emergency humanitarian assistance to internally displaced persons (IDPs) is a key objective for UNHCR pursuant to its leadership of the protection and emergency shelter/non-food items clusters. UNHCR works with cluster participants to respond to immediate needs, pursue advocacy to reduce displacement, and support durable solutions.

...UNHCR estimates that there are currently some 450,000 internally displaced Afghans. For 2013, UNHCR expects to expand its interventions for conflict-induced IDPs. Better coordination is required to track population movements as well as to understand and address the root causes of displacement, in addition to improving emergency response mechanisms.

...Urban displacements occur largely as a form of secondary displacement driven by the absence of basic protection, services and/or livelihoods, as well as natural disasters and lack of food security. UNHCR will continue to improve its emergency response to new conflict-induced displacement. Assistance will be provided to conflict IDPs, with priority given to the pursuit of solutions, including return and reintegration. Legal counseling and support will also be provided for IDPs.


The number of asylum-seekers and refugees in Afghanistan is modest (fewer than 130). In addition, more than 3,000 people are considered to be living in a refugee-like situation, having been displaced from their homes across international borders. UNHCR is increasingly engaged in the drafting of national refugee legislation, and is working with the authorities to improve reception conditions and ensure protection-sensitive border policies. While the number of refugees and asylum-seekers is expected to remain little changed in 2013, the number of people living in a refugee-like situation is expected to increase by some 3,000 due to instability in some border regions.

A complex array of political, security, and socio-economic factors in Afghanistan have contributed to the gradual decline in the number of refugees returning from neighboring countries. The most significant assumption regarding internal displacement in Afghanistan is the likely increase in conflict-induced IDPs. This may be due to security challenges in the wake of the withdrawal of international forces from Afghanistan and their handover of responsibilities to the nascent Afghan security forces.

It is expected that humanitarian access will continue to be limited, and perhaps worsen, in 2013. Attacks may continue to target international military forces as well as organizations perceived to be foreign in nature. Though UNHCR is making headway in obtaining humanitarian access directly and through partners, operational momentum is constrained by limits on freedom of movement. This hinders direct discussions with people of concern and visits to affected areas and makes it difficult to coordinate assistance with other actors.

Figure 38: Estimated UNHCR Afghan Refugee Population

![Statistical Snapshot](http://www.unhcr.org/pages/49e486eb6.html)

Narcotics, the Gray and Black Economy, Power Brokers, Criminal Networks, and Transition Flight

The failure to try to estimate and analyze the impacts of corruption, criminal gangs, and narcotics on the Afghan economy is one of the most critical areas of incompetent and dishonest economic analysis and is a major problem for Transition. Transition will not fix the existing challenges of corruption, narcotics production, or the links between the government and criminal networks, and may result in an increase in other problems, such as capital flight and inter-communal violence.

Reverting to a Narco-Economy

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 capital flight that will occur as many wealthy Afghans leave the country.

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

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 UNODC estimate of narcotics activity in 2011 is summarized in Figure 39. The UNODC survey reveals a projected increase in narcotics production in 2011, and the 2012 estimate indicated that this level was likely to be as high.

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Rising Area under Cultivation Even in Helmand and Other Areas in the South and Rebirth of Taliban Influence

The text in the final UNODC report for 2011 noted that,\textsuperscript{177}

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.

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,

\textsuperscript{177} Afghanistan Opium Survey 2011, UN Office on Drugs and Crime, p. 5-6 (© 2011 United Nations; reprinted with permission).
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.

The updated April 2012 UNODC report largely confirms the findings of the 2011 report, that opium production had either held steady or increased in most provinces:178

The result of this assessment in the Phase-1 regions indicates that the largest opium cultivating provinces, Hilmand and Kandahar, are not likely to see an increase in cultivation despite the current high price of opium. In Hilmand, no major changes in the level of opium cultivation are expected and in Kandahar, opium cultivation is expected to decrease in 2012. The reasons for this development were multiple and differed from area to area. In parts of Hilmand and Kandahar the main dominant reason for declining in poppy cultivation is due to improvement in the security situation, campaign by the government, fear of eradication and agriculture assistance particularly within the Hilmand food zone.

In the western provinces namely Farah, Hirat Ghor and Nimroz, poppy cultivation is expected to increase. Similar increasing trends were reported in eastern region namely Nangarhar, Kunar and Kapisa. However, these provinces would still remain at much lower level of cultivation as compared to Hilmand and Kandahar. The increase in poppy cultivation in Ghor province may lead to the loss of its poppy-free status if poppy eradication is not implemented in time. The remaining provinces in the central and eastern regions, which were poppy-free in 2011, are expected to remain so in 2012.

The result in the Phase-2 Regions indicates that the largest cultivating province in the north-east, Badakhshan is likely to see an increase in opium cultivation this year. The status of opium

cultivation in Takhar remains unpredictable due to large part of the province covered with snow during the survey. There would be no major changes expected in opium cultivation in Faryab and Baghlan provinces in the Northern region. These two provinces lost their poppy-free status last year after two years. The remaining provinces in the northern region would remain poppy-free this year as well.

Confirming the findings of the 2011 Afghanistan Opium Survey, the Risk Assessment of this year indicated the strong association between insecurity, lack of agricultural assistance and opium cultivation. Villages with a low level of security and which had not received agricultural assistance in the previous year were significantly more likely to grow poppy in 2012 than villages with good security and those, which had received assistance. Similarly, villages which had been targeted by an anti-poppy awareness campaign were significantly less likely to grow poppy in 2012.

The findings of the Risk Assessment in the Southern region are encouraging. A combination of events seemed to have contributed to this development. Efforts directed against poppy cultivation, increasing government control as well as licit alternatives to poppy may have played a role in preventing farmers from resuming poppy cultivation in the two major poppy growing provinces Hilmand and Kandahar despite the fact that high opium prices provide a strong incentive. However, due attention is required for a province like Ghor, which could lose its poppy-free status. Faryab and Baghlan can be poppy free if effective eradication is implemented. The increasing cultivation trends in the Western Eastern and North-eastern regions would also need attention, especially in Nangarhar and Badakhshan provinces, which, in the past, has shown its potential to be major poppy cultivating provinces.

The results of the qualitative assessment by province are the following:

- A decrease in opium cultivation is expected in Kandahar province.
- No major changes in opium cultivation are expected in Hilmand province.
- No major changes in opium cultivation are expected in Faryab, Baghlan Kabul, Laghman Nimroz, Day Kundi and Zabul provinces. Faryab and Baghlan provinces lost their poppy-free status last year after two years and are likely to remain same in 2012 unless eradication is implemented on time.
- Six provinces, Badghis, Farah, Kunar, Nangarhar, Uruzgan and Badakhshan are likely to show an increase in opium cultivation.
- Increases in opium cultivation are also expected in Ghor, Hirat and Kapisa provinces. Ghor which was poppy-free in 2011 may not remain so in 2012 unless timely eradication is implemented.
- The opium cultivation status remains unpredictable in Takhar province due to large part of the province covered with snow at the time of survey
- Fifteen provinces, Ghazni, Khost, Logar, Paktika, Party, Punisher, Parwan, Wardak, Nuristan, Balkh, Bayan, Jawzjan, Namangan, Sari Pul and Kunduz that were poppy-free in 2011, are likely to remain so in 2012.

The provinces which are likely to see an increase would still remain considerably below the cultivation levels of Hilmand and Kandahar. Timely eradication measures in provinces with very low levels of opium cultivation such as Kabul, Hirat, Kapisa, Faryab and Baghlan could lead to achieving poppy-free status.

This UNODC data is a warning that reveals a major ongoing problem that the 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 have accounted for some 15-16% of the GDP in 2011.

**Reality vs. Anti-Narcotics Claims of Progress**

This estimate of export value is far more important in understanding the impact of Transition on Afghan elites, criminal networks, and insurgents that profit from narcotics than estimates of the value of farm gate prices – particularly since the percentage of total GDP is likely to rise sharply as the direct and indirect impacts of military and aid spending decline.

Farm gate prices are useful in estimating the value of narcotics versus other crops, particularly given that Afghan farmers consistently give the high price of opium as the primary reason for growing the crop. Other factors include the availability of existing trafficking networks from which seed and loans can often be obtained, opium’s lower water demand, ease of storage as compared to other crops, and the risk of losing one’s harvest to government eradication efforts. Most strikingly, opium growing appears to concentrate in a few areas, suggesting that farmers and traffickers correctly assess a lower individual risk of eradication, interdiction, and prosecution in areas with an already high degree of participation in the opium economy.

At this point, the government has managed to keep almost half of Afghan provinces ‘poppy-free’ in 2011, but appears to have effectively given up on large parts of provinces such as Farah, Kandahar, and Helmand. Despite the massive commitment of US Marines and ANSF to Helmand province since 2009, the province accounted for 33% of global illicit poppy cultivation in 2011 and remained at similar levels in 2012.

Though they have succeeded in improving security and government control in Helmand, ANSF and ISAF forces appear to have refrained from pressing the issue of poppy eradication efforts beyond a specially designated Helmand Food Zone in the irrigated river valley, likely due to concerns about stretching security forces thin and antagonizing farmers whose livelihoods depend on the crop.

According to the UNODC estimates shown in Figure 39, opium cultivation was worth $1.4 billion in 2011 at farm-gate prices, with an additional $1.0 billion in value added by transport and processing by the time it crossed the Afghan border for export. Opiate processing and trafficking is a relatively low-risk enterprise in Afghanistan – due to low

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rates of interdiction – leaving the majority of drug revenue in Afghanistan to be collected by those involved in poppy cultivation. Once opiates cross the border, trafficking becomes much riskier and prices skyrocket.

Work by Stephen A. Zyck in the report on Counternarcotics in Afghanistan for August 2012 illustrates just how important a force narcotics have been, are, and can be in the Afghan economy. He notes that:

Data from the United Nations Office on Drugs and Crime (UNODC) and the World Bank shows that the value of Afghan opium equaled nearly half of the country’s gross domestic product (GDP) in 2004. Subsequent economic growth diluted the significance of poppies, with opium comprising 15% of Afghanistan’s GDP in 2011...poppies become proportionally less important to the Afghan economy in recent years. However, this trend primarily reflects fluctuations in the value of poppies and, more significantly, the increase in Afghanistan’s licit GDP, which grew from a modest USD 2.46 billion in 2001 to USD 5.7 billion in 2004 and USD 17.90 billion in 2011. Despite the fact that 38% more opium was produced in Afghanistan in 2011 than in 2004...the proportional economic significance of the poppy crop was far smaller.

**Narcotics, Criminal Networks, Leadership Flight, and the ANSF**

The problems in dealing with the Afghan Uniformed Police (AUP) and Afghan Border Police (ABP) are likely to be particularly serious if the Afghan government and outside aid do not deal effectively with the economic impact of cuts in outside military spending and aid. The failure to assess the impact of corruption on progress in the ANP – and to a lesser degree the ANA – is only part of the problem. Some studies of Afghanistan indicate that as much as 40% of the GNP was dependent on opium at the time of the Taliban. Current studies put the percentage at anywhere from 3% to 10% of the GDP, but do not explain any aspect of the calculation. Moreover, opium is only one of Afghanistan’s drug crops, and drugs are only a part of the activity of its criminal networks.

It makes no sense to analyze the role of the ANSF in transition – or any other aspect of Transition – by acting as if Afghanistan’s main domestic source of income was not dependent on a narco-economy, that criminal networks were not as serious a problem as corruption, that Transition would not lead to capital and personal flight out of the country, and that the ANP or any other element of the ANSF could be treated on a business-as-usual basis.

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UNODC reports that the total export value of opium in Afghanistan in 2011 was $2.6 billion or 15% of the total GDP, though this does not account for indirect economic activity spurred by opium profits in both the formal and informal markets. The updated April 2012 opium survey does not estimate the market value, export value, or any type of value for Afghan opium.

A range of sources note that even with the current flow of aid and military spending, narcotics offer strong incentives to both Afghan farmers and those who traffic in drugs. One of the best summaries of the forces at work is provided by Christopher Ward, David Mansfield, Peter Oldham, and William Byrd in work that predates any effort to estimate just how much stronger the incentives for drug production will be in 2014 and beyond. Their work summarizes these incentives as follows, and it should be clear that growing a

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small compact crop that does not require capital or large amounts of water, is easy to store and move, and with traffickers who can create their own security will be far more attractive from 2014 onwards.\textsuperscript{185}

\textit{Opium is a high-value crop well adapted to Afghan conditions, with a strong impact on rural incomes and employment.} In Afghanistan’s current economic and political climate there are distinct advantages to cultivating opium poppy. Opium is a high-value, low-weight commodity for which there is steady demand. Opium poppy is so well suited to Afghanistan’s climatic conditions that it produces yields of opium and morphine that are higher than the global average. As a crop, opium maximizes returns on scarce irrigation water. Opium has brought very substantial economic opportunities to both farmers and laborers, and has increased the overall level of activity in the rural economy through the multiplier effect the opium trade has on the wider economy…There are sufficient returns at each stage of the supply chain and, despite Afghanistan’s fractured infrastructure, there are well-linked markets in terms of credit, purchase, transport and processing. Some estimates suggest that as many as 5.6 jobs are created in the rural non-farm economy for every hectare of opium poppy cultivated.

\textit{The benefits of opium are very different between large landowners and the poor.} It is critical to recognize, however, that the economic advantages associated with cultivating opium poppy differ according to the assets that farmers have at their disposal. There is a considerable difference between the factors that drive a large landowner with 20 hectares of land, 24 family members, some of whom are sending remittances from Pakistan, two tractors, and a general store in the local bazaar, to cultivate four hectares of opium poppy, and the factors impelling a sharecropper, with 12 family members, solely dependent on the income derived from agriculture, to cultivate only a half of a hectare of opium poppy on the landlord’s land (giving the bulk of the final crop to the landowner as a payment for working on his land and for the credit advanced early in the year). For the relatively few large landowners, opium poppy represents a high-value crop that can accrue even greater value if it is sold after the harvest season when prices rise. Landowners who contract out land to sharecroppers can earn as much as two thirds of the final opium yield (despite contributing only 20 percent of the total costs of production). They may also have the financial resources to purchase opium in advance at rates considerably below the harvest price (Mellor 2005). Returns to a landlord can be as much as 1,400% higher than those of a sharecropper (Mansfield 2002; Mansfield 2004b; Mansfield 2007c).

\textit{Nonetheless, opium is often poor people’s only means of access to credit and land.} The traditional credit system, known as salaam, which provides an advance payment on a future crop, has increasingly favored opium poppy cultivation over other crops. In areas where opium poppy cultivation has become entrenched, access to credit is dependent on a farmer’s willingness to cultivate opium poppy. The willingness to cultivate opium poppy and possession of the requisite skills have increasingly determined sharecroppers’ access to land, and the rental value of land is determined by potential opium yield rather than wheat productivity. Under such conditions there is no other crop or activity that can provide the same range of benefits, and when cultivation declines or is suppressed, the opportunities for income from farming plummet, driving people off the land, or forcing them further into poverty (Mansfield 2006c).

\textit{Opium is also an invaluable source of employment for the rural poor.} Opium poppy cultivation creates a large demand for itinerant labor to weed and harvest the crop. Based on UNODC’s estimate that 193,000 hectares of opium poppy were cultivated in the 2006/07 growing season, the crop would have generated approximately 70 million labor days, of which potentially one-third would have been for hired labor (Mansfield 2004a). Where a household has more than one male able to follow the staggered weeding and harvesting seasons, the off-farm income generated from opium poppy can last up to five months, and it is usually higher than the on-farm income such a household might earn through sharecropping.

\textsuperscript{185} Excerpted from Christopher Ward, David Mansfield, Peter Oldham and William Byrd, Economic Incentives and Development Initiatives to Reduce Opium Production, The World Bank, Department for International Development, February 2008, p. 4-6.
Thus rural people have varying degrees of dependence on opium, and responses need to recognize degrees of dependence and of poverty. Rural people’s dependence on the opium economy is largely a function of their factor endowment and access to markets. A broad distinction can be made (Mansfield and Ward 2006: 3) between: (i) better off and not dependent farmers; (ii) more marginal dependent farmers; (iii) poor, highly dependent farmers; and (iv) the landless.

As a general rule, better off farmers (Type 1) have more diversified livelihood strategies. They reside in areas in close proximity to provincial or district centers, they cultivate a variety of crops including high-value horticulture, and they have better access to land and irrigation, and to the commodity and labor markets. They are not dependent on opium for a decent living and could be considered to be “opportunist producers”, for whom application of the law is the primary instrument of drug control.

More marginal farmers (Type 2) have less access to markets and lower land and water endowments. They have fewer or no alternative sources of income to opium. Poor, highly dependent farmers (Type 3) may live in low potential areas, often remote and mountainous, and with very limited market access or alternative income earning potential. In addition, there are the landless (Type 4), typically laborers with very few farming assets such as a few head of small livestock, who can be very dependent on opium. When the opium economy shrank in Nangarhar in 2005, laborers lost $1,000 in wages, and turnover of businesses and shops halved. More marginal farmers and laborers can be considered to a greater or lesser extent dependent on opium for their livelihoods. Although this rough typology needs to be treated with great care as poppy cultivation is very dependent on local factors, it does serve to identify the target population for development responses to the opium economy: the more marginal, poor farmers and laborers either engaged in the opium economy or vulnerable to the incentives it presents...

Narco-Corruption as a Critical Part of Afghan Economic and Transition

Poppy farming is also only part of the problem. As military spending and aid decline, there will less money for the government, police, power brokers, and warlords. Drug-related income or “corruption” is a key part of the cash flow of today’s government officials and members of the ANSF and will be a far more attractive source of money as military spending and aid phase down. Once again, both UNODC and outside reporting flag just how important this is, even in a pre-Transition economy: 186

A UNODC report on illicit financial flows notes that trafficking and corruption are seen to be mutually reinforcing. Traffickers can induce state officials to abandon their commitment to uphold the rule of law, according to GFI. Indeed, according to Mark Shaw’s “Drug Trafficking and the Development of Organized Crime in Post-Taliban Afghanistan” Afghanistan’s drug industry appears to have secured influence in some government and political circles through its financial resources, leading to widespread perceptions that government officials are involved in the trade. Traffickers can also use profits to influence electoral campaigns. The Brookings Institution details several examples where Afghan political entrepreneurs who sponsor the drug trade have used their illicit funds to buy votes. With regard to Afghanistan, William Byrd and David Mansfield point out that “[c]areful management will be required to mitigate [the] use of drug money in election campaigns and involvement of local and regional power holders as well as some at the central government level in the drug industry”.

The drug trade “generates a large income for numerous ex-warlords (many of whom are now officials at various levels of government)” says that Brookings Institution. Corrupt officials within the Afghan government, the Afghan National Police (ANP), and various provincial administrations receive funds from opium traffickers, and recent media reports have suggested that

some senior officials themselves engage in drug trafficking, according to USIP. The International Crisis Group (ICG) also points out that there is “pervasive political interference in major drug cases”. According to UNODC, 395 drug cases were recorded in Afghanistan, and 499 people were arrested in 2009; of those, 23 were Afghan public servants.

It is fundamentally dishonest and misleading for any effort that will analyze the economics of Transition to ignore the economic, governmental, and civilian impact of narcotics on the broader pattern of corruption in the Afghan police, officials, and justice system. Such studies must also take into account 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 not taking into account these variables is just as dishonest as writing about shifting funds from direct aid under the control of NGOs to control by the Afghan central government without talking about the scale of waste, corruption, and low ability of the Afghan government to absorb and use the money. It represents a fundamental lack of professional integrity on the part of any organization that does so.

At the same time, the UNODC blames “Afghan and foreign intelligence services” rather than itself or the World Bank for withholding information on “drug barons” in Afghanistan. The World Bank, IMF, and UNODC have in fact described pervasive high-level government involvement in the drug trade in multiple reports, though they have thus far limited themselves to general, rather than individual, accusations. Accused ‘drug barons’ include not only individuals associated with the insurgency, but also high-level figures in the Afghan government who are counted as strong US allies, such as the late Ahmed Wali Karzai, brother to the Afghan President, and the police chiefs of both Kandahar and Uruzgan provinces.

It is also important to understand that it is difficult to collect and report accurate information on the black market economy anywhere in the world. Reporting on the government-narcotics nexus in Afghanistan is especially difficult, not to mention dangerous, due to problems of credibility, access, and unwillingness to offend in-country allies allegedly involved with the drug trade.

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Counter-narcotics efforts in Afghanistan have failed to stem high levels of opium production. The experience of the past ten years suggests that opium production will continue at a high rate throughout Transition and beyond but is unlikely to significantly expand, if only due to the fact that current levels of production have already exceeded global demand. Total opium cultivation year to year will depend more on market swings, rainfall, and crop disease rather than eradication efforts.

A poor harvest in the spring of 2012 due to crop disease boosted once-falling prices, indicating that prices and thus production through 2013 will continue to be high.\textsuperscript{190} At some point, however, traffickers will likely stop accruing unsold opium as their stockpiles grow ever larger and as the US surge-driven uncertainty recedes, which would at least temporarily put downward pressure on prices and cultivation.

Eradication threats and efforts will succeed in making many provinces and districts poppy free; however, they will fall short of making any dent in national production totals. Opium cultivation is extremely productive per hectare; a small share of Afghanistan’s arable land and labor force is sufficient to meet the entirety of global demand.\textsuperscript{191} Cultivation can thus shift easily enough from one area to another in response to government pressures, without affecting overall production.

Given these challenges, eradication will likely be deprioritized even further by both international donors and the Afghan government in the coming years. Interdiction efforts have been hindered by the absence of functioning governance, police, and legal systems in many provinces, resulting in a seizure rate of 4% in 2011 – improved since 2008, but still quite low.\textsuperscript{192} Various schemes to redirect Afghanistan’s poppy crop towards pharmaceuticals, biofuels, other crops, or other licit purposes have proved infeasible.

Opium production will continue to have pervasive negative effects for governance in the country, particularly in southern Afghanistan, and will continue to provide illicit financing to government officials, informal powerbrokers, and the insurgency. As can be seen in Figure 40 to Figure 43, while Afghanistan leads the way in the production of opium, it does not lead the world in seizures; the Islamic Republic of Iran has seized the most trafficked opium from Afghanistan.

Figure 41 is particularly important because it shows that narcotics production increased in the south, reflecting the fact that the Taliban-controlled sharecroppers moved to the area of Taliban control in the upper parts of the Helmand River valley as well as the significant corruption in Afghan government-controlled areas.

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 will rely on ethnic and regional ties in their attempts to profit from aid-related corruption, narcotics, and the black market economy, deepening already-existing divisions. It is also all too likely that many Afghans will not stay and invest – they will instead take their wealth and leave the country.
### Figure 40: The Continuing Importance of a Domestic Narco-Economy

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>Change on 2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net opium poppy cultivation (after eradication) in % of global cultivation*</td>
<td>123,000 ha (104,000-145,000)</td>
<td>+7%</td>
<td>131,000 ha (109,000-155,000)</td>
</tr>
<tr>
<td>Number of poppy-free provinces²</td>
<td>20</td>
<td>-3</td>
<td>17</td>
</tr>
<tr>
<td>Number of provinces affected by poppy cultivation</td>
<td>14</td>
<td>+3</td>
<td>17</td>
</tr>
<tr>
<td>Eradication</td>
<td>2,316 ha</td>
<td>+65%</td>
<td>3,810 ha</td>
</tr>
<tr>
<td>Weighted average opium yield **</td>
<td>29.2 kg/ha</td>
<td>+52%</td>
<td>44.5 kg/ha</td>
</tr>
<tr>
<td>Potential production of opium³ ** in % of global production*</td>
<td>3,600 mt (3,000-4,200)</td>
<td>+61%</td>
<td>5,800 mt (4,800-6,800)</td>
</tr>
<tr>
<td>Average farm-gate price (weighted by production) of fresh opium at harvest time</td>
<td>US$ 128/kg</td>
<td>+41%</td>
<td>US$ 180/kg</td>
</tr>
<tr>
<td>Average farm-gate price (weighted by production) of dry opium at harvest time</td>
<td>US$ 169/kg</td>
<td>+43%</td>
<td>US$ 241/kg</td>
</tr>
<tr>
<td>Current GDP⁴</td>
<td>US$ 12.7 billion</td>
<td></td>
<td>US$ 16.3 billion</td>
</tr>
<tr>
<td>Total farm-gate value of opium production in % of GDP</td>
<td>US$ 0.6 billion</td>
<td>+133%</td>
<td>US$ 1.4 billion</td>
</tr>
<tr>
<td>Potential gross export value of opiates in % of GDP</td>
<td>US$ 1.4 billion (0.9-2.1 billion)</td>
<td>+79%</td>
<td>US$ 2.6 billion (2.1-3.4 billion)</td>
</tr>
<tr>
<td>Potential net export value of opiates in % of GDP</td>
<td>US$ 1.2 billion (0.6-2.0 billion)</td>
<td>9%</td>
<td>US$ 2.4 billion (2.1-2.9 billion)</td>
</tr>
<tr>
<td>Farmers’ gross income from opium per ha⁵</td>
<td>US$ 4,900</td>
<td>+118%</td>
<td>US$ 10,700</td>
</tr>
<tr>
<td>Farmers’ et income from opium per ha</td>
<td>US$ 2,900</td>
<td>+121%</td>
<td>US$ 6,400</td>
</tr>
<tr>
<td>Ratio of farmers’ gross (net) income from wheat to opium</td>
<td>1:6 (1:4)</td>
<td></td>
<td>1:11 (1:8)</td>
</tr>
</tbody>
</table>

* Based on provisional estimates for some countries and regions.
** Refers to oven-dry opium.

1. Numbers in brackets indicate the upper and lower bounds of the estimation range.
2. Poppy-free provinces are those that are estimated to have less than 100 ha of opium cultivation.
3. 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.
5. Income figures are indicative only as they do not include all expenditure and income components associated with opium cultivation.

Figure 41: No Reduction in Opium Growing in the South, West, and East and Probable Levels of Taliban Influence and Control After the Surge

Opium cultivation in Afghanistan, 2010-2012

Figure 42: Afghan Opium Production and Cultivation in Relation to the Rest of the World: 1997-2011


Figure 43: Heroin and Opium Seizures 2000-2010

Estimating the Real-World Economic Challenges of Transition

These complex economic and aid dependency issues create risks just as serious as the political and security risks Afghanistan now faces. Afghanistan is not Iraq. It cannot fund Transition or sustain its present economy with its own resources. 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 hundreds of thousands of armed Afghans who are now dependent on outside funding, and the Afghan government must fund a Presidential election in 2014 – the same year US and ISAF troops are to withdraw.

_Dodging the Worst Case, But the Bad Case Is Bad Enough_

The World Bank did not explicitly examine a worst-case scenario in which the US and other outside powers did not provide significant aid, but Figure 44 does show several scenarios that warn how much aid Transition will need to be successful. Similarly, Figure 45 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 in which 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 into account 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:

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 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 [National Solidarity Program], 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.

All of these studies recognize that a major Afghan effort will be needed to deal with the economics of Transition even if adequate aid is provided. Various sources have made the following suggestions to mitigate the impact of cuts in outside spending, but it is clear that both the Afghan government and donors may have to reallocate development aid to paying for jobs and stability, accept at least very limited growth or a recession, and/or provide emergency increases in aid to deal with any crisis:

• 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 Afghan or collective effort has yet been made, however, to determine a complete list of such measures or quantify their potential impact, and it is far from clear that the actions the Afghan government will take will be adequate. Much will depend on whether Afghanistan can maintain and grow its service and financial sectors as well as achieve enough stability, security, rule of law, and governance to increase agriculture, power output, and water supply. Various studies indicate that all three areas have potential, particularly urban services and agriculture.
Figure 44: 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.


Figure 45: 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.

The World Bank estimated in the spring of 2013 that aid dependence would be far more serious if security worsens, if there is a political crisis in 2014 or beyond, if rains hurt the agricultural sector, if capital and capacity flight become critical, if corruption worsens, and if outside and Afghan investors do not see reform and more stability during the period after 2014. The World Bank explained the basic forces shaping the dependency estimates shown in Figure 45 as follows:

Given that domestic revenue will be insufficient to cover spending and aid will likely decline, how can Afghanistan close this financing gap? The total core balance is projected to reach an enormous financing gap of 33 percent of GDP by 2014/15, easing to 25 percent of GDP by 2021/22 (after the bulk of the mining revenue materializes)

If the security sector (Afghan National Army and Police) remains at currently agreed levels, Afghanistan will have to rely on continued international funding to pay most salary and nonsalary security spending. The share of aid channeled through the government budget will need to rise sharply. Indeed, virtually all aid projected in 2021/22 (equivalent to 25 percent of GDP, or US$7.2 billion, and averaging US$7.8 billion for the intervening years in 2011/12 prices) would need to be on budget (figure 3.12). Thus, strict priorities will be required to contain nonsecurity budget expenditure within a fiscally manageable resource envelope: civilian aid, for example, will need to be spent much more selectively for development and O&M. Even so, Afghanistan’s fiscal situation will remain fragile and vulnerable to external shocks.

One can envisage various combinations of aid and domestic resources to cover the spending gap. A reasonable approach could be for domestic revenue to cover the full civilian operating budget wages and O&M—and part of the security costs (at the 2010/11 level of 3 percent of GDP). Donors would finance the remaining security costs plus a more highly prioritized core development budget.

Other low-income countries receive, on average, about 9 percent of gross national income in nonsecurity development assistance. Afghanistan would require close to three times that in total aid to plug its projected financing gap.

If achieved, the country could have a balanced budget by 2021. But if just 16 percent of GDP in aid materialized, this amount would finance only the operating budget... Lower, more rapidly declining aid would force the government to make even more difficult trade-offs between security and civilian spending.

If aid is 10 percent of GDP lower and the security sector is protected at the currently targeted size and cost, development spending would have no room at all, and civilian O&M would most likely be squeezed as well. But if the civilian budget is protected, security could be funded only at less than half of currently targeted levels.

If cuts in aid are even deeper, particularly if they are in line with the rapid decline in aid scenario with aid projected at 14 percent of GDP from 2018,...the trade-offs would become all the more stark and damaging. So it will be very important for the government, working closely with donors, to ensure that the core civilian budget does not become a casualty of high security costs and inadequate aid.

Increasing on-budget aid and managing O&M through government systems would greatly improve aid effectiveness. But in addition to further improving public financial management and governance to provide donors greater confidence to shift more aid on budget, the government will need to overcome serious absorptive capacity constraints if it is to be in a position to receive

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additional donor money on budget. After core development spending more than doubled in absolute terms between 2005/06 and 2007/08, disbursement has stalled at just under US$1 billion annually over the past four years... In contrast, operating budget execution has been high but was almost all wage spending. Thus, low execution rates are a combination of structural and capacity issues: weak budget formulation by line ministries and implementing agencies that led to unrealistic budgets and work plans; varying capacity for implementing projects and keeping to procurement procedures; poor predictability and late disbursement of donor funds; and security concerns that make project implementation difficult.

In the future, managing O&M—expected to increase from US$335 million now to US$4.8 billion by 2015/16 (including US$1.3 billion for civilian O&M)—will be a major challenge.

The greatest adverse impact of transition will be fiscal—Afghanistan faces a projected financing gap of 25 percent of GDP by 2021/22, even higher in some of the intervening years. The fiscal gap will be enormous despite hoped-for robust growth in domestic revenue (projected to rise from 10 percent of GDP to more than 17 percent a decade from now). This gap arises primarily because of high wage and nonwage security costs (projected at around 17.5 percent of GDP in 2021/22), along with funding the government and sustaining service delivery on the civilian side. The civilian wage bill is projected to increase to 9.0 percent of GDP, the nonsecurity O&M expenditure to 4.0 percent, other operating spending to 2.5 percent, and the core development budget to 10.0 percent.

To close this financing gap, Afghanistan must rely on continuing international funding to pay for most security costs. Even setting the size of the ANSF on a somewhat lower trajectory than previously targeted (352,000 personnel with an estimated sustaining cost of US$5 billion a year) will not substantially change the requirement for continuing large-scale external funding of the security sector and the need for government to make tough choices on how it spends its limited budget.

Making choices in a highly constrained resource environment is not easy for any government, but these choices are especially difficult in the current political and security situation in Afghanistan. Even so, working closely with donors, the government must ensure that the core civilian budget does not become a casualty of high security expenditure and falling aid. A reasonable approach could be for domestic revenues to cover the civilian operating budget and part of the security costs (at the current level of 3 percent of GDP). Donors would finance the remaining bulk of security costs plus a more highly prioritized core development budget.

Without continued and substantial international funding for security—even if security costs decline—the government will not be able to pay for its security forces and equipment, nor have any money for its development budget. In such a scenario, past development gains would not be maintained, potentially risking instability if people’s expectations went unmet. The total future package of core basic services to be maintained will depend on government and donor choices about what they can afford and their priorities going forward. Moreover, with civilian aid likely to drop well below the current US$6 billion annual figure,

Afghanistan will be hard pressed to continue funding all its civilian programs at current levels. Yet the room for government to maneuver will likely be constrained by political, social, and economic considerations. So any chance for fiscal viability will require continued international funding for most wage and nonwage security costs over the medium term. Facing large demands for security spending, the government will also need support in protecting a more prioritized civilian budget, including public investment, basic social services, and O&M.

At the same time, donors will need to channel a much larger proportion of aid flows through the government budget. This will help mitigate some of the adverse economic impacts of declining aid because the local economic impact of on-budget aid is much higher than aid channeled through the external budget.

But government’s absorptive capacity is limited. Budget execution has been stuck at around US$1 billion annually since 2007/08. Without improvements in budget execution, the government’s ability to absorb additional money on budget will be severely constrained. Over the next few years
a concerted push by donors and government alike is needed to improve government capacity to spend its development budget.

The World Bank provided the following explanation of the scenarios and assumptions in the various parts of Figure 45.\(^{197}\)

For this report, we analyzed six different scenarios, summarized as follows:

- **Gradual decline in aid** (BASE). This scenario represents a reasonable development outcome for Afghanistan and is the benchmark for the other scenarios. Its basic assumption is that the main variables of the economy develop in a manner that is similar to recent trends with little structural change, except for the development of mining. It assumes, in particular, a gradual decline of external aid (security and nonsecurity) and on-budget aid, resulting in total aid of about 23 percent of GDP in 2018 and 10 percent in 2025. Private and public demand (consumption and investment) shares are about 49 percent and 51 percent; this scenario assumes that they gradually improve to 75 percent and 25 percent, respectively. Other government revenue effects include an assumed increase in the tax take. Mining development reflects expected developments for Aynak and Hajigak only. Opium production, as part of the agriculture sector, is assumed to stay constant in the model.

- **Limited agricultural growth** (AGR–). This scenario illustrates the sensitivity of the BASE scenario. Unlike BASE, which assumes average agricultural growth of 6.3 percent annually, this scenario assumes agricultural growth closer to the historical average of 3.9 percent.

- **Improved security situation** (MIN+). Departing from the BASE case, this scenario assumes exploitation of 11 other mines (in addition to Aynak and Hajigak), resulting from higher private investment encouraged by improved security.

- **Deteriorating security situation** (GOV–). This scenario represents the consequences of a worsening security and governance situation with substantially lower levels of aid, lower investment, faster depreciation of capital investment, and nearly no growth in productivity.

- **Rapid decline in aid** (AID–). Under this scenario, donor-managed (off-budget) grant aid starts to decline faster from 2012, reaching 14 percent of GDP by 2018 and then gradually decreasing to 10 percent of GDP in 2025. Government on-budget aid is unchanged from the BASE scenario.

- **Shifting more aid on budget** (AIDALLOC). This scenario makes the same assumptions as BASE except that 50 percent of all aid is channeled through the budget starting in 2014/15.

It is important to note that the scale of the problems in each of the scenarios other than the base case is not defined, and they are assumed not to occur at the same time. This precludes the World Bank estimates from showing worst cases, and the problems are compounded by the fact that major post-election/non-election instability; increases in corruption, capital flight and capacity flight; serious problems in the development of the ANSF; problems with Pakistan; and the impact of a successful or failed peace settlement are not examined. In reality, Afghanistan seems to present a far more significant set of bad or worst-case risks than the World Bank examined in focusing on economic development.

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Moreover, for all the reasons explained earlier, there has been a tendency to assume that the remaining growth in the base-case estimate is adequate to bring stability, although the World Bank explicitly warns that it is too low to ensure adequate employment and stability and clearly ties it to donor aid spending that fully meets Afghan needs. The World Bank does not dwell on negative cases, but it does explain its model in some detail: 198

The model indicates that in a scenario with a gradual decline in aid (BASE), GDP growth (at factor cost) may drop from 9.1 percent a year in 2003–10 (8.4 percent in 2010/11 itself) to 5.9 percent in 2018/19...Donor consumption and investment decrease, and government expenditure stays more or less the same with a slight shift from investment to consumption. Imports decline as expected while aid is phased out; exports increase, not least because of the start of mining output but also due to the depreciated value of the Afghani. After 2018 until 2025, GDP growth may drop further to around 3.5–4 percent.

Mining is expected to contribute significantly to growth, accounting for 2.8 percentage points of the 5.9 percent total average growth in the BASE scenario...Assuming additional investment in mining (MIN+), for example, because of an improved security situation, mining could contribute even more (4.8 percentage points if a further 11 mines are opened) and increase medium-term growth to 7 percent, on average.

Agriculture remains an important source of growth, not least because of its high share of GDP. Depending on weather and investment, average GDP growth could produce volatility of 5–6 percent annually, on average. But the contribution of services, which accounted for 9.2 percentage points of growth in 2010/11, is set to fall heavily and account for an average of only 0.3 percent of growth under the BASE scenario, mainly reflecting weaker demand for transport and retail services.

Shifting more aid on budget (AIDALLOC) could increase average annual growth from 5.9 percent (in BASE) to 6.1 percent. The difference is explained by a higher contribution from services. Shifting aid on budget, therefore, has a slight mitigating effect on growth because the local impact content is larger for on-budget than off-budget spending. Although the difference appears marginal, other economy-wide effects—for example, more local employment—could be important.

A more rapid decline in aid (AID−) than in the base scenario could lead to a decline of GDP growth of nearly 1 percentage point to an average of 5.2 percent (and to 4.7 percent by 2018/19). Transmission would mainly be through a larger negative effect on growth of services. All these results need to be handled with considerable care. An economic model is only as good as its underlying data, which in Afghanistan are still very weak....

... Compared with many other post conflict countries, Afghanistan has kept its macroeconomic environment relatively stable. In 2001 it faced weak or nonexistent institutions, low domestic revenue, volatile aid flows, and high import needs (caused by lack of domestic output). In this light, Afghanistan has shown a remarkably solid macroeconomic performance over the last decade. Avoiding very high inflation is a prerequisite for a sound economy that offers good growth and employment prospects, and inflation, though volatile, has been relatively moderate. Soon after 2001 Afghanistan ended the hyperinflation of the 1990s, pushing through a highly successful currency reform, and then made good progress in taking inflation lower despite global food and energy price shocks and supply blockages in neighboring countries, which inevitably exacerbated its own price volatility.

Still, macroeconomic stability relied heavily on abundant aid flows. And commonly for a country undergoing reconstruction and recovery, Afghanistan’s large material needs skewed the trade balance heavily toward imports. After an initial sharp increase in imports, the trade gap has stayed more or less constant with imports about four times exports, giving a huge trade deficit of 64

percent of GDP in 2005/06–2010/11. In 2010/11 the current account deficit (excluding grants) was estimated at 40 percent of GDP and was financed—as in previous years—by grants... confirming Afghanistan’s aid dependency and raising concerns about the impact of aid reductions on the current account balance.

The transition may therefore have a pronounced effect on the balance of payments. Projections of exchange rate behavior in the different scenarios indicate a substantial depreciation of the local currency. Although capital inflows linked to investments in mining are expected, the decline in aid outweighs those inflows, particularly in the first years after 2014 (mining activities are expected to start only in 2016/17).

...The model exploits all available macro and fiscal data, sector studies, enterprise surveys, and household survey sources from the government, as well as International Monetary Fund and World Bank publications. Whenever necessary, data for comparable countries were used to fill in for missing information. Because of the simplifications that are inherent in any model, combined with the particularly weak data sets for Afghanistan, readers should view the results as approximate indicators of the effects of alternative policy options, to be considered with other inputs to economic policy making in Afghanistan.

Readers should also remember that the model has been developed to assess the integrated effects on an economy of certain policy or external variables. It is a model intended to help the policy discussion in considering the overall general equilibrium effects, not just the direct partial equilibrium effects. Thus, the quantitative results and the analysis of changes in parameters, size, and direction should be taken only as an indication of trends. For sector-specific, year-to-year developments, more detailed sector studies and fiscal sustainability analyses are required.

Finally, the model hinges on a set of underlying assumptions about developments in growth in Afghanistan that depend on a stable security environment—or at least on a general improvement in the investment climate (because of a stable security environment, institutional reforms, and infrastructure improvements)—that leads to higher levels of private investment. The results are therefore particularly sensitive to changes in the security environment and exogenous shocks, such as higher fuel prices.”
Figure 46: A World Bank Guesstimate of the Economic Scenarios and Impact of Given Risks and Financing Gaps during 2013/2014 to 2021/22 – Part One

Financing Gap with and without Security (% of GDP, excluding grants)

Note: Projections assume that domestic revenue equivalent to 3% of GDP is devoted to security costs, and the rest to civilian expenditure;


Total Core Financing Gap

Figure 46: A World Bank Guesstimate of the Economic Scenarios and Impact of Given Risks and Financing Gaps During 2013/2014 to 2021/22 – Part Two

Decomposition of GDP at Factor Cost, by Activity and Simulation, 11/2010–19/2018

Estimated Real Macro Indicators by Simulation, 11/2010–19/2018

<table>
<thead>
<tr>
<th>Indicator</th>
<th>BASE</th>
<th>AGR−</th>
<th>AIDALLOC</th>
<th>AID−</th>
<th>GOV−</th>
<th>MIN+</th>
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<tr>
<td>GDP at factor cost</td>
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<td></td>
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<tr>
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<td>Government</td>
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<td>1.6</td>
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<td>9.6</td>
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<td>-4.3</td>
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<tr>
<td>Absorption</td>
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<td>0.3</td>
<td>-1.4</td>
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<td>0.7</td>
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<td>Real exchange rate (index)</td>
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<td>3.4</td>
<td>2.3</td>
<td>2.9</td>
<td>1.8</td>
<td>2.8</td>
</tr>
</tbody>
</table>

Meeting the Economic and Aid Challenges of Transition

Developing even minimal security and stability requires Afghan, US, and allied planners to approach economics and the full range of civil and military aid activities in ways that recognize the need for US and allied realism about the necessity of serious military and civil aid well beyond 2014 and a continuing commitment to working with the Afghan government.

The coming cuts in military and development spending, which have long driven the growth of Afghanistan’s fragile economy, pose a critical challenge for US, allied, and donor policy. An updated World Bank analysis of the economic situation in Afghanistan – and the impact of aid – raises the following issues:199

- Most GDP growth in recent years has come from agriculture and rainfall, not from aid or outside spending.
- But, aid and military spending have equaled some 90% of market GDP.
- Aid alone, less military spending, has equaled 40% of GDP.
- 75%-95% of aid that goes through the GIRoA budget stays in country, versus 10-25% for off-budget aid.
- But, only 12% of aid to date went through GIRoA versus a future goal of 50% of aid to be managed and spent by GIRoA in spite of critical budget execution, management and corruption problems.
- Moreover, aid and military spending in Afghanistan has been high enough to vastly exceed absorption capacity, produce immense waste, distort the economy, and do much to corrupt Afghan society and the government.
- While only 6-10% of the population has been significantly affected by aid and military spending, this percentage represents the leading civil and security elite. Cuts will affect the government, market business sector, political leaders and power brokers, and civil service. This is the elite that drives security and stability, and spending cuts are already hurting this elite.
- Serious security problems and spending cuts could drive Afghanistan into recession and produce a serious crisis in stability and security.
- Even the 4-6% growth case that would occur with sufficient aid, security, and good rainfall will fall below the level needed for development and stability, and politics could produce negative growth.
- Unemployment (8%) and underemployment (48%) total 56% of the labor force, and the economy is under constant pressure from additions to the work force coming from a very young and rapidly growing population.
- Spending cuts pose a critical problem for the budget. Government revenues may be able to rise from 11% of GDP to 27% in 2020-2021 with good governance and security, but Afghanistan will need outside financing equal to 43% of its GDP through 2020-2021.
- Afghanistan would have to spend 17.5% of GDP on security if the cost is limited to $4.1 billion a year.

• A financing gap of 40% of the GDP will exist in 2014-2015. The gaps will still be 25% in 2020-2021 even if mining and other capital investment is high; and security, economic reform, and LOCS come through.

• Key uncertainties exist about the economic status of internally displace persons, the impact of urban population pressures, and infrastructure issues like road repair.

• The agricultural sector faces major challenges from dependence on rainfall, the impact of the narco-economy, and a lack of cold storage, food processing, market access, and transportation. One Afghan official claimed that 60% of food rots or is lost on the way to market.

• Outside spending cuts will push the agricultural sector towards opium and cannabis, benefiting crime lords and creating problems for farmers in terms of load dependence at a time of acute population pressure on the land.

The Need to Focus on the Afghan War Fatigue

Afghanistan must convince donors that they can work through the central, provincial, and local governments in ways in which aid money is actually used to benefit the people and bring economic stability. It must have outside support to focus on reforming its own economy and reducing government barriers to development.

Regardless of official rhetoric, public opinion polls in the US and most ISAF countries show little support for the war or serious aid spending, and some countries are already cutting aid and reducing their troop levels earlier than planned. Much of the aid effort in the field will be cut from 2013 onwards as ISAF troops depart, and the lead time to implement new or more effective programs in Afghanistan often requires 11-18 months to put major changes into action.

There is little time left to set forth a clear program to deal with Transition. There is well under two years remaining before most US and ISAF forces are gone and their military spending in Afghanistan goes with them.

The Need for Credible Economic and Aid Plans, Credible Resources, and Transparency

All of these issues highlight the need for a new approach to the war, one that highlights the need for credible civil and military spending plans that have a far greater degree of honesty and transparency. So far, there are no credible public plans for either the economic or military aid aspects of Transition.

In spite of the claims of success and token aid pledges that came out of the largely symbolic conferences in Chicago and Tokyo, there is no open-source evidence that the US and ISAF have really reversed insurgent momentum in Afghanistan or created conditions where tactical victories will have lasting strategic meaning. Possibly more importantly than military victories, the civil effort lags far behind the military effort. While there have been some successes in some aspects of Afghan governance and development, they are so limited and fragile they may well not survive beyond 2015.

The political and bureaucratic barriers to dealing with these realities are all too clear, but the US, other ISAF countries, donor countries, and the Afghan government still need to do what they can to develop detailed plans for 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.

These efforts should:

- Create an honest baseline of reporting and trend analysis based on the political nature of the war and net assessment of each side, while explicitly addressing uncertainty and the need for parametric analysis.
- Create credible civil and military plans for affordable levels of aid, and make both publicly transparent in an effort to win US and international support on a credible and sustainable basis.
- Focus on stability during the key period of Transition from 2013 to 2016, not development. Look at worst-case risks. Address issues like security, corruption, narco-economics, and capital flight.
- Make aid “conditional” in ways that are tied to the actual level of progress in Afghan politics, force development, and use of economic aid.
- Work with the ANSF and GIRoA to focus military and aid resources on holding key populated areas while securing other areas where the Afghan central government and/or key Afghan leaders and factions are strong enough to hold and have sufficient popular support to sustain their position. This will sometimes mean devolving power back to regional and local leaders on their terms – and then using aid and security assistance to support them – when this offers a practical way of providing some form of effective governance and security. It means backing Afghan leaders who are actually effective even if this means “doing it their way,” rather than setting unrealistic standards or backing the central government where it cannot lead or be effective.
- Phase down aid and outside military support during 2015-2018 with careful attention to how Afghan forces actually perform in the field and real-world time schedules for effective action.
- Move towards self-funding in as carefully planned a manner as possible. Rapid cuts will kill the chances of successful ANSF development and create economic and political instability. Throwing money at the problem in ways that waste and corrupt, setting goals Afghans don’t want and can’t achieve, losing sight of priorities by focusing on projects rather than national needs, and ignoring both the inevitable cuts in outside funding and the need for self-sustainment have been immensely destructive aspects of the civil and military efforts throughout the war. Repeating them during the most critical phase of Transition is a recipe for failure.
- Finally, accept the fact that the Afghan insurgency may drag on indefinitely and that it is certain to have de facto control over some parts of the country after 2014; this is a fact the US, its allies, and aid donors must be prepared to live with.

**Time Is Another Key Threat**

There is little time 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.

There are less than two years left before Transition in 2014, and there are no magic bullets that offer rapid growth and prospects for stability before 2020. This means it is necessary to create 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 FY2014 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.
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.

**Planning on the Basis of Economic Realism**

A successful Transition will require both Afghans and donors to take a realistic look at the economic impact of cuts in military and aid spending, Afghanistan’s real-world level of per capita income, gross inequities in economic distribution, and the need for internal economic reform as a substitute for high levels of aid and outside investment.

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

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 the US, the largest aid donor, dropped from $3.5 billion in FY2010 to about $2.3 billion in FY2012. Aid to support democracy, governance, and civil society dropped by more than 50%, from $231 million to $93 million. Aid for "rule of law" dropped from $43 million to $16 million.200

Other countries are cutting their civil and military aid programs, and some NGOs are already eliminating key programs or withdrawing from the country.201 Unfortunately, the time lag between US appropriations and disbursements – and allied pledges and actual spending – will make the impact of such cuts even worse during Transition. The past increases in appropriations and pledges and the spending impact in Afghanistan of the surge or peak in US forces mean actual disbursements peaked in 2011 and 2012, sharply increasing the problems of coming spending cuts in 2013-2015.

Moreover, the US and other current donors 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 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

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conference as follows: “It’s been another conference of flowery speeches: big on rhetoric and short on substance.”

Restructure Economic Aid to Reflect the Fact Afghans Will Need Aid for Economic Stability During Transition More Than for Development

Although there are no reliable estimates of the economics of Transition, the “guesstimates” that do exist make it clear that both Afghan military and civil efforts face major funding problems. Studies by the World Bank and Afghan government – and working 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, while also calling for equally ambitious reforms and improvements in governance as well as for the Afghan government to achieve full independence from outside support in 2030:

- 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 nation.

The Afghan government stated that meeting its goals will require some $120 billion in aid 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. At the Tokyo conference in July 2012, international donors pledged less than $4 billion per year through 2016, and it is highly likely that much of this pledged funding will never reach Afghanistan.

Create an Effective and Coordinated International Effort

While national tensions have so far crippled any unified UN or other effort to fully coordinate national aid, there is a clear need to create an effective international body to

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203 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.
replace UNAMA. Someone needs to help manage the transition from national and NGO aid that is largely spent outside the GIRoA budget and control to an effective Afghan-planned and -managed aid effort.

This body should have a mandate that gives it real power to work with the Afghan government and key Afghan factions at the regional and local levels to actually coordinate development planning and spending, while also working to find ways to ensure it actually reaches the Afghan people and meets their needs.

The weaknesses and corruption in the Afghan central government are not fixable before 2014 or in the medium-term thereafter. Cutbacks in PRTs, NGO presence, and aid staffs will further complicate the problem. The money that remains cannot be effective if it continues to be spent on a donor nation-by-donor nation, NGO-by-NGO, and compartmentalized into military and civilian basis. There is a desperate need for coordination, reform, and for someone and some organization to be in charge of the overall planning and management for the aid effort. There is a desperate need for expanding the realism and depth of the World Bank effort and for creating a UN body that can actually do its task.

The obvious need is to either reform or abolish UNAMA and create a UN body that can actually do the job or give the World Bank a major role in the field, and use international conferences to get donor states to both coordinate aid and spending and regulate NGOs.

An effort to coordinate aid was made at the Tokyo conference. It does not take much vision or many visits to Afghanistan, however, to predict that no real coordination will take place, that UNAMA will continue to be a dysfunctional mess, and that even the US internal effort will remain a poorly-planned and -coordinated mix of “golden silos” in which the talk of integrated civil-military efforts never goes beyond concepts to reality.

### Shift Governance Aid to Deal with the Realities of a Flawed Afghan Political System But Hold the Afghan Government Accountable Where This Is Critical to Transition

Governance aid will need major restructuring. The US, its allies, and other donor states seem bound to ignore the lessons most colonial governments learned after far longer periods of nation-building. Cultures and political systems are remarkably resilient, and while they seldom return to the past, they do quickly change to reflect local values, some elements of tradition, and local power.

Transition cannot be based on the illusion of perfect elections, reliance on the presidency and central government, the emergence of some form of Afghan consensus and unity, an end to corruption, an end to power brokers, rigid adherence to a largely foreign draft constitution, or the sudden sharing of money and power effectively with provinces and districts.

Transition must focus on “Afghanistan as good as can actually get,” and this Afghanistan is decades away from these goals – if it ever does emerge – and the task now is to get through the 2014 election with some form of credibility and effective national leadership, strong provincial leadership, and ensuring leadership in key districts that is workable on Afghan terms.
There are areas, however, where the US and its allies will need to make aid and support conditional on Afghan progress, and where it should be clear that Afghan failures will mean an end to outside support. These include credible plans to:

- Hold a 2014 election that is honest and open enough to win a reasonable degree of public support. Given the lead times involved, this plan should have already existed and been made public.

- Hold the Afghan central government accountable for the more critical reforms that it pledged at Tokyo and in the paper it circulated at Bonn. This should not involve a search for new anti-corruption bodies, more prosecutions, and more scapegoats.

- Create a focused effort on enforcing enough fiscal responsibility and accountability to limit waste and fraud to more reasonable levels, and tie funding flows to actual progress.

- Make it clear to Karzai, his successor, and all senior Afghan politicians that the US commitment to the war is conditional on their performance in key areas vital to the success of Transition. The US and its allies should make it clear that they have an exit strategy for Afghanistan if its leaders fail their people and do not work towards some form of strategic success, and make it clear they will act accordingly. This effort should, however, be narrowly focused only on essential aspects of Transition.

- Press for enough reform to make the Afghan legislature less of a corrupt and obstructive body. These steps require a far more focused and better planned and managed effort that is dependent on the understanding that the US and its allies have continuing strategic interests in Afghanistan, but scarcely vital ones or ones they cannot walk away from. It requires the US and its allies to take a hard line when it is functional and to avoid confrontation when it is not. It requires Afghans to clearly understand that they will be held accountable for their own actions: future successes or failures will be their own.

- Make it equally clear to Karzai and future presidents that outside aid and support to the central government – and to them personally – will be dependent on keeping effective ministers and provincial/district governors and removing corrupt and ineffective ones.

- It may be too late, but the US should at least press for sufficient political reform to produce stability and security in key provinces and districts. These reforms should be aimed at facilitating elected representation and enabling localities to raise and control their own funds.

- Push for reforms that allow provinces, key cities, and districts to control and raise their own funds; strengthen local assemblies, and create more representative government at the regional and local levels. The gross over-centralization of power, control of money, and appointment of key officials makes the present constitution and power structure a source of aid and comfort to the insurgency.

- Tolerating moderate levels of corruption and the abuse of power must remain an ongoing reality, but the US, its allies, and donors should publicly out grossly corrupt governors, senior commanders, and power brokers and make it clear they will not resume funding until these figures are gone and stay gone. Control of money, not anti-corruption bodies and prosecution, should be the key.

At the same time, if the central government does not succeed, the US and its allies should be prepared to accept a major weakening of the central government and support the de facto division of the parts of the country along regional, ethnic, and sectarian lines. Power brokers and warlords are scarcely desirable, but neither is a total collapse or failure at the center.
Accept the Reality That the “New Silk Road” and Regional Development May Benefit Afghanistan After 2020, But Offer No Practical Basis of Support for Transition

The fifth step is for the US to stop talking about economic miracles and instead focus on getting the aid necessary to ease the Afghan government and people through the coming cuts in military spending and aid. As World Bank studies in early 2013 make all too clear, no credible case exists for the New Silk Road or major revenues from mining until 2021 or beyond. As such, they should be dropped from all US policy and planning efforts.204

This does not mean that objective mid- and long-term economic development studies and plans are not needed. They should not, however, be contract studies to please given policies. Creating a dedicated section within a World Bank planning effort – tied to some counterpart group in the Afghan government – that is transparent and subject to peer review could prove to be of great value over time and especially in the period beyond 2015-2017.

Prepare to Shift Economic Aid from Development to Stability

The sixth step, and perhaps the most important for the period between 2014 and 2017, is to prepare to shift economic aid away from development projects and to help Afghanistan achieve economic stability if the cuts in military spending and overall aid trigger a serious recession, create problems in popular support for the government, or affect the elite (that has benefited from aid and spending and that effectively lead the country and represents its armed elite).

The data on the economy, military spending, and the impact of aid are so bad that it is not possible to predict the impact of coming cuts – a problem compounded by the inability to predict how serious these cuts will be and how much of a backlog of existing unspent aid will actually being spent in country over the next few years. The risks involved, however, are too great to ignore.

Far more realistic risk analysis is need almost immediately and must then continue throughout the next half decade. Scenarios need to include the full range of problems and risks. Plans need be created to rapidly shift funding to meet urgent employment and economic stability needs. Simply hoping or assuming no crisis will occur is not a meaningful form of planning.

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About the Author

**Anthony H. Cordesman** holds the Arleigh A. Burke Chair in Strategy at CSIS. During his 20-plus years at CSIS, he has completed a wide variety of studies on energy, U.S. strategy and defense plans, the lessons of modern war, defense programming and budgeting, NATO modernization, Chinese military power, proliferation, counterterrorism, armed nation building, the security of the Middle East, and the Afghan and Iraq conflicts. He has traveled frequently to Afghanistan and Iraq to consult for MNF-I, ISAF, U.S. commands, and U.S. embassies on the wars in those countries, and he was a member of the Strategic Assessment Group that assisted General Stanley McChrystal in developing a new strategy for Afghanistan in 2009. He frequently acts as a consultant to the State Department, Defense Department, and intelligence community and has worked with U.S. officials on counterterrorism and security in a number of Middle East countries. He has worked extensively in Saudi Arabia and the Gulf.

Before joining CSIS, Cordesman served as director of intelligence assessment in the Office of the Secretary of Defense and as civilian assistant to the deputy secretary of defense. He also served in other government positions, including in the State Department and on NATO International Staff. In addition, he served as director of policy and planning for resource applications in the Energy Department and as national security assistant to Senator John McCain. His numerous foreign assignments have included posts in the United Kingdom, Lebanon, Egypt, and Iran, as well as with NATO in Brussels and Paris. He is the author of a wide range of studies on energy policy, national security, and the Middle East, and his most recent publications include *Pakistan—Violence vs. Stability: A National Net Assessment* (CSIS 2011); *Afghan National Security Forces: What It Will Take to Implement the ISAF Strategy* (CSIS, 2010); *Iraq and the United States: Creating a Strategic Partnership* (CSIS, 2010); *Saudi Arabia: National Security in a Troubled Region* (Praeger, 2009); *Iranian Weapons of Mass Destruction: The Birth of a Regional Nuclear Arms Race?* (Praeger, 2009); *Withdrawal from Iraq: Assessing the Readiness of Iraqi Security Forces* (CSIS, 2009); and *Winning in Afghanistan: Creating Effective Afghan Security Forces* (CSIS, 2009).

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