Prepared Remarks of
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"Private Sector Development and Economic Growth: Lessons from the U.S. Experience in Afghanistan"

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Thank you for that very kind introduction. I want to thank Andrew Wilder, Bill Byrd, and Scott Worden for inviting me and my staff to discuss SIGAR's lessons learned report on U.S. and coalition private sector development efforts in Afghanistan.

This is SIGAR's third lessons learned report, following reports on anti-corruption efforts and on security sector assistance. Two more reports – on stabilization and on counter narcotics efforts -- will be released in the next few months. All of our reports are available on our website at www.sigar.mil.

As the head of SIGAR, I am required by our authorizing statute to:

- Inform the Secretaries of Defense and State about problems and deficiencies relating to Afghanistan reconstruction;

- Make recommendations on policies designed to improve the effectiveness and efficiency of the Afghanistan reconstruction effort; and
- Examine the degree to which reconstruction programs are coordinated among U.S. implementing agencies, the Afghan government, and the international community.

I take these responsibilities seriously and, using my authority under the Inspector General Act of 1978, initiated SIGAR's lessons learned program at the urging of, among others, former Ambassador Ryan Crocker, and former ISAF Commanding General John Allen. They noted that SIGAR was the only agency in the federal government that has the cross-jurisdictional authority to look across agencies instead of only within them, and thus the sole agency that could issue "whole of government" lessons learned reports on the nearly 17-year, $122 billion reconstruction effort in Afghanistan. While our reports naturally are focused on Afghanistan, they may have important implications for other current and future contingency operations.

I am encouraged by the positive reaction government agencies have had to our two prior lessons learned reports, particularly our report on security sector assistance reform efforts, which was embraced by the U.S. military as they finalized the new South Asia strategy. We were requested to brief General Dunford, the Chairman of the Joint Chiefs, as well as the Commandant of the Marine Corps, the head of Central Command, and of course, John Nicholson, the commanding general in Afghanistan, among many others.

SIGAR staff were asked to serve on the Joint Chiefs' "failure analysis" team which looked at the prior 15 years of effort in Afghanistan, and there continues to be interest in our findings, as we just recently briefed over 300 Marine Corps University students at Quantico, and the report is now required reading at the Army War College.

We are hopeful that our government agencies and Congress will similarly embrace today's report and are encouraged by some of the early reactions to it.

Report Background

Since the beginning of coalition efforts, private sector development has been seen as critical to economic growth in Afghanistan, which was in turn seen as key to maintaining security following the expulsion of the Taliban. A robust economy would presumably provide gainful employment to the young, unemployed men who were considered most likely to join an insurgency; create confidence in and legitimacy for the state; and generate revenue that would allow the Government of Afghanistan to provide services to its population.

In addition, U.S. policymakers anticipated that a private-sector driven, open-market economy would strengthen electoral democracy, individual freedoms, women's rights, and a free media.

But, hopes for the development of a dynamic private sector economy have yet to come to fruition. As USAID noted in 2016, "despite recent regulatory improvements and increased access to finance, the business-enabling environment in Afghanistan is one of the worst in the world." In the World Bank's 2017 Ease of Doing Business rankings, Afghanistan was 183rd out of 190 countries, six spots lower than in 2016.

Today's report, "*Private Sector Development and Economic Growth: Lessons from the U.S. Experience in Afghanistan,"* has been over two years in the making and synthesizes not only SIGAR's work and expertise, but also that of other oversight agencies, government entities, current and former officials who served in Afghanistan, and academic institutions and independent scholars. Our team interviewed over 90 individuals who directly worked on or otherwise had knowledge of U.S. private sector development efforts in Afghanistan.

The report, which lays out 11 findings, identifies 12 lessons, and recommends 8 actions, also underwent extensive independent peer review, as well as consultation with relevant government agencies. The panel discussion will delve into the report in greater detail, but this afternoon I want to focus on a few key observations.

Introduction to Private Sector Development in Afghanistan

As our report discusses, the fundamental problems with U.S. private sector development efforts in Afghanistan were that the United States:

- Didn't fully understand the operating environment;
- Didn't create an attractive enabling environment for business; and
- Didn't manage and coordinate its own programs very well.

U.S. Didn't Fully Understand the Operating Environment

If the United States wanted to create a thriving private sector in Afghanistan, the first thing it needed to do was understand where it was operating. But the United States made an early misstep when it decided to undertake a "light footprint" approach in Afghanistan. Officials assumed a positive trajectory of progress for Afghanistan and failed to anticipate that lingering Taliban elements would regroup and grow into an insurgency that would keep the country in a state of insecurity and uncertainty. It was a mistake that continues to haunt Afghanistan.

The United States and international donors also severely underestimated the amount of resources and time that Afghanistan – a country that had been at war since 1979 – needed to recover. A 2001 donor's conference estimate that Afghanistan would need just $10 billion in official development assistance over the next 10 years turned out to be off by over $110 billion – and that's only counting U.S. assistance.

While the U.S. and other donors quickly realized more support would be needed, it wasn't until 2006 that it became clear to them that the war had never really ended and that Afghanistan was not, in fact, a post-conflict state.

Maintaining its belief that economic development was a key to long-term success in Afghanistan, the United States and other donors did what they tend to do best when they face trouble: they threw more money at the problem. In 2007 alone, total official development assistance by all donors increased by 57 percent, and increased further the next year, despite growing evidence that Afghanistan and its international partners were unable to effectively spend existing resources. Donor assistance was routinely exceeding rates considered to be absorbable by a developing economy, and in some years, U.S. assistance alone exceeded Afghanistan's GDP.

In the short term, per-capita income in Afghanistan did increase more than five-fold, from $117 in 2001 to a peak of $669 in 2012. But any hope that the upward trend would be lasting was an illusion, since it was largely a result of the heavy international presence and the "bump" in growth typically experienced by nations emerging from conflict. In 2014, at the end of the three-year drawdown begun in 2011, development assistance was 40% below its 2010 peak and Afghan incomes were declining.

The failure to understand Afghanistan also led international donors to neglect to take strong enough steps to prevent spillage from their assistance from falling into the hands of Afghanistan's powerbrokers, warlords, and corrupt officials. This problem grew rapidly as donor money began to flood the Afghan economy. In 2004, the annual Asia Foundation survey didn't even list corruption as an area of concern for Afghan respondents to choose from, but just four years later 76 percent of respondents identified corruption as a major problem.

It is clear that the United States did not understand the investment of money and time it would take for private sector development in Afghanistan to succeed, nor did they appreciate the ongoing threat posed by the insurgency and corruption. Once they did recognize these realities, their instinct to throw money at the problem compounded matters even further, something which we highlighted in our 2016 report on anti-corruption efforts.

Nevertheless, some steps taken by the U.S. and other donors did have positive effects on the Afghan economy. For example, helping Afghanistan open up to trade provided benefits for Afghan consumers and helped to integrate Afghanistan into the world economy, even though Afghanistan remains at a competitive disadvantage in trade compared to its neighbors.

Additionally, USAID and the Department of the Treasury implemented a range of activities that strengthened the commercial banking sector, privatized state-owned banks, and attempted to regulate informal money service providers. And because commercial banks were unable or unwilling to reach poor and rural areas of the country, the U.S. also supported a number of non-bank financial institutions to offer loans that were attractive to small enterprises.

U.S. Didn't Create an Attractive Enabling Environment

Despite these positive initiatives, the U.S. and its partners were unable to create the conditions necessary to attract significant private sector investment in the Afghan economy. Successful private sector development in Afghanistan required the establishment of an enabling environment attractive to foreign and domestic businesses alike.

While I have spent most of my career in public service, I did, for a time, advise corporations, including some of the largest companies in the world. Two things that make most businesses shy away from new markets are uncertainty and instability – two things Afghanistan has a surplus of.

The security situation inherently creates instability, but businesses need certainty as well. Business certainty depends upon strong rule of law mechanisms that protect property and other rights by providing recourse for grievances. International donors have worked with Afghan government officials to strengthen their legal regime, but a dearth of legal experts and lawyers within Afghanistan, coupled with an inept and/or corrupt court system, has made resolving legal conflicts extremely difficult. Many Afghan laws are poorly understood today, even among Afghan judges and lawyers.

Enforcement of the law, especially with respect to property rights, has been one of the greatest challenges. Afghanistan's weak judicial system has meant that even the best-crafted laws can be manipulated by powerful individuals and business elites who use their connections and access to information to circumvent taxes, regulations, and other legal requirements. This unfair advantage has also been used against smaller and less well-connected businesses to suppress competition. Additionally, many new laws and regulations contradict laws still on the books from previous administrations, providing officials with an opportunity to cherry-pick which laws to enforce.

Predatory officials also create uncertainty. Fear of arbitrary and capricious government regulatory and tax-collecting institutions have reinforced Afghan firms' historical inclination to stay small and informal, rather than expand and risk catching a corrupt official's eye.

Patronage networks established during several decades of war, conflict, and dislocation have also had significant negative effects. Many of the most successful businessmen in Afghanistan have strong connections to political power, providing them with access to contracts, tax exemptions, and money-laundering channels. Such strongmen have acted, sometimes violently, to quash competition in key sectors such as transportation, private security, and extractives.

These individuals, whether they are government officials or simply well-connected businessmen, also have had the ability to send hard currency out of the country, depriving the Afghan government of desperately needed revenue. As the U.S. drawdown began, powerful

Afghans began to send more money abroad, out of the reach of the Afghan government. It is no coincidence that real estate prices in Dubai started to boom around the same time.

The bottom line is that powerful individuals have taken advantage of weak legal institutions creating significant uncertainty for anyone looking to do business in Afghanistan, dampening private sector growth in the process.

U.S. Didn't Manage or Coordinate Its Own Programs Very Well

In addition, as SIGAR has repeatedly documented in its many reports and investigations evaluating the reconstruction effort, the U.S. made achieving success much harder by not effectively managing or coordinating its private sector development programs.

While USAID has responsibility for most U.S. development programs, once the surge began every U.S. government agency in Afghanistan was under pressure to leave behind a functional and self-sustaining Afghan state before President Obama's deadline for withdrawal.

While USAID's Mission in Kabul was the agency's largest, the Department of Defense also began to undertake economic development projects. The Commander's Emergency Response Program, or CERP, allowed U.S. military commanders to spend money on projects to put people to work. Many were unsustainable, but in the middle of a war that wasn't the commander's primary concern. SIGAR will be releasing an in-depth performance audit of CERP in the next few weeks that will go into greater detail.

Another program, the Defense Department's Task Force for Business and Stability Operations, or TFBSO, derided USAID's programs as too slow and spent $675 million in its own effort to jump-start the Afghan economy. Unfortunately, DOD had relatively little experience or expertise in private sector development, and TFBSO operated on an ad hoc basis, with next to no oversight.

Other SIGAR work has examined TFBSO in detail, but what is clear is that DOD's entry into the economic development field complicated matters at best and may have harmed economic development at worst.

TFBSO coordination with other civilian agencies was sometimes considered a "courtesy" rather than a requirement, and in one embarrassing example that SIGAR has previously reported, an Afghan official thanked the then-American Ambassador for the completion of a project that State and USAID had recommended against, but that TFBSO had moved forward on anyway without notifying the Ambassador.

As former DOD Comptroller Dov Zakheim put it "if parts of DOD are reluctant to work in a collegial manner among themselves, what can be expected when DOD is asked to work alongside other departments?"

Too often, on too many initiatives in Afghanistan, the instinct has been to throw money against the wall to see if it sticks, and in this case, DOD's expeditionary development efforts seem to have had little long-term effect, other than burning through taxpayer dollars.

Conclusion

Based upon my most recent briefings from USAID and State Department officials, private sector development is one of the cornerstones of the current Administration's strategy in Afghanistan, making SIGAR's report a "must read" and not simply a historical record.

Remember, even if the Taliban signs a peace deal tomorrow, the Afghan government still relies on international donors to cover roughly half of its budget. Our soldiers may come home, but our wallets will have to stay behind. Development of a dynamic Afghan private sector is the long-term solution to that problem.

If the U.S. and its partners can help the Afghan government stabilize the security situation, strengthen the rule of law, reduce government regulatory impediments, including corruption, and support economic development through well-executed, cost-effective assistance programs, then the Afghan people will be able to achieve what both they and the U.S. want – a self-sustaining, independent, and prosperous Afghan state that no longer requires donor assistance.

Finally, I would be remiss if I didn't acknowledge the great work done by our team on this report. Project lead Paul Fishstein was ably supported by Mariam Jalalzada, Emily Bakos, Lauren Helinski, Nikolai Condee-Padunov, Margaret Jacobson, and Elizabeth Young. They, under the leadership of program director Joe Windrem, have made this report possible and have my gratitude and that of the agency.

Thank you very much.