Economic Aid Policy and Statebuilding.

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This note briefly discusses the role of aid policy and its implications for the internationally-supported state-building project in Afghanistan after 2001 with respect to (i) fiscal policy, (ii)institution-building in the security sector, (iii) choice of aid channels, and (iv) privatization.

What we can call the international aid regime and the new Afghan administration made clear from the beginning that the post-Taliban order would be cast in a liberal mould, incorporating the structures of liberal democracy (but respecting traditional Afghan institutions like the *loya jirga*) and reconstructing the economy in line with the principles of private sector-driven development and market forces. At the same time, or shortly thereafter, the "a state-building" agenda was moved forward, although variously defined. In a narrow sense it entailed comprehensive public administration reform to build capacity on the national and sub-national level, more broadly understood it meant an effective and accountable central state.

In all Afghan public planning documents (NDF, SAF, ANDS) the state appeared as 'lean but mean'. The state would have a monopoly on the legitimate means of force. It would set the rules and regulate the private sector, but relied on the private sector to drive growth and to a large extent reduce poverty. The state would collect revenue and effectively implement other basic policies, but would not itself deliver public services except in a narrow field (notably, primary education). It was a state in line with the dominant thinking in the IFIs and donor circles. In fact, it was pretty close to the rather minimalist state described in the World Bank's 1997 World Development Report; capacity was a main determinant of state function, and the state would not enter areas where the market could do the job better.[1]

The notion that such a lean state could readily also develop legitimacy raised some questions at the outset. [2] The main argument of this note, however, is different. Since 2001 international aid has taken a form that appears to have overwhelmed and marginalize the Afghan state, thereby undermining the very statebuilding process it supposedly is designed to promote.

[1] World Bank, 1997 The State in a Changing World- World Development Report 199, New York: World Bank / Oxford University Press.

[2] The central state in Afghanistan had historically increased its power and, presumably, legitimacy by a combination of coercion *and* favors, the latter in the form of tangible benefits extended by the ruler in Kabul to local groups and authority structures. A lean, Weberian state might succeed on the coercive side but would even under the best of circumstances appear merely as a facilitator of public services in the provision of benefits. See Barnett.R. Rubin, The Fragmentation of Afghanistan, Yale University Press, 1995. Interestingly, the notion that legitimacy was heavily dependent upon the state's ability to provide economic development and basic services was revived in the context of the growing Taliban insurgency after 2004. A main reason why the population in the south turned to the militants, it was widely argued, was the failure of development as well as lack of good governance in the South. As a result, the counter-insurgency strategy increasingly came to be based on a winning-hearts-and-minds approach. See work-in-progress by Andrew Wilder on the validity of the WHAM approach and its premises. Winning Hearts and Minds? Understanding the Relationship between Aid and Security. Presentation at PRIO (Oslo), 12 March 2008.

Fiscal policy
This contradictory tendency is quite evident in the area of fiscal policy. Recent literature has resurrected in convincing form the old thesis that taxation is good for statebuilding.[3] The argument has two aspects: first, that tax administration is a 'lead sector' for development of state capacity, and has historically been so both in Europe in earlier times and in some developing countries today. Secondly, taxation is a basis for "revenue bargaining" between state and society, which in turn promotes an effective, accountable and legitimate state (which presumably is a desired form of 'statebuilding'). A government that relies heavily on its own subjects for revenues will, under certain circumstances, move towards "revenue bargaining". A government that has liberal access to rents (from natural resources), or strategic rents (from military assistance or foreign aid), will have less incentive to tax its own subjects in the first place. On this point the statistical evidence is persuasive.[4] It follows that this government will be correspondingly unlikely to enter into revenue bargaining. The conclusion is familiar from the literature on rentier states and on aid dependence in sub-Saharan Africa more generally.

In this scheme of things, Afghanistan appears as an extreme case. Domestic revenue collection has indeed improved, from 4.7 percent of GDP in 2003/04 to 8.2 percent in 2006/7, but international aid transfers still constitute around 70 percent of the revenue for what is called "the core budget", i..e. that which is channeled through the Afghan government.[5] A second "budget" – called the external budget – is totally funded and controlled by the donors, and is much larger than the Afghan-controlled budget, perhaps in a ratio of 3:1. Putting the two together we get the total public expenditure in Afghanistan, and in this picture domestic revenue constitutes only around 10 percent of all funding

There are several reasons for this extraordinarily high ratio of external to domestic revenues. One is the limited capacity of the state to raise revenues in a country where the sub-national administration is weak, where a large part of the country – perhaps two-thirds- is controlled by local or hostile forces and de facto outside the government's control, and where over half of the GDP is generated in the illicit opium sector. Another factor is the willingness of the Western donors and the IFIs to provide continuous funding in light of the strategic importance of Afghanistan and the political investment made to date. After three decades of war, poverty and dislocation, moreover, the "need" factor is very considerable. Nevertheless, the result is that the government has very little incentive to engage in 'revenue bargaining' and open the process of institutionalizing state-society relations in ways that promote accountable, legitimate and effective states. This is evident, for instance, in the relationship between the executive branch and the parliament over the budget. Having virtually no control over the source of funding, the legislature is marginalized in the decision-making process over the budget.[6]

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[3] Deborah Bräutigam, Odd-Helge Fjeldstad and Mick Morre (eds.), Taxation and State-Building in Developing Countries. Cambride: Cambridge University Press, 2008.
[4] Mick Moore, Between coercion and contract: competing narratives on taxation and governance," in Bräutigam et al. op.cit. and D. Bräutigam and S. Knack, "Foreign Aid, Institutions, and Governance in Sub-Saharan Africa," Economic Development and Cultural Change, 2005, 52(2):255-86.
[5] IMF, Staff Report for the 2007 Article IV Consultation, Third Review. January 28, 2008, p. 9. .
[6] Astri Suhrke, Democratization of a Dependent State, Democratization, July 2008 (forthcoming), and Action Aid and ELBAG, Gaps in Aid Accountability, Feburary 2008
http://www.actionaid.org/assets/pdf%5CFEB%20ELBAG%20report.pdf

As for the link between taxation and capacity building, the picture is a little more nuanced… The Ministry of Finance was one of the first government agencies to be reformed and professionalized. When reconstituted after 2001, the ministry relied heavily on imported capacity in the form of international consultants paid for by the donors, however, and this is still the case today. Whether this process is sustainable, and whether it has a multiplier effect in terms of generating capacity building in other administrative sectors or becomes a professional but isolated outpost, remains to be seen.

Institution building

Next to revenue collection, the other presumably core function of the state is to establish a legitimate monopoly of force. Professionalizing the military is in this sense a central part of statebuilding. If states are to be accountable and legitimate, oversight mechanisms established by political institutions are also required, and, arguably, some overall balance between civilian elected institutions and the military.

Building a new Afghan national army was from the beginning a central goal in the international aid project. The mounting insurgency has made the process even more urgent. As of late 2007, the goal was to create an army of some 70 000 men. The numbers are perhaps not unreasonably large given the state of internal war in several parts of the country and uncertain relationships with its nearest neighbors. In terms of the accountability and legitimacy aspects of statebuilding, however, the rapid development of the ANA is problematic. The army is by far the most generously funded of any institutions in the country, and as an organization is far better developed than the principal civilian institutions that in principle would provide oversight (the judiciary and parliament are weak and fragmented, so is the cabinet as a whole, and the Ministry of Defense is an advocate of the military).

The US has been leading the process of rapidly building up the Afghan army, with growing support from other NATO members as well. The alliance's growing involvement in Afghanistan has generated disagreement about the wisdom and nature of the mission, but there is at least consensus on one point: strengthening the Afghan security forces is urgently required to permit NATO to scale back its presence. As a result, the ANA has been a privileged aid recipient. In 2007 alone, the US appropriate 7.4 billion dollars to develop Afghan security forces (army, police and militias). By comparison, the entire core budget of the Afghan government – i.e. the budget which the government itself controlled – was only 2.4 billion. Admittedly, the US appropriation in 2007 was unusually high. Military assistance in the range of 2-3 billion annual was more common. But even this is sizable compared to the resources available to the government for its entire state budget, and does not, moreover, included rapidly growing EU military assistance.

The donors are, in other words, building an imbalanced state, which favors the military to the point where one might call it a militarized state. This may or may not be intended, but it is contrary to the broader definition of "statebuilding" which includes dimensions of accountability and legitimacy. Recalling the recent history f Afghanistan, the contradiction may be resolved in the form of yet another military coup.

Choice of aid channels

The donors have to a very large extent bypassed the Afghan government when providing aid, preferring instead "direct execution" through agencies, organizations or contractors of their choice. Reliable figures for total aid are not available since some donors fail to report to the Afghan government, but a ballpark figure is 3:1 in favor of the external "budget". The practice is understandably of great concern to the Afghan government, particularly the finance ministers, and most forcefully so the second Finance Minister, Ashraf Ghani. A situation where the bulk of the public expenditures are effectively outside the operational control of the government creates a "sovereignty gap", Ghani argues. The statebuilding project becomes a formalistic exercise through the creation of parallel structures, "the non-state provision of traditional state services and its impact on state legitimacy", and the lack of predictability in aid flows.[7]

The donors' reasons for bypassing government channels are obvious – lack of local capacity, concern with corruption, a desire for quick and tangible results ("management for results", as the OECD/ Paris declaration emphasizes) and for donor control. Yet the result is to erode the statebuilding process by reducing the significance and visibility of the state as an agent of development, and its capacity to institutionalize change in view of the uncertain aid flow. Ghani does not elaborate on the meaning of "traditional state services", but his argument that non-state provision of certain expected or basic services will weaken the legitimacy of the state is familiar from utilitarian concepts of legitimacy, concepts of social contract and Afghan history and current counter-insurgency theories (see note 2 above). Nevertheless, considerations of efficiency, donor control, and the principles of the economic liberalism that guided the post-Taliban reconstruction led to an emphasis on non-state provision of services.

Non-state provision of services was not merely a result of parallel structures established by the donors. The Afghan government was also promoting outsourcing and privatization (although not always with an enthusiasm equal to that of the donors and the IFIs). In the health sector, for instance, the Afghan government worked closely with the World Bank to establish a "performance based" system where health services were provided by (mostly large, international) NGOs on a contractual basis. Privatization of state owned enterprises (SOE) was also undertaken in close collaboration with the Afghan government.

Privatization

Afghanistan had established state industries, since the Daoud period (1973-78), and the policy accelerated during the communist regime which nationalized some existing industries and established other under the law on state enterprises in 1980. The state had also whole or part ownership in utilities and the transport sector. By 2001, many of the SOE were destroyed, in disrepair or uneconomical, but most were located on valuable land in or near urban areas. The World Bank and the IMF concluded early on that privatization was appropriate as part of a larger restructuring. The IFIs were strongly supported by the United States, and USAID took a lead role in financing and monitoring the policy.[8] Afghans were divided, and the principle was incorporated in the first National Development Framework as a medium-term objective, rather than immediate priority. [9] The Cabinet endorsed the policy in 2005, and the Afghan National Development Strategy (Interim) in 2006 restated the commitment to "liquidating

[7] Ashraf Ghani, Clare Lockhart,Michael Carnahan, Closing the Sovereignty Gap: An Approach to State-Building, ODI, Working Paper 253, September 2005 http://www.odi.org.uk/Publications/working_papers/wp253.pdf Ironically, as a Finance Minister Ghani contributed to these very practices by his insistence on very large and quick transfers of aid funds. Given the limited Afghan capacity and donor concern for control, the result was predictably strong reliance on imported capacity or direct execution of projects.

[8] USAID, "Privatization", http://www.ltera.org/USAID_LTERA_privatization.html

[9] The NDF was developed by then-finance minister Ashraf Ghani, ho came to the job from many years of working in the World Bank.

and/or privatizing those state-owned enterprises (SOEs) that provide services that can and should be delivered through the market."[10]
In 2005, an inventory made by the new SOE Department identified 71 SOEs under 12 line ministries. It recommended that 10 should remain (including utilities), 41 be privatized and 20 be abolished. The process moved slowly, and by 2008 only a half a dozen had been auctioned off. The restructuring agenda monitored by the IMF also covered several companies where the state had less than 100 percent ownership, including banks, but this process moved even more slowly and the government did not succeed in meeting the benchmark for 2007 in the Fund's Poverty Reduction and Growth Facility.[11]

There are no detailed studies of the privatization process, but we may be reasonably sure that it entailed some conflict and raised issues of proper conduct of the kind that advocates of institutionalization-before-liberalization have flagged. The World Bank had warned of some problems. The economic and fiscal gains from privatization, a Bank report in 2005 concluded, would be reduced "if sales are not transparent and SOEs are undervalued, or excessively favourable terms are granted to investors (e.g. in the form o f tax concessions). In addition to the direct fiscal cost, these may also lead to indirect costs to the Government (and society) in the form o f reduced incentives for efficient and profitable operation. "[12] There were also potential political costs. Given the fragility administrative and legal institutions of post-Taliban Afghanistan - and the very considerable power exercised by informal solidarity structures linked to ex-military commanders inside and outside the government – the possibilities for non-transparent sales were significant. In formal terms the enterprises were auctioned off, and the auction mechanism lent itself to informal agreements or threats to limit bidding. It would not be surprising if the new owners were also those who had benefited most from the new order, either by accessing the aid flow, the illegal economy, or the handles on political power. If so, the privatization process would work against the efforts to establish Weberian-type state capacity, and weaken its legitimacy among civil society.

Conclusion

I have briefly indicated how certain aspects of economic assistance can be analyzed with respect to their consequences for the declaratory policy of statebuilding that the Western-led international community is pursuing to rebuild and reconstruct a country after war. As the Afghan case indicates, the impulses can be contradictory in the sense that aid policy directly or indirectly ten undermines the statebuilding process. This is hardly surprising. Different context, actors and primary policy objectives are associated with the various components of aid policy and statebuilding. Organizations that promote both agendas, including the World Bank, are increasingly recognizing that the form, magnitude and channeling of economic assistance has a direct bearing on the process we call "statebuilding" and try to harness the former in service of the latter. There is less recognition, however, that current practice in a strategic but fragile state like Afghanistan makes that bearing mostly negative.

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[10] Afghanistan National Development Strategy. Summary Report. An Interim Strategy For Security, Governance, Economic Growth & Poverty Reduction, p.18 (2006)

[11] See note 5 above.

[12] The World Bank, Afghanistan. Managing Public Finances for Development. Vol. 3. January 2006, p. 101.