

# Reforming Aid Practices: Reinforcing the State Building Process in Afghanistan

**Nematullah Bizhan**

*Afghanistan requires aid for the foreseeable future. The total estimated public expenditure, including security, for the next five years (2017–2021) is US \$60 billion. But on average there is 74 % financing gap annually. The Afghan government expects to fill this gap through foreign aid. Afghanistan thus urgently needs to use aid more effectively to put the country on a path to self-reliance by strengthening the state capacity and economy. This requires the reforms of aid practices, improvement in the quality of governance, and investment in programs with long time horizons.*

## **ABOUT THE AUTHOR**

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Despite some major achievements, however, the types of aid donors have given to Afghanistan to combat state weakness and corruption has proven largely ineffective, and in some cases has undermined state building. While some of the aid instruments were plausible in the short term, given Afghanistan's inherited unfavourable conditions donors mostly bypassed the state, relying on fragmented methods of funding, and concentrated on short-term objectives. This approach largely undermined effective state building. Aid practices therefore should be reformed to ensure they reinforce state building and development. The need for reform is urgent as the flow of aid to the country is declining, the bulk of the United States (US) and the North Atlantic Treaty Organization (NATO) combat troops have left Afghanistan, and security is deteriorating. To make aid more effective:

- Donors should increasingly direct aid to the government budget and national mechanisms, strengthening the state capacity.
- As the quality of governance is crucial for state building, the reform of aid should accompany the reforms in governance practices. The Afghan government, therefore, should weaken the politics of patronage and improve the quality of public services.
- The Afghan government and donors should focus their investments on programs with long time horizons of building the national economy by investing in human capital, agriculture, trade, energy, infrastructure, and industry.

## WHAT STATE BUILDING MEANS AND WHY IT IS IMPORTANT

State building refers to the process of strengthening the existing government institutions or the creation of new ones. This process includes interventionist strategies on the part of domestic or external actors. Failed states pose a challenge to global security. These states no longer perform basic functions such as education, security, or governance. The problems of, for instance, drugs, terrorism, and disease, which originate in weak and failed states, are no longer contained within national boundaries.

After a decade of neglect, Afghanistan became central to global security in the wake of the 9/11 attacks which Osama Bin Laden, the Al Qaeda leader, planned from Afghanistan under the Taliban regime (1996-2001). Following the removal of the Taliban regime in late 2001, the country received massive aid. Afghanistan has significantly improved in some areas. The progress in education and health sectors are notable. The number of school students increased from less than a million in 2002, while the Taliban officially banned girls from education, to about ten million in 2015, with 38 % girls. Also, under five (child) mortality rate per 1,000 fell from 141 in 2000 to 97 in 2013. Despite these achievements, the country is ranked as a highly fragile state, and the economy is lagging and unable to finance the government budget. It is thus crucial to address the question of how to ensure the building of an effective and sustainable state in Afghanistan.

## HOW DONORS HAVE SUPPORTED AND UNDERMINED STATE BUILDING

Donors used the on- and off-budget mechanisms to deliver their aid in Afghanistan. They aided state building through mechanisms such as direct budget support and trust funds—*Afghanistan Reconstruction and Law and Order Trust Funds*. In the latter donors and the Afghan government jointly managed the funds, using the Afghanistan's national mechanisms. These forms of aid are called on-budget aid. For which the Afghan government is accountable. In contrast, off-budget aid bypassed the government budget and national systems. Donors managed off-budget aid by financing autonomous projects through non-governmental organisations and private companies. The Afghan government had no control over off-budget aid, and nor was it overseen by the Afghan Parliament

On-budget aid financed the government operational budget and development projects. It helped to reform the budget, taxation and treasury. Besides, it increased the external accountability of government to donors. Donors demanded that the government should reform governance practices to ensure that their money was going through a credible system. This type of aid also improved the capacity of the government departments through learning by doing. The government, for example, improved its capacity through aid management and delivering results.

On-budget aid did not have a unified effect, however. The flow of on-budget aid and external pressure for reforms differed across government departments. The Finance Ministry benefited the most. The ministry collected and allocated domestic revenue and managed foreign aid, thus this ministry was important for donors. Other ministries, which were less relevant to initiatives supported by aid, such as the Ministry of Economy and Borders and Tribal Affairs, lagged behind. The execution of on-budget aid sometimes took much longer than off-budget aid. This situation is evidenced by the low execution rate of the on-budget development expenditure (50 % in 2014). Factors such as limited government capacity, complex legal frameworks and the gap between donor commitment and real aid disbursement undermined the execution of on-budget. Despite slow progress, on-budget aid fostered the domestic economy and the development of state institutions. The local content, when using local goods and services, of on-budget aid is estimated by the World Bank about 70-95 %, compared to 10-25 % for off-budget aid. On-budget aid, therefore, had a greater economic impact. Between 2002 and 2010, however, donors spent only 18 % of their aid on-budget.

On the other, off-budget aid comprised 88 % of the total aid between 2002 and 2010 (see Figure 1, next page). Donors used this method of funding to substitute for the Afghan state weakness and corruption. Some donors, like the US, were also legally constrained from using their aid on-budget.

Off-budget aid fostered the delivery of aid. However, it increased the transaction costs of projects because of multiple contractual arrangements. It also diverted political and financial resource away from state building and reduced the donors' demand for governance reform. Eventually, off-budget aid created a form of parallel public sector which in some cases was in competition with state permanent institutions. The Special Inspector General for Afghanistan Reconstruction (SIGAR), for instance, has documented a number of cases of corruption in the US off-budget spending in Afghanistan.

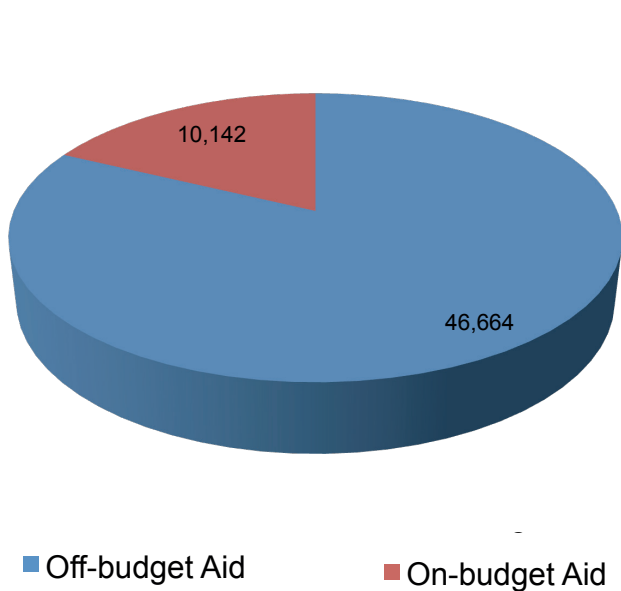


Figure 1: Aid Delivery Channels, 2002-2011

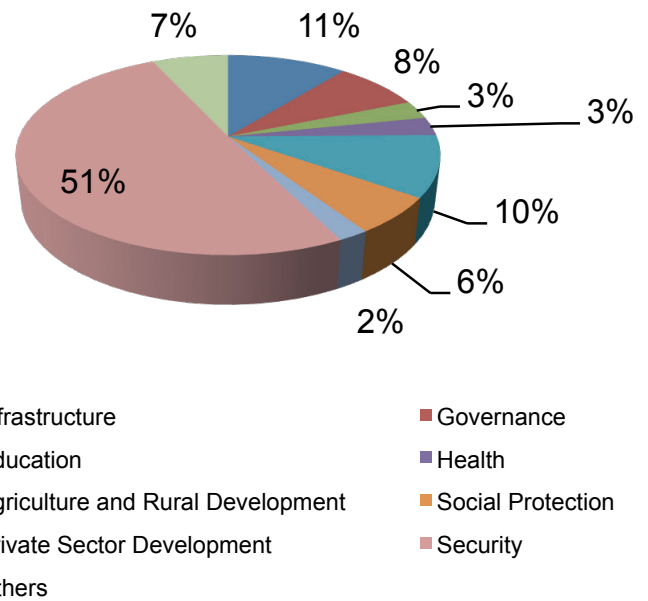


Figure 2 Aid Allocations by Sector, 2002-2011

Aid delivery channel had a greater implication for state building. While each donor used a different approach, as noted above, most of aid bypassed the state. The World Bank, Asian Development Bank and International Monetary Fund channelled their aid through on-budget mechanisms while major bilateral donors mostly relied on off-budget mechanisms. The US in particular, which provided 65 % of total aid to Afghanistan between 2002 and 2011, spent 95 % of its aid off-budget (Figure 3). While later the US changed its strategy and disbursed on average 44 % of its development aid through the government budget from 2012 to 2014, this remained below the expected target of 50 % and a significant portion of aid that included military assistance flew outside the Afghan government budget and national systems.

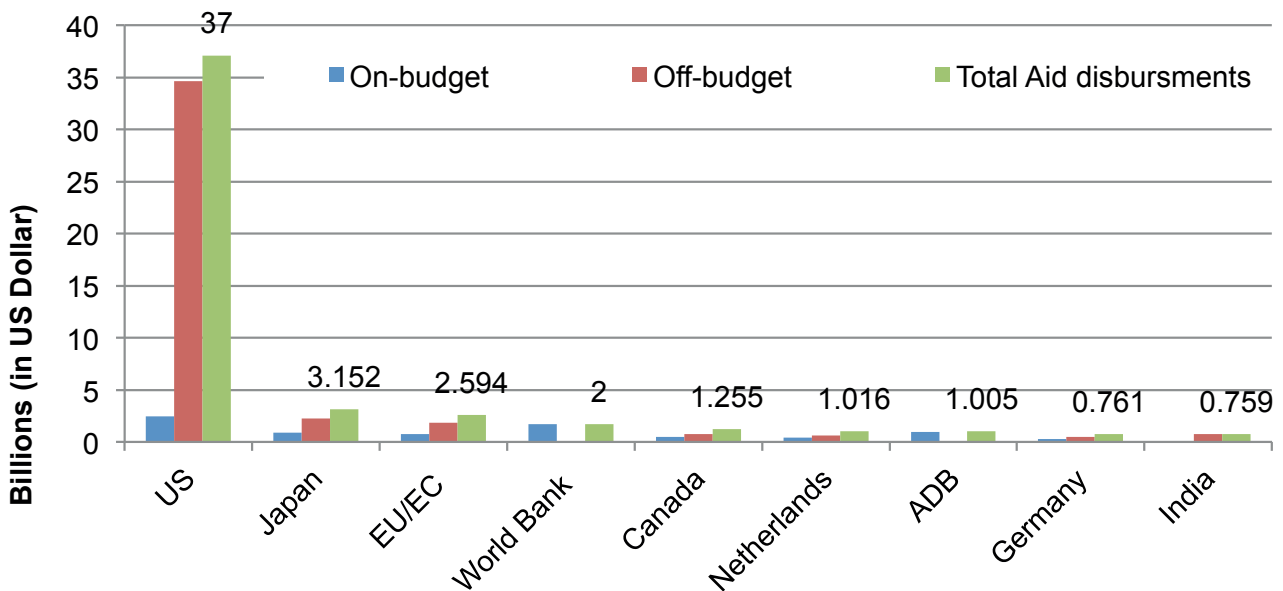


Figure 3: Top Ten Donors--Aid Delivery Channels, 2002-2011

Unbalanced aid allocation also posed a challenge to state building. Donors spent over half of the total aid on the security sector (Figure 2). Besides, a significant portion of development aid, especially in insecure areas, followed military priorities. A notable example of this aid is close to one billion US\$ which the 27 Provincial Reconstruction Teams from 14 different foreign nations spent on reconstruction and development in Afghanistan. This approach aimed to win the "hearts and minds" of people against the Taliban insurgency. While important, this type of aid damaged the legitimacy of and in some cases undermined the efforts to build the capacity of the state. Aid bypassed the local state institutions. People in communities would largely go to donors rather than the government for funding of their local projects (e.g. bridge, school and clinic).

In addition, poor governance eroded the prospects for state building. Patronage and corruption remained widespread. The Karzai government (2001-2014) offered most of the senior positions in exchange for political support. It also granted impunity to corrupt officials. The government in this period appointed most of the provincial governors based on patronage. The Killid Group in 2010 found that out of the 34 governors, 30 of them were appointed because they were linked with senior Afghan politicians, the former *mujahedin* leaders (who fought against the Soviet Union) and under pressure from donor countries. While Afghanistan budget transparency significantly improved— from 8 in 2008 to 59 in 2012, as measured by Open Budget Index— the country lagged behind in fighting corruption. In 2015, Transparency International, which measures the perceived level of corruption around the world, ranked Afghanistan 11 out of 100, one of the most corrupt countries.

### HOW THE AFGHAN GOVERNMENT AND DONORS REINFORCE STATE BUILDING

The effectiveness of aid for state building process not only depends on the volume and types of aid that Afghanistan receives but also on governance practices and where donors invest their aid. This policy brief provides the following three recommendations.

### DONORS SHOULD CHANNEL A GREATER PORTION OF THEIR AID THROUGH THE AFGHAN GOVERNMENT BUDGET AND NATIONAL SYSTEMS

The off-budget funded parallel public sector was fiscally bigger than the state. This institutional arrangement has undermined the development of the government institutions. Later this approach changed slightly. Donors committed in the 2010 Kabul Conference to channel at least 50 % of development aid through the government budget and to align their off-budget spending with Afghanistan priorities. This target envisages continuity in the existence of a parallel public sector that delivers about half of the total (development) aid. While some donors met or surpassed the target, some others failed to do so. Thus, a greater portion of aid still flows outside the government budget and is not thoroughly aligned with Afghanistan priorities. It is imperative to make the state fiscally larger than the parallel structures and increase the pressures on the government for reforms. Donors, therefore, should channel about 75 % of the total development

aid through the government budget and national systems. Achievement of this target for some bilateral donors, such as the US, may be challenging because they are legally bound to (directly) manage most of their aid in the recipient countries. However, these donors can identify practical measures so their aid does not undermine state building. The first best option seems to be budget support aid, the second best option is to use the national systems by using the Trust Funds. Also, it is imperative that off-budget aid should be aligned fully with Afghanistan's priorities. This change, in particular, requires that the Afghan government should reform and improve the quality of governance.

### THE AFGHAN GOVERNMENT SHOULD IMPROVE THE QUALITY OF GOVERNANCE

The Afghan government has partially reformed governance practices. Despite significant improvements in the public financial management system, however, the Afghan government lags behind in promoting meritocracy and fighting corruption. The National Unity Government since its inception in 2014 has promised to fight corruption and improve meritocracy. But the progress in these two areas has been slow and *ad hoc*. This along with the economic growth slowdown, from 14 % in 2012 to 1 % in 2015, and the deterioration of security situation because of a sharp decline in the flow of aid to Afghanistan and the Taliban insurgent increasing attacks respectively, adversely affected the public confidence in the government performance. Afghan optimism fell to its lowest level in a decade. According to the recent Asia Foundation Survey of Afghans, 37 % out of 9,586 people interviewed in 2015 said that Afghanistan was on the right direction, compared to 58% in 2013.

The government should improve the quality of public service. This in return depends on improvements in the quality of civil service and its independence from political pressure. The government should promote meritocracy and weaken the politics of patronage; implement a policy of zero toleration for corruption, especially, in the Ministries of Finance, Commerce, Mining, Police, Health and Education, and the judiciary. The taxation system should also be strengthened and fully reformed. The success of these measures may depend on three factors: the will of the government leadership, the state capacity, the citizens' role in holding the government to account, and donors' support for such reforms.

## INCREASE THE INVESTMENT ON PROGRAMS WITH LONG-TERM OBJECTIVES

If Afghanistan is to exit from aid dependency and overcome challenges it faces, it needs to have a much stronger national economy. While some of the short-term measures to deliver quick results that can help to improve stability in the short run are necessary, it is more important to focus on programs with long time horizons to empower Afghan citizens and to strengthen the national economy. The government and donors thus should increase their investment in human capital (e.g. education and health), agriculture, trade, energy and infrastructure as well as industries. Development of extractive industries (e.g. mining and hydro carbon) and medium and small size enterprises, for instance, would provide much-needed employment and a tax base to shore up future government revenue. These sectors are important for development of the country. But they suffer from poor quality and some of them are relatively underfinanced (e.g. 3 % of the total aid was spent on education between 2002 and 2010). Without a strong national economy and human capital, it is less likely that Afghanistan can exit from aid dependency and overcome the challenges it faces. These measures are imperative for the long-term success of state building in Afghanistan.



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