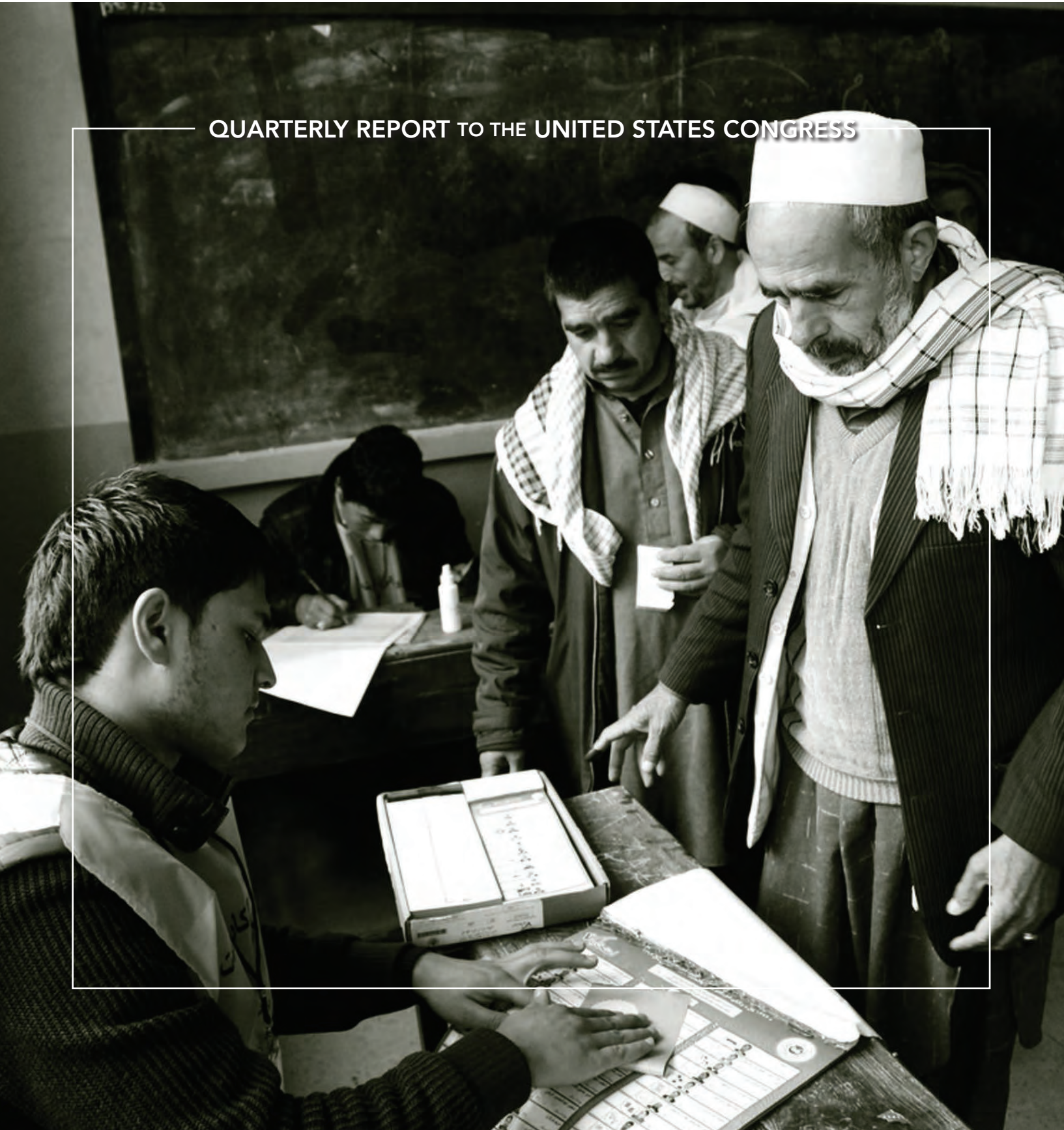


# SIGAR

Special Inspector General for  
Afghanistan Reconstruction

APR 30  
2014

## QUARTERLY REPORT TO THE UNITED STATES CONGRESS





**The National Defense Authorization Act for FY 2008 (P.L. 110-181) established the Special Inspector General for Afghanistan Reconstruction (SIGAR).**

SIGAR's oversight mission, as defined by the legislation, is to provide for the independent and objective

- conduct and supervision of audits and investigations relating to the programs and operations funded with amounts appropriated or otherwise made available for the reconstruction of Afghanistan.
- leadership and coordination of, and recommendations on, policies designed to promote economy, efficiency, and effectiveness in the administration of the programs and operations, and to prevent and detect waste, fraud, and abuse in such programs and operations.
- means of keeping the Secretary of State and the Secretary of Defense fully and currently informed about problems and deficiencies relating to the administration of such programs and operation and the necessity for and progress on corrective action.

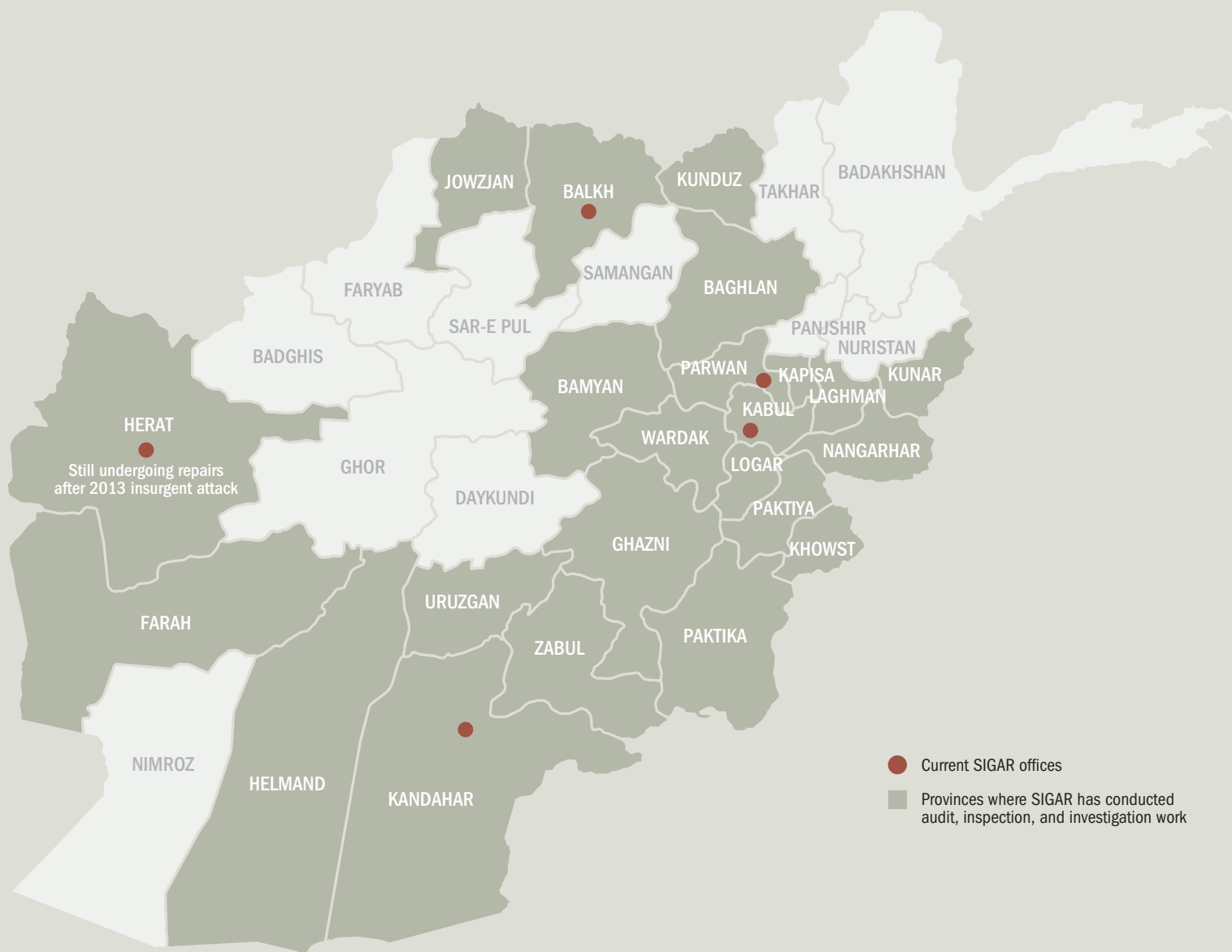
Afghanistan reconstruction includes any major contract, grant, agreement, or other funding mechanism entered into by any department or agency of the U.S. government that involves the use of amounts appropriated or otherwise made available for the reconstruction of Afghanistan.

Source: P.L. 110-181, "National Defense Authorization Act for FY 2008," 1/28/2008.

(For a list of the congressionally mandated contents of this report, see Section 3.)

**Cover photo:**

Afghans check in at a Kabul polling place on April 5 to participate in nationwide voting to select a new president and members of 34 provincial councils. (United Nations Assistance Mission in Afghanistan photo by Fardin Waezi)



- Current SIGAR offices
- Provinces where SIGAR has conducted audit, inspection, and investigation work





SPECIAL INSPECTOR GENERAL FOR  
AFGHANISTAN RECONSTRUCTION

I am pleased to submit to Congress, and to the Secretaries of State and Defense, SIGAR's 23rd quarterly report on the status of the U.S. reconstruction effort in Afghanistan.

Afghanistan enjoyed a rare moment of optimism this quarter. On April 5, 2014, more than seven million Afghans, 35% of them women, went to the polls to choose a new president and provincial council members, according to the National Democratic Institute. Despite Taliban threats and a string of murderous attacks on foreigners and Afghans in the weeks leading up to the elections, the Afghan National Security Forces managed to keep 6,218 out of 6,423 polling stations open. Early indications reported by Afghanistan's Independent Election Commission suggest a runoff is likely between presidential candidates Abdullah Abdullah and Mohammad Ashraf Ghani Ahmadzai. Both men have promised to sign a bilateral security agreement which would keep some U.S. troops in Afghanistan to support continued training of Afghanistan's security forces and pave the way for continued reconstruction support.

Despite the prospect of a peaceful, democratic transition of power, grave dangers still remain for U.S.-funded reconstruction. The World Bank has predicted for several years that Afghanistan would suffer an economic contraction as Coalition troops draw down. The country's domestic revenues for the last Afghan fiscal year (December 21, 2012–December 20, 2013) fell short of Ministry of Finance targets by 11.9%. At the same time, the Afghan government's expenses have increased, exacerbating an already significant gap between revenue collection and budget expenditures. Afghan revenues in 2014 could cover as little as a third of the country's \$7.5 billion budget. The revenue decline comes at a time when dozens of reconstruction projects and their associated operation-and-maintenance costs are being turned over to the Afghan government.

Some of SIGAR's work this quarter focused on this issue. Customs revenue has accounted for between 44% and 48% of Afghanistan's total domestic revenue for the past three fiscal years. Yet a SIGAR performance audit published in April found that, despite the U.S. allocation of \$198 million to develop Afghan capacity to assess and collect customs revenue, its potential as a stable source of government income remains uncertain. SIGAR's auditors found that the single biggest issue limiting collection of customs revenues is corruption. Moreover, U.S. advisors report that Afghan employees who try to properly collect customs duties have been kidnapped and intimidated. Section 1 of this report discusses the threat that corruption poses to the reconstruction effort as a whole.

During my visit to Afghanistan this quarter, I toured the forward operating base at the Torkham Gate Border Crossing on the border with Pakistan. About 80% of Afghanistan's customs revenues are reportedly collected at this crossing, the country's busiest. I was told that when U.S. mentors and observers are not present, revenue collection falls. This was not encouraging, especially as the crossing will soon be outside the reach of U.S. personnel because the U.S. military will no longer be able to provide escort to the area.

I continue to have serious concerns about the ability of U.S. agencies to implement and monitor reconstruction programs as U.S. forces withdraw. In February, SIGAR, together with the United States Institute for Peace, convened a symposium to discuss the oversight challenges and identify best practices for remote management and monitoring in insecure

environments. We will soon issue a report on the symposium that will outline the options for oversight post-2014.

The 20 audits, inspections, and other reports SIGAR issued this quarter examined programs and projects worth approximately \$31 billion. They identified failures of planning, construction, and oversight. They also raised concerns about International Security Assistance Force plans to sustain their capability-assessment efforts of the Afghan security forces, USAID's strategy for Afghanistan's water sector, and the rising cost of installing an additional power-generating turbine at Kajaki Dam. SIGAR also completed two financial audits which identified nearly \$14.5 million in questioned costs for this quarter out of almost \$75.3 million to date. Section 2 of this report summarizes our findings and recommendations.

Since my last report to Congress, SIGAR has opened 60 new investigations and closed 40, bringing the total number of ongoing investigations to 338. The criminal fines, restitutions, forfeitures, and cost savings to the U.S. government from SIGAR's ongoing investigations in this reporting period amounted to approximately \$6.7 million. SIGAR's suspension and debarment program referred 16 individuals and 15 companies for suspension or debarment based on allegations that they engaged in fraud and non-performance as part of contracts valued at almost \$61 million.

This quarter, I reiterate my concerns about the policies of the U.S. Army's suspension and debarment program. As I have pointed out in the last four quarterly reports, the Army's refusal to suspend or debar supporters of the insurgency from receiving government contracts because the information supporting these recommendations is classified is not only legally wrong, but contrary to sound policy and national-security goals. I continue to urge Congress to change this misguided policy and impose common sense on the Army's suspension and debarment program.

Since 2002, the Congress has appropriated nearly \$103.2 billion to rebuild Afghanistan—more than the United States has ever spent on reconstruction of any other nation. SIGAR is concerned about the ability of the Afghan government to sustain the achievements of the past 12 years in light of the increasing gap between its revenues and its obligations. The United States and its allies have been providing budget assistance—either through multi-national trust funds or as direct government-to-government aid—to help cover the Afghan government's budget shortfalls. We will continue to monitor and assess U.S. direct assistance programs. We will also be taking a serious look at program design, implementation, and sustainability in a series of sector-wide audits currently under way.

As Afghanistan embarks on the first democratic transfer of power in its history, my staff and I look forward to working together with Congress, implementing agencies, and other oversight bodies to ensure that U.S. tax dollars are not subject to corruption or waste.

Respectfully,

A handwritten signature in black ink, appearing to read 'John F. Sopko', with a long, sweeping horizontal line extending to the right.

John F. Sopko  
Special Inspector General for Afghanistan Reconstruction

# EXECUTIVE SUMMARY

This report provides a summary of SIGAR's oversight work and an update on developments in the three major sectors of Afghanistan's reconstruction effort from January 1 to March 31, 2014.\* It also includes a discussion of the threat corruption poses to the reconstruction effort. During this reporting period, SIGAR published 20 audits, inspections, alert letters, and other reports assessing the U.S. efforts to build the Afghan security forces, improve governance, and facilitate economic and social development. These reports identified a number of problems, including weaknesses of assessment and oversight, corruption, construction deficiencies, and other threats to health and safety. The criminal fines, restitutions, forfeitures, and cost savings to the U.S. government from SIGAR's ongoing investigations in this reporting period amounted to approximately \$6.7 million. SIGAR investigations also resulted in an arrest, a criminal information, two plea agreements, and six sentences in the United States. In Afghanistan, two subjects were convicted and sentenced and eight individuals were barred from having military installation access.

## SIGAR OVERVIEW

### AUDITS

SIGAR produced three performance audits, two financial audits, two inspections, and two inspection alert letters. The **performance audits** found:

- The International Security Assistance Force (ISAF) needs to improve its plans for sustaining capability-assessment efforts of the Afghan National Security Forces (ANSF) after Coalition troops draw down.
- Despite some successes in building the Afghan government's capacity to assess and collect customs revenue, challenges will limit customs as a sustainable source of revenue for Afghanistan.
- The United States Agency for International Development's (USAID) strategy for Afghanistan's water sector needs to be updated to ensure effective oversight and accountability.

The **financial audits** identified nearly \$14.5 million in questioned costs as a result of internal control deficiencies and noncompliance issues. These deficiencies and noncompliance issues included, among other things, inadequate cash disbursement controls resulting in theft of federal funds, missing timesheets, management and administration costs charged to the wrong Afghanistan reconstruction award, failure to conduct vendor suspension and debarment checks, ineligible entertainment expenses, poor record retention, lack of

supporting documentation, failure to adhere to procurement procedures, improper approvals for invoices and payment application requests, and failure to complete a road construction project in accordance with award requirements.

The **inspection alert letters** informed the Department of Defense (DOD) that SIGAR has opened a preliminary investigation into the construction of an incinerator system at FOB Sharana in Paktika Province and the State Department (State) of design and construction defects at a prison in Baghlan Province.

The **inspection reports** of U.S.-funded facilities discussed the following issues:

- Comments from U.S. Forces-Afghanistan (USFOR-A) on SIGAR's inspection of Salang Hospital
- Whether Camp Monitor in Jowzjan Province is being used as intended

### NEW AUDITS AND INSPECTIONS

This quarter, SIGAR initiated six new performance audits, 27 new financial audits, and five new inspections. The six new performance audits will assess:

- The status of all recommendations made to State, USAID, and DOD in financial, inspection, or audit reports

# EXECUTIVE SUMMARY

- U.S. assistance to develop rule-of-law programs in Afghanistan
- Programs and initiatives undertaken by State and USAID to assist Afghan refugees and internally displaced persons
- The extent to which DOD's Task Force for Business and Stability Operations (TFBSO) and USAID programs met their goals to develop Afghanistan's extractives industry

The 27 new financial audits will examine DOD, State, and USAID awards with combined incurred costs of more than \$2.3 billion, bringing the total number of ongoing financial audits to 45 with nearly \$4.1 billion in costs incurred.

The five new inspections will examine two industrial parks, an ANA slaughterhouse, the ANA Camp Commando complex, and the Afghan Ministry of Defense Headquarters.

## SPECIAL PROJECTS

During this reporting period, the Office of Special Projects issued a fact sheet on State's assistance to Afghanistan. In addition, the office issued inquiry letters on:

- An Mi-17 crash and demolition
- Afghan National Police (ANP) ghost workers
- Document preservation from a review of a decision to build a 64,000-square-foot building
- Communications towers not being used for their intended purpose
- DOD contract data
- Cancelled USAID contracts
- An ANP mobile money pilot program
- A U.S. Department of Agriculture soybean program

## INVESTIGATIONS

During the reporting period, SIGAR's ongoing investigations saved the U.S. government approximately \$2.7 million. SIGAR investigations also resulted in an arrest, a criminal information, two plea agreements, and six sentencings in the United States. In

Afghanistan, two subjects were convicted and sentenced and eight individuals were barred from having military installation access. Criminal fines, restitutions, and forfeitures amounted to nearly \$4 million. SIGAR initiated 60 new investigations and closed 40, bringing the total number of ongoing investigations to 338. In addition, SIGAR's suspension and debarment program referred 16 individuals and 15 companies for suspension or debarment based on evidence developed as part of investigations conducted by SIGAR in Afghanistan and the United States.

Investigations highlights include:

- An investigation of a trucking company that saved the U.S. government \$2.5 million
- Two U.S. soldiers sentenced for bribery and conspiracy
- Two Afghan truck drivers convicted of theft
- Disruption of a human trafficking scheme at Kandahar Airfield
- A U.S. couple convicted of conspiracy to commit fraud
- A U.S. Army sergeant convicted of conspiracy and theft
- A State Department contractor sentenced for receipt of an illegal gratuity

\* SIGAR may also report on products and events occurring after March 31, 2014, up to the publication date.

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“An economy can only absorb a certain amount of inputs until it becomes saturated. Additional input goes somewhere else, usually capital flight, usually illicit. In Afghanistan, absorptive capacity [was] reached in the first year of operations. That led to the corruption eruption.”

—*Senior USAID official*

# 1 CORRUPTION THREATENS RECONSTRUCTION



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An aerial view of the Khyber Pass with Torkham Gate, an important border crossing point in the Afghan customs system. This location will soon be inaccessible to SIGAR staff due to security concerns. (SIGAR photo by Smythe Anderson)



## CORRUPTION THREATENS RECONSTRUCTION

“Corruption directly threatens the viability and legitimacy of the Afghan state” was the dire warning of an important study issued this quarter by a section of the Joint Staff of the U.S. Department of Defense (DOD). The study, commissioned by General Joseph F. Dunford, Commander of U.S. Forces-Afghanistan (USFOR-A), summarized the danger: “Corruption alienates key elements of the population, discredits the government and security forces, undermines international support, subverts state functions and rule of law, robs the state of revenue, and creates barriers to economic growth.”<sup>1</sup> The Joint Staff report drew in part on SIGAR audits and echoed observations made by academics and individuals involved in Coalition efforts to stabilize and develop Afghanistan. Displaying a critical awareness and candor often missing from official documents, the report laid out some key findings:<sup>2</sup>

- The initial U.S. strategy in Afghanistan fostered a political climate conducive to corruption.
- Massive military and aid spending overwhelmed the Afghan government’s ability to absorb it. This, coupled with weak oversight, created opportunities for corruption.
- The lack of a common understanding of the nature of corruption stymied efforts to combat it.
- The lack of political will on the part of both the international community and the Afghan government to combat corruption resulted in a culture of impunity that frustrated anti-corruption efforts.
- The failure to develop a comprehensive U.S. anti-corruption strategy reduced the effectiveness of various anticorruption initiatives.

Surveys, audits, legal proceedings, and observations from Afghans and international observers have long identified corruption as one of the most serious obstacles to the reconstruction effort. Transparency International has Afghanistan tied for last place with Somalia and North Korea as the country perceived as the most corrupt of 177 countries rated.<sup>3</sup> Members of Congress and U.S. officials have expressed growing concern.<sup>4</sup> Even as U.S.

# CORRUPTION THREATENS



**Poppy fields share land** with legal crops in this view taken north of Kandahar. (SIGAR photo by Elizabeth Faulkner)

Agency for International Development (USAID) official Donald L. Sampler told a House subcommittee in early April about Afghanistan’s U.S.-funded achievements, he observed that it is “the most corrupt place I’ve ever been to.”<sup>5</sup> The Joint Staff report makes clear that U.S. government efforts helped create an environment in which corruption could flourish.

## U.S. STRATEGY CONTRIBUTED TO CORRUPTION

The U.S. military used a proxy force—composed largely of warlords associated with Afghanistan’s Northern Alliance—to drive the Taliban and al-Qaeda from power in 2001. However, as several civilian and military analysts have pointed out, and as the military’s latest study reiterates, these warlords often used U.S. support to operate with impunity to increase their political power and improve their economic positions.<sup>6</sup> Afghan political leaders have built allegiances by cutting political deals that put powerful figures in key government positions and allowed them to behave with impunity.

Some of these figures have used their government positions to entrench and expand their patronage networks. In some cases, these patronage networks have morphed into criminal networks involved in everything from extrajudicial land seizures and extortion, to narcotics trafficking and money laundering.

Rule-of-law and democracy scholar Sarah Chayes of the Carnegie Endowment for International Peace argues that the military gave short shrift to corruption, even as its presence aggravated the problem:

At every echelon, short-term security imperatives repeatedly trumped corruption concerns. Battalion commanders got cozy with police officials whose men were shaking down locals at every checkpoint, with a blow or an insulting sneer, or were imprisoning people for ransom, or demanding young sons for service as tea-boys—and other activities. Diplomats stood shoulder-to-shoulder with provincial governors who were key nodes in predatory government networks. The CIA insisted on secretly paying off key assets, including Afghan President Hamid Karzai ... And Afghans were watching. “People think the Americans must want the corruption,” a former Kandahar neighbor remarked.<sup>7</sup>

Into this environment, the United States poured billions of reconstruction dollars.

## TOO MUCH MONEY, TOO LITTLE OVERSIGHT

The Joint Staff report found “the deluge of military and aid money into Afghanistan” overwhelmed the Afghan government’s ability to absorb these funds. This, coupled with weak oversight by U.S. implementing agencies and other international donors, “created ample opportunities for corruption.”<sup>8</sup>

Afghan officials, including President Hamid Karzai, have accused the international community of fueling corruption.<sup>9</sup> Senior U.S. officials have acknowledged that the Afghan president has a point. U.S. Army Major General Herbert R. McMaster, who headed a task force set up in part to combat corruption, told a university audience in Kabul in 2011, “Corruption has been exacerbated by the vast sums of international resources that have entered Afghanistan over the last ten years, often without adequate oversight. . . .”<sup>10</sup>

Reconstruction assistance alone has dwarfed the size of the Afghan economy. For example, according to the World Bank, Afghanistan’s total GDP amounted to about \$15.9 billion in 2010. That year, Congress appropriated President Obama’s request for more than \$16 billion to build Afghanistan’s security forces, government, and economy. This did not include the tens of billions of dollars spent that year on the U.S. military operations in Afghanistan. Since 2010, Congress has provided nearly \$64 billion for reconstruction programs. This is nearly 62% of the \$103 billion Congress has appropriated for Afghanistan’s reconstruction since 2002.

In a speech to the Atlantic Council in March this year, Special Inspector General John Sopko posed the question: “How was Afghanistan, with its very poor economy, going to efficiently absorb this largesse, and why would corrupt officials and others looking at floods of poorly supervised cash and an uncertain future not take advantage of the opportunity to take a cut for themselves?”<sup>11</sup>

SIGAR and others have found that U.S. implementing agencies have not always exercised sufficient oversight of their massive spending. SIGAR

# CORRUPTION THREATENS

audits and inspections have catalogued lack of planning, contract mismanagement, poor quality control, and weak accountability. Consequently, Afghanistan has schools built so badly they are in danger of collapsing, clinics with no doctors or medical supplies, police and army barracks that are not fit to use, and roads that are disintegrating for lack of maintenance.

There are many explanations for the inadequate management and oversight, including poor security, a high turnover of U.S. military and civilian personnel, widespread failure to observe rules, lack of an integrated interagency system to track reconstruction projects, and inadequate imposition of accountability for incompetent or dishonest actions. The result of these and other flaws has been to leave the door open—or open it wider—to corruption.

Coalition efforts to tackle corruption have also been stymied by imprecise descriptions of corruption.

## NO CLEAR DEFINITION OF CORRUPTION

The Joint Staff report pointed out that the United States and its coalition partners have not had a clear, shared definition of corruption, or a full appreciation of how Afghans perceived corruption.<sup>12</sup> A 2013 International Security Assistance Force (ISAF) report on corruption made the same observation, pointing out that “The concept is generally understood the world over but cultural factors, variances in laws between nations, and other factors blur the line between what is acceptable or not in a given country; even the UN Convention Against Corruption does not define



**Snow is removed** from the Gardez Khowst road. Bribe seeking at highway checkpoints is a common form of corruption in Afghanistan. (USAID/Afghanistan photo)



the term.”<sup>13</sup> Afghanistan ratified the United Nations Convention against Corruption in 2008. However, as the ISAF report notes, the UN list of terms does not explicitly define “corruption,” but lists a number of “predicate acts” like embezzlement and money laundering.

The Afghan statute that established Afghanistan’s High Office of Oversight and Anti-Corruption, (or “HOO,” which is also sometimes abbreviated as “HOOAC”) takes a broader official view of corruption, covering conduct that many people would consider dereliction of duty or poor performance rather than overt corruption: unauthorized destruction of official records, exceeding legal scope of authority, “concealing the truth,” and delaying execution of assigned duties.<sup>14</sup> As the wording of the HOO statute illustrates, formal definitions of corruption can vary in their expansiveness.

The DOD Joint Staff, citing definitions that revolve around abuse of public office and private gain, pointed out that “The words ‘abuse’ and ‘private’ were often not appropriate” for dealing with conditions in Afghanistan, where gifts to officials and favors for ethnic or tribal patronage networks are normal. ISAF eventually defined corruption as “the misuse of power for personal gain,” but found applying even that loose standard challenging.<sup>15</sup> Corruption in Afghanistan includes everything from petty bribery for routine services, nepotism, and tribal preference, to contract fraud, large-scale theft of resources, and subversion of the justice system.

## Petty Corruption on a Grand Scale

No one knows just how much Afghans pay each year in bribes, but the estimates are substantial. The United Nations Office of Drugs and Crime (UNODC) reported last year that in 2012, “half of Afghan citizens paid a bribe while requesting a public service” and “bribes paid to public officials amounted to US \$ 3.9 billion,” equivalent to 20% of the country’s gross domestic product.<sup>16</sup> The biannual National Corruption Survey by the nongovernmental group Integrity Watch Afghanistan had a much lower number. It estimated that Afghans paid about \$1.25 billion in bribes in 2012 compared to \$1.07 billion in 2010.<sup>17</sup> This survey found that 18% of respondents had paid a bribe to public officials, such as the police. The average respondent had paid four bribes averaging about \$190 each—a significant cost for people in a country with a per capita gross domestic product of only \$687.<sup>18</sup> Integrity Watch is currently reviewing the findings of a new corruption survey which it plans to publish in the coming months. It told SIGAR that its preliminary findings indicate that corruption has become even more of a problem.

These varying estimates—at minimum equivalent to more than half the Afghan government’s domestic revenue—result from bribes paid to public officials for services such as getting a government form stamped or paying a bribe to get through a police checkpoint. The UNODC has pointed out that the scale and pervasiveness of corruption partly reflects Afghan

attitudes and practices. Afghans see corruption as a problem for their country—but also accept some forms of it in ordinary life. The UNODC says 68% of citizens interviewed in 2012 thought it acceptable for civil servants to augment their low salaries with small bribes, while 67% considered it sometimes acceptable for family ties and friendship to determine civil-service hiring.<sup>19</sup> The HOO has also described some petty bribery as simply a response to a “difficult, intolerable, time consuming and expensive” process for getting permits, licenses, or document recording, adding “All these processes involve and facilitate petty corruption.”<sup>20</sup> While some have argued that this “petty bribery” is the way Afghans have traditionally operated, Sarah Chayes, who ran a business in Kandahar and served as an advisor to ISAF for several years before joining the Carnegie Endowment for International Peace, says the bribery occurs within “vertically integrated” networks of corruption:

Western analysts and decision-makers tend to discount what they call “petty corruption”—constant police shake-downs in the guise of traffic enforcement; demands for payment by school principals, doctors, or even the clerk in charge of filling out death certificates . . . and systematic sale of judicial decisions. Many Westerners describe such abuses as merely the greasing of the wheels necessary to “get things done” in developing countries. In fact, such injustices and humiliations are sources of daily outrage to citizens . . . And they are intimately linked to the rent-seeking at the top. For these corrupt networks are vertically integrated. In Afghanistan, the Kandahar bench pays a monthly cut of the bribes local judges extort to the chief justice of the Supreme Court, according to public prosecutors.<sup>21</sup>

In other words, this petty bribery—or predatory corruption—is a significant feature of the spider web of corruption that has ensnared the financial and justice sectors, impeded revenue collection, tolerated land appropriations, and fed criminal patronage networks.

## Grand Corruption Undermines Public Trust

Systemic, large-scale corruption impedes Afghan revenue collection, jeopardizes economic development, and thwarts efforts to establish the rule of law.

The U.S. reconstruction strategy includes helping the Afghan government collect more revenues to cover its budget shortfall and become less dependent on the international community for its operating expenses. A SIGAR audit of the Afghan customs system released this quarter found, “Corruption is affecting all levels of the customs process and is the biggest issue affecting Afghan customs processes and revenues.” The audit notes that the extent and impact of customs corruption is “difficult to quantify,” but cites U.S. agencies’ estimates that tens of millions of dollars are lost to smuggling each year and that reducing corruption “could

# CORRUPTION THREATENS

potentially double the customs revenues remitted to the central government.” The audit also notes that the United States has spent at least \$198 million since 2009 to improve the Afghan government’s ability to assess and collect customs revenue.<sup>22</sup>

Since 2012, Afghanistan has not been able to meet its revenue collection targets. Between December 2012 and December 2013, it missed its \$2.4 billion target by nearly 12%. U.S. and Afghan officials have told reporters that it could miss its 2014 target of \$2.5 billion by as much as 20%. This would mean that the Afghan government will only be able to pay for about a third of its \$7.5 billion budget. It will depend on the international community to cover the shortfall. See Section 3 of this report, page 159 for a full discussion of the Afghan budget.

The Afghan government and the international community are hoping that Afghanistan can boost its economy and increase revenues by developing the private sector, particularly in mining. However, plans to develop the country’s energy and mineral resources, described in Section 3 of this report, could also expand the opportunities for grand corruption beyond those currently available through the country’s world-leader status as an opium producer if the government has not established and cannot enforce a legal framework for mine development.

At the same time, corruption seriously hampers efforts to develop a responsible and tax-paying private sector. As the HOO put it, “Corruption constrains private sector investment, increases transaction costs, exposes entrepreneurs to threats of extortion and erodes business confidence via the unpredictability of licensing, property ownership, intellectual and other property rights/contracts.”<sup>23</sup>

A World Bank analysis comparing the business climates of 185 countries supports this view. Although the World Bank put Afghanistan in 28th place for ease of starting a business, it ranked the country 164th for enforcing contracts and 185th for protecting investors.<sup>24</sup> Potential investors might well wonder how great a role corruption plays in those rankings—and how much it might cost them to ensure better treatment.

The Kabul Bank saga, which SIGAR has reported on extensively in both its quarterly report to Congress and its audits of the financial sector, exemplifies how the patronage system and the deliberate failure to prosecute people guilty of gross fraud and abuse is undermining the Afghan economy and putting future development efforts at grave risk. Before its near collapse in 2010, the Kabul Bank was Afghanistan’s largest private bank. Individuals and companies associated with the bank stole about \$935 million from the bank, largely through fraudulent loan activity. About 92% of the funds went to 19 well-connected individuals. Afghanistan’s central bank covered the losses, which were the equivalent of more than half the government’s entire domestic revenue in 2010, and represented about 5% of the country’s GDP at the time.



**U.S. customs advisors** work with Afghan customs officials at the Weesh border crossing point. (U.S. Army photo)

Despite multiple investigations and international pressure to hold the individuals involved in the theft accountable, the Afghan government has recovered only about \$174.5 million. The Afghan Attorney General's Office deliberately slow-walked the investigation and although a few people have received light sentences, most of the key perpetrators, including members of the country's political elite, have not been brought to justice. (See Section 3, page 167 for an update on the Kabul Bank.)

The Kabul Bank crisis has had a profound impact on the entire financial sector. SIGAR recently issued an audit that found the banking system remains extremely fragile. The central bank lacks capacity and is in desperate need of technical assistance. However, the Afghan government has banned U.S. advisors from working at the central bank. SIGAR auditors concluded that Afghanistan is at serious risk of another banking crisis.<sup>25</sup>

Failure to reform and regulate the banking sector is putting the country's future development in jeopardy. For example, the International Monetary Fund's (IMF) Extended Credit Facility (ECF) provides medium-term assistance to low-income countries at little or no interest. The loan agreement with Afghanistan is contingent on the government's making banking and financial reforms that would increase transparency and accountability. These include passing an internationally acceptable anti-money-laundering law—something the Afghan government has refused to do—and facilitating information sharing between the central bank and Afghan law enforcement agencies as well as meeting macroeconomic targets. The IMF will not disburse any ECF funds without a favorable board review. It has not disbursed any funds since 2012 because Afghanistan has not made enough progress on reform.

This quarter, the Financial Action Task Force (FATF)—an international body that sets standards to combat money laundering, terrorist financing, and other threats to the integrity of the international financial system—downgraded Afghanistan's status because of its continued failure to improve its money-laundering countermeasures. Experts have cautioned that Afghanistan is at risk of being blacklisted. A blacklisting, which would make it difficult for Afghan banks to have correspondent relationships with international banks, could be devastating to the financial sector and the overall economy. Afghanistan must have a reliable banking system that observes and enforces internationally accepted rules to attract foreign investment as well as keep international assistance flowing after 2014. For more information on this issue, see Section 3 of this report.

## LACK OF POLITICAL WILL TO COMBAT CORRUPTION

The Joint Staff report concluded that neither the international community nor the Afghan government has been fully committed to combating corruption. The study pointed out that Coalition forces did not focus on corruption at all until 2009 for a variety of reasons:



- ISAF did not have the ability to accurately assess the impact of corruption.
- The U.S. military has no programs to train and equip personnel to combat corruption.
- High turnover of staff made it difficult to institute anticorruption measures.

At the same time, the Joint Staff report found, the U.S. military was reluctant to address the problem of corruption unless there appeared to be countermeasures the military could take. Indeed, it said the Afghan setting creates a problem for donor nations attempting to implement both anti- and counter-corruption measures. DOD's JCOA report notes that *anticorruption* measures like transparency requirements, accountability control, inspections, and audits limit opportunities for corruption and influence individual behavior, but do not actually sanction wrongdoers. Sanctioning occurs under *countercorruption* measures that entail both punishment and deterrence. Unfortunately, in Afghanistan, "Countercorruption measures were strongly reliant upon an effective legal system, particularly an independent judiciary." Afghanistan has neither an independent judiciary nor a legal system focused on rooting out corruption.<sup>26</sup>

Developing indigenous institutions to combat systemic corruption is extremely difficult. In a study of legitimacy in fragile states, the international Organization for Economic Cooperation and Development (OECD) observed that "A fundamental problem in many fragile states is that political and economic elites may have very little interest in strengthening state capacity or in constructive engagement with their own citizens, because they do not depend on them for revenue." Instead, the OECD explained that elites in some poor countries enjoy "unprecedented opportunities for personal enrichment" through smuggling, export deals, and proceeds of trade in illegal narcotics.<sup>27</sup>

In an April 2014 speech, President Karzai argued that Afghanistan will not successfully address corruption unless it makes progress on government reforms that would provide civil servants with a living wage and secure future. "In order to fight graft, we must reform our administrative system and make sure we pay enough salary to our employees and make sure their future is guaranteed," he said, "So far, I don't see signs of success in fighting graft or making government reforms."<sup>28</sup>

The HOO has described corruption as a deep-rooted structural problem, exacerbated by both internal and external factors. Among the internal factors, the HOO listed the following:

- weak institutional capacity at national and provincial levels
- weak legislative and regulatory framework
- weak enforcement of laws and regulations
- poor and/or non-merit based recruitment of public officials

- low salaries and insufficient numbers of law enforcement officials
- lack of complaint mechanisms and systems for public scrutiny
- illegal profits from opium trade and cross-border smuggling<sup>29</sup>

The HOO also suggests the international community has contributed to corruption through its “unprecedented large inflows of international assistance” in the form of development and humanitarian aid and contract funds supporting international forces, security firms, and the Afghan National Security Forces.<sup>30</sup>

The HOO, however, is part of the problem. As USAID reported to SIGAR this quarter, the HOO has done very little to combat corruption. USAID’s program to build help the HOO build capacity ended in November 2013. USAID has described the HOO as dysfunctional, ineffective, and politicized.<sup>31</sup> See Section 3 for a discussion of the HOO.

DOD and State have also been very critical of the Afghan Attorney General’s Office, the institution charged by the Afghan constitution with investigating and prosecuting crimes in Afghanistan.<sup>32</sup> SIGAR investigators, working in close cooperation with other federal law enforcement agencies, have helped to identify some of the criminal networks and the degree to which they operate in collusion with Afghan authorities. They have first-hand experience of how difficult it is for Afghan law enforcement to prosecute serious corruption cases. Afghanistan’s Attorney General has deliberately avoided prosecuting either senior officials or individuals with ties to senior officials.

## **FAILURE TO DEVELOP A COMPREHENSIVE ANTICORRUPTION STRATEGY**

Although U.S. civilian and military agencies have launched a variety of programs to tackle corruption in Afghanistan, the United States has never had a comprehensive strategy to guide U.S. anticorruption activities in Afghanistan. It was not until the 2010 donor conference in London that the international community specifically raised corruption as a serious concern. That year, the donors and the Afghan government also established the Joint Anti-Corruption Monitoring and Evaluation Committee (MEC) to address international concerns about corruption. By 2012, at the Tokyo donors’ conference, the donors were far more explicit. They made assistance after 2014 contingent on the Afghan government’s meeting reform benchmarks defined in the Tokyo Mutual Accountability Framework. These benchmarks, however, tend to be vague and lack measurable outcomes.

Meanwhile, the United States began establishing various task forces to try to understand the pervasive and interlinked nature of corruption. In 2010, the Defense Department established Task Force 2010 to ensure that U.S.-funded contracts did not support the insurgency. It also created Task

Force Shafafiyat—which means “transparency”—to focus on the intersection of corruption with the narcotics trade and the insurgency. The U.S. Embassy Kabul circulated a draft of a comprehensive anticorruption strategy in 2010, but the Secretary of State never formally approved it.<sup>33</sup>

SIGAR has repeatedly recommended that the United States develop and implement a comprehensive anticorruption strategy to deal with what General John Allen, the outgoing commander of U. S. Forces in Afghanistan in 2013, described to President Obama as “*the* existential, strategic threat to Afghanistan.”<sup>34</sup>

While developing such a strategy may not be easy, it is an essential step to tackling a problem that threatens to undermine the entire U.S. effort in Afghanistan.

## DEVELOPING AN ANTICORRUPTION STRATEGY IS NOT EASY

International financial institutions and global think tanks have pointed out that corruption cannot be solved easily or quickly. Norway’s internationally funded **Chr. Michelson Institute** recently published an analysis of donor responses to corruption in Afghanistan, Tanzania, and Zambia. It concluded that available research suggests that development partners “have a limited likelihood of influencing wider corruption trends.” The Norwegian report also suggested that “failed reform efforts can even be harmful by reinforcing the feeling the majority has of being ‘trapped’ in a corrupt ‘game.’” The study posed an important question for policy-makers to consider: “Would it be a mistake to try and ‘take the bull by the horns’ in environments where the bull has a million horns?”<sup>35</sup>

In Afghanistan and other developing countries, the United States and other international donors have called for, promoted, advised on, or finally supported in-country monitoring agencies, democracy, rule of law, higher wages for public employees, independent courts, free press, growth of civil society, and other efforts to undercut corruption. Swedish university researchers examining the results of such efforts in Africa, however, concluded “Few successes have resulted from the investment.”<sup>36</sup> The researchers found that “Insofar as corruption is the expected behavior in a particular society we should expect monitoring devices and punishment regimes . . . to be largely ineffective since there will simply be no actors willing to enforce them.”<sup>37</sup>

People intent on illicit enrichment can and will change their behavior to evade anticorruption measures. A research review by professors at MIT and Harvard found “fairly robust evidence” for believing that “Corrupt officials respond to monitoring and punishments as one would expect from basic incentive theory,” but adds, “the ability of corrupt officials to substitute to alternate forms of corruption and to otherwise adapt to policy changes,

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**The Chr. Michelsen Institute (CMI):** is an independent, internationally funded development-research institute in Bergen, Norway. Founded in 1930, CMI is named for former Norwegian Prime Minister Christian Michelsen (1857–1925), its original benefactor. CMI hosts the Anti-Corruption Resource Centre (“U4”) and conducts research on poverty, human rights, conflict, and development in low- and middle-income countries. Funding comes from the Norwegian government, the Research Council of Norway, and various nongovernmental organizations. CMI clients include the United Nations, the World Bank, and the UK Department for International Development. Its website is [www.cmi.no](http://www.cmi.no).

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Sources: CMI and the International Centre for Tax and Development (<http://www.ictd.ac/en/cmi-chr-michelsen-institute>).

# CORRUPTION THREATENS



**The MEC** expresses serious concerns over impunity in high-profile corruption cases, detailed in the organization's most recent six-month report. (UNAMA photo by Fardin Waezi)

either in the short or long run, suggests that applications of these [anticorruption] principles will be tricky in practice.”<sup>38</sup>

Despite the enormous challenges of implementing an anticorruption strategy, several developments in Afghanistan suggest that an emerging civil society is increasingly focused on exposing and combating corruption. As Special Inspector General John F. Sopko told the Atlantic Council in March this year, “Afghanistan has a growing number of organizations and individuals dedicated to exposing corruption and fostering the rule of law. It has a robust media that has highlighted and reflected Afghan dissatisfaction with corruption.”<sup>39</sup> The MEC, which has Afghan and international representation, has proved to be an important body that has grappled with serious issues, identified corrupt practices, and made recommendations to improve transparency and accountability. It produced the single most important report on the Kabul Bank scandal. It has also pointed out that the Afghan Attorney General’s Office has not followed legal requirements in hiring prosecutors and needs to raise prosecutors’ salaries “to reduce the incentive for corruption.”<sup>40</sup> Another MEC corruption-vulnerability assessment reported that Afghanistan’s pension-administration system suffered from opportunities for bribery, fake documents, lack of information on beneficiaries, and “unfair influence of high-ranking government officials.”<sup>41</sup> Such courageous work from civil society actors like the MEC needs continued multifaceted support from the international community.



## SAFEGUARDING FUTURE U.S. RECONSTRUCTION FUNDS

SIGAR has repeatedly called on the U.S. government to develop and implement a comprehensive civilian-military anticorruption strategy to protect the U.S. investment in Afghanistan. To prevent the waste, fraud, and abuse of reconstruction assistance, both the United States and whatever Afghan government emerges from the elections must make fighting corruption a high priority. The United States and its Coalition partners must also encourage the new government to comply with its international agreements and undertake the reforms promised at previous international donor conferences.

Special Inspector General Sopko has outlined areas where SIGAR believes the United States can help Afghans counter corruption. He has urged U.S. implementing agencies to take the following steps:

- Hold U.S. contractors and government employees accountable.
- Insist that the Afghans hold their contractors and government employees accountable.
- Continue to support U.S.-funded anticorruption efforts such as Task Force 2010 and the Afghan Threat Finance Cell.
- Care less about the burn rate and more about how funds are being spent.
- Recognize that too much money, spent too quickly, with too few safeguards, is a recipe for disaster.
- Insist that Afghan ministries develop and maintain good internal controls to receive U.S. funds.
- Provide support for Afghan civil society groups fighting corruption such as the MEC, Integrity Watch, and the nascent independent Afghan media.<sup>42</sup>

Establishing and sustaining a long-term, coordinated, multi-front attack on corruption is a vital task for stewardship of America's human and financial stake in Afghanistan, and for the future of the country and its people.



**Special IG John F. Sopko** speaks before the Atlantic Council about corruption in Afghanistan. (Atlantic Council photo)

“The costs in Afghanistan—both in lives lost and money spent—have been enormous. If we don't take advantage of this opportunity and get serious about corruption right now, we are putting all of the fragile gains that we have achieved in this—our longest war—at risk of failure.”

—*Special Inspector General John F. Sopko*