

SIGAR

Special Inspector General for
Afghanistan Reconstruction

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QUARTERLY REPORT TO THE UNITED STATES CONGRESS





The National Defense Authorization Act for FY 2008 (Pub. L. No. 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.

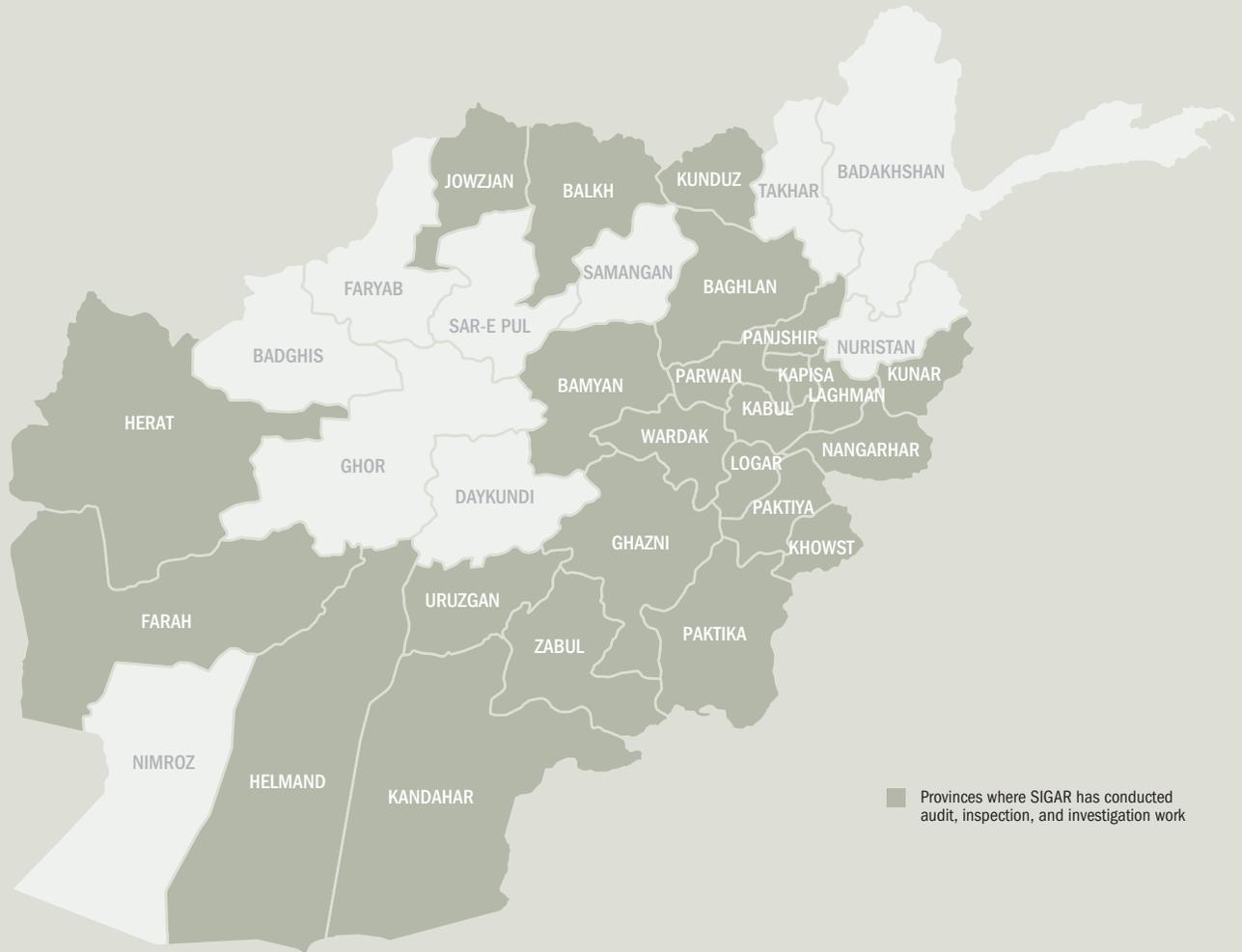
Afghanistan reconstruction includes any major contract, grant, agreement, or other funding mechanism entered into by any department or agency of the U.S. government that involves the use of amounts appropriated or otherwise made available for the reconstruction of Afghanistan.

Source: Pub. L. No. 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:

Members of the DOD Task Force on Business Stability Operations (TFBSO) sometimes stayed at rented villas like this one in Kabul. (Former TFBSO employee photo)





SPECIAL INSPECTOR GENERAL FOR
AFGHANISTAN RECONSTRUCTION

I am pleased to submit to Congress, and the Secretaries of State and Defense, SIGAR's 30th quarterly report on the status of the U.S. reconstruction effort in Afghanistan.

This quarterly report focuses on the Afghan economy, but as the essay in Section 1, "Growing an Economy in Stony Ground," concludes, developing Afghanistan's economy may depend more on improving security, the business climate, and the educational system than on implementing specific economic programs. However, in this reporting period, Afghanistan proved even more dangerous than it was a year ago. The Taliban now controls more territory than at any time since 2001. Vicious and repeated attacks in Kabul this quarter shook confidence in the national-unity government. A year after the Coalition handed responsibility for Afghan security to the Afghan National Defense and Security Forces (ANDSF), American and British forces were compelled on several occasions to support ANDSF troops in combat against the Taliban.

The lack of security has made it almost impossible for many U.S. and even some Afghan officials to get out to manage and inspect U.S.-funded reconstruction projects. This quarter the dangers of absent oversight were exposed when a task force appointed by President Ashraf Ghani reportedly found that millions of dollars were being embezzled while Afghanistan pays for numerous nonexistent "ghost" schools, "ghost" teachers, and "ghost" students.

Notwithstanding these obstacles, SIGAR, the largest U.S. oversight organization in Afghanistan, has managed to continue its work of overseeing U.S. programs and projects, partly through the creative use of local Afghan national staff. This quarter, SIGAR issued 11 audits, inspections, alert letters, and other products. SIGAR work to date has saved over \$2 billion for the U.S. taxpayer.

A SIGAR performance audit examined the United States' \$488 million effort to develop Afghanistan's oil, mineral, and gas industries. The audit determined that 11 Task Force for Business and Stability Operations and two U.S. Agency for International Development (USAID) programs had mixed success due to challenges in dealing with the Afghan government. Another performance audit this quarter found that despite U.S. training efforts, the Afghan National Army's National Engineer Brigade is incapable of operating independently.

SIGAR completed five financial audits this quarter of U.S.-funded contracts and cooperative agreements to rebuild Afghanistan. SIGAR also announced five new financial audits of Defense and State Department contracts and grants with combined incurred costs of more than \$122.5 million, bringing the total number of ongoing financial audits to 23 with more than \$2.7 billion in auditable costs.

During the reporting period, SIGAR investigations achieved significant results. A civil settlement agreement totaled \$1.45 million; cost savings to the U.S. government amounted to over \$100,000; and, fines, forfeitures, and restitutions amounted to \$110,000. Additionally, there was one indictment, one conviction, and two sentencing. SIGAR initiated 17 new investigations and closed 14, bringing the total number of ongoing investigations to 309.

The accomplishments of the quarter bring the cumulative total in criminal fines, restitutions, forfeitures, civil settlement recoveries, and U.S. government cost savings from SIGAR's ongoing investigations to over \$946.2 million.

This quarter, SIGAR's suspension and debarment program referred seven individuals and 10 companies for suspension or debarment based on evidence developed as part of investigations conducted by SIGAR in Afghanistan and the United States. Three of these individuals were referred for suspension based upon criminal charges being filed against them alleging misconduct related to or affecting reconstruction contracting in Afghanistan. These referrals bring the total number of individuals and companies referred by SIGAR since 2008 to 697, encompassing 368 individuals and 329 companies to date.

SIGAR continues to provide vigorous oversight of reconstruction projects and programs, while examining Afghanistan reconstruction as a whole for lessons learned to be used in future contingency operations. My staff and I look forward to working with Congress and other stakeholders in the New Year to prevent waste, fraud, and abuse of U.S. funds appropriated for reconstruction in Afghanistan.

Respectfully,

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

John F. Sopko
Special Inspector General for Afghanistan Reconstruction

EXECUTIVE SUMMARY

This report summarizes SIGAR's oversight work and updates developments in the three major sectors of Afghanistan's reconstruction effort from October 1 to December 31, 2015.* It also includes an essay on Afghanistan's growing economic crisis, the barriers to private-sector economic growth, and options for bolstering the country's economic prospects. During this reporting period, SIGAR published 11 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 a lack of accountability, failures of planning, deficiencies in internal controls, and noncompliance issues. The cost savings to the U.S. government from SIGAR's investigative work amounted to over \$100,000; civil settlement recoveries totaled \$1.45 million; and fines, forfeitures, and restitutions amounted to \$110,000. SIGAR investigations also resulted in one indictment, one conviction, and two sentencing. Additionally, SIGAR referred seven individuals and 10 companies for suspension or debarment based on allegations that they engaged in fraud and contract nonperformance.

SIGAR OVERVIEW

AUDITS

SIGAR produced two performance audits and five financial audits.

The **performance audits** found:

- Task Force for Business and Stability Operations (TFBSO) and U.S. Agency for International Development (USAID) programs to develop Afghanistan's oil, mineral, and gas industries had mixed success due to challenges in dealing with the Afghan government.
- Despite U.S. training efforts, the Afghan National Army's National Engineer Brigade is incapable of operating independently.

The **financial audits** identified nearly \$1.8 million in questioned costs as a result of internal-control deficiencies and noncompliance issues. These deficiencies and noncompliance issues included, among other things, failure to follow competitive procurement procedures, purchase of materials from restricted sources, overcharging due to utilization of improper currency exchange rates, lack of sufficient documentation to support costs incurred, and billing for ineligible tax fines and penalties.

NEW AUDITS AND INSPECTIONS

This quarter, SIGAR initiated one new performance audit to assess the administration, monitoring, and reporting of the Afghanistan Reconstruction Trust Fund. This brings the total number of ongoing performance audits to 15.

SIGAR also announced five new financial audits of Department of Defense and Department of State awards with combined incurred costs of more than \$122.5 million, bringing the total number of ongoing financial audits to 23 with more than \$2.7 billion in auditable costs.

SPECIAL PROJECTS

During this reporting period, the Office of Special Projects issued three products, including one inquiry letter and one review letter addressing issues including:

- TFBSO's decision to spend nearly \$150 million, or nearly 20% of its budget, on private housing and private security guards for its U.S. government employees in Afghanistan, rather than having those employees live on U.S. military bases.
- The operating conditions of and inaccuracies in the geospatial coordinates for 32 USAID-funded public-health facilities in Kabul Province.

EXECUTIVE SUMMARY

INVESTIGATIONS

During the reporting period, SIGAR investigations resulted in cost savings to the U.S. government of over \$100,000; fines, forfeitures, and restitutions amounted to \$110,000; and civil settlement recoveries totaled \$1.45 million. Criminal investigations resulted in one indictment, one conviction, and two sentencing. SIGAR initiated 17 new investigations and closed 14, bringing the total number of ongoing investigations to 309. SIGAR's suspension and debarment program referred seven individuals and 10 companies for suspension or debarment.

Investigations highlights include:

- A U.S. Army sergeant pled guilty to conspiracy to receive and accept illegal bribes by a public official and was sentenced to 24 months' incarceration, followed by 12 months' supervised release.
- Another U.S. Army sergeant pled guilty to the same charge and was sentenced to 12 months and one day of incarceration, followed by one year's supervised release, and was ordered to forfeit \$10,000.
- An investigation of an alleged contract bid-rigging scheme led to a civil settlement recovery of \$1.45 million. In a related criminal investigation, four individuals were sentenced for their roles in the scheme and were debarred from doing business with the U.S. government.
- An investigation confirmed a duplicate payment made under the National Afghan Trucking contract, resulting in a cost savings to the U.S. government of more than \$100,000.
- A U.S. Army captain pled guilty to solicitation and receipt of a gratuity of \$50,000 in return for facilitating the award and payment of transportation contracts to an Afghan trucking company.

* SIGAR may also report on products and events occurring after December 31, 2015, up to the publication date.



Special Inspector General John F. Sopko prepares to testify before a subcommittee hearing of the Senate Armed Services Committee on January 20, 2016. The hearing dealt with SIGAR's work on the Task Force for Business Stability Operations, a former DOD component that operated nearly \$800 million in programs and projects in Afghanistan. (SIGAR photo by Alex Bronstein-Moffly)

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“Significant amounts of Afghan private capital are being held outside the country—probably tens of billions of dollars—which could be repatriated and invested productively in Afghanistan, but this cannot be expected to happen unless there is greater confidence in the future, a more effective NUG [National Unity Government], and prospects for reduction of violence and progress of reconciliation.”

—*United States Institute of Peace*

1 GROWING AN ECONOMY IN STONY SOIL



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A vehicle travels under lights powered by a new transmission line from Uzbekistan that has boosted electricity in Kabul from 4-hour to 24-hour availability. (Asian Development Bank photo)

GROWING AN ECONOMY IN STONY SOIL

AFGHAN ECONOMY REMAINS IN CRISIS: RECONSTRUCTION FOCUS NEEDS TO CHANGE

Intractable insurgents, cutbacks in foreign military personnel, persistent emigration of people and capital, and a slowing global economy are shifting Afghanistan's economic prospects from troubling to bleak.

President Ashraf Ghani recently summarized both the impact of the reduced foreign presence and the stubborn persistence of poverty in Afghanistan:

Hundreds of thousands of people lost their jobs as a result of the [Coalition] troop withdrawals. In the transport sector alone, which constituted roughly 22 percent of GDP [gross domestic product], at least 100,000 jobs were lost. Construction of the military facilities was a major driver, with the service sector connected with it comprising an amazing 40 percent of gross domestic product. In addition, the large sum of funds that were provided in annual assistance did little to alleviate poverty, because the government did not focus on the poor. Today, 70 percent of the population still live on less than \$1.75 a day.¹

Afghanistan recently scored poorly in the “High Alert” and “Worsening” lists of the United Nations-supported Fund for Peace's empirically driven *Fragile States Index 2015*, with particularly bad marks in areas like demographic pressure, refugees, poverty and economic decline, and security.² The Fund noted that its data were drawn from 2014 sources. Facts emerging from 2015 reports touching on security, health, and education are unlikely to brighten the picture. SIGAR's authorizing statute directs it to call attention to deficiencies in U.S. reconstruction efforts in Afghanistan and to suggest corrective actions.³ Afghanistan's economic travails clearly demand corrective actions.

The governments of Afghanistan and the United States share an urgent interest in spurring growth to raise Afghans from their pervasive poverty, offset the decline in foreign spending, and boost the Kabul regime's fiscal soundness and legitimacy. But even seemingly simple steps to promote farming and small business may founder in the country's overgrown

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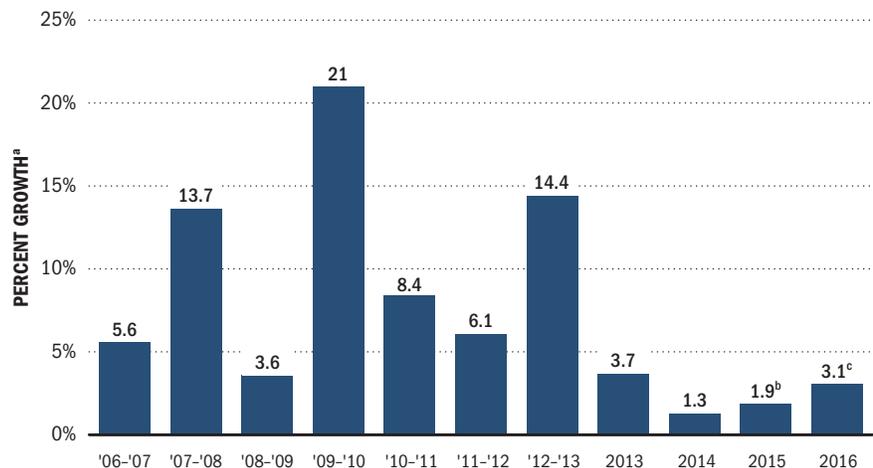
thickets of insecurity, favoritism, corruption, and other obstacles to conducting business and trade.

The reduced military presence of the United States and other foreign nations has trimmed cash flows and business opportunities for Afghan individuals and businesses who provide everything from bottled water to cargo transport for Coalition forces. International aid continues, but a recent report from the U.S. Institute of Peace (USIP) warns that “offsetting the negative demand shock of declining international military spending and aid will be impossible.” One reason, USIP notes, is that “significant amounts of Afghan private capital are being held outside the country—probably tens of billions of dollars” that are unlikely to return without better security and governance.⁴

With the sharp contraction in foreign presence, formerly robust Afghan GDP growth rates slowed from 14.4% in 2012 to 3.7% in 2013 and to 1.3% in 2014, according to the World Bank.⁵ (See Figure 1.1.) The slowdown, according to the USIP report, “also reflects loss of business and consumer confidence, lack of private investment, very low public investment, and deepening uncertainty over the political transition and security outlook,” as well as concerns about “the slow start and continuing weaknesses of the national unity government.”⁶

FIGURE 1.1

RATES OF INCREASE, AFGHAN REAL GROSS DOMESTIC PRODUCT, 2006–2016 (PERCENT)



Note:

^a Figures exclude opium income.

^b Estimate.

^c Estimate, conditioned on security and reform improvements.

Source: For 2006 through 2015, The World Bank, “Afghanistan: Emerging from Transition,” presentation, Senior Officials Meeting, Kabul, 9/4–5/2015, pp. 6, 10; for 2016, The World Bank, “Afghanistan Overview,” <http://www.worldbank.org/en/country/afghanistanoverview>, 10/20/2015.

Private investment, the World Bank recently reported, has shown “strong signs of slowdown,” while registrations of new firms have declined by nearly half since 2012. The Bank says Afghanistan’s medium-term outlook is “unfavorable,” with “sluggish growth” of 1.9% projected for 2015, and a mild recovery in real (inflation-adjusted) GDP growth to 3.1% in 2016 and 3.9% in 2017. But that modest forecast carries a caveat—“conditioned on improvements in the security environment and strong reform momentum.”⁷

Even a return to real growth in the 3% range would do little to lift Afghanistan from the ranks of the world’s most impoverished countries. The nation’s population growth for the years 2011–2014 has run around 3%.⁸ Consequently, per capita GDP—a standard measure of economic well-being—would remain essentially unchanged. Per capita GDP is, moreover, an average that does not indicate whether income disparities are growing or shrinking. Uneven growth could deepen the hardships of the population if the scope and delivery of government services cannot mitigate them.

That is not an idle concern. A 2015 study of the Afghan private sector by the Stockholm International Peace Research Institute (SIPRI) concludes that “The significant amount of aid and vast international military spending post-2001 has re-ingrained a culture of aid-rentierism: the Afghan elite competes internally for political rents from the international community. . . . The little wealth there is in the country is inequitably distributed, and the rich-poor gap has been widening.”⁹ (Rentier states rely heavily or principally on aid, resource sales or royalties, transit fees and other external funds rather than domestic revenues, with possible consequences for government receptiveness to change and attentiveness to citizens’ well-being.¹⁰)

Neither Afghanistan’s security outlook nor its economic prospects are doing anything to inspire confidence among the population. The Asia Foundation’s 2015 public-opinion survey of more than 9,500 Afghans in all 34 provinces found optimism at a low: “Afghans are particularly concerned about security, and the proportion who fear for their personal safety is at the highest point in the past decade.” The survey determined that the economy and unemployment are also major concerns, especially for women and young people.¹¹

Considering the choices before them, many young Afghans are voting with their feet. The past year, according to the Asia Foundation, has found the Kabul Passport Office issuing more than 2,000 passports a day, six times the pace of a year earlier.¹² Afghans accounted for 20% of the million-plus migrants to the European Union in 2015, second only to Syrians fleeing their own civil war.¹³

Even more worrisome, the emigrants may be disproportionately drawn from the younger, educated ranks of Afghans. “It’s a huge loss,” says economist Ahmed Siar Khoreishi, chief executive of Ghazanfar Bank. “The majority of these people are under the age of 30. This is really scary, we have very limited qualified, specialist people. . . . The brains are leaving.”¹⁴

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The potential for a larger exodus seems real. The latest Asia Foundation public-opinion survey indicates nearly 40% of Afghans would leave the country if they could.¹⁵

Emigrants from Afghanistan take with them more than financial assets. They take away knowledge, skills, and other forms of human capital. Afghanistan can ill afford to suffer such losses. “There is a critical shortage of skilled labor in Afghanistan,” according to the U.S. State Department (State), partly because the literacy rate for ages 15 and up is only 32%.¹⁶ Harvard researchers have observed that “human capital is underdeveloped” in Afghanistan: business operators complained in interviews that architects, engineers, managers, plumbers, and electricians were hard to find.¹⁷

On a more positive note, State says “The Afghan government recognizes that the development of a vibrant private sector is crucial to the reconstruction of an economy impaired by decades of conflict and mismanagement.”¹⁸

MANY BARRIERS IMPEDE PROGRESS

Recognizing needs and realizing results are, of course, separate issues. The State Department says the Afghan government’s ability to advance a private-sector growth agenda has been limited by weak institutional capacity, economic “rent-seeking behavior” (individuals or firms obtaining special status, favored treatment, and legal prerogatives that could not be obtained in an open market), and lack of political will to undertake reforms.¹⁹

State’s list of obstacles to growth in Afghanistan is sobering.

Problems include:

- “Underdeveloped and irregularly implemented” legal and regulatory frameworks and enforcement mechanisms, all troubled by corruption
- Unofficial “taxes” and bureaucratic delays
- Anticompetitive behaviors aided by wealth and social connections
- Weak property-rights protection, commercial-court incapacity, and corruption
- “No serious enforcement of intellectual property rights”
- “Systemic corruption at border crossings”
- Lack of criminal prosecution or penalties for official corruption²⁰

In a similar vein, another USIP report observes that “The ambivalence of government officials, which is due to a combination of ideology and self-interest, has delayed, suppressed, or hijacked implementation of liberalization policies.”²¹

Economists broadly agree that the design, operation, and incentive structure of a society’s institutions are a critical factor in economic growth. For settings like Afghanistan, however, it is important to note that institutions include more than ministries, courts, and regulatory agencies. “Institutions,” said economic historian Douglass C. North in his Nobel Prize acceptance



Afghan man shops at the main market in Kabul: a strong retail sector can support local jobs and boost revenues for public purposes. (Asian Development Bank photo)

lecture, “are the humanly devised constraints that structure human interaction. They are made up of formal constraints (rules, laws, constitutions), informal constraints (norms of behavior, conventions, and self-imposed codes of conduct), and their enforcement characteristics. Together they define the incentive structure of societies and specifically economies.”²²

In that sense, widespread practice and expectations of corruption, traditional gender roles, some religious dictates and prohibitions, and patronage networks are among the institutions that can be detrimental to economic growth.

Because of the many barriers to growth that exist in Afghanistan, the country’s circumstances require more—and more effective—action to spur development.

DEVELOPMENT MAY TAKE MANY FORMS

Deciding what action to take is a judgmental challenge, for as the World Bank has observed, “There is no known formula for stimulating economic growth.”²³

Governments have tried many ways to stimulate economic development. They may involve “industrial policy,” directed investment in specific sectors of the economy such as public investment in steel mills or cement plants. “Value-chain” development can include building processing capability to capture value added that is foregone when raw products are shipped out of the country for finishing and shipment.

Import-substitution policies encourage domestic production of goods or services that are normally imported. Export-promotion policies focus on developing and marketing exportable goods to create new jobs and earn foreign exchange. Another stimulative effort might simply involve boosting the supply of money and credit, although particularly in Afghanistan, that could lead to more purchases of imports, as opposed to boosting domestic demand.²⁴

British economist John Weiss notes that developing countries may still be attracted to industrial-policy interventions, which theoretically could be helpful, but adds, “Paradoxically, one can argue that where such interventions are most needed (in the lowest-income countries with thin markets and a small private sector) the capacity to introduce them is weakest.”²⁵ Afghanistan, with its widely reported shortages of skilled civil servants, weaknesses in ministerial capacity, and prevalence of corruption (not to mention its low fiscal capacity and the prospect of declining foreign assistance) could well be one of those cases.

Much of the foreign financial assistance that has flowed into Afghanistan since 2001 has been directed into projects that can provide foundational support for growth and development. The U.S. Agency for International Development (USAID), for example, has invested more than \$2 billion to

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build and expand more than 2,000 kilometers of roads; has helped develop 172 megawatts of electric generation and increased the portion of the Afghan population linked to the electric grid from 6% in 2002 to 28% today; and has funded construction of more than 500 schools and 600 health facilities.²⁶ U.S. funding of electrical-sector projects in Afghanistan via USAID and contributions to the Afghan Infrastructure Fund exceed \$3 billion.²⁷

Within the Department of Defense, the now-closed Task Force for Business Stability Operations (TFBSO) conducted 11 initiatives costing \$215.4 million aimed at developing Afghanistan's minerals and hydrocarbons potential by restoring productive capacity across industrial sectors, stimulating economic growth, and catalyzing private investments.²⁸ (SIGAR has, however, documented serious shortcomings in some TFBSO initiatives; see Section 2, "SIGAR Oversight," in this and previous quarterly reports for discussions.)

Other efforts aimed at developing and growing the Afghan economy involve more targeted geographic-, function-, or sector-specific projects and programs. They take many forms, and are funded, directed, and executed by many actors, including the United States, United Kingdom, European Community, World Bank, Asian Development Bank, Afghanistan Reconstruction Trust Fund and other multilateral funds, and assorted non-governmental organizations (NGO).

Some of the reported outcomes may be less solid than they appear. As noted in many reports by SIGAR and other U.S. and international oversight organizations, development projects vary widely in the soundness of their conception, appropriateness to the Afghan context, adherence to schedule, sustainability, and success in attaining desired outcomes. A new RAND Corporation report prepared for the U.S. Secretary of Defense, for example, concludes that TFBSO "had problems implementing large, complicated infrastructure investments." Causes included "a naïve view of the risks and difficulties of implementing a project or a lack of appreciation of local or market conditions."²⁹

In any case, despite more than a decade of these reconstruction and development efforts, the Afghan economy remains in fragile and worsening condition. As a recent report from the SIPRI concludes,

Amid contracting aid resources and ongoing insecurity, post-transition economic instability is likely [in Afghanistan]. A toxic set of conditions has created a deadlock: the government can neither kick-start the economy nor provide the core public goods and services [e.g., roads, literacy, security] necessary for the formal private sector to blossom.³⁰

MEASURING RESULTS IS ANOTHER CHALLENGE

Even if development initiatives—whether led by Afghan, international, or nongovernmental organizations—have optimized their chances of success

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by taking appropriate account of local environments, security threats, impediments to movement, conflicts of interest, staffing, sustainability, and vulnerabilities to corruption, there is another great difficulty. That is the challenge of monitoring programs and projects, and of collecting and using the information needed for decisions to expand, modify, redirect, relocate, or terminate a program.

A number of SIGAR products have documented the difficulty of determining the conceptual soundness, quality of execution and oversight, and actual impact of donor-funded projects in Afghanistan. For example,

- A 2015 audit of U.S. approaches to developing Afghanistan's extractives industry to exploit large reserves of minerals, oil, and natural gas found divergent approaches and a lack of overall strategy, poor coordination and limited information sharing, and an inability of Kabul's Ministry of Mines and Petroleum to handle contract research, awards, and management on its own.³¹
- A 2014 inquiry into the Gereshk Cold and Dry Storage Facility in Helmand province, a \$2.89 million facility funded by the Department of Defense's TFBSO, found it to be apparently well built, but never used, and with no private-sector interest in evidence.³²
- A 2014 inspection of the USAID-funded Gorimar Industrial Park in Balkh Province found a lack of required documentation for contracts, task orders, and payments; power and water systems inoperable for lack of fuel; and an occupancy rate of less than 20%.³³
- A 2013 audit of USAID's Stability in Key Areas Program, which aimed to have contractors award "quick delivery" grants for projects like graveling roads, building culverts, and lining canals, found that the program had disbursed none of its \$47 million six months after the program started, and had reached no formal agreement with Afghan government partners until nine months after the first contract was signed.³⁴

USAID has funded many reconstruction projects in Afghanistan that aim to promote growth. Its efforts include establishing 125 business associations, including women-owned operations; facilitating marble exports; helping more than 2,700 Afghan firms obtain business loans; and providing management training and marketing assistance.³⁵

USAID's Office of the Inspector General recently audited the agency's strategy for monitoring and evaluating its programs in Afghanistan. The audit made a number of troubling observations. The USAID/Afghanistan mission could show only one instance out of 127 contracts, grants, and cooperative agreements where prescribed multi-tier monitoring was being used. Reasons included lack of site access, making office visits and reading reports rather than going to work sites, and relying on software that could not centralize collected data.³⁶



A truck rolls along near Kandahar: the lack of good transportation infrastructure is a challenge in Afghanistan. (USACE photo by Karla Marshall)

Further, the USAID/Afghanistan mission provided plans for only six of its 127 project activities; none explained how USAID could decide how much monitoring was needed. Mission offices also had no annual monitoring plans, as required, to guide the work of contract third-party monitors, even though USAID has spent more than \$242 million on their services since 2006.³⁷

Given the mixed results of development efforts, the difficulties of assessing government- and NGO-funded initiatives, and the prospect of declining international assistance, it may be incumbent on Afghanistan and its international partners to sharpen the focus of their efforts to promote private economic activity.

WHAT SHOULD AFGHANISTAN DO?

“Afghanistan’s economy has a complex mix of informal, formal, illicit and aid-sustained elements,” according to the SIPRI, with the formal private sector accounting for only 10–12% of GDP.³⁸ By way of contrast, formal private-sector activity in the United States accounts for about 82% of GDP.³⁹

“In its current state,” SIPRI says, “the Afghan private sector is not the engine of economic growth or instrument of social inclusion it has the potential to be.”⁴⁰ In addition, individuals and firms operating outside the formal economy may be paying few or no taxes, worsening Afghanistan’s vast fiscal gap between revenues and expenditures.

Stimulating the private sector toward spontaneous activity seems more likely to bolster Afghanistan’s economic standing than focusing on development projects that are closely tied to government operations. “Afghanistan can be characterized as a weak rentier state, subsisting on aid,” Dutch development scholars have written. They warn, “‘State building’ in this context cannot be successful,” for “more aid ‘ownership’ and a strengthening of the Afghan bureaucracy will simply consolidate aid rentierism rather than reverse-engineer a market democracy.”⁴¹

The focus on facilitating private activity makes sense. “The private sector holds the key,” a World Bank investment-climate report explains, “as 9 out of 10 jobs are created in the private sector. Consequently, a predictable and business-friendly investment climate stands as an integral component of the policy framework for job creation.”⁴²

From that point of view, Afghanistan would benefit from business-climate change.

The World Bank’s *Doing Business 2016* report on regulatory quality and efficiency ranks Afghanistan 177th of 189 countries compared. It stands ahead of countries like Haiti, Chad, South Sudan, and last-place Eritrea, but trails some of its neighbors: Uzbekistan ranks 87th, Iran 118th, and Tajikistan 132nd.⁴³

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Afghanistan's only high mark is in ease of starting a business: 34th. Ease of paying taxes (89th) and getting credit (97th) are middling. Afghanistan standing in seven other categories includes 156th for obtaining electricity, 172nd for enforcing contracts, and a last-place 189th for protecting minority investors.⁴⁴

The World Bank points out that “The economies performing best in the *Doing Business* rankings . . . are not those with no regulation but those whose governments have managed to create rules that facilitate interactions in the marketplace without needlessly hindering the development of the private sector.”⁴⁵

The World Bank notes that many factors apart from the regulatory setting affect the growth and efficiency of private enterprises, including access to finance and managerial and technological capacities. In addition, the *Doing Business* ratings do not directly reflect matters of security, market size, macroeconomic stability, financial system, corruption, or labor-force training and skills. The Bank says it “focuses on the rules and regulations that can help the private sector thrive—because without a dynamic private sector, no economy can provide a good, and sustainable, standard of living for people.”⁴⁶

Statistical research bears out the *Doing Business* message. World Bank economist Jamal Ibrahim Haidar's team assembled five years of data from 172 countries and found “robust support for the claim that business regulatory reforms are good for economic growth,” each reform being correlated with an average 0.15% increase in the GDP growth rate.⁴⁷

Another argument for business-climate reform comes from the United Kingdom's Department for International Development (DFID). “High levels of regulation and red tape are used as a means of extracting bribes and other [economic] rents, in corrupt contexts,” DFID says. “For firms seeking to enter the market, this imposes an onerous bureaucratic process” that may persuade some firms to stay in or withdraw to the informal sector, with consequent reduced access to the financial and legal systems.⁴⁸

For those who may be skeptical that growth can emerge in a sparse-resource, low-capital setting like Afghanistan, New York University economist Paul M. Romer has noted that “Taiwan started with little of either and still grew rapidly.” He argues that investments in education, intellectual- and real-property protection, and avoidance of heavy regulation and high marginal tax rates can produce real benefits.⁴⁹ The Asian Development Bank has likewise pointed out the “need and urgency of growth-friendly reforms in developing Asia,” especially regarding human capital, research and development, and institutions.⁵⁰

Focusing national and provincial efforts on basic education could be one of the most powerful growth stimuli realistically within Afghanistan's reach. Stanford University scholar Eric Hanushek points to empirical research findings that “Cognitive skills of the population—rather than



Exhibitors at a Kabul furniture fair show their chairs: promoting more local trades could reduce Afghanistan's heavy reliance on imports. (USAF photo by Staff Sgt. Rachel Martinez)

school attainment [years of attendance] are powerfully related to individual earnings, to the distribution of income, and most importantly to economic growth.” He adds that the lower technological levels of developing countries may entail a stronger demand for basic as opposed to high-level skills.⁵¹



About 40% of Afghan primary-school-aged children are not in school: low literacy rates, especially among girls, are a drag on economic growth. (Asian Development Bank photo)

Afghan officials and foreign donors have heard the education message. A World Bank presentation at the September 2015 Senior Officials Meeting in Kabul included the message that “Investment in adult literacy and skills could improve mobility and productivity of existing labor force, enhance participation of the poor in the growth process, and better equip them to participate in civil society processes and initiatives.”⁵²

Unfortunately, the outlook for an education boost to Afghan growth is clouded. UNICEF, the United Nations Children’s Fund, reported in 2015 that most of the world’s out-of-school children live in South Asia, and that Afghanistan has the highest percentage of such children in the region. Some 4.2 million Afghan primary-school-age children, or nearly 43% of that age group, have either never enrolled in school or have dropped out. The group with the greatest likelihood of being out of school are girls in the poorest fifth of the income distribution.⁵³

The Tolo News organization reported on January 2 that an Afghan presidential task-team had issued a report describing hundreds of nonexistent “ghost” schools, thousands of “ghost” teachers, Ministry of Education projects falsely reported as complete, large discrepancies in numbers of students reported in school, inflated salaries, and millions embezzled.⁵⁴ SIGAR has previously raised concerns on some of these issues; if the official release of the report bears out the Tolo News description, it would be another large and troubling development both for the use of American taxpayers’ dollars and for the future of the Afghan people.

Afghanistan’s civil, social, and economic future requires not only improving cultivation of cognitive skills, but getting more children—including girls—to school in the first place, and in keeping them there longer. It is a basic goal, and a daunting challenge.

CAVEATS AND QUESTIONS

The realities of a large informal sector, a large insurgency, capacity constraints, and corruption suggest the following caveats regarding attempts to bolster Afghanistan’s economic prospects:

- Continued and worsening security may depress both Afghans’ and foreigners’ willingness to invest or expand in the country, reducing GDP growth.
- Reforms may trigger special-interest and bureaucratic opposition, and/or create new opportunities for corruption and rent-seeking behaviors.

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- Even effective structural reforms may not bring many informal businesses into the formal, tax-paying structure because most are low-productivity, low-margin firms with poorly educated managers who cannot bear the added costs of formal operations.⁵⁵

With those caveats and the likelihood of declining aid in mind, the most promising path for economic development—assuming some level of security is maintained—is to focus on helping Afghans do things for themselves. U.S. lawmakers and policy makers might therefore wish to review American policy and operations from the standpoint of these questions:

- Are the U.S. military presence and security-assistance programs in Afghanistan providing appropriate enabling contributions essential to helping the Afghan National Defense and Security Forces achieve the operational battlefield effectiveness necessary to suppress the insurgency that threatens all other objectives?
- Are U.S. plans and programs rendering appropriate and effective support, including outreach to Afghan opinion leaders, essential for President Ghani's anticorruption and counternarcotics campaigns?
- Are U.S. plans and programs effectively assisting the Afghan government in systematically improving public services like education, health care, water, and electricity that not only support humanitarian objectives, but also promote business growth?
- Are U.S. plans and programs providing appropriate and useful guidance and support for improving Afghanistan's public economic institutions' capacity to manage policy, business regulation, and investment climate?
- Are U.S. plans and programs appropriately conceived and conducted to increase the Afghan government's ability to provide fair, efficient, and transparent justice for all citizens?
- Are U.S. strategies, plans, and programs being continuously reviewed for possible modification in light of new developments and facts on the ground?

Economic development in Afghanistan requires more than aid, technical advice, training programs, subsidies, and trade fairs. It requires more than plunking down new projects and programs. It requires attention to growth-enabling fundamentals including improved security and honest governance, as well as energy, health, and education, spurred by recognition of a bedrock reality: fear, injustice, and corruption spur emigration, inhibit entrepreneurial impulses, and deter both domestic and foreign investment.

Achieving business-climate reform and expanding education could be force multipliers for Afghan growth. But placing new furniture in a house gains little if the foundation is crumbling and the roof is rotten.

“Oversight is mission critical. If we don’t learn that lesson, I can safely predict to you, based upon my 30 years watching Washington government bureaucracies, that we will be doomed to repeat history.”

—*Special Inspector General John F. Sopko*