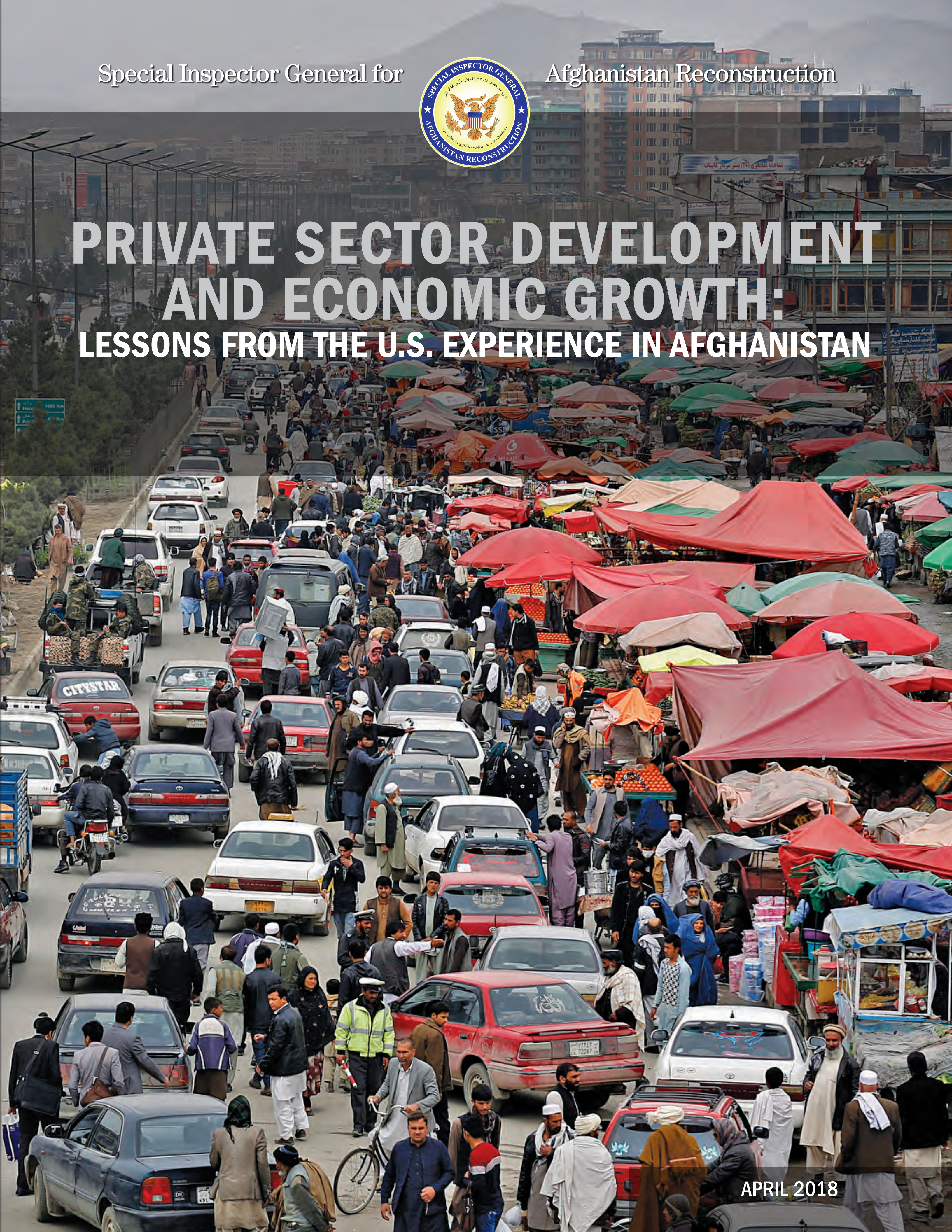
Special Inspector General for Afghanistan Reconstruction

PRIVATE SECTOR DEVELOPMENT AND ECONOMIC GROWTH:

LESSONS FROM THE U.S. EXPERIENCE IN AFGHANISTAN



APRIL 2018

Cover photo: Traffic in Kote Sangi, on the western edge of Kabul city. (UNAMA photo by Fardin Waezi)

Special Inspector General
for Afghanistan Reconstruction

Private Sector Development and Economic Growth: Lessons from the U.S. Experience in Afghanistan is the third in a series of lessons learned reports issued by the Special Inspector General for Afghanistan Reconstruction. The report examines how the U.S. government supported private sector development in Afghanistan since 2001 through efforts led by the U.S. Agency for International Development, with additional significant roles played by the Departments of State, Defense, Commerce, and Treasury.

The report provides both the chronology of U.S. government support to private sector development and an in-depth look at the five major areas of economic intervention: creating an enabling environment, providing access to finance, promoting investment, developing regional and international trade, and supporting enterprises. The report identifies lessons to inform U.S. policies and actions at the onset of and throughout a reconstruction and provides recommendations for improving private sector development efforts. These lessons and recommendations are relevant for ongoing work in Afghanistan, where the United States remains engaged in building and supporting the Afghan economy, and in future endeavors to rebuild other weak states emerging from protracted conflict.

Our analysis highlights the difficulties of supporting economic development in a war-shattered country. Afghanistan's early economic gains were largely due to post-conflict recovery and substantial foreign spending, and optimistic predictions of future progress did not reflect the nation's economic and security environment, the capacity of Afghan and U.S. institutions, or the impact of corruption. The United States also overestimated the speed at which Afghanistan could transition to a Western-style market economy. The U.S. government's provision of direct financial support sometimes created dependent enterprises and disincentives for Afghans to borrow from market-based financial institutions. Furthermore, insufficient coordination within and between U.S. government civilian and military agencies often negatively affected the outcomes of programs. On the other hand, early foundational investments in the economic system, undertaken in concert with allies and international organizations, established the basis for the progress that did take place and for future development. Afghanistan's long-term prospects may also improve as a result of progress in regional integration and participation in bilateral and multilateral trade agreements, as well as investments in human capital.

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SIGAR began its lessons learned program in late 2014 at the urging of General John Allen, Ambassador Ryan Crocker, and others who had served in Afghanistan. The lessons learned reports comply with SIGAR's legislative mandate to provide independent and objective leadership and recommendations to promote economy, efficiency, and effectiveness; prevent and detect fraud, waste, and abuse; and inform Congress and the Secretaries of State and Defense about reconstruction-related problems and the need for corrective action.

Unlike other inspectors general, Congress created SIGAR as an independent agency, not housed within any single department. SIGAR is the only inspector general focused solely on the Afghanistan mission, and the only one devoted exclusively to reconstruction issues. While other inspectors general have jurisdiction over the programs and operations of their respective departments or agencies, SIGAR has jurisdiction over all programs and operations supported with U.S. reconstruction dollars, regardless of the agency involved. Because SIGAR has the authority to look across the entire reconstruction effort, it is uniquely positioned to identify and address whole-of-government lessons.

Our lessons learned reports synthesize not only the body of work and expertise of SIGAR, but also that of other oversight agencies, government entities, current and former officials with on-the-ground experience, academic institutions, and independent scholars. The reports document what the U.S. government sought to accomplish, assess what it achieved, and evaluate the degree to which these efforts helped the United States reach its strategic goals in Afghanistan. They also provide recommendations to address the challenges stakeholders face in ensuring efficient, effective, and sustainable reconstruction efforts, not just in Afghanistan, but in future contingency operations.

SIGAR's Lessons Learned Program comprises subject matter experts with considerable experience working and living in Afghanistan, aided by a team of seasoned research analysts. I want to express my deepest appreciation to the team members who produced this report, and thank them for their dedication and commitment to the project. I thank Paul Fishstein, project lead; Mariam Jalalzada, senior research analyst; Emily Bakos, Nikolai Condee-Padunov, and Margaret Jacobson, research analysts; Lauren Helinski, student trainee; Olivia Paek, graphic designer; and Elizabeth Young, editor. In producing its reports, the Lessons Learned Program also uses the significant skills and experience found in SIGAR's Audits, Investigations, and Research and Analysis directorates, and the Office of Special Projects. I thank all of the individuals who provided their time and effort to contribute to this report. It is truly a collaborative effort meant to not only identify problems, but also to learn from them and apply reasonable solutions to improve future reconstruction efforts.

I believe the lessons learned reports will be a key legacy of SIGAR. Through these reports, we hope to reach a diverse audience in the legislative and executive branches, at the strategic and programmatic levels, both in Washington and in the field. By leveraging our unique interagency mandate, we intend to do everything we can to make sure the lessons from the United States' largest reconstruction effort are identified, acknowledged, and, most importantly, remembered and applied to ongoing reconstruction efforts in Afghanistan, as well as to future conflicts and reconstruction efforts elsewhere in the world.

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EXECUTIVE SUMMARY

This lessons learned report looks at the U.S. government's support to private sector development and economic growth in Afghanistan since 2001. The report focuses on two main, somewhat overlapping areas of U.S. assistance: (1) support to economic policy and governance, and (2) support to individual firms, groups, and entrepreneurs. The report also touches on infrastructure, agriculture, and the extractive industries because of their relevance to the overall economic picture.

U.S. officials viewed private sector development as foundational to economic growth, which in turn was seen as a key driver of security. The U.S. government saw the development of a robust economy in Afghanistan as contributing positively to security by (1) providing gainful employment to the young, unemployed men who were considered most likely to join an insurgency; (2) creating confidence in and legitimacy for the state; and (3) generating revenue that would enable the state to deliver services and prevent dependency on the international donor community. In the wake of the Taliban regime, a private-sector driven, open-market economy was seen as reinforcing electoral democracy, individual freedoms, women's rights, a free media, and other Western values. These views were held by both the President George W. Bush and President Barack Obama administrations.

The U.S. strategy for and overall approach to private sector development remained largely the same from 2001 through 2017, although with sharp variations in amounts of funding and some shifts in emphasis at various stages, most significantly during the 2009–2012 surge years. The U.S. Agency for International Development (USAID) was the lead agency for these efforts, but a range of other U.S. institutions played a role, including the Departments of Defense, Commerce, Treasury, and State, the Overseas Private Investment Corporation (OPIC), the U.S. Trade and Development Agency, the U.S. Trade Representative, and the U.S. Geological Survey. The prevailing view that economic development played a role in security called for an expanded role for the military and therefore a need for interagency partnerships and civil-military coordination.

Our report identifies 11 key findings regarding the U.S. experience with private sector development and economic growth:

1. Afghanistan's significant economic gains in per capita income and growth in sectors such as telecommunications, transport, and construction were largely the result of post-conflict recovery and substantial foreign spending, and were therefore not sustainable.

2. Establishing the foundational elements of the economic system, including sound macroeconomic policies and capacity for public financial management, at the start of reconstruction allowed some successes and set the stage for future development.
3. Optimistic projections for the pace and level of progress did not reflect the realities of the Afghan economy and operating environment, the ongoing conflict, and the capacity constraints of Afghan and U.S. institutions.
4. Afghans have benefited from a more open trade policy, and future benefits from trade agreements and increased regional integration may continue to accrue; however, Afghanistan's physical and institutional infrastructure and political relationships with its neighbors have limited its ability to become a trade hub benefiting from regional commerce and sustainable export markets.
5. The persistence of corruption within the Afghan government, along with uncertainty about and uneven enforcement of tax and regulatory policies, discouraged economic growth.
6. Inadequate understanding or mitigation of the relationships between corrupt strongmen and other powerholders limited the effectiveness of U.S. support to private sector development in generating broad-based economic growth.
7. Neither the Afghan government nor society was adequately prepared for the sudden introduction of a Western-style market economy.
8. The U.S. government's provision of direct financial support to enterprises sometimes created dependent, commercially nonviable entities, as well as disincentives for businesses to use local financial and technical services.
9. Insufficient coordination within and between U.S. government civilian and military agencies negatively affected the outcomes of programs.
10. Within U.S. government agencies, organizational factors and human resource policies constrained the implementation of private sector development projects.
11. Despite economic growth, estimated poverty, unemployment, and underemployment were not substantially reduced.

AFGHANISTAN'S ECONOMIC PERFORMANCE

Afghanistan's economy grew sharply during the first decade of reconstruction, with the early years showing the economic recovery often seen in a post-conflict environment, and the later period reflecting the heavy international spending of the surge years. Between 2001 and 2012, per capita income increased more than five-fold, from $117 in 2001 to a peak of $669 in 2012, just before the run-up to the 2014 drawdown of U.S. military personnel. Construction and services (especially communications, transport, logistics, government services, and financial and business services) were the strongest consistent drivers of growth in gross domestic product. Despite a few high-profile exceptions, foreign private investment was limited. Domestic investment was relatively strong, especially during the 2009–2012 surge, but tailed off along with international spending. The primary impediments to investment, and private sector development more broadly, were related to insecurity and uncertainty, including the effects of institutional corruption.

Afghan consumers benefited from an open trade policy which made imported consumer goods available at lower prices. However, Afghanistan's trade imbalance increased consistently over the past 16 years as domestic industries were unable to compete in regional and world export markets, and imports out-competed local producers in some domestic markets. Predatory or unfair trade practices by regional neighbors also discouraged domestic production.

U.S. SUPPORT TO PRIVATE SECTOR DEVELOPMENT

In the first several years after 2001, the U.S. government provided limited support to private sector development, in part because of its reluctance to be involved in nation building. The United States emphasized a "light footprint" due to its desire to not be drawn into, or give the impression of undertaking, a long-term occupation. Moreover, with less than one month between 9/11 and the start of Operation Enduring Freedom, there was no time for systematic planning or assessing Afghanistan's economic needs.

Some of the initial foundational investments, undertaken in concert with the International Monetary Fund (IMF) and the World Bank, included the critical priorities of macroeconomic stabilization, institutional infrastructure development, monetary policy creation, banking system rehabilitation, currency conversion, government revenue collection, and basic economic governance. These efforts, which were considered successful, made early growth possible and set the stage for future development.

The U.S. government also emphasized the promotion of investment, the privatization of the former state-owned enterprises (SOE), trade liberalization, lowering barriers to trade, integration with regional and world markets, and accession to the World Trade Organization (WTO). USAID, the lead agency for U.S. private sector development efforts, focused primarily on agriculture, the "cornerstone of recovery and a pillar of reconstruction for a sustainable future." Agriculture was recognized as a crucial sector of the Afghan economy, with the potential for multiplier effects and linkages with other sectors.

By the end of 2002, U.S. officials began to consider the possibility that more resources would be needed to stabilize Afghanistan. Meanwhile, the United States was increasingly preoccupied with the looming invasion of Iraq. By 2006, it was clear Afghanistan was not a post-conflict state. As the insurgency grew and security deteriorated, Afghans also began to express dissatisfaction with their economic situation, which was further exacerbated by the 2007–2008 global food crisis. In response, the United States and its allies increased their humanitarian and development assistance. U.S. agencies began a series of enterprise development initiatives aiming at expanding markets, developing a technically skilled workforce, increasing access to capital, creating jobs, promoting investment, and developing domestic products to become more competitive with imports. During this period, the Department of Defense (DOD) began to engage more significantly in private sector development in two key ways: (1) the Commander's Emergency Response Program (CERP), which was intended to improve short-term security through quick-impact projects such as micro grants, and (2) the Afghan First procurement initiative, an explicit policy for contracting with Afghan companies to ensure more of the money donors spent on goods would remain in Afghanistan, rather than going to Pakistan, China, Turkey, and other countries.

In December 2009, President Obama presented a strategy intended to represent a break with the past and give attention and resources to what he had previously called "the right war." The administration's strategy to stem the tide of the insurgency included a large troop surge and its development counterpart, the "civilian uplift." The surge was supported by massive increases in funding: Governance and development funding alone increased by 58 percent from FY 2009 to FY 2010. However, the simultaneous announcement of the 2009 surge and the 2011–2014 drawdown introduced a cloud of uncertainty that hung over most of the period. During this era of counterinsurgency, USAID came under greater pressure to align its programming and geographical focus with the U.S. military's stabilization and counterinsurgency priorities as part of a unified U.S. response. DOD also increased its direct involvement in private sector development through CERP micro grants, strengthening the Afghan First procurement initiative, and introducing the Task Force for Business and Stability Operations (TFBSO) from Iraq. TFBSO was critical of USAID's traditional development approach and saw itself as more nimble and expeditionary.

The run-up to the 2014 transition was characterized by great uncertainty due to the drawdown in international forces and the upcoming Afghan presidential election. Economic activity declined due to a combination of reduced international spending and uncertainty about the political and security outlook, manifesting itself in a plunge in property prices, a leveling or decline in wages, and increased capital and human flight as Afghans sought a safe haven for their money and themselves. USAID shifted its focus to a few high-capital, high-impact foundational investments and the increased sustainability of economic growth and Afghan government institutions.

MAIN AREAS OF INTERVENTION

U.S. government support to private sector development and economic growth from 2001 through 2017 can be classified into five main areas of intervention.

Creating an Enabling Environment

The first task related to private sector development was to create an enabling environment in which a dynamic, licit private sector could thrive. This environment included fundamentals such as establishing macroeconomic stability, curbing inflation, overhauling the currency, creating sound fiscal and monetary policies, drafting laws and regulations for a regulatory framework, and bolstering institutions to maintain and promote the private sector. Many of the solid, early successes in macroeconomic policy and public financial management set the stage for future gains. Ministries saw improvements in financial management and in revenue collection from taxes and customs. Enduring impediments to achieving an enabling environment were largely those related to a lack of good governance, including corruption and uneven enforcement of laws and policies, which made it more difficult to encourage businesses to operate in the formal sector.

Providing Access to Finance

Recognizing the importance of access to finance in promoting private sector investment, the U.S. government provided support to create a commercial banking sector and make other sources of financing available. USAID and Treasury implemented a range of activities that included strengthening the commercial banking sector, primarily through building the supervisory capacity of Afghanistan's central bank, Da Afghanistan Bank (DAB), privatizing state-owned banks, and regulating the informal money service providers or *hawala* dealers. Encouraging financial flows through formal institutions was intended to limit criminal money laundering and terrorism financing. In addition, in response to what was seen as the inability or unwillingness of commercial banks to reach the poor and rural areas of the country, the United States also supported the establishment of a number of non-bank, sector-specific financial institutions to offer loans that were attractive to micro and small enterprises and provide direct loans and credit guarantee schemes.

A number of new commercial banks and newly privatized state banks began to provide financing to small and medium enterprises. Despite the increase in the number of financial institutions, however, firms consistently listed access to finance as one of their major challenges. Only 2 percent of Afghan firms used banks to finance investment, and the banking sector continued to be fragile. Larger firms mainly used private bank loans, while smaller firms continued to rely on other sources of financing, including business profits, personal savings, and private loans. The 2010 Kabul Bank collapse demonstrated just how fragile the banking sector was and the extent to which well-connected political actors could undermine DAB's supervision. DAB became more aggressive in its oversight, but commercial banks continued to suffer from weak governance, deteriorating asset quality (especially an increase in nonperforming loans), and low profitability. Lending by financial institutions continued to be concentrated in the urban areas and a limited number of sectors, mainly because lending to small enterprises, especially in rural areas, was costly and did not generate sufficient returns.

The U.S. expectation that some of these newly created financial institutions would become self-sustaining within a limited project timeframe was unrealistic. Today, these institutions continue to rely on external assistance, and face ownership, management, and operational sustainability challenges.

Promoting Investment

Fostering private foreign and domestic investment was another key component of private sector development. The U.S. government sought to promote investment through a variety of formal and informal means, including privatizing or liquidating the majority of the 65 Afghan SOEs and building industrial parks, which were intended to promote investment by removing a number of constraints facing Afghan businesses, including the lack of reliable and cheap power, unstable land tenure, and physical insecurity.

Employing the value chain approach, where value is added as raw materials flow through production and marketing channels, the United States chose to support certain key sectors to make them more attractive to potential investors. For example, investments in the agricultural sector were intended to lead to production of value-added goods for domestic consumption and potentially for exports.

Aside from a few high-profile exceptions, foreign direct investment was limited. The majority of domestic investment occurred in the construction industry, especially during the 2009–2012 surge, driven in part by the construction boom that resulted from the massive of inflows of international funding. Otherwise, investment was limited due primarily to ongoing uncertainty and insecurity, poor economic governance, and the lack of a comparative advantage in potential industries.

USAID's efforts to encourage investment in and expansion of agribusiness experienced some success; however, the imperfect and risky nature of Afghanistan's markets, as well as the poor state of the country's infrastructure, posed challenges. Smaller players, in particular, faced constraints that included market access, inconsistent and unfair trade practices of neighboring countries, the high cost of logistics and transportation, and expensive and time-consuming bureaucratic procedures. The industrial parks remained underutilized, largely due to limited electrical power and other infrastructure. Driven by increasing uncertainty, much of the capital accumulated by Afghans and Afghan companies flowed out of the country.

Promoting Regional and International Trade

The United States promoted regional and international trade as an engine of growth that, along with the strengthening of high-value agriculture, would encourage investment and economic development. Regional integration was prioritized from 2002 onward in the belief that increased linkages with neighboring countries would create opportunities for such trade and investment, as well as contribute to stability through building relationships. In 2004, Afghanistan gained observer status in the WTO with the hope that joining the WTO would help Afghanistan reap the benefits of opening to trade. WTO accession was also seen as a positive forcing function for the country to meet numerous international standards that would be needed for Afghanistan to engage in international commerce.

Afghanistan has seen some benefits from trade and regional integration, including reduced prices of consumer goods, ongoing political discussions with neighboring countries, and improvements in standards for health and safety. Long-term prospects may improve as a result of progress made by Afghanistan in integrating regionally and participating in bilateral and multilateral trade agreements. Still, the trade imbalance continues to grow as Afghan producers struggle to compete with more established players in protected markets, and neighbors engage in unfair trading practices.

Providing Direct Support to Enterprises

The U.S. government provided direct technical and financial support to individual Afghan enterprises through a variety of initiatives, primarily implemented by USAID and DOD. These programs included the provision of financial assistance in the form of in-kind grants, technical assistance, and business development mentorship. Direct support was seen as a way to leverage investment; USAID applied elements of its Global Development Alliance model through two large-scale enterprise support initiatives that required the grant recipients to contribute at least half of the investment costs.

USAID also provided support to local business associations and new or existing business development services (BDS) providers, which helped nascent companies expand using modern business methods. Given the often low levels of business literacy, BDS providers assisted businesses with preparing grant applications, developing business and management plans, and purchasing machinery. The U.S. military provided micro grants to rural enterprises through CERP and required U.S. agencies to use Afghan firms' services, to the extent possible, through the Afghan First procurement initiative. Starting in 2010, TFBSO facilitated investment and business mentorship and provided technical and financial support to enterprises in the energy, mining, and indigenous industries.

Despite some successes, direct support to enterprise programs had shortcomings in design, implementation, and oversight. While some companies used financial support and technical assistance to expand their access to markets, other companies that received direct grants became dependent on these sources of "free money," without which they could not sustain profitable operations. In addition, the security environment restricted the ability of project managers to confirm the information provided in grant recipients' financial and legal documents.

Finally, U.S. government agencies overestimated their capacity to implement projects. Internal constraints, such as high staff turnover and limited human resources relative to the volume of activities and funding they were asked to manage, along with external obstacles, such as Afghan government bureaucracy, corruption, and poor infrastructure, delayed operations, affected quality, and increased costs.

LESSONS

This report identifies 12 lessons drawn from the U.S. experience with private sector development and economic growth in Afghanistan.

1. It is not realistic to expect robust and sustainable economic growth in an insecure and uncertain environment.
2. Establishing the foundational elements of an economic system at the beginning of a reconstruction effort sets the stage for future success.
3. Any new economic system which represents a break with a host nation's past knowledge and practice must be introduced carefully and with sufficient time to ensure adequate buy-in and the development of the robust institutions required to maintain it.
4. Spending too much money too quickly can lead to corruption and undermine both the host nation and the goals of the United States, while too abruptly reducing funding can hurt the economy.
5. Inadequate understanding and vetting of the webs of personal, sometimes criminally related, networks can allow elites to control economic activity at the expense of open and competitive markets.
6. Successful private sector development efforts must be nested within the development of the rule of law and overall good governance.

7. The choice of a model for economic growth must realistically acknowledge a country's institutional and political environment and its physical endowments.
8. The provision of grants and below market rate loans can undermine commercial banks and other market-oriented institutions and create unsustainable businesses.
9. Support to businesses and government institutions needs to be tailored to the environment.
10. Clear agreements on institutional roles, responsibilities, and lines of authority, reinforced by human resource policies that fit a post-conflict environment, are necessary for an effective private sector development strategy and for overall development.
11. Rigorous monitoring, evaluation, and analysis, which transcend individual projects and programs, are necessary to understand the effectiveness of private sector development interventions.
12. Investments in human capital have significant returns, although it may be years before they are realized.

RECOMMENDATIONS

SIGAR recommends the following actions be undertaken by the executive and legislative branches of the U.S. government to inform private sector development efforts at the onset of and throughout reconstruction efforts, and to institutionalize the lessons learned from the U.S. experience in Afghanistan.

Executive Branch

1. At the start of any major reconstruction effort, the National Security Council should direct the creation of an interagency working group led by USAID and staffed at the appropriate levels to plan and coordinate private sector development activities across civilian and military agencies.
    a. The interagency working group should include members from all agencies with a significant private sector development role and be given a clear mandate.
    b. The interagency working group should reach consensus on the respective roles and responsibilities of civilian and military institutions in private sector development, as well as the role development plays in contingency operations.
    c. The interagency working group should draw on existing analysis, supplemented by a rapid but in-depth assessment, to outline a strategic approach to rebuilding the host nation economy and to anticipate the likely impact of U.S. funds and material resources.
    d. The interagency working group should draw from intelligence and other sources to understand the host nation's political economy networks, and

should use that information to make an informed decision regarding the tradeoffs and implications for who receives financial and other support.

e. The interagency working group should take the necessary steps to understand the host nation's historical and social conditions and traditions, and to identify and mitigate possible areas of contention, resistance, and circumvention.

2. To the extent possible, State and USAID should focus market interventions at the industry or sector level, rather than selecting and supporting individual firms.
3. USAID and State should assist the Afghan government in reviewing the effectiveness of all Afghanistan's regional and bilateral trade agreements, especially the Afghanistan-Pakistan Transit Trade Agreement, and then engage with trading partners to resolve constraints to Afghan exports and imports.
4. USAID officials working in private sector development should continue to participate in mission-wide anticorruption initiatives, and ensure these initiatives are reflected in technical and policy work at the ministry level.
5. USAID should continue to closely team with a host nation's local institutions, such as universities, think tanks, and business associations, to provide technical assistance and training tailored to the local environment and its modes of doing business.
6. USAID should continue to invest human, financial, and time resources in rigorous monitoring, evaluation, and analysis, including establishing a long-term framework that transcends individual projects.
7. State and USAID should review human resource policies to make them more suitable for conflict environments, ensure continuity, and maintain institutional knowledge.

Legislative Branch

8. Congress may wish to consider creating a long-term private sector development fund to reduce the pressure to use spending levels as a measure of progress and avoid sharp funding fluctuations during reconstruction efforts.

UNAMA photo by Fardin Waezi

CHAPTER 1
INTRODUCTION

As part of SIGAR's analysis of the reconstruction effort in Afghanistan, this lessons learned report looks at the U.S. government's support to private sector development and economic growth in that country since 2001. U.S. officials viewed private sector development as foundational to economic growth, which in turn was seen as a key component of security through its creation of employment, government revenue, and legitimacy for the new Afghan state.

In the largest sense, almost everything can be considered as related to private sector development, including infrastructure, governance, and even education, which is part of the human capital development necessary to improve productivity in progressing economies. Acknowledging this breadth, our report focuses on two main, somewhat overlapping areas of U.S. assistance that had objectives directly tied to developing the private sector:

1. Support to economic policy and governance, including developing overall economic policies and reforms, creating or strengthening government and private sector institutions, facilitating external trade, and privatizing state-owned enterprises
2. Support to individual firms, groups, and entrepreneurs, including financing and other material support, technical assistance and training, promotion of investment, promotion of regional trade, and enabling market access

The report also touches on infrastructure, agriculture, and the extractive industries as part of the overall economic picture. At the same time, while U.S. assistance to other sectors, such as health and education, had components that were intended to support a private sector economy, for example, private hospitals and pharmaceutical companies, these are beyond the scope of this report.

The U.S. Agency for International Development (USAID) was the lead U.S. government agency for private sector development in Afghanistan. In addition, the Departments of Commerce, Treasury, and State, the Overseas Private Investment Corporation (OPIC), the U.S. Trade and Development Agency (USTDA), the U.S. Trade Representative (USTR), and the U.S. Geological Survey (USGS) played a role. The Department of Defense (DOD) supported private sector development primarily through the Commander's Emergency Response Program (CERP) and the Task Force for Business and Stability Operations (TFBSO). In addition to these two programs, military contracting for bases, other infrastructure, and services injected billions of dollars into the economy.

Because of the complexity of funding mechanisms, the difficulty of defining exactly what constitutes private sector development, and the dispersion of funding throughout various sector programs, it is not possible to quantify the percentage of total U.S. government funding that went to private sector development. For example, USAID supported private sector development in Afghanistan through a variety of economic growth and agriculture programs, which, as of 2017, had disbursed $1.22 billion and $2.15 billion, respectively.[1] The majority of USAID funding for these projects came through the congressionally approved Economic Support Fund (ESF). ESF funds were appropriated annually for programs in countries where funding for economic development could be justified explicitly on the basis of U.S. national interests, rather than solely development.[2] Funding for these USAID programs was also supplemented by non-ESF funds.[3]

DOD's role in private sector development was supported by its own funding, including its obligation of more than $675 million to TFBSO.[4] Although only 0.44 percent of the $838 million disbursed through CERP was devoted to micro grants, the primary CERP activity discussed in this report, additional CERP funds were spent on roads, culverts, bazaars, and market buildings, which stimulated economic activity.[5]

Our report identifies the following key findings:

1. Afghanistan's significant economic gains in per capita income and growth in sectors such as telecommunications, transport, and construction were largely the result of post-conflict recovery and substantial foreign spending, and were therefore not sustainable.

2. Establishing the foundational elements of the economic system, including sound macroeconomic policies and capacity for public financial management, at the start of reconstruction allowed some successes and set the stage for future development.
3. Optimistic projections for the pace and level of progress did not reflect the realities of the Afghan economy and operating environment, the ongoing conflict, and the capacity constraints of Afghan and U.S. institutions.
4. Afghans have benefited from a more open trade policy, and future benefits from trade agreements and increased regional integration may continue to accrue; however, Afghanistan's physical and institutional infrastructure and political relationships with its neighbors have limited its ability to become a trade hub benefiting from regional commerce and sustainable export markets.
5. The persistence of corruption within the Afghan government, along with uncertainty about and uneven enforcement of tax and regulatory policies, discouraged economic growth.
6. Inadequate understanding or mitigation of the relationships between corrupt strongmen and other powerholders limited the effectiveness of U.S. support to private sector development in generating broad-based economic growth.
7. Neither the Afghan government nor society was adequately prepared for the sudden introduction of a Western-style market economy.
8. The U.S. government's provision of direct financial support to enterprises sometimes created dependent, commercially nonviable entities, as well as disincentives for businesses to use local financial and technical services.
9. Insufficient coordination within and between U.S. government civilian and military agencies negatively affected the outcomes of programs.
10. Within U.S. government agencies, organizational factors and human resource policies constrained the implementation of private sector development projects.
11. Despite economic growth, estimated poverty, unemployment, and underemployment were not substantially reduced.

The report consists of 12 chapters. The introductory chapter describes the post-2001 political and security environment, presents the rationale for private sector development investments, and provides an overview of Afghanistan's economic performance from 2001 to 2017. Chapter 2 introduces the key private sector development actors and activities. Chapter 3 traces U.S. assistance chronologically, dividing the post-2001 period into five eras defined by funding levels and the type and intensity of specific activities. Chapters 4 through 8 discuss in detail the U.S. government's five major areas of economic intervention: creating an enabling environment, providing access to finance, promoting investment, developing regional and international trade, and supporting enterprises. Chapters 9 through 12 provide the report's findings, lessons, conclusions, and recommendations for ongoing reconstruction efforts in Afghanistan and potential future U.S. engagements elsewhere.

An enabling environment is a set of interrelated conditions, including legal frameworks, regulations, fiscal and monetary policies, and macroeconomic stability, along with related institutions, that can facilitate or hinder the ability of businesses to flourish and grow.

CONTEXT: DEVELOPMENT AID AND SECURITY POST-9/11

Throughout modern history, the U.S. government has used foreign development assistance to pursue political and security goals. Even before 9/11, the United States and other Western nations believed that weak, fragile, or failing states constituted a threat to national and global security, and that economic development could be an instrument to stabilize those states.

> *"America is now threatened less by conquering states than we are by failing ones."*
>
> —President George W. Bush

Post-9/11, this belief became more widespread and more explicitly incorporated into policy. The 2002 U.S. national security strategy, for example, stated that "America is now threatened less by conquering states than we are by failing ones."[6] This belief was enlisted and employed in President George W. Bush's Global War on Terror, and continued to be held throughout the President Barack Obama administration. In his final State of the Union address in 2016, President Obama noted, "In today's world, we're threatened less by evil empires and more by failing states."[7] Poor governance or slow socioeconomic development, hallmarks of failing states, were therefore seen as justification for the United States to intervene in those areas. And, while the term "stabilization" was often used generically, and took on different meanings over the last 16 years, at its core it reflected the belief that there was a positive relationship between economic development and stability.

The U.S. government created new structures and processes to reflect the role of development in security and to enable a comprehensive or "whole of government" approach. In 2005, National Security Presidential Directive 44 gave the Department of State responsibility for the coordination of and planning for stability operations and established the Office of the Coordinator for Reconstruction and Stabilization (S/CRS) and the Policy Coordination Committee for Stability and Reconstruction.[8] In January 2006, the Bush administration created the Office of the Director of U.S. Foreign Assistance within the State Department to tighten the use of foreign assistance to achieve foreign policy objectives.[9] This U.S. government approach was mirrored by other Western nations that created stabilization units and by the UN's integrated missions.[10]

The new emphasis on development also required expanded roles for the military and a need for interagency partnerships and civil-military coordination. The military's role in economic development was made more explicit by the 2005 DOD Directive 3000.05, *Military Support for Stability, Security, Transition, and Reconstruction (SSTR) Operations*, which stated that stability operations were a "core" mission with "priority comparable to combat operations."[11] Stability operations were intended to achieve short-term objectives of force protection and stabilization, but also to convert short-term tactical success into long-term strategic success, not just by defeating threats, but by shaping an environment that discouraged future threats by contributing to economic well-being.

Publicly, U.S. government civilian officials welcomed the opportunity to be on the same team as the military. In the words of former USAID Administrator Rajiv Shah, "USAID works side-by-side with the military [in Afghanistan], playing a critical role in stabilizing districts, building responsive local governance, improving the lives of ordinary Afghans, and—ultimately—helping to pave the way for American troops to return home."[12] This was especially true for USAID's Office of Transition Initiatives, which historically worked in fragile and conflict-prone countries that were not secure enough for long-term development programs. At the working level, however, development officials' views about working closely with the military varied: some were positive, while some were more ambivalent or even negative, in large part because they saw development and stabilization as requiring different timeframes and approaches than security, albeit with some overlap.

"In today's world, we're threatened less by evil empires and more by failing states."

—President Barack Obama

Nongovernmental organizations (NGO) generally, although not universally, had even more skeptical views. While fully endorsing the belief that economic development led to the achievement of security goals, they were often reluctant to be associated with the military in the field. This was sometimes due to a philosophical objection to "militarizing aid" or "blurring the lines" between civilian and military actors, but also due to pragmatic considerations: In an insecure environment, visible association with the military could jeopardize their relations with communities or put their staff at physical risk.[13]

Despite the Bush administration's wariness of nation building, Afghanistan provided an example of using aid to attempt to create security, an approach that continued under President Obama. The assumption that humanitarian and economic development projects contributed to the development of the state and to security was shared by aid agencies, government departments, NGOs, and the military.[14] The relationship was further articulated in a 2010 speech by Secretary of State Hillary Clinton when she spoke of the need to better integrate the three Ds: defense, diplomacy, and development.[15]

The Council on Foreign Relations defines nation building as "the process of establishing civic order and governmental functions in countries that are emerging from a period of war or other types of upheaval."[16]

THE CASE FOR STRENGTHENING AFGHANISTAN'S ECONOMY

The U.S. government saw the development of a robust economy in Afghanistan as contributing positively to security through several dynamics. First, a growing economy would provide gainful employment to the young, unemployed men who were considered most likely to join an insurgency; creating jobs would help to draw the alleged "$10 a day Talib" away from anti-government activities, a view widely shared by Afghans.[17] Second, a growing economy and rising standard of living would create confidence in and legitimacy for the state and therefore reduce hostility toward it. A growing economy would also allow the state to deliver services and programs to a population that was increasing in numbers and expectations, especially with the return of nearly two million Afghans in 2002 alone.[18] U.S. government officials reasoned that if the Afghan government was seen as offering something better than the Taliban, the population would become stakeholders in the reviving state.[19] Third, a growing and robust economy would generate revenue through direct and indirect taxes that would enable the government to pay its bills and, critically, not remain a "permanent ward of the international community."[20] Finally, the choice of a private-sector, open-market economy was seen as reinforcing electoral democracy, individual freedoms, women's rights, a free media, and other Western values. Free enterprise was seen as transformational, freeing the country from the "dead hands" of tradition, socialism, and the Taliban.[21]

While the emphasis and intensity of specific policies and programs have changed over the past 16 years, the core belief and theory of change—that a growing economy contributes to stability and security—has remained constant. Still, there is not universal agreement on the relationship between economic growth and security. Research in Afghanistan and other conflict situations suggests that the decision to oppose and even take up arms against the state can be the result of a varied, complex, and often overlapping mix of factors, including poor governance, corruption, and predatory government; injustice; micro- or macro-level ethnic, tribal, or factional conflicts; resistance to international military forces in conflict areas; scarce resources; and even aid itself.[22] All of these factors may be exploited by insurgents, as may the sense of relative poverty that feeds a feeling of exclusion and grievance.

AFGHANISTAN'S ECONOMIC PERFORMANCE SINCE 2001

Afghanistan's post-2001 economic performance has juxtaposed sharp growth and expansion, yet with growth driven primarily by international spending; creation of great wealth, yet the persistence of grinding poverty; and, the shifting of the composition of the economy from agriculture to services, yet with the persistence of low-productivity agriculture.

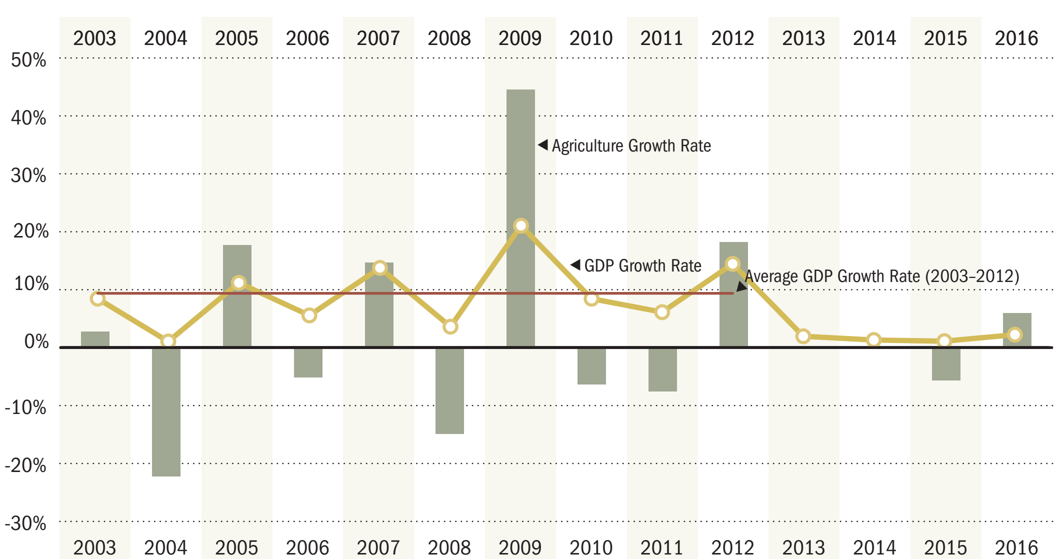
GDP

Influenced significantly by high levels of donor spending and the recovery typically seen in post-conflict situations, Afghanistan's GDP growth averaged at or near double digits for the first decade of reconstruction. Between 2001 and 2012, per capita GDP increased more than five-fold, from $117 in 2001 to a peak of $669 in 2012 in the run-up to the 2014 drawdown. This included the period of the 2007–2012 global economic recession. Since 2012, total GDP has been stagnant or even falling. Moreover, per capita GDP has fallen each year since 2012, dropping to $562 in 2016.[23]

Due to the volatility of weather-dependent agriculture, GDP growth varied greatly from year to year (see figure 1). While agriculture remained the base of Afghanistan's licit, formal economy, contributing from 21 to 38 percent of value added to GDP, construction and services (especially communications, transport, logistics, government services, and financial and business services) were the strongest consistent driver of GDP growth through 2013.[24] The significant drop in growth beginning in 2013, in parallel with the drawdown of coalition military and civilian personnel, confirmed that much of the growth was driven largely by the international presence.

FIGURE 1

AGRICULTURE AND GDP GROWTH RATES, 2003–2016



Source: SIGAR analysis of data from the World Bank, "GDP growth: Afghanistan (annual % growth)" and "Agriculture, value added: Afghanistan (annual % growth)," data for 2003–2016, World Bank, World Development Indicators database, accessed on January 12, 2018.

Employment

According to the Afghan government's Afghanistan Living Conditions Survey (ALCS), unemployment was 7.1 percent in 2008, 8.2 percent in 2012, and 22.6 percent in 2014, the only available data points. Drawing conclusions about true levels of employment is difficult, in part, because data in Afghanistan are notoriously poor.[25] For example, Afghanistan has never had a full census, and therefore all population numbers and percentages are estimates.[26] Also, ALCS counted anyone who did any agricultural, nonagricultural, or occasional paid work for even one hour in the previous 30 days as "employed," a situation that does not represent sufficient employment.[27] In fact, a large majority of the population is underemployed, a problem considered as serious as unemployment.[28] Furthermore, 90 percent of employment in Afghanistan (including day laborers and unpaid family workers) has been classified as "vulnerable."[29]

The extent to which employment depended on international spending was illustrated by a 2016 International Monetary Fund (IMF) country report that estimated 500,000 jobs had been lost in the two years after the 2014 drawdown, a number roughly equivalent to the number of jobs that were created in the 2009–2012 surge years preceding it.[30] Moreover, the World Bank estimated that

Defining Economic Terms

Informal Economy: All economic activity that is not taxed or regulated by the government. This includes the entire illicit economy, as well as licit, but unregistered, activity, such as self-employed individuals who are paid in cash.

Labor Force: The number of people in a population who have a job or are actively looking for a job.

Own Account Workers: Those workers who are self-employed and who have not hired anyone to work for them on a continuous basis.

Underemployment: The percentage of those in the labor force who are employed in jobs that are less than full-time, jobs that are below their education or training level, or jobs that are inadequate to meet their economic needs.

Unemployment: The percentage of people in the labor force who do not have jobs.

Vulnerable Employment: Own account workers and contributing family workers, including day laborers and informal workers, who are considered vulnerable because they are "more likely to lack decent working conditions, adequate social security and 'voice' through effective representation by trade unions and similar organizations."

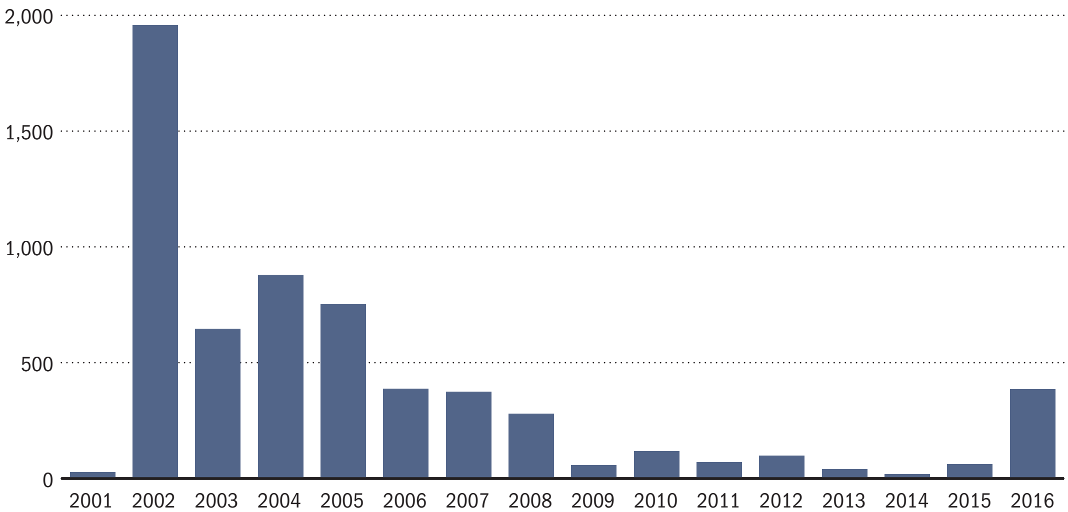
Source: World Bank, *The Informal Sector: What Is It, Why Do We Care, and How Do We Measure It?*, May 8, 2007, pp. 21–23, 27, 29; Gregory Mankiw, *Macroeconomics*, 8th Edition (New York, NY: Worth Publishers, 2012), pp. 606, 610; Merriam-Webster, "Underemployment Definition," Merriam-Webster website, accessed on March 8, 2018; OECD, "Own Account Worker Definition," OECD Glossary of Statistical Terms website, accessed on February 26, 2018; International Labor Organization, "Vulnerable Employment Definition," 2017.

approximately 80 percent of the jobs that had been created were informal day labor jobs that were not sustainable.[31]

The challenge of creating jobs for the existing labor force was exacerbated by the return of refugees from neighboring countries, especially during the early years of reconstruction. In 2002 alone, 1.96 million refugees voluntarily returned to Afghanistan.[32] Returnees added to the number of people looking for work and needing services from the state. (See figure 2.)

FIGURE 2

NUMBER OF VOLUNTARILY RETURNED AFGHAN REFUGEES, 2001–2016 (IN THOUSANDS)



Source: SIGAR analysis of data from the UN High Commissioner for Refugees (UNHCR), "Returned Refugees: Afghanistan," 2001–2016, UNHCR Population Statistics, accessed on February 20, 2018.

Finally, with one of the highest population growth rates in the world and nearly half of its population under the age of 15, Afghanistan will need to add 400,000 jobs annually just to meet the needs of labor market entrants—a situation described as a "socio-economic time bomb."[33]

Poverty

From 2002 to around 2012, workers benefited from the substantial rise in wage rates and salaries for all types of work that were driven by international spending. Remuneration paid to office personnel and lower-skilled workers by international agencies and contractors was often up to 11 times the civil service wage rate.[34] Beginning in 2014, the availability of employment and the wages of both office workers and casual laborers began to level off or decline.[35]

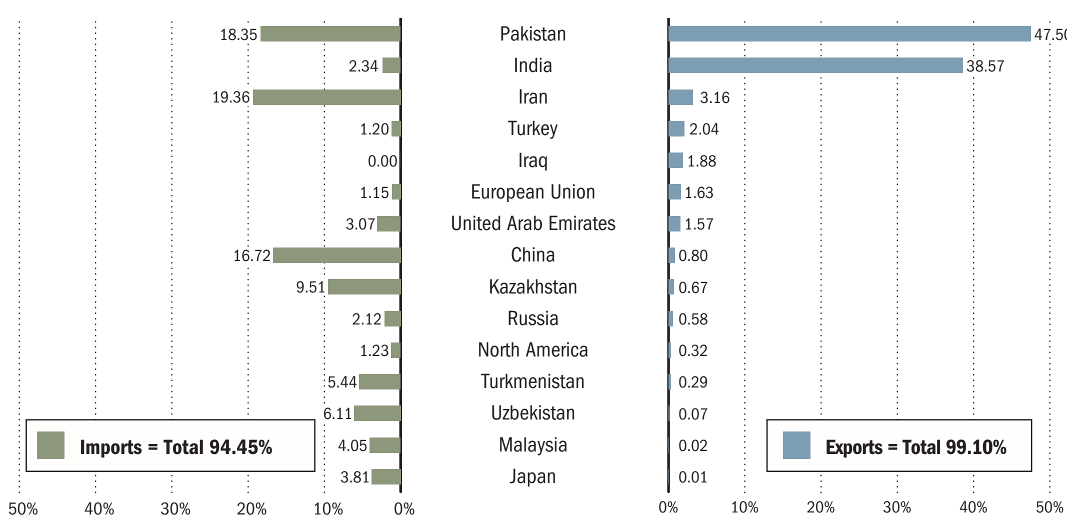
Even though Afghanistan saw strong growth in GDP between 2002 and 2012, benefits did not accrue equally to the rich and the poor, widening the inequality gap in the country. Poverty levels remained extremely high, largely due to unemployment and underemployment. Around one-third of the population has remained below the poverty line since at least 2007, when the first consistent indicators were available.[36] At the same time, however, poverty is hard to measure because data in Afghanistan are notoriously inadequate.

Trade

Afghanistan's trade imbalance increased consistently over the past 16 years as domestic industries were unable to compete in regional and world export markets and consumption fueled by the inflow of civilian and military funding attracted imports.[37] Afghanistan reported substantial growth in imports from Pakistan, Iran, and China, three of Afghanistan's largest trading partners, between 2008 and 2016, the only years for which Afghanistan reported trade data.[38] Analysts attribute part of the trade imbalance to competitive advantages, but also to predatory or unfair trade practices by these nations, who saw Afghanistan as a market for their own production. Especially concerning for Afghanistan were the rising imports of competing products from its neighbors, for example, stone, carpets, dried fruits, and nuts.[39] Recent transit and trade issues between Pakistan and Afghanistan due to political tensions reportedly have led to a substantial decrease in imports from Pakistan from 2016 to 2017.[40]

FIGURE 3

AFGHANISTAN'S TOP TRADING PARTNERS, 2016 (BY PARTNER SHARE OF MARKET)



Source: SIGAR analysis of data from UN Comtrade, "Afghanistan Reported Exports and Imports by Partner (Partner Share of Market in %)," 2016, World Integrated Trade Solutions, UN Comtrade database, accessed March 12, 2018.

This has further motivated Afghanistan to strengthen its trade relationships with Central Asia, as illustrated by the Lapis Lazuli Route agreement signed in November 2017 between Afghanistan, Turkmenistan, Azerbaijan, Georgia, and Turkey.[41] Figure 3 illustrates Afghanistan's top trading partners in 2016 by value of trade.

Investment

Drawing conclusions about investment in Afghanistan is difficult due to the lack of precise numbers and other gaps in information. Nevertheless, it is clear that despite a few significant and high profile exceptions, foreign private investment has been limited throughout the reconstruction period. While domestic investment was relatively strong during the surge of 2009–2012, it subsequently declined and overall contributed little to economic growth.[42] The primary impediments to investment were related to uncertainty, including the effects of institutional corruption.[43] While private investment began ramping up in 2005, alongside the increased inflow of foreign spending and a higher international presence, the growth was short-lived. Between FY 2005 and FY 2011, private investment nearly tripled. However, it peaked in FY 2011 at $1.5 billion and has fallen since. Between FY 2011 and FY 2015, private investment dropped 24 percent.[44]

Insecurity vs. Uncertainty

The terms insecurity and uncertainty are often conflated to portray some level of doubt or vulnerability. In this report, however, insecurity and uncertainty describe two related, yet different, situations.

Insecurity reflects a current state of risk to direct physical safety or political stability. An individual, group, or region is insecure when it is vulnerable or subject to danger. In the case of Afghanistan, insecurity is often directly tied to the presence of insurgent groups.

Uncertainty signifies a level of unpredictability about the future, rather than an imminent risk. Uncertainty often refers to future risks facing individuals or groups, particularly economic or political risks about specific policies, for example, diminishing returns on investments. Uncertainty can also be tied to confusion, which makes doing business more difficult and complex.

CHAPTER 2

OVERVIEW OF SUPPORT TO PRIVATE SECTOR DEVELOPMENT

UNAMA photo by Fardin Waezi

FUNDING STREAMS

While over 60 nations helped to fund Afghanistan's reconstruction, U.S. aid dwarfed all other individual country funding.[45] Since FY 2002, the U.S. Congress has appropriated $122.09 billion in reconstruction assistance to Afghanistan.[46] Almost immediately following 9/11, debates began about how much funding would be required to reconstruct Afghanistan, with little or no empirical basis for precise estimates. At the November 2001 Senior Officials Meeting (SOM) on reconstruction assistance to Afghanistan, co-chaired by the United States and Japan, authorities estimated a notional $10 billion for funding over 10 years based on past international experience. This was substantially increased two months later by the $14.6 billion main estimate in the "Afghanistan Preliminary Needs Assessment for Recovery and Reconstruction" produced by the World Bank, Asian Development Bank (ADB), and the UN Development Program (UNDP).[47] Meanwhile, according to a report by Radio Free Europe, Afghanistan's Interim Authority stated in January 2002 that reconstruction would require $45 billion over a 10-year period.[48] The Tokyo donor's conference that same month led to international pledges of $1.8 billion for 2002 and a total of $4.5 billion across a range of timeframes.[49]

Various scholars and development agencies advocated for additional funding and criticized the needs estimates, arguing that, on a per capita basis, international pledges and U.S. funding authorizations for Afghanistan were substantially lower than the aid allocated for other recent post-conflict states, such as Rwanda, Bosnia, Kosovo, and East Timor.[50] While comparisons of absolute and per capita funding levels alone were not a sufficient basis for criticism given the inherent differences in the countries' economies, populations, productivity, and other circumstances, some of those charged with overseeing the reconstruction effort criticized the estimates for their relatively low levels of projected funding. Furthermore, these discussions took place against the backdrop of planning for the invasion of Iraq and with the feeling that the United States had no interest in staying in Afghanistan for the long term—and that the low needs estimates reflected this.[51]

By 2003, as insecurity grew and donors became concerned that the reconstruction effort was faltering, more resources, primarily from the United States, began to flow into Afghanistan to support what would eventually be formalized as the counterinsurgency (COIN) strategy.[52] In the years before the 2009–2012 surge, despite growing evidence that Afghanistan and its international partners were unable to effectively spend the existing resources, funding levels continued to increase. U.S.-appropriated reconstruction funding in FY 2009 was $10.4 billion, and peaked in FY 2010 at $16.7 billion (see figure 4).[53] Thereafter, development funding fell in parallel with the military drawdown that was to be completed in 2014. Total U.S. appropriations in 2014 for both development and security were only about 40 percent of their peak in 2010. Subsequent years saw continued reductions in U.S. appropriations.[54]

Total international funding levels grew substantially during the surge years as well. In 2007, official development assistance (ODA) increased by over

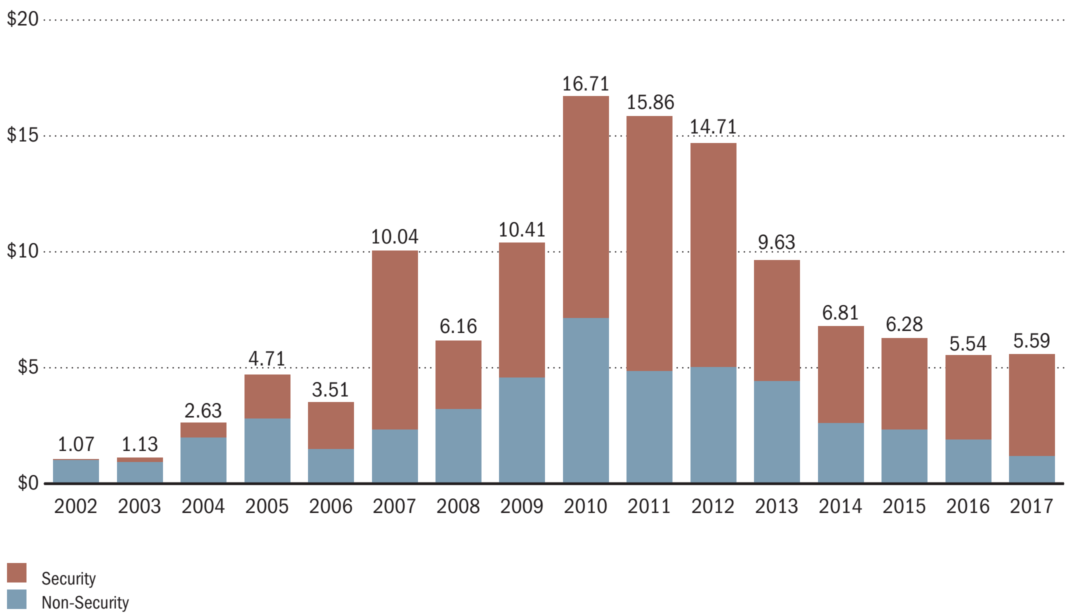
Official Development Assistance

OECD's Development Co-Operation Directorate calculates ODA from all OECD member countries. ODA includes aid provided by an official agency or government with the specific objective of promoting economic development and improved welfare, including humanitarian aid. ODA does not include funding for military equipment or services, antiterrorism activities, most peacekeeping efforts, and other funding directly tied to security or military forces.[55]

While ODA and U.S. appropriations are measurements of donor assistance, the two are not directly comparable. ODA is calculated by OECD and includes certain grants, loans, and technical assistance that are not included in SIGAR's calculations of U.S. appropriations. ODA numbers also represent historical calculations of disbursements, not appropriations.

FIGURE 4

U.S. GOVERNMENT APPROPRIATIONS BY FISCAL YEAR, 2002–2017 ($ BILLIONS)



Source: 2002–2006 data from SIGAR *Quarterly Report to the United States Congress*, October 30, 2014; 2007–2017 data from SIGAR *Quarterly Report to the United States Congress*, January 30, 2018.

57 percent and remained at about that level through 2008. In 2009, an even larger influx of money began to flow into Afghanistan as donors increased ODA to over $6.2 billion.[56]

It is not possible to determine the percentage of total U.S. government funding that went to private sector development due to the complexity of the agencies' funding mechanisms and the overlap of these and other U.S. efforts in a variety of cross-cutting programs. For example, USAID supported private sector development through a variety of economic growth and agriculture programs, which, as of December 31, 2017, had disbursed $1.22 billion and $2.15 billion, respectively.[57] The majority of USAID funding for these projects came through the congressionally approved Economic Support Fund. ESF funds were appropriated annually for programs in countries where funding for economic development was justified on the basis of U.S. national interests, rather than solely on development.[58] Funding for these USAID programs was also supplemented by non-ESF funds.[59]

In addition, DOD's role in private sector development was supported by more than $675 million in funds obligated for TFBSO.[60] And, although only 0.44 percent of the $838 million of CERP funding was disbursed for micro grants, the primary CERP activity discussed in this report, additional CERP monies were spent on roads, culverts, bazaars, and market buildings, which contributed to private sector development.[61]

KEY ACTORS AND ACTIVITIES

U.S. Government Agencies

Starting in 2001, U.S. government civilian agencies that contributed to private sector development included USAID, Treasury, Commerce, OPIC, USTDA, and the U.S. Trade Representative. DOD supported private sector development through such mechanisms as TFBSO, Afghan First, Agricultural Development Teams, and CERP micro grants. In addition, some DOD stabilization programs such as Village Stability Operations had private sector development-related activities. All of these efforts were intended to be part of a whole-of-government or integrated approach (see appendix B, Select U.S. Government Projects).

U.S. government support to private sector development and economic growth can be put into two broad but overlapping and complementary categories: (1) overall support to creating an enabling environment, effective market structures, and institutions in which the private sector could thrive, and (2) targeted support to individual firms, entrepreneurs, and groups. Within those two broad categories, the U.S. government supported a wide variety of efforts, including reforming Afghan government institutions, laws, and procedures; providing technical and financial support to individual small and medium enterprises; encouraging businesses, which added value to primary commodities and products; building business associations; supporting the privatization or liquidation of the state-owned enterprises; strengthening the financial sector, including microfinance institutions; promoting foreign and domestic direct investment; encouraging regional trade; providing vocational training and education; and targeting assistance to women's economic activities. These efforts were complemented by other U.S. investments in infrastructure, border management, and rule of law, which were critical to underpinning the institutional environment necessary for a market economy.

U.S. Allies

The United States and its allies, primarily the UK and Germany, were aligned in their view of the private sector as the main engine of development, with some minor policy differences, mainly concerning the extent to which the state would intervene in the economy. And, while the European Union didn't focus explicitly on the economy, its programs in rural development, governance, and social protection were complementary to private sector development.[62]

The UK, which in some years was Afghanistan's second-largest bilateral donor, was the lead nation for counternarcotics and supported the institutional infrastructure for the enabling environment and economic management, working primarily within the ministries.[63] Due to its leadership of the Lashkar Gah Provincial Reconstruction Team (PRT), the UK also provided significant support in Helmand Province, including funding for its industrial park.[64] In 2009, the UK's Department for International Development (DFID) Supporting Employment and Enterprise Development (SEED) program served as an umbrella project that included technical assistance to the Ministry of Mines and Petroleum (MOMP) and Ministry of Commerce and Industry (MOCI).[65] This assistance included support to legislation, mentoring and training, restructuring of institutions, and, as a new initiative, more direct assistance to enterprises through funding the Business Edge management and business skills training program and the Afghanistan Business Innovation Fund.[66]

Germany, which in some years was Afghanistan's third-largest bilateral donor and which had a long history of private sector linkages with the country, played a major role in the founding of the Afghanistan Investment Support Agency (AISA), one of the key institutions formed post-2001, and was involved in trying to revive the pre-war Afghanistan Chamber of Commerce.[67] Germany took on a larger role after 2009, especially in the north where it had a large troop contingent. Although supportive of private sector development, in part through enterprise projects similar to USAID's, Germany took a European approach that envisioned a more active role for the state, which created some tension with the United States over the characteristics of the reborn Chamber of Commerce.

Regional Influences

In addition to Western donor nations, the following regional neighbors had a significant influence on Afghanistan's economy, both through development assistance and, more extensively, through commercial activities, many of which were motivated by the countries' political and diplomatic aims.

The Silk Road

Named for the prominence of the silk trade at the time, the Silk Road was an historical network of trade routes that spanned the Eurasian continent, most significantly from the late BCE period to the 1400s. The territory that is now Afghanistan served as an important transit point between Persia (Iran), India, and China. The Silk Road has been invoked in modern times in endeavors aimed at strengthening trade and political relations between the nations of South and Central Asia. These endeavors include the U.S. New Silk Road initiative and China's One Belt, One Road initiative.[68]

Pakistan

Pakistan is regularly criticized by Afghan media and government officials not only for political intervention in Afghan affairs and maintaining Taliban safe havens, but also for predatory economic practices, such as product dumping and non-tariff barriers to trade. Because the southern port city of Karachi provides land-locked Afghanistan with its main access to global and regional shipping, Pakistan's ability to close its borders or impose restrictions on the transport of goods leaves Afghanistan vulnerable.

Pakistan is Afghanistan's largest trading partner, although its exports to Afghanistan outweighed imports by a factor of 3.7 in 2016.[69] The 2010 Afghanistan-Pakistan Transit Trade Agreement (APTTA), replacing the 1965 Afghanistan Transit Trade Agreement, has not resolved the many trade-related tensions between the two countries, including transshipment of goods and access to Pakistan's roads for Afghan vehicles. In the second half of 2017, Afghanistan's trade with Pakistan was reported to have fallen substantially, while trade with Iran and India grew.[70]

Iran

Iran has extensive commercial interests in Afghanistan, especially in the western province of Herat, where Iran has historically provided electricity. Afghanistan is an important export market for Iranian consumer goods, which are especially attractive to those Afghans who acquired Iranian tastes during years spent there after the onset of conflict in 1979.[71] In 2016, Afghanistan reported $1.27 billion in imports from Iran, the highest in the region.[72] In return, cash from Afghanistan was a source of hard currency for Iran during the U.S.-backed economic sanctions. Cash remittances from the estimated 2.5 million Afghans currently living and working in Iran have been an important means of support for their households in Afghanistan. The opening of the Iranian port of Chabahar in December 2017 provides Afghanistan with an alternative to the Pakistani port of Karachi.

India

India has been both a donor nation to Afghanistan and an important regional economic actor. One of India's largest economic development contributions was the reconstruction of the Salma Dam (now renamed the Afghan-Indian Friendship Dam), which was designed to generate up to 42 MW electricity and provide water to irrigate agricultural land in Herat.[73] Indian companies have also done work on roads and electrical transmission lines. The option for the Hajigak iron mine in central Bamyan Province, Afghanistan's second largest mining contract, went to an Indian consortium of private and state-run companies, although final contract status and actual exploitation have stalled due to security concerns and low world mineral prices.[74] Trade between the two

Fruits from the Kandahar region of Afghanistan are shipped to India with help from USAID. (USAID photo)

countries significantly increased from $20 million in 2001 to $753 million in 2016, of which nearly two-thirds were imports of Indian goods into Afghanistan.[75] Because of the constraints of land transport across Pakistan, a growing percentage of exports to India travel by air, especially spices, carpets, fresh and dried fruit, and nuts.[76] Partly because of its rivalry with Pakistan, India has been especially supportive of the expansion of the Iranian port of Chabahar, which facilitates trade with India and lessens Pakistan's influence.[77]

China

China has extensive political and commercial interests in Afghanistan, with significant bilateral trade and investment efforts and some minor development assistance. Post-2001 trade has been very much skewed in China's favor; in 2016, its exports to Afghanistan were valued at nearly 95 times its imports.[78] China's involvement in Afghanistan's extractive industries includes the state-owned Metallurgical Group Corporation of China's (MCC) winning bid to exploit the Aynak copper mine in Logar Province for $808 million.[79] Chinese companies also acquired drilling rights in the Amu Darya Basin, one of the oil and gas fields in northern Afghanistan.[80] In 2016, Afghanistan and China signed a memorandum of understanding for Afghanistan's integration into China's One Belt, One Road initiative, without significant practical implications to date.[81]

Turkey

A North Atlantic Treaty Organization (NATO) ally and coalition partner of the United States, Turkey sees itself as a regional power in Central Asia. It has commercial interests in trade, especially in northern Afghanistan, and many Turkish construction companies have won major contracts for reconstruction activities.[82] Turkey has historically supported northern Afghan politicians, most notably First Vice President Abdul Rashid Dostum.[83] Turkey has also facilitated Afghanistan's participation in the Istanbul-based Economic Cooperation Organization.[84]

Central Asian Republics

Despite geographic proximity, Afghanistan's economic relationships with its northern neighbors Tajikistan, Uzbekistan, and Turkmenistan are nowhere near as extensive as its other neighbors. During the Soviet period, there was limited official trade, and the river borders were much less permeable than the land borders with Pakistan or even Iran. The limited trade continues due to disputes over river water allocation, protectionist economic policies, and fears of spreading chaos and violence from Afghanistan.[85] The share of imports from Turkmenistan and Uzbekistan are 5.4 percent and 6.1 percent, respectively, and Afghanistan does not have significant exports to either country.[86] A number of regional initiatives of various strengths have been signed to foster economic cooperation, transport linkages, and regional trade, but the success of these initiatives has been limited due to security fears and countries' perceptions of their own self-interest.[87]

Russia

Russia has kept a low profile in Afghanistan since the former Soviet Union ended its 1979–1989 occupation of the country. Russia helped facilitate some aspects of the coalition's efforts in Afghanistan from 2001–2014, including training Afghan security forces, in coordination with NATO, and providing air and land transit for NATO forces. Russia's primary interests in Afghanistan are related to concerns about potential instability in Central Asia and the flow of opiates from Afghanistan; more than 80 percent of heroin exports to Russia and Europe pass through Tajikistan.[88] On the economic side, Russia contributed to reconstruction by writing off more than $11 billion of the debt owed by Afghanistan to the Soviet Union. The limited trade between the two countries heavily favors Russian exports, mainly for petroleum products, wood, and steel. Russian companies, mostly state-owned, have gained some contracts from the reconstruction, including lucrative transport contracts.[89] As the 2014 transition approached, Russia increased economic ties with Afghanistan and began rebuilding and revitalizing some of the industrial infrastructure it built there during the Cold War.[90]

International Organizations

A substantial portion of aid and technical assistance, especially in the early years after 2001, came from international organizations, whose support was closely aligned with the U.S. strategy for economic growth and private sector development in the initial phases of reconstruction.

The main objective of the IMF during the immediate post-2001 period was to quickly restore financial and macroeconomic stability to support a sustainable economic recovery. Because Afghanistan's central bank, Da Afghanistan Bank (DAB), and the Afghan Ministry of Finance (MOF) had both essentially ceased to function by 2001, the IMF was the lead organization in rebuilding economic institutions and implementing macroeconomic policies.[91] This included technical assistance programs and training for public sector employees.[92]

The World Bank focused its initial funding on "critical short-term priorities including education, infrastructure rehabilitation, and job creation," seen as "opportunities for 'quick wins'," as well as "addressing urgent financial management and public administration needs." Other World Bank priorities included investment funding for technical assistance in the financial sector, private sector, and infrastructure.[93] The World Bank also became the administrator of the Afghanistan Reconstruction Trust Fund (ARTF) in 2002 and played a major role in building the capacity of the MOF.

The Asian Development Bank's immediate priority post-2001 was to generate economic growth through the creation of employment. Longer-term priorities included large-scale infrastructure, gender equality, and regional trade, including energy. ADB acknowledged the existing constraints to private sector development and sought to invest in "capacity building, institution building, governance support, and the reform and development of the financial system."[94]

The UN Development Program, meanwhile, had very few programs that directly contributed to private sector development. Those that did were largely focused on government reform and capacity building, or were primarily area- or community-based projects.[95]

UNAMA photo by Zakarya Gulistani

CHAPTER 3

U.S. SUPPORT TO PRIVATE SECTOR DEVELOPMENT: 2001–2017

U.S. government support to private sector development in Afghanistan from 2001 to 2017 can be divided into five periods: (1) 2001–2005, the initial reconstruction efforts; (2) 2006–2008, the rise in assistance due to the fear the country was slipping backwards; (3) 2009–2012, the military and civilian surge, with accelerated spending; (4) 2013–2014, the drawdown of military forces and transition to Afghan government authority; and (5) 2015–2017, the post-transition years. While the general strategy of supporting a private sector, open economy remained constant, each of these periods was distinguished by the level and types of inputs, as well as by events in the larger Afghanistan context.

After a brief history of Afghanistan's economy and a discussion of these periods of U.S. government support to private sector development, we turn to the five main U.S. private sector development interventions—creating an enabling environment, providing access to finance, promoting investment, developing regional and international trade, and supporting enterprises—which are discussed in chapters 4 through 8.

AFGHANISTAN'S ECONOMY BEFORE 2001

Prior to 1978, Afghanistan had what could be called a mixed-guided economy, with the agriculture, small-scale manufacturing, and trading sectors largely

ENDURING CHARACTERISTICS OF THE AFGHAN ECONOMY

Aside from the devastation of years of war, Afghanistan's post-2001 economy reflected several enduring characteristics: reliance on external finance, low-productivity agriculture, limited industry, mixed responsibilities between public and private sectors, and pervasive uncertainty.

Throughout its history, Afghanistan has relied on external finance: from plunder and tribute during the 18th and early 19th centuries, to British "subsidies" during the 19th century, to foreign aid during the 20th century, especially during and after the Cold War, when Afghanistan used the competition between the United States and the Soviet Union to extract foreign assistance from both. A succession of relatively weak central Afghan governments was reluctant to levy and collect direct taxes, including income and corporate taxes, out of fear of alienating powerful elements in society. Afghanistan has therefore been called a classic rentier state, one that receives all or most of its revenue from the outside, either from the sale of its natural resources or from foreign aid.[96]

Rentier State

A rentier state is one that earns most of its revenue from "renting" resources, such as oil and minerals, to foreign powers. Typically, only a small portion of the workforce is employed in the mining or other extraction of these resources and, therefore, the majority of the population does not benefit directly from the generation of rent. The state is the primary recipient of the rent revenues.

A rentier state can also be a state whose revenue streams are primarily foreign aid, as income is still being brought in from outside, but through bilateral or multilateral assistance rather than the purchase of resources.

Even during its most prosperous period immediately prior to the breakout of conflict in 1978, Afghanistan relied overwhelmingly on low-productivity agriculture for its predominantly rural population. Most of Afghanistan's minimal large-scale industry was owned by the state and financed and built by international donors. The informal agriculture, trading, and small-scale production sectors were mostly privately owned. With elements of both market and command or socialist economies, it is more accurate to call Afghanistan's pre-1978 economic system mixed-guided rather than "socialist" or "Soviet-style."

Uncertainty arose not only from a lack of confidence in the state's ability to survive, but more significantly, from fear of sudden changes in policy and of predation by the state or its officials. As illustrated by Prime Minister Mohammad Daoud's radical shifts on national ownership in the 1950s and 1960s, sudden and sharp changes in major policies, for example, taxation and state vs. private ownership, created a level of uncertainty that discouraged investment and many forms of economic risk-taking. This atmosphere, viewed as contributing to entrepreneurs' preference for short-term, lower-risk trade rather than long-term production, continues today. Over time, the enduring informality of economic activity has been largely attributed to the desire of entrepreneurs to avoid the clutches of a predatory revenue collection system or, potentially more significantly, appropriation by the government itself or by strongmen associated with or protected by it.

private, and the larger-scale manufacturing sector the province of the state.[97] Starting in the 1930s, Afghanistan gradually modernized, especially after World War II, when the country built infrastructure and a few large industrial facilities, which were seen as symbols of modernization and were intended to lead to import substitution and exports. The government also tried to maintain influence over the economy through heavy controls and mechanisms such as monopsony purchases of certain agricultural products, for example, cotton and sugar beets, and through the *shirkat* system of shared ownership, although its effectiveness was limited, especially with respect to prices. Afghanistan was largely dependent on imports, but in good agricultural years, it was self-sufficient in food grains; in such years, the country also had a modest trade surplus from the primary commodities of cotton, animal skins, wool, natural gas, dried fruits, and nuts.[98] Remittances from Afghan migrant workers in the Persian Gulf during the oil boom years of the mid- to late-1970s further contributed to a relatively positive economic picture.[99]

The *shirkat* (share) system was an arrangement in which a minority of stock (typically 40–45 percent) was owned by the government, and the remainder was in private hands.

USAID's first private enterprise development program in Afghanistan was launched in the early 1960s. While efforts to promote private investment in agribusiness, metals, textiles, tobacco, and furniture had limited success, the agency's support to other industries, such as *qarakul* sheep and fertilizer supply, was retrospectively assessed as successful.[100] This success was attributed to the establishment of investment laws and other legal foundations, the support given by key ministries for private investment, the consolidation of those ministries' responsibilities, the fielding of experienced USAID technical advisors, and, critically, relative political stability. Institutional support for the private sector was fragile, however, and there remained many structural obstacles to private sector growth. In the end, USAID concluded that the most serious obstacle to growth was the government's hostility toward private sector development after Mohammad Daoud returned to power in a 1973 military coup.[101]

***Qarakul*, also known as Persian lamb, is a type of sheep valued for its wool and pelt, which were used to make hats and coats. In high demand in U.S. and European markets during the 1950s and 1960s, qarakul became a less valuable product when international tastes moved away from animal fur.**

The "golden era" of modest development and relative domestic tranquility came to a violent end with the 1978 coup, after which the Peoples' Democratic Party of Afghanistan (PDPA) took the country in a more socialist direction, with hostility toward those who had been large landowners, businessmen, and capitalists, many of whom were killed or driven into exile. At the end of 1979, fearing that growing unrest and resistance could threaten the PDPA government, the Soviet army invaded Afghanistan. Subsequent armed conflict over the next 12 years resulted in a significant contraction of the Afghan economy.[102] Markets atrophied due to destruction of infrastructure, breaks in international trade linkages, and the inability of farmers to produce outputs for export. After President Mohammad Najibullah's fall and the ascendance of a fractious mujahedeen government in 1992, and then its replacement with the Taliban government in 1996, the economy continued its decline.

OPIUM ECONOMY

Opium poppy is an illegal crop used to make heroin and other opiates. By value, it is the most important crop in the Afghan economy, generating economic activity, providing employment, and supporting livelihoods in many provinces across the country. While the share of opium in economic activity has fallen from 33 percent of total GDP in 2004 to 16 percent of GDP in 2016, it remains the largest cash-generating industry in the country.[103] From a macroeconomic perspective, opium has positive impacts on the economy by increasing aggregate demand and improving the overall balance of payments.[104] Opium exports strengthen Afghanistan's balance of payments, helping to stabilize the foreign exchange rate for the Afghan currency.[105]

In recent years, the total net export value of opium at the border has ranged from $1.5 billion to as much as $4 billion, in some years exceeding all other Afghan exports combined.[106] The actual economic impact is much larger than this number suggests, however, considering the multiplier effect the industry has in other sectors, especially in rural communities. The majority of the farm-gate value of opium, in 2017 estimated at $1.4 billion, is spent on basic consumption by rural households. However, some portion of the export value also returns downstream to the domestic economy, further multiplying the income effects from opium production and increasing the opium economy's impact on the licit economy.[107]

From a livelihoods perspective, opium poppy cultivation can positively impact rural households in a number of ways. First, it provides a significant amount of employment due to its high labor intensiveness. In 2017, the drug industry accounted for approximately 590,000 full-time equivalent (FTE) on-farm jobs.[108] It is estimated that poppy is as much as

Partially eradicated opium poppy field in Badakhshan Province in May 2013. (Organization for Sustainable Development and Research photo) eight times more labor-intensive than wheat, the largest licit crop in Afghanistan.[109] Opium additionally provides a substantial number of off-farm jobs in trade, transport, processing, and security for the drug industry. In poppy-growing areas, opium also has a strong multiplier effect, creating secondary jobs as farmers accrue capital to spend on food, medical care, and other consumer products.[110]

Opium can further improve rural livelihoods by providing increased purchasing power for households, allowing them to improve food quality or pay for unexpected expenses. It is also a convenient means of generating capital for larger purchases, providing both access to credit and a means to pay off debts, and as a durable store of value. Households in poppy-growing areas have been able to send children to school and finance the purchase of capital assets that enabled them to leave opium poppy cultivation, for example, the purchase of vehicles for licit transport activity.[111]

Because it is so labor-intensive, poppy cultivation provides substantial access to land for the land-poor in rural Afghanistan through sharecropping and rent, in addition to providing wage labor opportunities. This provides access to cash, as well as land for cultivating food crops or keeping some livestock for households that would otherwise not have any.[112]

However, even as a high-value, labor-intensive crop, poppy generates substantially higher income for the traders and traffickers than it does for those farmers who grow it. The yields, prices, and border-crossing values of opiate products fluctuate each year, but the farm-gate value consistently represents well less than half of the border-crossing value.[113] The majority of rents from opiate production, therefore, are skewed away from the rural farmers and do not provide proportional benefits to the poor. By 2004, the majority of income went to traders and traffickers or to recipients of rent and protection payments, and this trend has continued since.[114]

Finally, while providing income for the landless and land-poor, and creating a multiplier effect for other portions of the population, opium production and trade exacts a profound cost on the economy due to macroeconomic volatility, insecurity, corruption, and degradation of the rule of law, as well as drug addiction and other health conditions. The macro effect shows the potential for Afghanistan to suffer from “Dutch disease,” a situation where foreign exchange inflows from the drug trade or a natural resource lead to an appreciation of the real exchange rate, making other licit sectors relatively less competitive, and thus discouraging the production of other goods.[115] Furthermore, the drug industry funds warlords whose militias undermine security efforts in order to maintain an unsettled environment in which the drug industry can thrive. Opium also distorts the rural economy as it impacts land prices, wage rates, and sharecropping rates.[116]

After the removal of the Taliban in late 2001, Afghanistan found itself in a completely new and unfamiliar landscape. Globally, much had changed between 1978 and 2001 and returning to the previous economic status quo was not an option.[117] Since the fall of the Soviet Union and restructuring of much of Eastern Europe, the market economy had become *de rigeur* for the developing world, outside of a few exceptions such as North Korea and Cuba. In addition, changes in international tastes and an increasingly globalized economy rendered Afghanistan's previous exports, for example, qarakul and dried fruit, less valuable.[118]

The Taliban's removal ended the 2000 ban on opium poppy cultivation and subsequently reinvigorated the illicit economy. Prior to the ban, opium cultivation had steadily increased since the 1980s, becoming the most valuable crop and export for the Afghan economy.[119]

2001–2005: AFGHANISTAN IS "OPEN FOR BUSINESS"

In late 2001, after years of conflict and the ouster of the Taliban, Afghanistan began the complex and difficult transition toward peace and reconstruction. After a political agreement was reached in Bonn in December 2001, the next several months witnessed a frenetic series of meetings in Kabul, Washington, and other world capitals, with the United States and more than 60 other nations trying to assess what was needed immediately and over the longer term, mobilizing U.S. and international community resources, establishing their own physical presence in a badly destroyed Kabul, and beginning to support the rebuilding of fractured Afghan government institutions. Much of the larger effort was focused on establishing the foundations of electoral democracy. At the same time, the coalition military sought to eliminate what were considered the last remnants of the Taliban.

During the Senior Officials Meeting of the January 2002 Tokyo conference, international representatives pledged $1.8 billion for 2002 and a total of $4.5 billion in grants for the reconstruction of Afghanistan. Donors were largely enthusiastic, as the international community felt a strong desire to show support in the wake of the tragedy of 9/11.[120] Of the more than $1.8 billion disbursed in ODA during 2002, approximately 26.4 percent came from the United States.[121]

For the U.S. administration, it was "all hands on deck," with government agencies feeling pressured to show what they could do or contribute, even where they had little or no experience in an environment such as Afghanistan. With less than one month between 9/11 and the start of Operation Enduring Freedom, there was no time for systematic planning. As one senior government official noted:

> The U.S. government did not engage, anywhere in any of its various departments and agencies, in extensive planning for a post-Taliban Afghanistan. There was no time, and not much incentive, to do so. Policy was focused on obviating the threat of another attack on the American homeland from al Qaeda's sanctuary in Afghanistan. The assumption was that the international community would pick up the pieces after the Taliban regime was displaced.[122]

As another senior official described, "When engaged in a crisis, cabinet members don't like to be excluded, so Commerce sent a representative to the field on its behalf. There was no group saying, 'Here's our overall strategy, here's what we need on the ground.' No, people just showed up."[123]

In Kabul, working conditions were chaotic, with U.S. officials operating out of the dilapidated and overcrowded embassy with its unreliable power, heat, and internet connectivity, often holding meetings in the homes of Afghan officials. Despite the difficult conditions, there was a palpable sense of optimism about the future among both Afghans and foreigners.[124]

Laying the Foundation for a Private Sector Economy

With the encouragement of the United States and its allies, and in a break from modern Afghan tradition, Afghanistan adopted a market economy. Private sector development was included as one of the three pillars in the new government's first official strategy document, the April 2002 *National Development Framework* (NDF).[125] The primacy of the private sector was made official in Article 10 of the 2004 constitution, which declared that "the state shall encourage, protect, as well as ensure the safety of capital investment and private enterprises in accordance with the provisions of the law and market economy."[126] All subsequent strategy documents affirmed the government's aim of "development of an enabling environment that encourages the private sector to play a central role in the economic development of the country," and that "government is the policy maker and regulator of the economy, not its competitor."[127] In the words of the chairman of the Interim Administration of Afghanistan, Hamid Karzai, "The state will enter into a direct managerial role only when social justice demands its presence."[128]

To lay the foundation for a private sector-driven market economy, the United States and its partners recognized a number of critical priorities, including institutional infrastructure, monetary policy, the banking system, currency conversion, government revenue collection, and basic economic governance.

As the lead development agency, USAID led the U.S. support for private sector development. In a series of plans, USAID outlined various interconnecting and linked programs and priorities, reflecting the crosscutting nature of the components necessary for economic growth.[129] Consistently, however, the agency viewed agriculture as a "cornerstone of recovery and a pillar of reconstruction for a sustainable future" because it was such a crucial piece of the Afghan economy, with the potential for multiplier effects and linkages with other sectors.[130] In the most general sense, U.S. priorities were similar to those articulated in the NDF.

At the same time, however, beginning in 2002, USAID was under substantial pressure from the U.S. National Security Council (NSC) and other agencies to rehabilitate the Ring Road, which led to budgetary shortfalls and forced defunding of other programs, including agriculture.

Ring Road

Originally built in the 1950s, although never completely paved, Afghanistan's 1,300-mile Ring Road encircles the country, connecting the primary cities of Kabul, Kandahar, Herat, and Mazar-e Sharif. The post-2001 rehabilitation of the road was completed except for a 140-mile segment between Herat and Maimana in the northwest, although other sections of the road in the south have subsequently been damaged by insurgent activity.

U.S. strategy documents from these early years emphasized the "light footprint" approach to reconstruction due to the desire to not get drawn into, or give the impression of, a "long-term [military] occupation of Afghanistan."[131] Afghans interpreted the light footprint to mean the United States did not intend to maintain a strong physical or direct monetary presence in the country for a long period of time.

Numerous international actors were involved in helping the Afghan government establish macroeconomic stability and foster an enabling environment during this time. The overarching strategy of the international financial institutions reflected their recent experience in the post-conflict countries of Kosovo and East Timor. The IMF took the central role in identifying initial technical assistance needs and advising on currency and monetary policy, while the World Bank took the lead in carrying out reconstruction assessments, followed by technical assistance and institutional support.

In November 2002, USAID launched its first post-2001 economic growth program in Afghanistan, the Afghanistan Economic Governance Program (AEGP), a $30 million program which ultimately increased to $90 million.[132] The AEGP ran through December 2005 and was implemented by the contractor BearingPoint as a catch-all program for economic reform, including property rights and land titling.[133] Reflecting the priorities outlined in USAID's early strategy documents, AEGP focused on four sectors: fiscal, financial, legal and regulatory, and trade policy.[134] Also, as was the case with most projects supporting Afghan institutions, AEGP included capacity building, with advisors working alongside

Afghan civil servants in the ministries, with a special focus on building MOF capacity in budgeting, customs, and tax administration.

The U.S. government recognized the need for an independent advocate and focal point for the private sector, and funded the Center for International Private Enterprise (CIPE) to help create a self-supporting Chamber of Commerce with those capabilities, rather than resurrecting the pre-1978, government-affiliated Chamber.[135] CIPE worked with the Virginia-based Afghan-American Chamber of Commerce (AACC), which had been founded in 2002 to stimulate business and investment between the United States and Afghanistan. The core of the AACC was a group of U.S.-based Afghan businessmen who had formed the Afghan Business Council in the late 1990s.[136]

To promote domestic and foreign investment in Afghanistan, U.S. government agencies organized conferences and meetings for potential U.S. investors. In January 2002, OPIC hosted a conference on the involvement of U.S. private investors in "economic reconstruction and U.S. investment in post-Taliban Afghanistan," and announced a $50 million credit line for work in Afghanistan.[137] Because OPIC's statutes precluded loans to non-U.S. companies, OPIC attempted to find diaspora Afghans with U.S. citizenship to receive loans or participate in joint ventures. The same year, Commerce formed the Afghanistan Investment and Reconstruction Task Force (AIRTF) as a clearinghouse of information for U.S. businesses trying to access NATO contracts or who might be willing to invest in Afghanistan.

To further support investment, in September 2003, an Afghan presidential directive created the Afghanistan Investment Support Agency, a new institution with the mission of facilitating and promoting domestic and foreign investment. Supported financially and technically by the German development agency Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), AISA was intended to be a "one-stop shop" that would bypass government bureaucracy.[138]

During this time, a number of USAID programs attempted to promote investment. AEGP aimed to encourage domestic and foreign investment through the development of industrial parks, in part by helping construct facilitating amendments to Afghanistan's Investment Law. In September 2004, USAID's Land Titling and Economic Restructuring in Afghanistan (LTERA) sought to promote investment through the two primary goals of "improving land tenure security for millions of Afghans and assisting the Islamic Republic of Afghanistan to undertake a comprehensive privatization program."[139] Resolving land tenure and ownership issues was seen as key to encouraging economic activity; land titling was urgent, given the poor and unreliable land records and the fact that the first land grabs by strongmen were starting to take place. (See page 32.) In addition, USAID viewed privatization of the state-owned enterprises as a means to promote private investment, especially from foreign investors willing to enter the Afghan market.[140] Privatization was also seen as a means of generating revenue for the government.[141] At the same time, however, most Afghans were unenthusiastic about privatization because they still looked to the state to be the lead economic actor.

In 2005, another USAID project, Rebuilding Agricultural Markets Program (RAMP), provided a $3.8 million grant to the Afghanistan Renewal Fund (ARF), which was established the previous year by Afghan Capital Partners (Acap), an

Emergence of Economic Strongmen

During the jihad (1979–1992) and mujahedeen government (1992–1996) periods, many of the powerful Afghan elites were displaced by a new class of strongmen who took advantage of the lack of rule of law to accumulate wealth and power, largely through drug and weapons trafficking, smuggling, extortion, and other forms of criminality. According to one analysis, "The large inflows of Soviet and U.S. patronage, coupled with the devastation that the fighting inflicted on the country's economy, led to the emergence of new types of political and economic organizations typified by the commander network."[142] These "commanders" were sidelined by the Taliban; in fact, their abuses were a factor in the Taliban's 1996 accession to power in Kabul. However, in the confusion that followed the 2001 military intervention, many of the strongmen were able to re-establish themselves through their relationships with coalition military forces, which relied on them to help overthrow the Taliban and maintain order and control. Electoral democracy and the market economy then created the environment in which they could launder their financial capital, leverage their political connections, and become businessmen.

The accumulation of wealth and power by strongmen was further enhanced through "land grabbing," or the acquisition of state land by a combination of force and quasi-legal maneuvers, often with the tacit approval of government officials. In the overheated post-2001 economy, land in the major cities increased in value by as much as 1,000 percent.[143] The subsequent distribution of plots of land generated income and patronage, often along ethnic or political party lines. Many of the major strongmen developed *shahraks* (little cities, or residential communities), including the Khalid bin Walid development in Mazar-e Sharif built by Balkh governor Atta Muhammad Noor, and Aino Mina in Kandahar developed by presidential brothers Mahmoud and Ahmad Wali Karzai, partly through a $3 million loan from OPIC.[144] According to estimates, between 2001 and 2012, 890,000 hectares of land were stolen or usurped.[145]

One expert went so far as to say, "The partial conversion of Afghan strongmen into businessmen resembles in many ways the establishment of 'mafia' or organized crime networks which are active both in the legal and the illegal economy and are able to use force to protect their interests and possibly to expand."[146] A former U.S. government official stated, "Many of these warlords became multimillionaires overnight. They had access and control. Powerful people controlled access to markets, including inputs and labor markets."[147]

independent company with offices in London and Kabul. RAMP's interest was in supporting direct investment in Afghan agribusiness, with the intention that the fund would continue to use USAID's contribution beyond RAMP's 2006 end date.[148]

Not Going According to Plan

Despite these and other early private sector development and reconstruction activities, there was concern among Afghans that the United States had a limited commitment to nation building and would therefore not devote sufficient financial and political resources to reconstruction, including private sector development, over the long term. This concern was reinforced by the shifting of the U.S. administration's gaze to the looming invasion of Iraq. According to one senior DOD official, "Within months of the end of major combat operations [in Afghanistan], it was clear to me—and to others—that the U.S. government was losing its focus. Its attention was elsewhere, and the Afghans knew it."[149]

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>
> —Dov Zakheim, former DOD Comptroller

By early 2003, however, Secretary of Defense Donald Rumsfeld, a skeptic of nation building, began to consider the possibility that more resources would be needed to stabilize Afghanistan.[150] Afghan-American Zalmay Khalilzad, who had been a member of President Bush's transition team at DOD and was at the time serving as Special Envoy for Afghanistan, agreed that a more robust "state- and nation-building program" was needed. Encouraged by Rumsfeld and National Security Advisor Condoleezza Rice, Khalilzad prepared a stepped-up U.S. strategy to consolidate the Afghan government's control over the country.[151] The strategy, Accelerating Success, was approved by President Bush in June 2003.

Accelerating Success was designed to show quick and visible progress and to reduce the risks posed by expected increases in violence before the 2004 Afghan presidential elections. An additional motivation was the Bush administration's desire to show progress to a domestic audience as the U.S. presidential election approached. The strategy's "stepped-up economic development programs" focused on bolstering economic and financial institutions, which, it was hoped, would help foster progress in reconstruction.[152] Specifically, Accelerating Success appeared to prioritize revenue collection to help ensure sustainable government budgets.[153] The initiative was ambitious, requiring the U.S. government to support the reconstruction of the Kabul to Kandahar portion

USAID'S SUPPORT TO ROAD INFRASTRUCTURE

The stepped-up economic activities of the 2003 Accelerating Success strategy included more visible infrastructure projects. President Bush announced that road construction was a top priority and, highlighting the shared priorities of Hamid Karzai and U.S. Embassy officials, U.S. Ambassador Robert Finn pressed for more funds for roads.[154] In 2002, Ambassador Finn wrote:

> Because Afghanistan is so fragmented, its most immediate need—as Chairman [of the Interim Administration] Karzai knows—is to be knitted together and, in order to protect our nation's investment and sacrifices here, to be knitted together soon. A dramatic, visible, hope-inspiring, and developmentally sound way to accomplish this goal is to build roads and bridges. . . . One poignant project would be the repair of the Kabul-Kandahar road, originally built by the [United States]. Chairman Karzai's priorities should be our priorities as, to paraphrase [President] Bush's recent remarks, his success is surely ours.[155]

Despite USAID Administrator Andrew Natsios' skepticism over funding big infrastructure projects due to their high cost and "dubious economic consequences," as well as the lack of engineering firms, equipment, and trained personnel to implement them, the NSC tasked USAID with the reconstruction of the Kabul-Kandahar portion of the Ring Road. (See figure 5.)[156]

In February 2004, Ambassador Khalilzad pledged to Karzai that the United States would pave 1,000 km of secondary roads connecting the Ring Road to regional road networks by the end of the year. The embassy had $100 million in funds for this through Accelerating Success, though the original cost estimate failed to factor in the expenses of demining and other required preparations. The estimate was later adjusted to $215 million, but the original amount had already been allocated, creating a budgetary shortfall.[157]

The directive to build roads created a dilemma for USAID, as the budget shortfall required it to revamp its priorities and slash other programs to fund the secondary roads.[158] A 2004 embassy cable reported that USAID's RAMP would be cut by $4.5 million to support the roads.[159] Similarly, $10 million was cut from other agricultural programs, leaving only enough money to fund the alternative livelihoods activity. Further, $15 million was cut from economic growth programs, $12.5 million from water and irrigation programs, and $8.5 million from democracy and governance programs, including rule of law initiatives and support for local government and parliament.[160] Yet, even these cuts failed to fill the funding gap. Ultimately, USAID was forced to suspend work on the road and delay its completion.[161]

Administrator Natsios argued that much of the failure surrounding infrastructure construction stemmed from the rush to show progress on development projects that would inherently be slow and messy, but sustainable and completed with Afghan buy-in.[162] The Bush administration's desire for visible and tangible signs of progress led to a focus on "burn rate" at the NSC, where dollars spent and number of projects implemented became the benchmarks.[163] The timelines for the Ring Road were unrealistic from the beginning, and while USAID was heavily criticized by the NSC for failing to meet deadlines, it had not been consulted on the deadlines or even the assigned tasks.

By 2005, despite USAID's struggle to complete these major construction projects, Ambassador Ronald Neumann, as part of his plea to the U.S. government to do more to win the war, urged more ambitious projects, calling for an additional $600 million to connect eastern and southern provincial centers to the Ring Road via gravel roads. In his effort to convince Washington to allocate more funds to Afghanistan, Ambassador Neumann stated that "in this fight, roads are life," and that construction of roads was the most important means to both extend state presence and promote economic activity.[164]

FIGURE 5

RING ROAD PROGRESS: SECTIONS COMPLETED, 2012

Note: Donors indicated dates.

Source: The International Institute for Strategic Studies, January 10, 2012.

of the Ring Road by December 2003 and complete construction of the Kandahar to Herat portion of the highway shortly thereafter.[165]

Also during 2003, the Afghanistan Reconstruction Group was created by the NSC as a flexible and "experimental" institution staffed by senior private sector executives who could advise both the U.S. and Afghan governments. The ARG was widely seen as Ambassador Khalilzad's reaction to existing aid channels and institutions, which he considered cumbersome, bureaucratic, and slow.[166]

Despite the alignment of Afghan government strategy documents with the international community's overall strategy and outlook, a number of contentious issues emerged during this period. One issue concerned the role of the state and whether it should be more like the United States or more of a "British-South Asian, government-led concept of how services should be provided to the people."[167] Further, while the United States emphasized the "light state," German officials stressed "the importance of combining the principles of a market economy with values of social responsibility."[168]

A second major issue was to what extent international assistance would be channeled on-budget through the Afghan government or spent off-budget by the donors themselves. (See page 38.) To provide a mechanism to simplify international donor funding streams for on-budget aid so they would be easier for the nascent Afghan government to manage, in May 2002 the World Bank-administered Afghanistan Reconstruction Trust Fund was launched through a joint proposal with UNDP, ADB, and the Islamic Development Bank. Especially in the early years, the majority of bilateral U.S. aid was provided off-budget, justified in part because of the widespread assumption that Afghanistan was a blank slate, without any functioning and accountable institutions or capacity for implementation.

At a meeting convened by the German Federation of Industries in advance of the November 2004 Berlin Conference for donors to pledge additional support for private sector development, Karzai and other senior officials touted the new liberal trade and investment laws and the recent establishment of AISA, and reiterated support for the private sector in the context of Afghanistan's trading history and its strategic location astride trade routes. Karzai described his vision as "less government, more society, and more business. We don't want to remain poor; we want to get rich."[169]

By the time of the Berlin Conference, however, it was clear that not all Afghan officials supported the same extent of reliance on the market economy. The government's updated development strategy, *Securing Afghanistan's Future* (SAF),

AFGHANISTAN RECONSTRUCTION GROUP

The ARG was created by the NSC in 2003 to advise both the U.S. and Afghan governments. Characterized as "experimental," the ARG was intended to be a flexible group that could mobilize expertise from inside and outside government, and assist the ambassador in looking at those reconstruction issues with which agencies did not have expertise.[170] At its creation, the ARG was staffed with five senior, highly successful private sector executives with specialized skills and experience, along with a chief of staff and public affairs personnel.[171] Over time, the ARG was generally credited with bringing in expertise from the private sector that could not be found in the U.S. government, as well as complementing the then-anemic State and USAID presence in country.[172]

ARG members most successfully engaged as advisors to Afghan ministers, many of whom had limited experience and struggled with the creation of programs and the economic problems that came with the transition to a market economy.[173] The ARG's value was generally seen at the strategic level, rather than in implementation.[174] Specifically, the ARG focused on identifying high-level issues that were not being adequately addressed, such as the creation of a framework to foster private sector activity and pinpointing areas that were either unrealized or lacked funding. The ARG's activities included the attempted reform of the national air carrier, Ariana Afghan Airlines, which the group identified as necessary for providing access to regional and global markets and simplifying travel for foreign investors, and work on the development of a national Afghan supply chain management system.[175]

At the same time, the ARG suffered from rivalries with other U.S. agencies, a lack of dedicated activity budgets, and an unclear mandate and role within the embassy. A 2005 Government Accountability Office (GAO) audit found that the ARG suffered from the lack of a clear mission and "focused its efforts on criticizing USAID programs rather than providing constructive advice."[176] The lack of a clear demarcation of missions caused tension and confusion between ARG and USAID personnel, including in the economic governance sector. For example, ARG advisors tried to provide direction to a USAID contractor; in response, USAID notified its contractors that they should take guidance only from USAID.[177] Rivalries were especially inflamed by an ARG chief of staff memo which was critical of USAID's management and oversight of infrastructure.[178]

From the ARG's perspective, the tension was the result of USAID and State personnel defending their territory against outsiders, in a response referred to by a senior ARG official as "the antibodies."[179] By the end of 2005, Ambassador Neumann decided that many of the functions of the ARG should be incorporated into normal embassy operations, obviating the need for an independent ARG.[180] The ARG was officially disbanded in 2008.

which contained this market-oriented approach, was presented at Berlin but never approved.[181] Noting that "removing obstacles to private sector development [was] an urgent priority," SAF reiterated the importance of trade liberalization and World Trade Organization (WTO) accession, developing and implementing trade and investment-related policies, building the capacity of relevant ministries, and facilitating regional transit and transportation.[182] One analyst wrote that SAF "ignores the reality of a highly uneven playing field in the world economy and fails to address the fundamentals of social justice and existing inequalities. . . . There should be a heavier state playing a more interventionist role."[183]

On-Budget vs. Off-Budget Assistance

From the start of reconstruction, there was disagreement over whether international donor money should be provided through the Afghan government's budget (on-budget assistance) or spent by the donor nations themselves on their own projects in Afghanistan (off-budget assistance). In its 2001 approach paper, the World Bank recommended that a substantial portion of on-budget international aid be channeled through a non-earmarked trust fund.[184]

In May 2002, the World Bank-administered Afghanistan Reconstruction Trust Fund was launched through a joint proposal of the World Bank, the UNDP, ADB, and the Islamic Development Bank. The idea was to simplify international donor funding streams for on-budget aid so they were easier for the nascent Afghan government to manage. The ARTF was also seen as a way to augment the low tax base, while simultaneously increasing the government's capacity to implement its own development programming. Additional justification was provided several years later, when analysis suggested that funds spent through the government's budget had a higher economic multiplier effect than funds spent by the donors on their own projects, as much of that money either left Afghanistan or never entered the country in the first place.[185] Critics, however, worried about the prospect of giving Western international institutions with little experience in Afghanistan control over so much on-budget aid spending. Supported by 31 donors, the ARTF has generally been considered a success, with a 2015 independent review of evaluations concluding it "achieved a number of significant and concrete results."[186]

In the 2006 Afghanistan Compact, donors agreed to increase the proportion of funds that were provided on-budget, as well as to provide more predictable and long-term funding. In 2010, the donors further agreed to a target of 50 percent of funding to be provided on-budget, with 75 percent of all funds aligned to the Afghan government's priorities. From 2002 to 2017, USAID disbursed approximately $3.9 billion in on-budget assistance. The majority of these funds were provided to the ARTF and other multilateral trust funds. Approximately $660 million of the total disbursed funds went toward bilateral (government-to-government) assistance to Afghanistan.[187]

In December 2004, Karzai appointed a new Minister of Finance, Anwar-ul Haq Ahadi, to replace Ashraf Ghani, who had been the driving force behind the SAF strategy. Ghani's removal was due to a combination of disagreements with the rest of the cabinet over his vision for a modified market-oriented economy (i.e., tight fiscal discipline with no subsidies or price controls), as well as the generally strained relationships with the other ministers, who saw his aggressive reforms and control of the government budget as those of a "de facto prime minister."[188]

In trade, 2004 began with the signing of the South Asian Free Trade Agreement (SAFTA) and ended with Afghanistan being granted observer status to the WTO, the first step toward full membership. As the end of 2005 approached, the urban economy, especially the construction sector, appeared to be thriving, although lingering Taliban elements continued to threaten areas of the south and east, complicating development.

2006–2008: RATCHETING UP ASSISTANCE

With the September 2005 parliamentary elections, the international community judged the Bonn process to have been successfully completed. Many Afghans, however, were not seeing the promised fruits of electoral democracy. As the nascent insurgency grew, security deteriorated, mainly in the south and the east, but occasionally in Kabul. In addition, according to the 2008 Asia Foundation (TAF) annual perceptions survey, Afghans felt a "higher level of dissatisfaction with the economic situation," and the proportion of respondents who said they were "less prosperous than one year ago" increased from 26 percent in 2006 to 36 percent in 2008. Respondents identified unemployment, high prices, and the poor economy as the biggest problems facing the country.[189]

Fearing that high prices resulting from the 2007–2008 global food crisis could further fuel anger toward the U.S.-backed Afghan government and boost recruitment by the Taliban, the United States and other donors increased their humanitarian and development assistance.[190] In September 2008, USAID launched the Afghanistan Vouchers for Increased Production in Agriculture (AVIPA) program, a $33 million voucher program to address the shortage of wheat, whose budget rose to $60 million as its scope expanded between November 2008 and May 2009.[191] While initially designed to provide wheat seed and fertilizers to farmers in the drought-affected areas of the country, AVIPA shifted toward implementing agriculture-related stabilization activities—for example, cash for work such as clearing of irrigation canals, small grants for farm equipment, and provision of agriculture inputs—in the increasingly insecure southern provinces of Kandahar and Helmand. At the U.S. military's request and in preparation for an anticipated troop surge, another five-year planned agriculture project was canceled and USAID was asked to extend AVIPA and be ready to implement stabilization activities as part of the "clear, hold, and build" process.[192] This was one of many instances where USAID came under pressure to align its efforts with the military's short-term stabilization and counterinsurgency activities.

During this time, corruption and the perceived diversion of millions of dollars of reconstruction money were starting to become a serious issue with Afghanistan's citizens and the U.S. government. For example, 76 percent of respondents to the 2008 TAF survey selected "corruption" as a major problem, whereas the 2004 survey had not even included corruption as a choice.[193] In 2006, the United States began discussing ways to tackle corruption, although serious efforts were not undertaken until 2009.[194]

A further, related reason for Afghan dissatisfaction was the perception of an increasingly unequal distribution of income and wealth. As early as 2005, the World Bank noted that small groups of business people (mainly former jihadi commanders and other influential people with political connections) dominated trading activities and used their insider connections to acquire land, resolve disputes, obtain credit, and win contracts.[195] Afghans believed this reflected negatively on the central government, which was blamed for not ensuring the population's welfare.

Many observers consider 2006 the tipping point when it became increasingly clear that Afghanistan was not a post-conflict state. Although there were concerns as early as 2003 that development progress was uneven and security conditions were deteriorating, it was not until 2006—when alarming levels of insecurity, insurgent activity, and poppy production could not be ignored—when significantly more resources began to flow from the United States into Afghanistan in an attempt to stabilize the country.

Setting a New Path Forward

In January 2006, the United States and its donor partners convened the International Conference on Afghanistan in London to reaffirm support for the nation and establish a path forward. Conference attendees signed the Afghanistan Compact, a new five-year partnership of the Afghan government and the international community in which security became the central focus, followed by governance, rule of law, economic governance, and social development. The economic governance and private sector development objectives included increasing the ratio of domestic revenue to GDP by 8 percent over the five-year period, simplifying investment laws and regulations, strengthening banking supervision, and reducing transit times for imports and exports. Due to concerns about the spike in opium poppy cultivation, counternarcotics was designated a cross-cutting issue to be addressed, in part, by rural development, especially the alternative livelihoods programs.[196]

The compact tasked the Afghan government with developing a prioritized and detailed national development strategy and providing regular reporting on the use of donor assistance.[197] To meet this requirement, the *Interim Afghanistan National Development Strategy* (I-ANDS) was issued in 2006, followed by the full ANDS in 2008. In response to criticisms over the limited buy-in to previous national strategies, the ANDS was developed over two years through an extensive consultative process in which a total of 17,000 individuals from government ministries, the parliament, provincial councils, civil society, international donors, and the private sector in all 34 provinces participated. The ANDS reaffirmed, albeit with greater specificity, the theme of the previous development strategies: Sustained economic growth depends on a vibrant private sector facilitated by a strong enabling environment for private sector growth and robust domestic and foreign investment. Although government officials emphasized that the ANDS was Afghanistan's own roadmap for development, it also fulfilled the technical function of a Poverty Reduction Strategy Paper, which made Afghanistan eligible for the Heavily Indebted Poor Countries Initiative of the IMF and World Bank.[198]

The Heavily Indebted Poor Countries Initiative

Being classified a Heavily Indebted Poor Country (HIPC) allows a low-income country with a high and unmanageable debt burden to access the debt relief programs of the IMF and World Bank. A country that meets the initial HIPC eligibility criteria must establish sound economic policies and develop and implement a Poverty Reduction Strategy Paper, which outlines how a nation's macroeconomic, structural, and social policies and programs will promote growth and reduce poverty. The IMF and World Bank monitor the HIPC's performance and reforms, and when the country has achieved satisfactory progress, it becomes eligible for full debt relief.[199]

New Initiatives, Same Focus

During this period, the U.S. government escalated its efforts to improve the enabling environment, including prioritizing infrastructure in, for example, transportation, communications, and power generation; creating industrial parks; supporting land and property rights reforms; and providing financing for economic opportunities.[200] USAID's Economic Governance and Private Sector Strengthening (EGPSS) program provided support to key ministries responsible for economic reforms, including fiscal, financial, legal and regulatory, and trade policy.

As part of its efforts to support small and medium businesses, U.S. agencies began a series of enterprise development initiatives aiming at expanding markets, developing a technically skilled workforce, increasing access to capital, creating jobs, promoting investment, and developing domestic products to become more competitive with imports. In 2006, USAID started providing direct support to enterprises by launching the Afghanistan Small and Medium Enterprise Development (ASMED) project, which provided grants and technical assistance to new and existing businesses and business associations, through partnerships in which the partner had to provide at least 50 percent of the funds. Small and medium enterprises were envisioned to be "a major driver of Afghanistan's economic development."[201] ASMED also supported business development services providers, which were intended to be market-oriented companies that would provide business advisory services to Afghan firms on a fee basis.

Small and medium enterprises were envisioned to be "a major driver of Afghanistan's economic development."

—ASMED Final Report

During this period, DOD also began to engage more significantly in private sector development through two main vehicles. The Commanders Emergency Response Program, developed in Iraq for short-term stabilization activities and subsequently introduced in Afghanistan, began giving micro grants to enterprises. To further support Afghan businesses, the Afghan First procurement policy was announced by Lieutenant General Karl Eikenberry in 2006, then codified in the FY 2008 National Defense Authorization Act (NDAA). The policy was intended to create jobs and promote the Afghan economy by awarding contracts to Afghan companies.[202] Both CERP and Afghan First were to become much more significant in the following years, and are discussed in the next section of this report.

In addition to supporting individual businesses, the U.S. government also increased its emphasis on access to finance by supporting the establishment of new and expansion of existing financial institutions that could lend to small and medium enterprises in urban and rural areas. In 2007, for instance, OPIC financed the establishment of Afghan Growth Finance (AGF), a non-bank subsidiary of the Washington-based Small Enterprise Assistance Funds, to reach out to Afghan-owned companies. The same year, USAID established the Afghan Rural Finance Company, expecting it to become an independent self-sufficient financial services provider. USAID also provided support to the microfinance sector by providing financial and technical support to microfinance institutions and the Microfinance Investment Facility of Afghanistan, which was established under the leadership of the World Bank.

Trade was another increased area of emphasis during this time, with EGPSS being the first USAID project to have explicit trade-related goals: milestones to

WTO accession and regional integration. To support the objective of increasing exports, the Export Promotion Agency of Afghanistan (EPAA) was established in 2006, with GIZ technical and financial support, as part of the Ministry of Commerce and Industry. EPAA's purpose was to help turn enterprises "into internationally successful operators by identifying new international opportunities, markets, and partner[s]."[203]

Although minerals were mentioned in both the U.S. and Afghan government strategies from 2002, early U.S. assistance in the extractives sector was overshadowed by other priorities. There were few major developments until May 2008, when the rights to exploit the copper deposits at Aynak, one of the world's largest unexploited copper deposits, were granted to the Metallurgical Group Corporation of China for a bid of $808 million, against which, as of 2016, MCC had only paid the first $80 million installment. MCC also committed to investing $2.9 billion for infrastructure over five years.[204] At the time, the Afghan government estimated that royalties, direct and indirect taxes, and other fees from developing Aynak would provide more than $200 million in annual revenue.[205] With other potential mining sites anticipated, this was seen as a test case for the tender process.

2009–2012: THE MILITARY AND CIVILIAN SURGE

With an increasing awareness that security was deteriorating and many of the reconstruction efforts were stalling, in 2008 the Bush administration undertook reviews of both military and civilian efforts.[206] In December 2009, after a series of further reviews, President Obama presented a strategy that was intended to represent a break with the past and give proper attention and resources to what he had previously called "the right war."[207] The Obama administration's strategy to stem the tide of the insurgency included a large troop surge and its development counterpart, the so-called "civilian uplift."

The surge was supported by massive increases in funding: Governance and development funding alone increased by 58 percent from FY 2009 to 2010, despite widespread reports and analysis that suggested spending at the previous, lower levels of funding was already problematic, in terms of both accountability and budget execution.[208] For example, the doubling of AVIPA's budget from $150 million to $300 million was done over the objections of USAID leadership, who were concerned that trying to spend that much money would be "ineffective and wasteful."[209]

On top of development funding, massive construction of bases and facilities for the international military and the Afghan National Defense and Security Forces (ANDSF) also put money into the economy, especially the construction and

President Barack Obama and President Hamid Karzai sign the Strategic Partnership Agreement on May 1, 2012. (Resolute Support photo)

logistics sectors. At the same time, however, the simultaneous announcement of the 2009 surge and the 2011–2014 drawdown and transition introduced a heavy cloud of uncertainty that hung over most of the period.

This was also the era of counterinsurgency, which provided an intellectual underpinning to development efforts with its mantra of “the people are the prize.”[210] The 2009 *Integrated Civilian-Military Campaign Plan* noted that U.S. government efforts “must focus on the people of Afghanistan” and the need to “shift our focus to the Afghan population.” The plan included sustainable jobs, agricultural markets, and cross-border access for commerce as three of its “transformative effects,” asserting that “significant growth in jobs can provide a viable alternative to violence or criminality, ‘outbid’ the Taliban, and promote a sense of progress.”[211] More effort was made to get aid to the subnational level due to the belief that most development funding, regardless of sector, had not yet made it out of Kabul and the primary cities.

In trying to align its programming and geographical focus with the U.S. military’s stabilization and counterinsurgency priorities as part of the whole-of-government approach, USAID’s portfolio contained quick impact activities that aimed to “provide immediate employment and income in insecure areas, promote alternative livelihood to poppy production and insurgent activities, and address grievances and sources of conflict with communities.”[212] Projects such as USAID’s ASMED, which had been started in 2006 to provide enterprise-level support in four provinces, were directed to work in insecure districts throughout the country as part of the COIN strategy.

In addition to COIN, the other big policy shift during this time was the formulation of the Afghanistan-Pakistan (AF-PAK) concept. The creation of the Special Representative for Afghanistan and Pakistan (SRAP) office within State in 2009 and the appointment of senior diplomat Richard Holbrooke to head it were based on the belief that it was necessary to consider the two countries within one policy. The AF-PAK policy reinforced the regional focus, and the New Silk Road (NSR) initiative, which was articulated by Secretary of State Clinton in a July 2011 speech in Chennai, India, further supported it. Clinton described the founding principles of the NSR:

> An Afghanistan firmly embedded in the economic life of a thriving South and Central Asia would be able to attract new sources of foreign investment and connect to markets abroad, including hundreds of millions of potential new customers in India. And, increasing trade across the region would open up new sources of raw material, energy, and agricultural products, creating more jobs in India, Pakistan, and Afghanistan.[213]

The NSR initiative provided the most explicit description of the U.S. regional vision for Afghanistan, which included reducing barriers to trade—such as poor infrastructure, bureaucratic hurdles, and poor border-crossing facilities—and upgrading trade policies so that "goods, capital, and people can flow more easily across borders."[214]

Looking Ahead to the Transition

Because the drawdown had been announced at the same time as the surge, this period was also marked by the international community's engagement with the Afghan government to prepare for the phased departure of international military forces, beginning in July 2011 and concluding at the end of 2014, when most international combat troops were to be out of the country. While the troop drawdown received the most attention, it was clear to all that civilian development spending would likewise be reduced. For example, while the USAID Afghanistan mission's proposed budget for FY 2010 was the largest of any USAID country program, ever, by October 2010 mission management was told to prepare for "significant funding reductions for 2011."[215] These "draconian budget reductions" and the shift to a "transition-centric approach" were ascribed, in part, to U.S. domestic politics, including declining support for the Afghan conflict.[216]

The London and Kabul Conferences of January and July 2010, respectively, marked the start of a new phase during which the Afghan government was to incrementally assume responsibility for its own security and development initiatives by 2014—also the year in which the next Afghan presidential election was to be held.[217] The Afghan government introduced a list of redesigned

National Priority Programs (NPP) that were intended to serve as a focused implementation plan for the ANDS.[218]

The NPPs contained the Afghan government's first small and medium enterprise strategy, the *Integrated Trade and Small and Medium Enterprise Support Facility*, which was to serve as the roadmap for "strategic and sequential development of private sector in Afghanistan."[219] The strategy consisted of four components: improving the business climate, increasing trade, developing private enterprises, and reforming the lead ministry, the MOCI. The small and medium enterprise section of the Private Sector Development NPP was mainly informed by the small and medium enterprise strategy that was developed in 2009, with support from the USAID ASMED project.[220]

The strategy identified six priority sectors—agribusiness, carpets, cashmere, construction materials, gemstones, and marble—based on a number of criteria, including labor-intensiveness, high growth potential, availability of locally sourced raw materials, competitiveness, and involvement of a large number of domestic firms. It wasn't until 2011, however, that action plans were drafted to identify sector-specific bottlenecks and ways to resolve them, as well as proposed actions to move Afghanistan up the value chain within each sector.

Ramping Up Trade

With the WTO negotiations and formal meetings of the working party for Afghanistan's accession beginning to take place during this time, the United States reinforced its support for regional integration, trade liberalization, and increased exports by launching USAID's first projects that specifically targeted international trade.[221]

USAID's Trade Accession and Facilitation for Afghanistan (TAFA) project (November 2009 to November 2012) and its successor TAFA II (November 2012 to August 2013) were intended to support the development of Afghanistan's economy "by fulfilling the trade potential of its strategic location on the historic Silk Road."[222] The projects helped with trade policy liberalization (mainly supporting Afghan accession to the WTO), customs reform, and trade facilitation.[223] TAFA and TAFA II assisted in this complex process by helping the Afghans build public institutional capacity for creating legislative reform, and increasing coordination and cooperation both within the government and between the public and private sectors.[224] Specific achievements included helping the Afghan government to negotiate and implement a number of formal regional trade and transit agreements with its neighbors, including the critical Afghanistan-Pakistan Transit Trade Agreement, an updated version of the 1965 Afghanistan Transit Trade Agreement, which granted land-locked Afghanistan the rights to import goods passing through Pakistani seaports duty-free.[225]

Unloading freight from the Hairatan to Mazar-e Sharif railway. (Asian Development Bank photo by Jawad Jalali)

Other U.S. Support

The U.S. government continued to build the Afghan government's capacity to act as steward of the economy through USAID's third economic governance program, the $92 million Economic Growth and Governance Initiative (EGGI). Between 2009 and 2013, EGGI's overarching goal was to enhance the Afghan government's "capacity to develop and sustain a market environment that supports responsible economic management and fiscal sustainability."[226] In the second year of the project, a critical external assessment found that EGGI's work did not provide an "integrated and coherent program or policy framework" that would have contributed to a better functioning private sector.[227] As a consequence, EGGI's scope during its final two years was significantly reduced, and was focused mainly on helping the government generate revenue streams.

At the same time, because strengthening customs collections increasingly became a priority in light of the need for the Afghan government to generate more revenue in anticipation of the U.S. drawdown, USAID's TAFA project focused, in part, on supporting improved customs collection.

Starting in January 2011, USAID's Land Reform in Afghanistan (LARA) project continued with some of the same objectives as its predecessor project LTERA, focusing on improving land and property rights through various legal, policy, and institutional reforms. However, unlike LTERA, LARA did not address privatization.[228]

Commerce's Afghanistan Investment and Reconstruction Task Force also expanded its activities in 2009 to include capacity building of government and private businesses from the three sectors of agribusiness, construction, and mining, with a special focus on the marble sector.[229]

In the finance sector, the 2010 collapse of Kabul Bank sent shockwaves through the economy and undermined faith in government institutions.[230] The aftermath of the collapse negatively affected U.S. technical assistance and support to building the private sector enabling environment; for example, USAID prohibited working with the national bank, DAB, due to its role in Kabul Bank's collapse.[231]

Despite this, the U.S. government continued to try to provide access to finance using new approaches, including USAID's Financial Access for Investing in the Development of Afghanistan (FAIDA), which was begun in 2011 to help the commercial and microfinance sectors meet a wide range of financial needs, including those of micro, small, and medium enterprises.[232] In 2012, USAID initiated a loan guarantee program for four select financial institutions under its Development Credit Authority model, intended to help mitigate the risks associated with lending to small and medium enterprises.[233]

DOD Involvement

During the 2009–2012 period, DOD increased its direct involvement in private sector development in three main ways: CERP micro grants, the Afghan First procurement initiative, and TFBSO.

CERP was originally developed in Iraq and introduced in Afghanistan in 2004 as a means of providing short-term stabilization and "walk-around" money for the PRTs. During the surge period, the use of CERP funds expanded from meeting emergency and security needs to infrastructure (including roads), agriculture, and incentivizing entrepreneurship and growth of small and medium enterprises. CERP guidelines initially prohibited funding of private businesses, but starting in 2009, an exception was made for micro grants.[234] The 2009 guidelines set the ceiling for micro grants at $2,500, although greater amounts were allowed with approvals at progressively higher levels of command. The limits were later increased to allow grants greater than $30,000 with the approval of the USFOR-A commander.[235] Micro grants were for the explicit purpose of increasing economic activity, particularly in areas where small businesses had suffered because of insurgent violence. The extremely small percentage (0.44 percent) of overall CERP funds that explicitly supported private sector development initiatives was provided through these micro grants.[236]

The Afghan First procurement initiative, initially announced by Lieutenant General Eikenberry in 2006 and formalized in the FY 2008 NDAA, was expanded in 2010 to boost the Afghan economy. The premise was, having DOD, State, and USAID, as well as other coalition partners, purchase goods and services locally rather than import them from Pakistan, China, Iran, Turkey, and other countries would keep money in the local economy and lead to the creation of

Carpet being washed at Herat Carpet Facility, a cut-and-wash facility supported by TFBSO. (SIGAR photo)

jobs. An additional intent of the initiative was to show that quality goods could be produced economically in Afghanistan.[237]

TFBSO was DOD's most ambitious private sector development effort. Originally created in Iraq in 2006, TFBSO's mission in Afghanistan was to "promote economic stabilization in order to reduce violence, enhance stability, and restore economic normalcy."[238] TFBSO was critical of USAID's traditional development approach and saw itself as more nimble and "expeditionary." The task force supported projects in seven categories: agriculture, banking, energy, indigenous industries, investment facilitation and business support, mining, and women's advancement. The 2010 TFBSO and USGS assessment of Afghanistan's mineral deposits, estimated to have a potential value of $908 billion, helped to build enthusiasm for the extractives sector, especially given the interest in increasing Afghan government revenue in the run-up to 2014.[239] TFBSO was a temporary agency, and from 2011 onward there was uncertainty about whether it would be reauthorized each year, which made planning and implementation more challenging.[240] Also beginning in 2011, TFBSO was required by Congress to submit an annual plan to demonstrate the successful transition of activities by 2014.

Chapter 8 of this report provides further information about TFBSO's activities to promote private sector development.

Increasing Friction and Uncertainty

At the same time U.S. spending was ramping up to support the surge, a 2009 series of media reports on how U.S. contracting practices were unwittingly funding the Taliban was reinforced by a report from the Commission on Wartime

Contracting in Iraq and Afghanistan (CWC).[241] CWC noted the vulnerabilities that resulted from U.S. government agencies' lack of sufficient staff and capacity, disparate contracting mechanisms, and weak planning and interagency coordination.[242] As a result of this reporting, U.S. government agencies began extensive vetting of Afghan companies; however, despite efforts to improve accountability, vetting remained a challenge. A 2012 SIGAR audit found that because contracting authorities did not consistently use information that was available in various databases to vet companies for Afghan ownership, licensing, and past performance, not all potential bidders had access to contracts. In addition, the audit found that contracts might have been awarded to companies that were not eligible to receive U.S. funds because of their past questionable activities.[243]

The contested 2009 Afghan presidential election—after which Senator John Kerry and Ambassador Eikenberry stepped in to resolve the conflict between President Karzai and challenger Dr. Abdullah Abdullah, who each claimed victory—got the Afghan government's relationship with the new Obama administration off to a rocky start. Tensions between the two governments further grew after recurring U.S. complaints about Afghan corruption, and were exacerbated by the increasing sense of uncertainty created by the preparations for the drawdown of international forces, the lingering effects of the global recession, and the collapse of Kabul Bank.

In this uncertain and contentious atmosphere, the international community and Afghanistan agreed to a set of commitments called the Tokyo Mutual Accountability Framework (TMAF) at a July 2012 donor's conference in Tokyo. The international community committed to $16 billion in support to Afghanistan for four years—less money and fewer years than the Afghan government had hoped, but viewed as a commitment, albeit lukewarm, from the international community.[244]

2013–2014: DRAWDOWN AND TRANSITION

As the clock ticked toward the completion of the phased drawdown of the international security forces by the end of 2014, Afghans felt increasing uncertainty, not just due to the drawdown, but also in anticipation of the 2014 Afghan presidential elections, which were feared to be as contested as those in 2009. As the United States and its allies tried to instill confidence in Afghans about their continued commitment to the country, in part by renaming the International Security Assistance Force (ISAF) "Resolute Support" and referring to the U.S. "enduring presence," Afghans showed their skepticism by reducing investment, curtailing spending, and moving their capital to safer havens outside the country.

Through most of this two-year period, economic activity declined due to a combination of reduced international spending and uncertainty about the political and security outlook. GDP growth in 2013 was 2 percent, the lowest since 2004, which was then followed by 1.3 percent in 2014.[245] Even before official indicators such as GDP were issued, informal observations of a plunge in property prices, leveling or decline in wages, and increased capital flight indicated a lack of confidence in the economy and confirmed the sense of foreboding. News reports from 2012 indicated that while real estate prices of large homes in Kabul were declining, villa prices in Dubai were rising as wealthy Afghans purchased multiple properties, often in cash.[246] Analytical reports also indicated reductions in household discretionary spending on private schools and purchases of private vehicles.[247]

OECD defines capital flight as "the transfer of assets denominated in a national currency into assets denominated in a foreign currency, either at home or abroad, in ways that are not part of normal transactions."[248] Capital flight is often spurred by political or economic instability, rapid currency devaluation, or the imposition of capital controls. In Afghanistan, the transfer of international donor funds by Afghan government officials and companies to accounts abroad is an example of capital flight.

In 2014, Afghan and U.S. fears about the presidential election were realized when an impasse occurred similar to that which followed the 2009 election. This time, Dr. Abdullah and former Minister of Finance Ghani each declared himself the winner. The United States again stepped in to broker a political settlement out of fear Afghanistan could fall into civil war. A "National Unity Government" (NUG) was formed through the creation of an extra-constitutional position of Chief Executive, in which Abdullah would serve alongside Ghani, who was proclaimed president.

The Run-Up to the Transition

Concern about Afghan government revenue helped invigorate U.S. interest in the Afghan mining sector. While extractives had earlier been recognized as a potential source of growth, employment, and revenue, the sector was slow to get going. (For more details, see Extractives in Afghanistan, page 114.) In March 2013, USAID awarded its only mining-specific program, the $43 million 2013–2017 Mining Investment and Development for Afghanistan Sustainability (MIDAS) project, focused on helping the Afghan government build the capacity to manage mines throughout their lifecycle, especially through legal and regulatory reform. The U.S. government emphasis on "sustainability," which was manifested, in part, by pressure on the Afghan government to increase taxes in order to replace foreign aid with another revenue stream, reinforced the existing uncertainty and pessimism about the drawdown that fostered a "last call" mentality.

The U.S. government continued its support to trade and regional integration through USAID's Afghanistan Trade and Revenue (ATAR) project. Similar to the preceding TAFA and TAFA II projects, ATAR had three components: trade liberalization, regional integration, and customs reform. Afghanistan's accession to WTO was prioritized as a separate element because the required formal working party and bilateral and multilateral negotiations for accession were already underway. As the 2014 transition approached, ATAR's work on strengthening

SUSTAINABILITY

Even while the international community was applauding Afghanistan's double-digit growth in GDP from 2002–2013, critics were concerned about the lack of sustainability. While some aid officials were keenly aware of this issue in 2001 and early strategy documents referred to "sustainable economic growth," the focus on sustainability increased sharply after the 2009 announcement of the drawdown and the 2014 transition date approached.[249]

The term sustainability referred to a number of different, but related, issues. First, sustainability referred to the ability of the Afghan government to generate enough revenue to pay for its own operations, including public administration, defense, and social services, and not remain dependent on the international community. Activities such as customs reform and strengthening of the government's tax-collection capacity received significant investments from the United States. While the government increased the amount of revenue it mobilized from domestic sources, for 2016 this accounted for only 31 percent of the resources for the national budget.[250] Moreover, there was a tradeoff between government revenue and economic activity, which created decreasing returns for efforts spent tightening collection, potentially driving firms into noncompliance or into the informal economy. Many believe that the ratcheting up of collection during the last several years, largely at the behest of the United States and the international community, had negative effects on businesses because it created a climate in which predatory officials could extract additional illegal payments from businesses.[251]

Second, sustainability referred to the ability of specific project-funded institutions to continue to function after the completion of the project and the termination of funding. In some cases, institutions created with U.S. project funding were unable to sustain themselves once funding was reduced or withdrawn. For example, financial institutions that extended agricultural credit to farmers required the creation of a large administration that could not be sustained in the absence of funding.[252] Such new donor-created institutions also had an unclear legal status, which raised questions about their future. Also, in a risky environment such as Afghanistan, donor funding was necessary to cover some significant loan defaults.

Third, and perhaps most important, sustainability referred to economic activity that would maintain itself after the reduction of international funding. This was an issue for both individual enterprises and the Afghan economy as a whole. The provision of grants or highly subsidized loans (which recipients often treated as grants) sometimes provided support to nonviable commercial enterprises that would have been unable to make it on their own. Such enterprises typically folded once funding was terminated or exhausted. At a higher level, the Afghan economy was dependent upon the massive infusion of international funds through aid projects, military and civilian contracting, and general spending by the international community. For example, 67.7 percent of the 1395 (2016/2017) Afghan core budget was financed through donor assistance.[253] In 2016, official development assistance was valued at 16.98 percent of GDP and 17.62 percent of final consumption expenditures, numbers that indicate an extremely high level of aid dependency.[254]

customs revenue collection through the launch of electronic payment systems increasingly became a priority, as did capacity building for Customs, MOCI, the Ministry of Justice (MOJ), DAB, and other Afghan institutions. ATAR also continued TAFA's work in persuading an historically skeptical Afghan public about the potential benefits of free trade and WTO accession.[255]

After the completion of ASMED in 2012, USAID's main activity of grant support to enterprises was picked up by a follow-on five-year project, Assistance in Building Afghanistan by Developing Enterprises (ABADE). While somewhat narrower in scope than ASMED, ABADE had similar overall objectives and approach: increase domestic and foreign investment, stimulate employment, and improve sales of Afghan products through providing in-kind grants and technical support to enterprises. The program supported MOCI in developing three-year action plans for key sectors, including agribusiness, marble, gemstones and jewelry, construction materials, carpets, and women-owned enterprises.[256] Through workshops, conferences, and one-on-one support, ABADE also provided assistance to firms in developing business and financial plans—in large part because these were necessary for applying for ABADE grants—and post-award support for a range of technical and management concerns.

Support to economic governance continued under EGGI until August 2013. EGGI provided technical assistance to a number of ministries and institutions, focusing on managing public expenditures and revenue collection, supporting DAB to ensure continued monetary stability, and assisting in the promulgation of commercial laws and in building capacity to implement those laws and their related regulations.

As the population tried to look past the 2014 election debacle, advocates for the private sector were encouraged by the NUG's initial pronouncements, with President Ghani, a former World Bank official, emphasizing the need to get the economy going. In advance of the NUG's participation in the September 2014 London Conference on Afghanistan, co-hosted by the governments of the UK and Afghanistan, President Ghani met with representatives of the Afghan private sector who presented him with a 22-point summary of issues and proposed remedies, most of which spoke of the need for increased transparency and improved governance.[257]

Earlier that year, the Afghan government's report on the completed ANDS confirmed the belief that the strategy had been unrealistic and lacked direction and prioritization. The report showed that fewer than half of the targeted private sector development outcomes had been achieved, and those that had were primarily in processes, such as the "creation of legal frameworks for the trading sector, and simplification of regulations for business licenses and registration." Planned impacts, such as "percent increase in private investment" or "percent GDP increase," lacked baselines and targets and therefore could not be evaluated. The report also noted the marked increase in the trade deficit and the fact that domestic revenue could finance only 52 percent of the government's operational budget, or half of what was projected in the ANDS.[258] In response, the NUG decided the NPPs would be consolidated and reprioritized to reflect the new government's priorities, including infrastructure, employment and human capital development, private sector development, and effective governance.[259]

2015–2017: AFTER THE TRANSITION

After the NUG raised hopes in late 2014 for engagement on the economy, by early 2015 advocates for the private sector were becoming disenchanted by the lack of progress, perceived micromanagement of government programs and contracts, and paralysis on policy and personnel appointments due to political maneuvering within the government.[260]

In addition to the NUG's increasing internal turmoil, insurgents intensified their attacks, adding to the population's concerns and creating an even more uncertain environment. In 2015, the security situation deteriorated significantly, with a 19 percent increase in security incidents in the south and an intensification of insecurity in the north, including the seizure of 16 district centers and, temporarily, Kunduz City, the first provincial center lost to the Taliban.[261] Given this uptick in insecurity, in October 2015 the United States and its NATO allies met in Brussels for a summit in which they pledged to revise their planned troop commitments. Soon after the meeting, the United States committed to maintain its troop level at 9,800 for 2016 and retain 5,500 troops into 2017. Other NATO members followed suit by committing to maintain or, in the case of Germany, increase troop levels.[262]

In October 2016, 75 countries and 26 international organizations once again convened in Brussels, this time to hear the Afghan government present its latest strategy, the *Afghanistan National Peace and Development Framework*. Donors pledged a total of $15.2 billion in support of the government's priorities until 2020.[263] The strategy highlights the Afghan government's continued efforts toward achieving self-reliance by pursuing improved governance, anticorruption, and organizational reforms.[264] Acknowledging that the early reconstruction years' high GDP growth rate was a result of foreign assistance, the Afghan government prioritized investment in agriculture, energy, and infrastructure as the main drivers of economic growth, jobs, and revenue.

The need for private sector-led economic growth was reiterated by USAID's three-year Afghanistan strategy developed in 2015. USAID continued to emphasize the need for the private sector to "become the main source of increases in government revenue to replace donor assistance and provide resources for quality service delivery," and focused on "promoting investment and growth in industries with high potential for employment and revenue generation."[265] The strategy continued to move away from stabilization and large-scale infrastructure projects and instead focused on three main objectives: expanding agriculture-led growth; maintaining the gains in education, health, and women's empowerment; and improving the legitimacy of the Afghan government.[266] USAID underlined its support for women by launching the Promoting Gender Equity in National Priority Programs Project (PROMOTE), its largest ever support for women's empowerment, which contained a component devoted to women's economic empowerment. Meanwhile, existing projects such as Agricultural Credit Enhancement, ABADE, and FAIDA continued their support to the private sector, and ATAR continued its technical support to trade.

Large-scale extractive efforts, which especially in recent years had been assigned a major role in Afghanistan's future, largely stalled due to insecurity, including in the Aynak mine region. The U.S. and Afghan governments continued to emphasize improving legislative and regulatory frameworks to encourage private sector investment in extractives, with USAID supporting the sector through the MIDAS project, which ended in early 2017. However, amending the mining law to make it more friendly to business and resistant to corrupt or illegal practices, one of the main indicators of the Afghan government's commitment to progress in the sector, remained a source of contention between MOMP, the parliament, and the executive offices.[267]

On a positive note, in July 2016 Afghanistan officially became a full member of the WTO, an achievement highlighted by both the Afghan and U.S. governments.

At the end of 2017, with increased Taliban attacks, the growing presence of the Islamic State, and no visible progress toward a political settlement, uncertainty was even more widespread than in previous years, and the economic outlook in Afghanistan was discouraging. As the USAID transition plan for 2015–2018 noted, "Despite recent regulatory improvements and increased access to finance, the business-enabling environment in Afghanistan is one of the worst in the world."[268] It is no surprise that in its 2017 Ease of Doing Business rankings, the World Bank ranked Afghanistan 183 of 190 countries, six spots lower than its rank in 2016.[269]

U.S. private sector development efforts can be put into the two broad categories of providing support to the enabling environment and to individual enterprises. Within those categories, the United States focused on five somewhat overlapping areas: creating an enabling environment, providing access to finance, promoting investment, developing regional and international trade, and supporting enterprises. The next five chapters describe each of these areas over the period 2001–2017.

UNAMA photo by Fardin Waezi

CHAPTER 4

CREATING AN ENABLING ENVIRONMENT

Given the condition of the Afghan economy and government institutions in 2001, the first task was to create an environment in which a dynamic, licit private sector could thrive. The most immediate priority for the United States and its international partners, therefore, was creating such an enabling environment through the establishment of macroeconomic stability, including curbing inflation, overhauling the currency, creating sound fiscal and monetary policies, drafting laws and regulations for a regulatory framework, and bolstering transparent institutions to maintain and promote the private sector. This enabling environment was necessary to build confidence in the stability of the economy so businesses would establish, expand, and invest.

Support for creating the enabling environment was primarily provided to the key Afghan partner institutions of Da Afghanistan Bank, the Ministry of Finance, and the Ministry of Commerce and Industry. In the first few years of reconstruction, the IMF and World Bank led this effort, with on-the-ground support from USAID, Treasury, DFID, and GIZ.

Early in the reconstruction period, the U.S. government did not fully appreciate the threat that corruption and poor governance posed in Afghanistan. Counterterrorism, security, and political stability were the immediate priorities.[270] Concern mounted over time with the growing outcry from the Afghan population and as the United States realized that corruption and poor governance posed a threat to stability. Even then, U.S. institutional reform efforts were “tentative” and “stymied by lack of Afghan political commitment, weak capacity, and strong incentives for officials to continue to engage in corrupt behavior.” The imperative to maintain a positive relationship with President Karzai due to the need for his cooperation on the Bilateral Security Agreement and other, mostly security-related, issues limited the robustness with which the U.S. government could press for action on corruption.[271]

Overall, there were some solid, early successes in macroeconomic policy and public financial management, but other aspects of creating and maintaining an enabling environment were more difficult to achieve.

U.S. private sector development projects tried, to a varying extent, to address corruption and poor economic governance as an integral part of their main objectives. For example, as early as 2002, USAID’s AEGP identified corruption as a serious issue and drafted a Bribery and Official Corruption Law.[272] As corruption began to gain profile, the 2005–2009 EGPSS listed anticorruption as one of three cross-cutting components.[273] Many of these elements were incorporated across program designs, but were not always included as measured outcomes.[274]

USAID’s trade-related projects were based on the assumptions that formulating laws and regulations, streamlining licensing procedures, and automating customs would all contribute to reducing corruption. USAID also believed that trade liberalization itself would reduce opportunities for corruption.[275] Similarly, LTERA and LARA assumed that improvements in land titling and other aspects of land administration would reduce corruption.[276] Other anticorruption activities employed by USAID projects included support for bodies and institutions to address corruption and resolve disputes, technical assistance in public financial management, propagation of mobile money or electronic payment systems, awareness training, and backing public reporting mechanisms.[277]

Overall, there were some solid, early successes in macroeconomic policy and public financial management, but other aspects of creating and maintaining an enabling environment were more difficult to achieve. Enduring impediments to private sector development were largely those related to a lack of good governance, including corruption and uneven enforcement of laws and policies, which made it more difficult to encourage businesses to operate in the formal sector.

BUILDING CAPACITY IN THE FISCAL SECTOR: REVENUE COLLECTION, BUDGET CONSTRUCTION, AND TAX REFORM

Degraded from years of conflict and the effects of the mujahedeen and Taliban governments, the Afghan Ministry of Finance was in a state of disrepair in 2001. The ministry's depleted human capital and devastated physical infrastructure resulted in the complete breakdown of communication between Kabul and the provinces, making revenue collection or transfer of funds extremely difficult. Moreover, customs revenue collected at key border crossings was being retained by regional strongmen who controlled the local administration. In part due to the need for a government revenue source, customs reform was prioritized early on, as USAID projects noted that customs revenues were an important component of government revenue. EGPSS had a goal of increasing customs and tax revenues to 49 percent of financing for the operating budget; according to the EGPSS final report, by 2009, 56.2 percent of the budget was being financed through taxes and customs, an achievement of that goal.[278] Still, the Afghan government has been unable to meet its budgetary targets, and in 2017, a SIGAR report noted U.S. officials' "concerns that approximately half of customs duties for Afghan FY 1393 [2014] were believed to have been stolen."[279]

A more detailed discussion of tariff reform is found in chapter 7 of this report.

After the IMF's January 2002 preliminary assessment to determine the levels and types of assistance needed, the World Bank and the IMF, supported by USAID AEGP and Treasury, along with international partners DFID and GIZ, focused on rebuilding the capacity of key MOF departments, beginning with the treasury, accounting, budget, and customs departments. These efforts met with varying levels of success.

Capacity building was primarily executed through the provision of resident experts from various organizations, including non-civil service Afghan experts. Eventually, so many essential ministry functions were carried out by these well-paid, short-term outside experts that concerns were raised about what would happen when this "second civil service" was withdrawn.[280]

Budget Construction

Beginning in January 2002, the World Bank, Treasury, and ADB resident experts began work on developing Afghanistan's budgets.[281] The IMF's initial assessment found that while the MOF had a sound legal framework for budget formation, most of the legal practices had not been used for many years, primarily because of insufficient reporting from provinces, a lack of automation in offices, and lack of trained staff. The adoption in April 2002 of the April 2002–March 2003 operating budget by the Afghan Interim Administration was therefore a huge feat considering the lack of financial information available. This achievement in public financial management was considered one of Afghanistan's early successes.

Second Civil Service

The second civil service refers to the Afghan government employees and contractors who received significant salary supplements from international donor funds to perform ministry functions. The supplements were intended to be a temporary mechanism to quickly mobilize the knowledge and skills needed to manage the accelerated level of aid programs after 2001. While enabling the ministries to overcome the low skill levels of existing civil servants, the level of salary payments—up to 11 times the highest civil service rate—was criticized as being unsustainable after donor funding ended. The supplements also led to accusations that the international community was "renting," rather than building capacity.[282]

Tax Reform

To generate sufficient revenue streams to fund the operating budget, it was necessary to reform the tax system. This reform needed to make compliance easier and taxes less subject to evasion, while simultaneously limiting any negative impact on economic activity.[283] Tax reform was primarily supported by USAID's AEGP. Working with the MOF, AEGP advisors sought to amend existing tax laws, including drafting legislation to bring Afghanistan up to international standards, and provided extensive training for MOF staff so they could effectively administer the new regulations. Advisors also sought to improve tax administration capacity and support both the private sector and government revenue generation.[284]

Between March and July 2004, a number of new taxes were put into place, including rental services, business receipts, and wage withholding. USAID also supported the development of a fixed tax schedule on money changers and the establishment of various tax compliance and education programs.[285] An income tax law in 2005 attempted to encourage businesses by reducing the top marginal tax rate from 60 percent to 20 percent, plus an additional fixed amount of 8,750 afghanis ($175 at the 2005 exchange rate). The law also provided certain license-based tax privileges for the extractive industry to attract investment in the sector.[286] In 2007, taxpayers were differentiated into small, medium, and large in order to make it easier for the Afghanistan Revenue Department (ARD) to "best manage the risks associated with the different characteristics, compliance behaviors, and risks to the revenue each segment presents."[287] Still, despite significant reforms, poor governance, confusion, and a lack of information regarding the tax system plagued the formal business sector.

AN EARLY WIN: SUCCESS IN REFORMING AND STRENGTHENING PUBLIC FINANCIAL MANAGEMENT

The extensive technical assistance programs aimed at reforming and strengthening various MOF departments showed that certain factors led to a higher likelihood of long-term success. A comparison of the experience in reforming the customs, accounting, and budget departments illustrates the distinct combination of elements that led to successful capacity building.

Given the importance of customs as a revenue stream, the customs department was one of the first MOF departments to receive capacity-building technical assistance. With USAID's assistance in developing and implementing reforms, customs saw early successes as the tariff schedule was rebuilt, tariffs were calculated using the floating exchange rate, collection enforcement improved, and revenues began making their way from the provinces to Kabul, the latter due, in part, to some strong-arm tactics by Ambassador Khalilzad.[288] USAID also provided training programs to increase the capacity of government officials.[289] However, especially since 2011, corruption in the customs department "has become organized and pervasive," leading to significant losses in potential revenues.[290] Because the amount of capital involved in customs collection is so large, the inability to adequately counter corruption has made customs an attractive access point for capturing money as it crosses the border.[291]

In contrast to the slow erosion of progress in the customs department after initial gains, capacity building in the accounting department is viewed as a success. The most important factor in fostering this success was the decision to build upon the existing accounting framework that the Afghan civil servants had been using and therefore already understood. The gentler learning curve for building the skillsets of these employees made it easier for them to implement the reforms that were introduced. Furthermore, the reforms in the department were more technocratic than political, limiting any potential backlash from employees and minimizing the vulnerability to corruption.[292]

Like the accounting department, reforms in the budget department were also largely technocratic. However, budget creation was inherently political, making it difficult to systematically apply the reforms. In addition, the capacity in budget execution was largely built through bringing in third-party, non-civil servant experts. (For more details, see Second Civil Service, page 60.) It was therefore difficult to adequately integrate reforms into the existing civil service structure in an efficient and sustainable manner.[293]

Important factors for generating sustainable capacity in government institutions, therefore, included oversight of the resources that were available for potential corrupt activities (or taking early measures to make corruption more difficult), limiting the political exposure of ministries, and using or building upon existing frameworks or systems for modernization.[294]

Rent-seeking is the practice of manipulating policy or economic conditions to gain profits, or the use of state resources for personal economic gain without reciprocating benefits to society through wealth creation.

Above all else, corruption among tax officials made it more difficult and costly for businesses to comply, which discouraged them from participating in the formal economy. In many cases, the time taken up by the actual filing and paying of taxes was even more onerous than what was owed in the taxes themselves. A 2008 UK review attributed a significant part of the post-2005 decrease in foreign and domestic private investment to a 2004 tax reform and the subsequent aggressive rent-seeking behavior of officials in the MOF Revenue Department's Large Taxpayers' Office, which the review labeled an "economic 'shock' which has, to a significant extent, caused a reduction and stagnation in foreign and domestic private investment since 2005."[295]

Transparent tax collection was further complicated by revisions to the tax law in 2005, 2009, and again in 2015, which confused businesses and often increased their tax burden. For example, a lack of clear information about a 2005 tax holiday, intended to encourage businesses to expand their operations and join the formal economy, resulted in some firms improperly applying and therefore not qualifying, or applying when they were not eligible, with the end result being firms having to pay several years of back taxes to the government all at once. Along with the back taxes, additional "fees" were paid to officials to avoid legal consequences. Further, in some cases, firms followed the correct procedures for getting the exemption, but did so through officials who did not have the authority to grant it.[296]

Tax reforms were intended to maintain and increase government revenue streams, especially following the drawdown of international financing. While necessary for the government to generate revenue, increasing taxes on businesses became a double-edged sword, in effect encouraging businesses to remain informal and further shrinking the tax base. As discussed below, there were similar issues in the customs administration, where despite early and continued reforms to clarify customs values and procedures, corruption at the borders continued to encourage smuggling in order to evade payment.

At the end of 2015, new rules increased the business receipts tax from 2 percent to 4 percent, a move vigorously opposed by the business community, in part because they considered the receipts tax a form of double taxation. As one report noted, while "absolute levels are not high by international standards, compliance imposes a heavy burden for a sector where many had been used to paying no tax at all."[297] In 2014, the IMF also pushed heavily for the addition of a value added tax (VAT) in order to move some of the tax burden off businesses, while still generating additional revenues. While VAT implementation was tabled after substantial delays in negotiation, it has not been ruled out for the future.[298]

ESTABLISHING MACROECONOMIC STABILITY

The international community's first private sector development task was restoring basic financial and macroeconomic stability. Over the previous 23 years of conflict, DAB's role had diminished to subsidizing successive government deficits. Taking on a Soviet-style institutional role, DAB had relinquished its ability to influence interest rates or inflation, and as a result of this and the ongoing conflict and instability, the previous decade had seen high levels of inflation and a rapid depreciation of the national currency, the afghani (AFA). By 2001, the afghani was trading at an exchange rate of between AFA70,000–80,000 per dollar, compared to around AFA40,000 per dollar in early 1999.[299] The first step forward, therefore, was the establishment of firm monetary controls to generate price stability and faith in the currency.[300]

Overhauling the Currency: The New Afghani

At the end of 2001, in addition to the widespread use of several foreign currencies, at least three versions of the afghani were circulating, including two warlord counterfeit currencies trading at a discount. Given the magnitude and importance of the issue, a steering committee of senior officials from DAB and the MOF, and international experts from the IMF, USAID, the German central bank Deutsche Bundesbank, and the UN, was established.[301] With IMF in the lead, a number of currency models were discussed, including full or partial dollarization. While the latter was the choice of the IMF, the Afghan authorities felt that the afghani was an important symbol of national unity and sovereignty. They therefore chose to introduce a new version of the existing currency, a decision that was ultimately supported by the IMF in the interest

Money changer in Kabul in August 2010. (Institute for Money, Technology, and Financial Inclusion photo) of Afghan ownership.[302] The introduction of a new afghani (AFN) so quickly and under such extremely fluid political conditions, with the challenges provided by Afghanistan's geography and poor infrastructure, and with no accurate knowledge of the amount of old currency in circulation, was a massive undertaking.

Once the outlines of the plan were established, USAID led the media and public outreach campaign to inform as many Afghans as possible of the conversion to the new currency, relying heavily on radio broadcasts and word-of-mouth dissemination. The plan was for money changers to exchange their currency first, followed two weeks later by the general public. The exchange rate was set at AFA1,000 to AFN1.[303] The entire conversion was envisioned as taking eight weeks.

Dollarization

Dollarization occurs when a nation adopts the U.S. dollar as its official currency, thereby losing independence in monetary policy (because it must follow the same monetary policy as the U.S. Federal Reserve Bank). Dollarization is sometimes preferred in an economy that requires immediate stability. Under partial dollarization, sometimes referred to as unofficial dollarization, a nation maintains its national currency as the official currency, but government transactions are conducted in U.S. dollars. This requires the maintenance of an exchange rate pegged to the dollar and helps to protect the purchasing power of the national currency and maintenance of macroeconomic stability. Both full and partial dollarization limit the national institutions' ability to implement economic policies.[304]

USAID was instrumental in establishing the Bagram Bank of DAB for promoting the new Afghan currency and processing the in-flow of the physical currency by the U.S. Army.[305] USAID also set up an air operations unit and provided two helicopters and one airplane to manage the air transport of the currency to distribution points. The Afghan Air Force also provided assistance in the early stages of the currency conversion.[306]

On September 4, 2002, President Karzai publicly announced the conversion, and the actual process started one month later. Despite public uncertainty and some currency depreciation that required DAB to extend the conversion period by one month, the entire process successfully concluded in early January 2003 without major events or financial hiccups.[307] The achieved exchange rate of around AFN50 per dollar was seen as comforting to the population, as it had traditionally been in that range until the start of conflict in 1978.

Establishing Monetary Policy

A stable exchange rate was a key component of the macroeconomic stability necessary to give businesses confidence to establish themselves, expand, and invest. Because the money supply, inflation, and the exchange rate were all so closely tied in the absence of a functioning banking system, it was imperative that the exchange rate remain within a tight range. Allowing the currency to float freely would cause a lack of confidence in the currency, ultimately resulting in the same inflation and depreciation that occurred with the old currency. Afghanistan chose to implement a quasi-floating exchange rate regime, keeping the rate within a specified range, so DAB could pursue independent monetary policy and increase the economy's ability to absorb external shocks, such as border closings or increases in fuel prices.[308]

The technical requirements for conducting independent monetary policy required substantial capacity development within DAB, which was constrained by staff who were untrained in modern monetary policy and banking, difficult communications with provincial branches, poor physical infrastructure, and the lack of a recent, accurate balance sheet. Therefore, beginning in November 2002, USAID launched AEGP to help support IMF and World Bank initiatives to develop monetary policy and increase DAB's capacity to implement it.[309] To help ensure the successful implementation of the new monetary policy, the IMF and Afghan authorities agreed that DAB would remain independent and would maintain full control over the printing of the new currency. In turn, the government would maintain financial discipline and would not require DAB to finance any government deficit.[310] The international community insisted on the latter stipulation to guard against runaway deficit spending.[311]

With an independent central bank, a floating exchange rate, and no functioning banking system, options for monetary policy were limited. Maintaining stability was further complicated by the widespread circulation of foreign currencies, especially the U.S. dollar, which influenced inflation and made control of the domestic money supply more difficult. It was imperative to establish a monetary policy mechanism or the massive inflows of foreign assistance would quickly lead to inflation and an erosion of the value of the new currency.[312] Therefore, the IMF supported DAB in implementing a system of foreign exchange auctions beginning in May 2002. These auctions were open to all money changers, including the informal *hawala* traders. Measures were taken to avoid potential pitfalls, such as the cornering of the market by high-volume money traders. Auctions were held every one to two weeks for the first few years, and slightly less frequently to the present.[313] In September 2004, DAB added daily, short-term capital note auctions in addition to the foreign exchange auctions to manage the domestic money supply.[314]

Hawala **is an informal money transfer system found primarily in the Middle East and South Asia. Hawala dealers rely on personal networks and trust to move money both domestically and internationally; because they operate outside of formal, state-supervised channels, they have frequently been used by terrorists and other criminals to transfer or launder money.[315]**

U.S. EFFORTS TO CURB OR REGULATE THE HAWALA SYSTEM

Concerns that the hawala system allowed the transfer of funds from and to criminals, insurgents, and terrorists drove the U.S. government to attempt to curb or regulate the system.

Toward this end, advisors from Treasury's Office of Technical Assistance worked closely with representatives from the IMF and World Bank to help the Afghan government develop its Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT) laws. Treasury also provided capacity-building support to newly established entities, such as the Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA), which was created to assist in combating money laundering and financing of terrorism, and the Major Crimes Task Force, an initiative led by the FBI to train Afghan investigators in high-level investigations of economic crimes, corruption, kidnapping, and organized crime.[316] One aspect of the AML/CFT laws was the requirement that hawala dealers be licensed.

Money changer in Kabul in August 2010. (Institute for Money, Technology, and Financial Inclusion photo)

Yet, even licensing didn't stop hawala dealers from engaging in money laundering. Two of the largest and most high-profile scandals associated with dealers involved New Ansari, a decades-old hawala that was eventually blacklisted by Treasury in 2011 for its extensive laundering of billions of dollars in drug money, and the Shaheen Exchange, a money service provider founded and run by Sherkhan Farnood.[317] Farnood started the Shaheen Exchange in 1996 after authorities in Moscow, where his previous business was based, charged him with illegal banking and money laundering. He managed to stay on the run until he returned to Kabul after the collapse of the Taliban regime to found the ill-fated Kabul Bank in 2004 and plot a highly sophisticated money laundering scheme using the Shaheen Exchange.[318] (For more details, see Kabul Bank Crisis, page 83.)

Despite significant growth, the small and fragile formal banking sector was unable to match the vast reach and scale of the hawala network. Moreover, while formal banking and informal hawalas were two distinct systems, they often complemented each other: Hawala dealers maintained bank accounts, and banks used hawalas to transfer money to remote areas of the country. The collapse of the Kabul Bank in 2010 confirmed the fragile nature of the formal banking sector and reinforced the preference of Afghans to continue to use informal money services, such as hawalas. According to a 2016 U.S. State Department report, around 90 percent of financial transactions in Afghanistan were conducted through the hawala system.[319]

LEGAL FRAMEWORKS

Because a strong, predictable, and transparent legal framework was seen as an important component of the enabling environment for formal private sector development, the United States sought to support Afghan authorities in developing and improving this framework.

The Afghan government's aspiration to join international initiatives and trade organizations in order to better enable international trade and investment was also a driving force behind the passage of many new laws, as well as amendments to established laws. For example, as part of the WTO accession process, Afghanistan passed three intellectual property laws, along with a number of food safety and sanitation laws to support agricultural exports.[320]

A *shura* (Dari) or *jirga* (Pashto) is a local council of elders and respected individuals within a community, convened to mediate conflicts and resolve issues. These councils usually deal with family matters, but have also been used to settle commercial disputes.

After the fall of the Taliban in 2001, the interim government revived the Civil Code of 1977 and the Commercial Code of 1955. These two codes are still in effect today and govern areas where new laws have yet to be created.[321] The Constitution of Afghanistan was signed in January 2004, after which subsequent laws to shape the new market economy were passed; in some cases, these various laws contradict each other. In practice, three legal systems, including traditional law, sharia law, and the formal or statutory laws, exist concurrently within Afghanistan, and it is often unclear which ones take precedence.[322] Moreover, decisions made by traditional shuras and jirgas, which may or may not conform to the written laws of Afghanistan, are often endorsed by agencies within MOJ.[323]

Afghanistan received assistance in drafting laws from a range of nations and international organizations. While Italy was designated by the Group of Eight (G8) Security Sector Reform process as the lead nation for the overall justice sector, other international partners worked on components of the sector: the United States tended to focus on broad (omnibus) laws, and other nations provided assistance in specialized areas. For example, mining and energy laws were supported by the World Bank and individual countries, including Norway. Commercial law development and awareness activities were undertaken by Commerce's AIRTF using funding provided by USAID.[324] USAID is currently funding the Commercial Law Development Program, a four-year, $12 million project, with activities including establishing commercial and trade law clinics at Afghan universities; educating the Afghan government and businesses on commercial regulation, arbitration, and contract administration; and assisting in drafting and amending laws related to insolvency, procurement, companies, and minerals.[325]

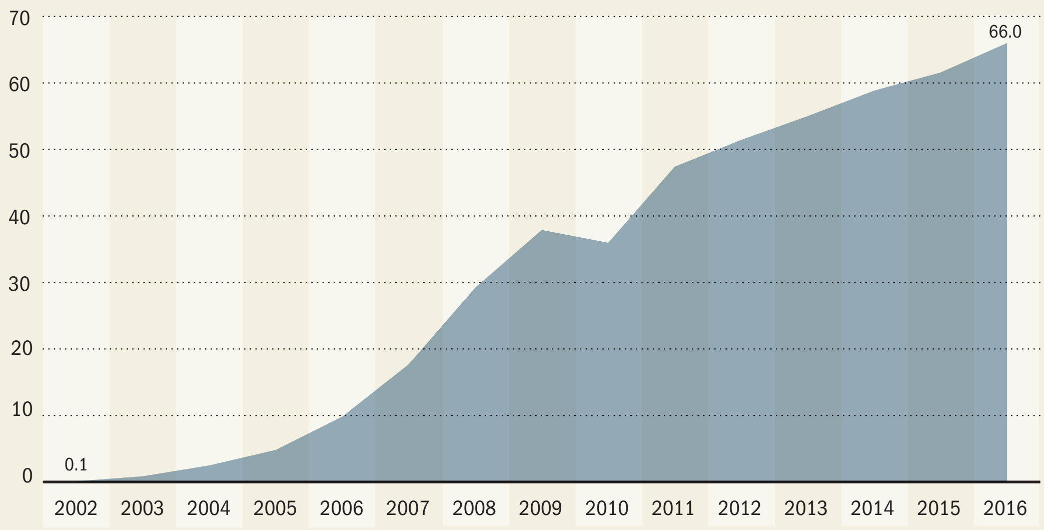
Because there was a sense of urgency in establishing a legal framework, donors and international legal advisors often found it easier to adapt laws from

TELECOMMUNICATIONS

The telecommunications sector in Afghanistan is widely viewed as a success. The sector has grown significantly since 2001, due primarily to a combination of government initiatives, strong domestic demand, availability of low-cost, off-the-shelf technology, and support from international donors. In 2003, only one in 550 people had access to telephone service, and even fewer to the internet.[326] By the end of 2014, 90 percent of residential areas had telecommunications coverage, with six active telecommunications service carriers, 62 internet service providers, and five 3G mobile network service providers, according to the Afghan Telecom Regulatory Authority (ATRA).[327] In 2016, the World Bank reported that there were 21.6 million mobile cellular subscriptions, or about 66 subscriptions for every 100 people. (See figure 6.)[328]

FIGURE 6

AFGHANISTAN MOBILE CELLULAR SUBSCRIPTIONS, 2002–2016 (PER 100 PEOPLE)



Source: SIGAR analysis of data from the International Telecommunications Union, "Mobile cellular subscriptions: Afghanistan (per 100 people)," data for 2002–2016, World Bank, World Development Indicators database, accessed on February 21, 2018.

Most of the telecommunications infrastructure, including cell phone towers, was built by the private sector.[329] Industry competition made mobile services more affordable and accessible, and cell phones are now common not only for business use, but for personal use, even in rural areas.

Establishment of the policy and institutional framework for telecommunications was seen as an immediate need early in the reconstruction effort. In 2002, the Afghan government had to decide between setting up a state-owned telecommunications network with a single provider and allowing open bidding for service contracts. Ashraf Ghani, then Minister of Finance, strongly supported the latter private-sector approach.[330] Ghani also called on OPIC to provide risk guarantees to help investors, which it did. Afghanistan approved its first Global System for Mobile Communications (GSM) license with the Afghan Wireless Communication Company in 2002 and its second GSM license with Roshan in 2003. Roshan is now the largest mobile service provider in Afghanistan, with over 6.5 million subscribers.[331]

The 2003 Telecommunications and Internet Policy established the regulatory framework for the industry and created the interim governing body, the Telecom Regulatory Board (TRB), within the Ministry of Communications and Information Technology (MCIT). The TRB drafted the National Numbering Plan, the National Frequency Table, and began working on the Telecommunications Law. In 2005, this law was enacted and the Afghanistan Telecom Regulatory Authority replaced both the TRB and the State Radio Inspection Department and became the primary regulatory agency.[332]

While the Afghan government established a favorable regulatory environment, private investors and donors sought to create or rehabilitate technical capacity. For example, the World Bank's Rehabilitation of Telecommunications Systems Project worked between 2003 and 2006 to connect Afghanistan to neighboring countries by rebuilding the satellite earth station in Kabul, as well as improving transmission links.[333]

Since 2002, DOD has spent around $2.5 billion to support Afghan information and communications technology (ICT), primarily to provide networked communications support for the ANDSF.[334] State and USAID have also supported the ICT sector through investments of $83 million and $44 million, respectively, with State focusing on supporting independent media and USAID concentrating on capacity development within the Afghan government. Although USAID has been working in this sector since 2001, direct ICT program support through State did not begin until 2010.[335] The U.S. efforts in Afghan ICT as a whole were coordinated by U.S. Embassy Kabul, originally through the Afghanistan Reconstruction Group. In 2010, the ISAF Telecommunications Advisory Team assumed responsibility for coordination until the ISAF mission ended in 2014.[336]

Additional support in telecommunications development was provided by the U.S. Trade and Development Agency, which in 2002 funded a short-term advisor to the Ministry of Telecommunications to assist the ministry in drafting the telecom policy.[337] USTDA also conducted feasibility studies and provided policy advice that, in the agency's 2005 and 2009 annual reports, was identified as critical to designing and implementing subsequent projects, including establishing a national satellite network, microwave communications systems, and the fiber optic ring network, discussed below.[338]

The Afghan government envisions the country functioning as a data and telecommunications transit hub for Central Asia, a digital analogue of the Silk Road. In 2017, the government was closing out a project to establish a fiber optic ring network along the Ring Road, called the Optic Fiber Cable Backbone Ring Project. The fiber optic ring network, which will serve as the backbone of the telecommunications sector when fully completed, was launched in 2006 with support from the World Bank. While the initial phases of the project are complete and most of the network has been installed, with 25 of 34 provincial capitals connected to the backbone, not all of it is operational. Security issues delayed completion of portions of the network, especially between Herat and Maimana.[339] The remaining nine provincial capitals will be connected under a follow-on project called Digital Central Asia-South Asia,

Man with multiple mobile phones in Balkh Province in August 2010. (Institute for Money, Technology, and Financial Inclusion photo)

also supported by the World Bank, which will install fiber optic cable alongside the planned Turkmenistan-Afghanistan-Pakistan-India (TAPI) natural gas pipeline.[340]

Some private telecom companies worry that the sector's success will result in the "golden goose effect." The sector has been one of the largest tax contributors to the Afghan government, accounting for about 45 percent of the revenue from the Large Taxpayer Offices in 2010–2011 and a significant part of the government's total revenue.[341] In 2015, a presidential decree levied an additional 10 percent telecom provider service tax, which affected the purchase of top-up cards and other services for mobile phone users.[342] According to MOF, these new taxes provided a 21 percent boost to the national budget.[343] Yet, telecom providers already paid mandatory annual fees, business receipt taxes, and frequency spectrum fees, with a total tax burden of 25 percent.[344] Because the Afghan government had only a small pool of properly licensed and regulated industries from which it could extract taxes, the telecom companies believed that, in such a target-poor environment, the industry was being unfairly squeezed to generate revenue for the government.[345]

other countries and draw from international experience in formulating new laws for Afghanistan, rather than going through the typically long process of development and approval.[346] This urgency, specifically in enacting commercial laws, can be seen in the adoption of the Banking Law in 2003, even before the new constitution. At the time, the 1994 Law on Money and Banking had been in effect since the mujahedeen government, and many of DAB's outlined objectives, responsibilities, and powers were ill-defined and outdated.[347] Given the moribund state of the commercial banking sector and acknowledging the critical role financial institutions play in economic growth, Afghan authorities, with support from USAID, the IMF, and DFID, sought to improve financial sector laws so the commercial banking sector could expand.

Many laws were promulgated in advance of the first parliamentary elections in September 2005, with the worry that enacting legislation would likely become more complicated once a sitting parliament was in place. By the end of 2005, a number of new or updated laws were awaiting examination and approval by the relevant ministries, including an industrial parks decree and laws on private investment, procurement, and business organizations.[348] The customs code and the first hydrocarbon and minerals extraction laws governing the provision of mine and quarry licenses were also passed around the same time.[349] USAID's AEGP specifically focused on the Ministry of Commerce and Industry to help it establish a regulatory environment that was competitive for private sector growth and commerce, based on free market principles.[350]

The first legislation regarding competition policy for a specific sector was the Telecommunications Law, supported by USAID AEGP and presented to President Karzai's cabinet in August 2005. The law sought to assist the rapidly developing telecommunications sector, historically a government monopoly, by including provisions for foreign and domestic private investment and eliminating unnecessary regulations and bureaucratic procedures.[351] The telecommunications sector was widely considered one of Afghanistan's success stories, in part because of these initial steps.

The 249-seat *Wolesi Jirga*, or House of the People, is the lower house of Afghanistan's National Assembly. It plays a more important role in making laws than the 102-seat *Meshrano Jirga*, or House of Elders, which is the upper house of the assembly.

While the pace of establishing the new legal environment was rapid, the environment remains today a work very much in progress. Laws drafted by foreigners, albeit with some Afghan involvement, reflected a wide range of legal ideas and concepts, some of which conflicted with local precedent and tradition.[352] As noted above, one of the recurring complaints about the laws and regulations introduced in Afghanistan in the early years was they were imported from elsewhere by Western experts and advisors who failed to adequately take into consideration Afghan norms and traditions. In some cases, mullahs in the *Wolesi Jirga* objected to certain laws because they were claimed to be in violation of sharia law.[353] In late 2017, for example, there was a debate in the Afghan parliament about introducing a law to formally establish a legal foundation for an Islamic banking system, either in tandem with the current conventional banking system or potentially as a replacement.[354]

Similar discussions took place, in part, because there was little engagement or open debate about commercial laws and their compliance with sharia before the laws were passed. At the same time, sharia was subject to wide interpretation in Afghanistan. The failure of Western advisors to build a good understanding and knowledge of sharia and its application in Afghanistan prevented them from addressing sharia-related barriers and objections to some private sector development projects and activities upfront.[355]

The arbitration and mediation laws, a set of laws which attempted to establish a legal mechanism for dispute resolution outside of court, were an especially poor fit for Afghanistan. Based on international experience with alternative dispute resolution, these laws were intended to assist foreign investors. However, the laws inadequately considered the existence of shuras and jirgas, which held a position of power and respect within Afghan society that the formal court system lacked. When President Karzai signed the laws into effect in January 2007 while the parliament was in recess, he reinforced the widespread perception that laws were being brought in from foreign experts without engaging or consulting with the Afghan people.[356]

A dearth of legal experts and lawyers within Afghanistan, coupled with an inept or corrupt court system, made resolving legal conflicts and reforming laws especially difficult.[357] Many Afghan laws are poorly understood today, even among judges, lawyers, and legal professionals.[358] A study funded by GIZ found that most medium-sized business owners were aware of the existence of key commercial laws and appreciated their importance, but few understood their contents.[359] Furthermore, many of the laws were not accompanied by any plan to build or modify the institutions necessary to apply them.[360]

The greatest challenge, however, has been the enforcement of new laws. Afghanistan's weak judicial system has meant that even the best-crafted laws, unless uniformly and fairly enforced, can be manipulated by powerful individuals and business elites, who use their connections and access to information to circumvent taxes, regulations, and other legal requirements.[361] This same advantage has been used against smaller and less well-connected businesses to suppress competition.[362] Additionally, many of the new laws and regulations contradicted the laws which were still technically on the books from previous administrations, thereby offering officials the choice of which laws to enforce.

In some cases, the strengthening of government institutions made corruption more likely. One donor-funded review noted, "Administrative fees, permits, and licenses at the national and subnational levels of governance have increased, many of them unsanctioned, misapplied, or illegal." For example, the review stated that trucks carrying melons from northern Mazar-e Sharif to markets south of the mountains could be stopped and illegally taxed up to 20 times, and concluded that "an inherently weak institutional setting, such as currently exists within the Afghan government, cannot prevent 'informal' taxes and corruption."[363]

A further legal issue that contributed to large foreign corporations' reluctance to invest was the lack of a proper and transparent land registration system.[364] Despite U.S. government recognition of the problem and assistance in land titling going back to 2002, according to a recently published SIGAR audit of the U.S. government's land reform initiatives, Afghanistan's land administration remains "an ad hoc system of overlapping formal and informal approaches to land titling and transfer, with the formal approach mainly based on paper documents that may be registered by multiple institutions."[365] Corruption remains endemic in land administration, partly because of a judiciary system that is perceived by Afghans as one of the country's most corrupt institutions.[366]

FINAL POINTS ON CREATING AN ENABLING ENVIRONMENT

Creating a positive enabling environment that fostered confidence in the private sector was the first economic development priority of the U.S. government after 2001. Stabilization of the economy through the currency overhaul, creation of fiscal and monetary policies, and the establishment of a sound legal framework were all taken on within the first year of reconstruction, and were largely successful. The currency overhaul was effective in generating confidence in the new currency, as well as in the future of the economy for the population as a whole. Concurrently, the establishment of monetary policy without a functioning banking system was an impressive feat. Similarly, the establishment of fiscal policy, specifically regarding budget construction and public financial management, was an important success that helped to foster confidence. With President Ghani serving at the time as the Minister of Finance, the ministry overall was considered successful in building its capacity and was critical for the success of the Afghan government, as well as the economy. In all of these areas, USAID and Treasury followed the lead expert institutions, the IMF and World Bank, and contributed to success by providing substantial financial, technical, and political support.

However, despite incremental successes, the sound enabling environment of laws, regulations, and institutions has not yet been fully achieved. The biggest issue has been the failure to instill transparency and accountability in the wide range of Afghan government institutions that are responsible for supporting private sector development and whose lack of cooperation discouraged firms and entrepreneurs. Rather, corruption has been a hallmark of and a major constraint to private sector development. Of the 50 Afghan firms surveyed for this report (see appendix A, Methodology), 39 firms or 78 percent of total respondents considered tax administration to be difficult, specifically citing long delays, cumbersome and confusing procedures, and corruption.[367] According to one respondent, "A corrupt and inefficient government is a bigger problem or threat to the private sector than the Taliban."[368]

"A corrupt and inefficient government is a bigger problem or threat to the private sector than the Taliban."

—International telecommunications executive

While the U.S. government backed a number of general anticorruption activities, its primary anticorruption focus was on procurement, contracting, and general misuse of U.S. funds, especially as they were linked to terrorism, international crime, and drugs. Less attention was placed on the types of corruption and poor economic governance that posed a constraint to Afghan firms and private sector development.

In many cases, the fixes to corruption were of a technical nature, such as electronic payment and accounting systems, and depended on the commitment of government officials to make them effective; yet, U.S. officials often lacked the ability to exert sufficient leverage on individuals and institutions to reduce corruption, especially when it existed beyond their immediate counterpart.[369] For example, U.S. officials pushed Afghanistan to adopt the Extractive Industries Transparency Initiative (EITI) standards, which it did in 2010 as part of its candidacy for membership; however, the 2014 mining law passed by Parliament removed many of the conditions suggested by MIDAS and the international advisors, and therefore had weaknesses that were likely to "fuel conflict and corruption instead of development."[370]

A further issue has been the reform of the tax system, a daunting challenge anywhere, but especially in an environment where individuals and businesses were not used to paying any taxes at all. While policy improvements have been positive, implementation has been uneven due to bureaucratic issues, corruption, and poor governance. There have also been tensions between different objectives, such as increasing revenue collection while encouraging economic activity. For example, the pressure from the international community to step up tax collection as the 2014 drawdown approached created an opportunity for corrupt officials to extract additional payments from businesses.

AFGHANISTAN AND THE EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE

Afghanistan's estimated $1 trillion in unexploited mineral resources is considered to have the potential to drive inclusive economic growth and generate revenue for the government. It also has the potential to develop into a classic case of the "resource curse," where a country becomes dependent upon a nonrenewable resource at the expense of wider growth and the development of other industries, making the economy volatile and leading to greater inequality. The deciding factor between these two paths rests largely on whether the Afghan government can manage and regulate the sector for transparency and sustainability, or if weak institutions will allow strongmen, corrupt politicians, and unscrupulous domestic and foreign companies to exploit these resources solely for their own gains. To attempt to put Afghanistan on the former path, Afghanistan's leaders and civil society groups are working to join the EITI, a voluntary global standard for the governance of mining, oil, and gas.[371]

Managing extractives in Afghanistan has been difficult, and many contracts have been mired in corruption and controversy. The contracting process for Mes Aynak, one of the largest untapped copper deposits in the world and Afghanistan's first major mining tender, is a good example. The $2.9 billion contract, the largest single foreign investment in Afghanistan to date, was awarded to the Metallurgical Group Corporation of China in 2008 after a short bidding process. A year later, the Minister of Mines, Mohammad Ibrahim Adel, was accused of accepting a $30 million bribe to favor MCC over its competitors.[372] As a minister, Adel was immune from investigation at the time and has since retired, and the issue remains unresolved. Poor or nonexistent recordkeeping of the tender process within MOMP, and the ministry's refusal to release the Aynak contract document to the public until 2015, only furthered public suspicion.[373] Further, in the years after the award of the Aynak contract, other mining contracts have been awarded to close relatives of politicians and government officials, in spite of prohibitions outlined in the 2009 Minerals Law.[374] For example, the contract for the Ghori cement factory was awarded to the brothers of prominent politicians. (For more details, see Sell-Off of Ghori Cement, page 100.)

The major mining sites of Mes Aynak in Logar Province and Hajigak in Bamyan Province are part of the National Resource Corridors Program, which is a plan to develop the mines in tandem with their supporting infrastructure, including roads and railways, which will in turn generate and support other local economic activity.[375] However, this is a process that will require significant foreign private investment and effort from the Afghan government to plan and implement. Currently, both mining sites have been in limbo for several years due to a combination of insecurity and the fall in international commodity prices.

In addition to the two major mining sites of Mes Aynak and Hajigak, Afghanistan has extensive smaller or artisanal mining activity, which has the potential to create wealth and employment. However, medium and small mines continue to experience "industrial-scale looting" by strongmen and well-connected individuals.[376]

In becoming a candidate for EITI in 2010, Afghanistan signaled its commitment to design and implement a transparency process that includes requiring companies to disclose beneficial ownership (any person or entity holding 10 percent or more of company shares), provide notice of all payments made by companies to the government, publish revenues from extractives, allow independent audits of all payments, and involve civil-society actors as part of a national-level Multi-Stakeholder Group to assist with designing and monitoring the process.[377] These requirements are designed to prevent or expose common methods of political deal-making, corruption, and illegal exploitation of mineral resources.

Afghanistan's Finance Minister speaks at a conference on the Afghanistan Extractive Industries Transparency Initiative in Kabul in July 2012. (UNAMA photo by Fardin Waezi)

The Multi-Stakeholder Group, which is composed of government, industry, and civil society representatives, commissions regular reports to monitor progress and track government revenue and payment data.[378] The EITI International Secretariat reviews these reports, and appoints an independent validator to confirm that sufficient progress is being made, after which Afghanistan will gain full admission into EITI. Afghanistan did not make sufficient progress to achieve EITI compliance in 2013 or 2014, and remains a candidate for full admission after its last assessment on November 1, 2017.[379]

While the United States withdrew from EITI in November 2017, it remains a "supporting country" and will continue to promote the initiative internationally through State and USAID.[380] Afghanistan continues to receive significant assistance from the World Bank in implementing EITI.

Asian Development Bank photo

CHAPTER 5

PROVIDING ACCESS TO FINANCE

Early on, the U.S. government recognized the importance of access to finance as a critical factor in promoting private sector investment. It also recognized that a private sector economy required different types of government financial institutions than existed before 1978. The U.S. government provided support to create a formal commercial banking sector in order to promote private sector activity, but also to encourage the channeling of financial flows through formal institutions to limit criminal money laundering and terrorism financing. (For more details, see U.S. Efforts to Curb or Regulate the Hawala System, page 66.) In addition, in response to what was seen as the inability or unwillingness of commercial banks to reach the poor and rural areas, the United States also supported the emergence of a number of non-bank, sector-specific financial institutions, enabling them to offer loans that were attractive to micro and small enterprises that might be less interested in traditional loans for a variety of reasons, including short grace periods, high interest rates, the borrower's lack of collateral, and distrust for loans that weren't sharia-compliant.

USAID and Treasury both supported the banking sector by building the supervisory capacity of DAB, while USAID and OPIC helped to establish sector-specific financial institutions, such as Afghan Growth Finance, Agriculture Development Fund (ADF), and Afghanistan Rural Finance Company (ARFC).

Sharia-compliant loans are loans that are made in accordance with Islamic law. These loans include prohibitions on excessive interest and risk taking, overcharging for commodities at times of scarcity, and the manipulation of markets.

Additionally, through the provision of direct loans and credit guarantee schemes, as well as technical assistance, the U.S. government sought to increase financial institutions' lending capacity to smaller and riskier enterprises.

Results of these efforts have been mixed. While U.S. and other donors' regulatory and policy advice, as well as consistent support to DAB in the supervision and regulation of commercial banks, contributed to privatization of state banks and emergence of a number of commercial banks that provided financing to small and medium enterprises, the Kabul Bank debacle, one of the world's largest banking sector failures, demonstrated just how fragile the banking sector was and continues to be. Moreover, finance continues to be a constraint; reporting from the World Bank in 2014 highlighted that small and medium enterprises remained "chronically financially underserved," with only 2 percent of Afghan firms using banks to finance investment and only a few banks providing specialized financing to these enterprises.[381]

SUPPORT TO THE COMMERCIAL BANKING SECTOR

The U.S. government recognized that the lack of formal sources of finance at reasonable rates was a serious constraint to business development. In early 2002, Afghanistan's financial system consisted solely of the central bank, two state-owned commercial banks, and four state-owned development banks, each of which had essentially ceased operations and could not perform the functions required to support a modern, market economy.[382]

In order to encourage commercial lending, USAID provided support to the banking sector, starting in 2002 with the Afghanistan Economic Growth Program, followed by Economic Growth and Private Sector Strengthening in 2007 and Economic Governance and Growth Initiative in 2009. A major component of these projects was supporting DAB in the modernization of procedures and laws, setting up payment and transfer systems, strengthening its provincial presence, and allowing supervision and risk management of commercial banks and other financial institutions by supporting the establishment and strengthening of DAB's Financial Supervision Department (FSD). Established in 2002, the FSD received continuous technical support from USAID, as well as the IMF and World Bank, to improve its supervision of a rapidly growing banking sector.[383] By 2008, the banking sector had grown to include 15 licensed commercial banks, with 58 percent growth in deposits and 84 percent growth in loans.[384] The banking sector had also started becoming profitable due to increases in both interest and noninterest incomes, the latter including fees and other service charges.[385]

Despite, or perhaps because of, its significant growth, the banking sector continued to be fragile. In 2009, one year before the Kabul Bank collapse, an

Afghanistan Renewal Fund

In the first few years of reconstruction, there was a great deal of enthusiasm for encouraging investment opportunities through finance, but not always with the best understanding of what was required in the Afghan market. One early example was the Afghanistan Renewal Fund, established in 2004 by Afghan Capital Partners, an independent company with offices in London and Kabul. According to the President Bush archives, "The United States has established the Afghanistan Renewal Fund, the first venture capital fund in Afghanistan specifically targeting small and medium-sized enterprises, and supported the stimulation of economic growth by creating a venture capital fund and separate loan guarantee program for ex-combatants in order to stimulate local private sector development and create sustainable employment."[386]

ARF planned to raise $20 million in investment funds and attract private investment. In 2005, USAID's RAMP provided a $3.8 million grant to ARF to support direct investment in agribusinesses along the value chain, with the intention that the fund would continue past RAMP's end date and generate "market-based returns."[387] An additional $16 million was obtained from ADB, OPIC, the UK-government owned investment fund CDC Group, and "high net-worth private investors."[388]

The Acap Partners' final report to RAMP in 2006 listed 164 potential investment opportunities that were investigated, but provides no indication that any actual investments were made. The final report noted difficulties in making investments, such as lack of credible business plans, management and financial skills, and certainty to investors on tax policy and protection of assets, as well as "few service and production industry enterprises with greater expansion potential."[389] The fund appears to have closed by 2008.

IMF analysis of the banking sector found a wide variety of risk-taking behavior among commercial banks. Private domestic banks that were rated poorly on international measures of performance and risk exposure had taken on excessive credit risk through substantial domestic lending, while foreign banks that had higher ratings than Afghan banks did not lend in Afghanistan at all. Afghan banks were more willing than foreign banks to lend in the local market because of greater familiarity with the business environment, clients, and loan repayment enforcement mechanisms that included personal mediation, issuance of warnings against becoming "blacklisted with the bank," and application of extrajudicial and "nonconventional" enforcement methods. While the IMF report didn't elaborate on these methods, it noted that in at least one bank, one-third of the employees were guards and security staff.[390]

In response to commercial banks' risk-taking behavior, in 2008 DAB tightened reserve requirements to ensure commercial banks had sufficient liquidity.[391] At the same time, the IMF reported that DAB's supervisory and onsite monitoring had significantly improved, including doubling the frequency of onsite examinations.[392] EGGI project reports also highlighted improvements in DAB's supervisory services, noting that the department could "conduct onsite examination at all commercial banks to verify financial data and assess banks' safe and sound operations."[393] Further, the EGGI project highlighted other achievements, such as various amendments to banking laws, especially those related to corporate governance, including prevention of excessive shareholder involvement in bank management.[394]

Despite eight years of consistent U.S. and other international support to DAB and positive progress reports, the Kabul Bank crisis in 2010 revealed DAB's limited capacity for supervising commercial banks and the extent to which political actors could undermine the economy.

However, despite eight years of consistent U.S. and other international support to DAB and positive progress reports, the Kabul Bank crisis in 2010 revealed DAB's limited capacity for supervising commercial banks and the extent to which political actors could undermine the economy. While EGGI reported that the project had achieved the objectives of its banking sector activities, it also noted that "progress on legislative and regulatory initiatives was dependent on political and policy factors outside control of the sponsoring institutions."[395] Furthermore, the project report highlighted factors that may have contributed to the 2010 Kabul Bank collapse. For example, in 2008 USAID and the Afghan government together decided to stop donor program advisors from accompanying DAB's FSD staff in performing onsite supervision at commercial banks. This was problematic because the FSD staff had limited experience in oversight, and USAID personnel couldn't detect the nature of the fraud at Kabul Bank through FSD's written reports alone.[396] Further, a SIGAR audit in 2014 confirmed that FSD hadn't conducted rigorous checks of the bank's shareholders, adding that the department also hadn't conducted any onsite monitoring of Kabul Bank for its first two and one-half years of operation, had failed to impose and collect fines for the bank's failure to maintain required reserves, and didn't ensure that the bank's branches had the legal permits to operate.[397]

The fallout from the Kabul Bank collapse included a March 2011 Afghan presidential directive that U.S. advisors were no longer welcome at DAB.[398] Therefore, the USAID EGGI project was re-scoped to focus mainly on public financial management, and all U.S. agencies, including USAID, Treasury, and State, either limited or stopped their work with DAB.[399] While there was widespread criticism of USAID's DAB support both officially and in the media, DAB senior officials later lauded USAID and other donors' overall efforts in the

KABUL BANK CRISIS

Prior to its collapse in 2010, Kabul Bank was the largest banking service provider in Afghanistan. Its failure, and the subsequent $825 million bailout by the Afghan government, represented approximately 5 to 6 percent of GDP, making it one of the largest banking failures in the world, relative to GDP.[400]

Customers seek to withdraw money from Kabul Bank after large-scale corruption allegations in September 2010. (Agence France Presse photo by Massoud Hossaini)

Kabul Bank was established in 2004, a year after DAB was resurrected and several crucial banking laws were enacted. It later emerged that there were fundamental problems with Kabul Bank supervision and regulation due to DAB's lack of capacity and political influence surrounding the bank. Kabul Bank's shareholders' and supervisors' personal, financial, and criminal backgrounds weren't thoroughly reviewed by DAB or vetted through the Ministry of Interior as part of the license application review process. Moreover, DAB didn't conduct any onsite examinations until 2007, two and one-half years after Kabul Bank started operations.[401]

Kabul Bank established a sophisticated and fraudulent embezzlement system based on dual financial records: one set of records was to satisfy regulators and the other was to keep track of the real distribution of bank funds. Through this system, the bank provided funds to proxy borrowers and fabricated company documents and financial statements. The ultimate beneficiaries of this fraudulent system were large shareholders, related companies and individuals, and politically connected individuals. Over 92 percent of the bank's loans, or approximately $861 million, were given to 19 related parties, consisting of companies and individuals.[402] The bank also misappropriated funds through non-loan disbursements that included excessive expenses, investments in related businesses, fake capital injections, advanced payments of salaries and rent, salaries paid to nonexistent employees, inflated costs for assets and payments for fake assets, unjustifiable bonuses, and political contributions, including to President Karzai's re-election campaign.[403]

While DAB officials conducted regular and special examinations of Kabul Bank between 2007 and 2010, during which they consistently raised concerns about the bank's violations related to governance, loan files, and promotional incentives, they couldn't detect the extent of the fraud. Even the external audit reports of Kabul Bank didn't raise any red flags.[404]

In February 2010, a *Washington Post* article accused the bank of fraudulent lending practices, with loans to major shareholders that included the brothers of President Karzai, the Vice President, and many others, some of whom had purchased property in Dubai and registered it under the bank chairman's name.[405] Additionally, the bank chairman and CEO had created hundreds of fake companies to which loans were granted. The loans were then transferred to individuals in Afghanistan through Shaheen Exchange in Dubai, a money transfer company owned by the bank's shareholders. The bank's chairman and CEO were actively using its funds in violation of Afghan banking laws. Activities such as the bank's purchase of property in Dubai and the purchase and running of Afghan businesses by bank officials and board members were illegal. For example, Pamir Airways was a domestic airline that was owned and operated by the bank's chairman. The airline's license was revoked in 2011 following an air crash that killed 44 passengers. The investigation revealed that the plane's registration had been forged to avoid safety inspections.[406]

In July 2010, as the result of a rift between bank chairman Sherkhan Farnood and CEO Khalilullah Ferozi, the chairman exposed the fraudulent activities of the bank to the U.S. Embassy, which eventually resulted in the firing of both executives. By then, the bank's customer base had ballooned to one million Afghans, with a total of $1.3 billion in deposits. At the same time, the bank maintained an alarming loan to deposit ratio of 70 percent, which meant more than $900 million of its deposits were committed to mostly fraudulent loans.[407] The news of the firing of the bank's officials caused widespread panic among Afghans, who rushed to withdraw almost $500 million of the bank's funds in a span of only a few days. DAB had to intervene as a lender of last resort to secure deposits and avoid a larger crisis.[408]

The New Kabul Bank was established in 2011 to inherit the "good assets"—those acquired legally by Kabul Bank—while the Kabul Bank Receivership inherited the "bad assets"—those that were acquired through fraudulent transactions. The receivership's activities faced delays because of meddling and intimidation from politically connected figures. Since the establishment of the receivership, other than the imprisonment of the bank's chairman and CEO, and despite presidential decrees offering incentives such as reduced prison time or interest rates, the recovery of funds, indictment, and imprisonment of other large debtors with political connections have been very slow. At one point in November 2015, news broke about the bank's CEO becoming a major contributor to an Afghan government land development project. However, given the public attention and outcry, a few days later President Ghani declared the contract null and the CEO was reportedly back in prison. The Afghan government continues to find it challenging to recover money from debtors, especially from the chairman and CEO, because their assets are hidden under other people's names.[409]

Most of the recovery of Kabul Bank's funds so far has come from small debtors, many of whom were Kabul Bank employees who had received salary advances or had legal debts. The large debtors have yet to repay all of their debt, despite having legally binding contracts with the receivership to do so.[410] In March 2016, the Afghan government approached SIGAR for help in detecting and retrieving the bank's assets from foreign countries. An Afghan presidential decree directed Afghan authorities to cooperate with and provide documents to SIGAR to assist with the Afghan government's ongoing investigation of the bank.[411]

modernization of the banking sector, stating, "In 2002, we didn't have formal financial systems. There are now 16 banks, mainly private sector. If we didn't have the assistance from USAID, we couldn't have developed the framework for private sector banks."[412]

The Kabul Bank crisis served as a wakeup call for international donors, leading to the World Bank's audit of commercial banks and IMF's decision to make the continuation of its Extended Credit Facility program (a mechanism through which IMF provides low-income countries with financing assistance) conditional on the Afghan government's willingness to reform the banking sector. The IMF also supported DAB's attempts to consolidate and revise banking laws to strengthen corporate governance structures, regulate capital requirements, and enhance bank supervision.

However, according to a 2016 IMF report, the banking sector continued to face critical challenges, such as weak governance, deteriorating asset quality, and low profitability.[413] While lending rates across the sector increased slightly in 2015, the quality of loan portfolios deteriorated, as was evidenced by a 7 percent rise in the proportion of nonperforming loans against total gross loans.[414] This was especially problematic because 60 percent of the nonperforming loans were attributed to only two private banks. These two banks combined also issued the lion's share (48 percent) of overall loans.[415] Despite DAB's efforts, bank loans were mostly concentrated in Kabul and in a few sectors such as services, construction, and mortgages, despite the knowledge that inadequate geographic and sectoral diversification can expose banks to risk in the event of crisis.[416]

PROVISION OF DIRECT LOANS AND LOAN GUARANTEES

In addition to supporting the commercial banking sector, USAID and OPIC worked to make finance available to Afghan and U.S. firms through direct loans and loan guarantees.

Direct Loans

To encourage foreign direct investment and support U.S. investors interested in doing business in Afghanistan, OPIC, the U.S. government's development finance institution, began Afghanistan operations in 2002 by establishing a $50 million line of credit to "support economic reconstruction and U.S. investment in post-Taliban Afghanistan."[417] OPIC provided direct loans and political risk insurance to U.S. investors, many of whom were Afghan-Americans.[418] By 2013, OPIC's Afghanistan portfolio had grown to $252 million, including loans ranging from $35,000 to $60 million provided to companies investing in hotel and housing construction, beverage production, agriculture and food security, renewable energy, and small and medium enterprise credit.[419] As discussed below, OPIC also provided debt financing for the

Political risk insurance protects investors, firms, and other entities against financial loss due to events such as political violence or unrest, government expropriation, sovereign debt default, and inability to convert currency.

establishment of Afghan Growth Finance, a small non-bank financial institution that provided loans and business advisory services to Afghan-owned businesses.[420]

OPIC's financing of companies had mixed results. In 2004, OPIC gave a $9.2 million loan to Afghanistan Beverage Industry to help set up the company, which then became the main provider of bottled water to the U.S. military and, later, the manufacturer and distributor of Pepsi products in Afghanistan.[421] In 2009, OPIC provided $15 million in financing for the expansion of the Insurance Corporation of Afghanistan, the country's first private insurance company that provides various types of insurance to Afghan and foreign clients.[422] These were both considered successful ventures.

However, other OPIC loans did not fare as well. In 2016, SIGAR highlighted problems with two construction projects run by a consortium of four companies that had received around $85 million in OPIC loans, one of the highest amounts among OPIC's borrowers in Afghanistan.[423] The loans, which were disbursed on an incremental basis, were for the construction of a hotel and adjacent apartment building in close proximity to the U.S. Embassy in Kabul. In late 2017, both structures were incomplete and uninhabitable, with no obvious prospect of ever being completed. The developers presented OPIC with documents making false claims about the construction progress and completion dates, and continued to receive loan disbursements because OPIC didn't have an onsite monitor to verify those claims and instead relied on the recipient's information, which was "blatantly false and unrealistic."[424]

A loan guarantee covers a share of the default risk associated with credit given to a borrower. The guarantee encourages a financial institution to make loans to borrowers who are perceived as high-risk or who have insufficient collateral. One objective of loan guarantees in Afghanistan was to increase small and medium enterprises' access to finance.

Another recent case of non-repayment of an OPIC loan involved another company that obtained a $15.8 million loan in 2010 for the development and operation of a marble mine in western Afghanistan. (For more details, see Marble Sector in Afghanistan, page 109.) A June 2017 indictment for "allegedly defrauding" OPIC stated the company had made false statements about its ability to repay the loan.[425]

Loan Guarantees

OPIC began providing loan guarantees to U.S. investors in Afghanistan as early as 2002, when Ashraf Ghani, then Minister of Finance, requested OPIC provide a $20 million loan guarantee to encourage private investment in the telecom sector, which it did. Although the guarantee was never called upon, it encouraged private companies to invest in the sector.[426]

In addition to OPIC, in 2012 USAID also started providing loan guarantees to commercial and microfinance banks through its Development Credit Authority (DCA), a legislative authority that allows USAID to make direct loans and issue partial loan guarantees to private financial institutions.[427] USAID initiated the DCA model with an eight-year, $10.3 million loan portfolio guarantee to the commercial Afghanistan International Bank (AIB). This guarantee sought to mitigate risk for AIB and allow it to expand its lending capacity to offer longer-term loans to small and medium enterprises. As of 2017, AIB's lending under the program has been limited to only seven loans, or 26 percent of the total loan the bank could make under the DCA guarantee. Moreover, some of the borrowers defaulted on their loans, which led to USAID bearing the cost of a little over $100,000.[428]

In 2014, USAID extended the loan guarantee program to three microfinance institutions: Oxus, FINCA Afghanistan, and First MicroFinance Bank Afghanistan.[429] The purpose of this program was to help the microfinance institutions secure loans from larger lenders, which would be used for onward lending to micro and small businesses. To date, none of the microfinance institutions have extended any loans under this guarantee.[430] While it is too early to evaluate the results of the DCA efforts, Afghan central bank officials have favored such credit guarantee initiatives, rather than USAID projects providing loans directly to enterprises.[431]

CREATING FINANCIAL INSTITUTIONS

In order to increase access to finance for businesses not served by commercial banks, the U.S. government supported the creation of independent private or government-owned financial institutions, including Afghanistan Rural Finance Company and Afghan Growth Finance. The United States also provided financial and technical support to the microfinance sector to improve its ability to lend to small and medium enterprises. Although Afghan commercial banks increased in number and capacity in the years after 2001, they preferred to operate in major urban areas such as Kabul, Herat, and Balkh Provinces, and to provide credit mainly to sectors such as trade, mining, manufacturing, communication, and services, with lower-risk trade dominating the loans.[432]

Commercial banks globally tend to remain reluctant to engage in rural finance because the remoteness of clients, coupled with poor infrastructure and banks' limited outreach, making delivery of services and monitoring of clients more costly and challenging.[433] In addition, commercial banks are reluctant to provide finance in the agriculture sector because of its perceived high risks and costs. Banks also tend to cater to medium and larger businesses that possess forms of collateral that smaller firms can't provide. According to a former USAID implementing partner official, this was no different in Afghanistan, where relatively few banks could support rural financing.[434] This was partly because, unlike non-bank financial institutions, commercial banks were subject to DAB's stricter capital and credit requirements. While the microfinance and non-bank financial institutions served as alternative sources of credit for small and medium enterprises, they continued to struggle to achieve self-sufficiency.

CHALLENGES IN DEVELOPING THE MICROFINANCE SECTOR

The need to develop the microfinance sector was based on the assumption that Afghans, especially women and those living in rural areas, had limited or no access to credit at reasonable rates and terms of payment, and that this was a binding constraint to the expansion or initiation of small-scale enterprises that would allow borrowers to raise their incomes and contribute to economic growth. In 2002, it was estimated that over one million Afghan households had an unmet demand for microcredit.[435] In 2003, the World Bank established the Microfinance Investment Support Facility for Afghanistan (MISFA) to serve as an apex funding and capacity-building institution that would subsidize, regulate, and support the expansion and sustainability of the microfinance sector in Afghanistan. Most funding to MISFA has come through the Afghanistan Reconstruction Trust Fund, a financing instrument for the Afghan government that is funded by multiple donors, including USAID.[436]

In addition to USAID's contribution to the ARTF to finance development priorities of the Afghan government, the agency also provided additional targeted technical and financial support to MISFA and its affiliated Afghanistan Microfinance Association and microfinance institutions (MFI), through a series of rural financing initiatives. Starting in 2003, USAID funded the Rebuilding Agriculture Markets Program, which provided some support to microfinance institutions as part of its development of rural finance services, and which was followed by Afghanistan Rural Investment and Enterprise Strengthening (ARIES) in 2007. USAID's more recent financing initiative, Financial Access for Investing in the Development of Afghanistan was launched in 2011. Promoting enterprise lending through the provision of funding to MISFA for onward lending purposes, with the ultimate goal of increasing MFI borrowers, was a major part of these projects.[437]

The microfinance sector experienced rapid growth between 2003 and 2008, increasing from four MFIs and 12,000 clients to 15 MFIs and around 450,000 clients.[438] However, this rapid expansion was followed by a repayment crisis that resulted in a decline in the growth and quality of loan portfolios.[439] In 2009, a World Bank-commissioned investigation of one of the MFIs found evidence of data manipulation by the MFI in order to conceal financial losses and misappropriation of funds.[440] Given the mismanagement and increasing skepticism about the microfinance sector expressed in some independent analyses and MISFA's own assessment, MISFA began a consolidation and reform process. As a result, the number of MFIs shrunk to only seven, after the disestablishment or consolidation of MFIs that were not performing well.[441]

A number of factors contributed to the MFIs' decline. First, a combination of environmental and external factors, including the 2007 drought, deteriorating security, and rising inflation, reduced clients' ability to repay loans or take new loans. Second, the MFIs had to bear increasingly higher service delivery and operating costs because of these issues, as well as the low population density of the MFI-targeted areas. Third, partly due to the small number of staff and their limited capacity, the MFIs struggled to develop an in-depth understanding of existing alternative sources of credit, including the extensive hawala system and other sources, including relatives, colleagues, friends, wealthy villagers, shopkeepers, traders, and large landowners.[442] Finally, the MFIs strived to balance their dual mission of serving the poor while becoming financially sustainable. Unlike the commercial banking sector, the microfinance institutions' mandate required them to be concerned about their operational sustainability and their clients' livelihoods—an emphasis that resulted in dropouts and negative perceptions of the MFIs. In some cases, households had to borrow from an informal credit source, often their relatives, to repay a loan taken from the MFI.[443]

Afghan Growth Finance

In 2007, the Washington-based investment management group Small Enterprise Assistance Funds (SEAF), in partnership with OPIC, established Afghan Growth Finance, one of the first non-bank private financial institutions in Afghanistan that specifically targeted small and medium enterprises. Because OPIC was statutorily limited to providing financing and political risk insurance to U.S. companies only, establishing the AGF as an intermediary financial services provider allowed OPIC to indirectly support non-U.S. investors in Afghanistan.[444] As a for-profit private company wholly owned by SEAF, AGF worked primarily with more established companies that were selected after an assessment of their annual turnover, future growth prospects, and management capacity, and which had a sustainable business model focused on consumer products and services that met local demand and could compete with imports. These clients included an ice cream manufacturer, a pharmaceutical company, and construction material manufacturers.

AGF differentiated itself from other non-bank financial institutions in that it predominantly provided long-term capital financing, as opposed to short-term working capital. It also sought to reduce the burden of debt servicing by working closely with its borrowers and by having flexible and fluid loan structures.[445]

In 2010, AGF received financial support from USAID to expand its operations and presence beyond Kabul by establishing satellite offices in Herat and Balkh Provinces. By 2015, AGF had made a total investment of $46 million in 24 enterprises.[446] According to AGF, this low number of clients and loans demonstrated a cautious investment strategy and careful consideration of the company's limited management capacity to maximize the effectiveness of its capital and minimize incidents of nonpayment—a sensible approach in the uncertain Afghan environment. AGF believed it had to be disciplined and cautious in its investments because, as a private company, it had to receive sufficient revenue to pay its investors and its operating costs.[447]

According to a senior AGF official, AGF generally did not rely on the corrupt and time-consuming Afghan commercial courts or legal system to resolve disputes or enforce contracts. Instead, AGF took various preventive measures to ensure companies did not default on their loans, including conducting extensive company and market assessments and forming close relationships with the company by providing management and operational support.[448] These measures did not mean, however, that AGF clients never defaulted on their loans. In 2014, for example, AGF had to take legal action against four companies that did.[449] At the same time, AGF senior management claimed it had fewer nonperforming loans than other financial institutions and, despite all the risks associated with business operations in Afghanistan, the number of such loans was low.[450]

Afghanistan Rural Finance Company

In order to serve rural small and medium enterprises in the agriculture sector that would otherwise be unable to access credit, in 2007, USAID's ARIES project supported the establishment of the Afghanistan Rural Finance Company. ARFC, owned by ACDI/VOCA, a Washington-based nonprofit, had planned to provide conventional and sharia-compliant loans ranging from $20,000 to $1 million. Within two years, USAID reported ARFC's success in surpassing its target, having provided 87 loans worth a total of $20.5 million.[451]

However, following the completion of the ARIES project in 2009, ARFC struggled with a myriad of problems that were common among the financial institutions set up by donors, such as complex ownership structures and serious challenges with repayment. These problems were confirmed by a 2012 report of the USAID FAIDA project, which was tasked as part of its banking sector support activities with conducting an assessment of ARFC's financial status and developing a set of options for FAIDA and ACDI/VOCA's future relationship. The assessment report highlighted a number of ARFC's challenges in repayments, ownership, and management, as well as in profitability and sustainability. The report noted that, in 2010, facing serious difficulties in recouping money from its borrowers and increasing numbers of nonperforming loans, ARFC was forced to restructure. The company began cleaning up its loan portfolio by writing off loans that were in default, including 22 loans worth $7.3 million. For a company with an initial capital investment of $18 million from the ARIES project, this was a significant loss.[452]

Further, based on its experience with larger loans, ARFC reduced its maximum loan size from $2 million to $500,000, targeting smaller enterprises. As the assessment report highlighted, lending to small and medium enterprises was risky in Afghanistan, as these enterprises didn't have sufficient management capacity, often were not financially stable, and did not always have a reliable market for their products. Despite these shortcomings, lending to small enterprises could be profitable mainly because there were so many more of them, resulting in a higher demand for loans.[453] In 2011, after years of being managed by the company owner ACDI/VOCA, the management of ARFC was handed over to an Afghan team.[454]

Despite the changes in its lending structure and management, ARFC continued to struggle with nonperforming loans. The 2012 FAIDA assessment report noted ARFC's serious capacity constraints and limited future prospects for profitability, and concluded that the company could not sustain operations without external support, even if it reduced expenses. The report suggested the company explore merging or partnering with another financial institution; however, given ARFC's significant number of nonperforming loans, ARFC has

Farmer with potatoes at the end of the harvest season in Bamyan Province in April 2017. (USAID photo)

not been able to find a potential partner from among those it approached. Another option suggested by the report was for FAIDA or ACDI/VOCA to assist the company in recouping as much money as it could from its outstanding loans, and then let the company phase out and close its operations. Other than some technical advice, USAID's FAIDA project did not commit to any further financial support to the company after 2017, when the project ended.[455]

Agriculture Development Fund

In 2010, USAID embarked on setting up an Afghan government-owned financial institution that would provide credit exclusively to farmers and businesses in the agriculture sector. The agency launched the Agriculture Credit Enhancement (ACE) program for the primary purpose of creating the Agriculture Development Fund. While the Afghan government had operated an Agriculture Development Bank in the 1970s, it was highly subsidized and mainly channeled inputs to farmers. In contrast, USAID envisioned ADF specializing in lending and becoming a proactive and self-sufficient institution that would identify and select existing businesses in the agriculture sector that were eligible for loans and had the potential for profit. According to a former Ministry of Agriculture, Irrigation, and Livestock (MAIL) minister who was also an ADF board member, banks such as ADF are essential for agriculture sector development as they provide affordable loans to farmers with limited collateral based on their specific needs for long term and seasonal loans.[456] ADF's business strategy included the provision of both operating capital and capital investments in agro-processing.[457]

Initially, ADF was designed to serve as a credit wholesaler, providing credit through other financial institutions. However, because the commercial banks were unwilling to engage in the volatile agriculture sector, the program had to focus on using MFIs and nonfinancial institutions, such as farmers' associations, for on-lending. Because these institutions didn't have lending capacity, ADF created credit management units to work closely with each of the institutions that received funding from ADF.[458]

By 2016, ADF had disbursed $60.7 million in loans to more than 31,000 borrowers, with the majority of loans provided to three types of enterprises: agribusinesses, cooperatives, and producer groups. Borrowers used the money to modernize agriculture practices, such as building processing facilities and procuring machinery and equipment. By the time the first round of support from the ACE program ended in 2015, ADF had maintained a recovery rate of 95 percent.[459]

ADF was lauded for making agricultural credit available to many farmers in the rural areas. However, it continued to be a fragile, donor-dependent entity that was far from reaching operational self-sufficiency, which is defined as generating sufficient income to cover operating expenses other than losses. ADF's excellent loan recovery rate would have been almost impossible to maintain in the absence of the external support that paid the staff who were tasked with client follow-up.

Despite its successes, ADF also faced challenges. Toward the end of the first round of the ACE project in 2015, ADF had to write off four loans valued at more than $480,000.[460] The ADF final evaluation report noted a deliberate refusal by some defaulters to pay ADF loans, although it didn't elaborate on the reasons behind the refusal.[461] Nevertheless, lack of enforcement mechanisms and deficient rule of law made it challenging for ADF to obtain repayment.

In 2016, at the request of the Ministry of Agriculture, Irrigation, and Livestock, USAID extended its support under a second project, ACE II, in order to guide the transition of ADF to a sustainable, stand-alone agriculture financial institution by strengthening its management systems and governance structure.[462]

The size and legal status of ADF were challenges highlighted at the end of the first round of the ACE program. The program evaluation noted that since its inception, ADF had grown in size and capability, mainly because it had to build an in-house capacity to seek out clients and partners, assess their creditworthiness, and determine their absorptive capacity before lending to them. Also, in the absence of the other financial intermediaries with which USAID had originally planned to partner, ADF had to assume the responsibility for all aspects of providing credit. ADF therefore became a large structure with 63 full-time employees, which was impossible to sustain in the absence of additional donor support. And, as the number of ADF clients increased, managing a large portfolio of small borrowers also caused an increase in administrative costs, which had to be offset either by continuing external support or raising the interest rate, which would defeat the purpose of ADF as an entity intended to be a cheaper source of credit.[463] Furthermore, the ACE project was not required by USAID to develop a business plan for ADF to demonstrate the appropriate portfolio size and loan pricing required for its sustainability.[464]

The evaluation report's concern about ADF's legal status noted that although it was created by a presidential decree as an independent, non-bank financial intermediary, and was guided by a set of bylaws and managed by a high council, the governance structure of ADF and its related tax payment responsibilities wasn't clear, which is why strengthening that structure became a major focus of ACE II.[465]

Additionally, ADF found it difficult to attract borrowers, perhaps due to the prevalent culture of dependency on grants or "free money," as opposed to loans that had to be paid back. In its efforts to entice enterprises to apply for ADF loans and under pressure to show success by giving out more loans, ADF cut interest rates and offered grants as an incentive.[466] The evaluation report noted that each loan recipient who was interviewed for the report expected some form of grant. Some of these clients had received multiple grants from various USAID projects because of the availability of grants.[467]

FINAL POINTS ON PROVIDING ACCESS TO FINANCE

The U.S. government's efforts to increase access to formal sources of finance were seen as crucial in encouraging domestic and foreign investment and in increasing small and medium enterprise lending by non-bank financial institutions. However, the Kabul Bank crisis highlighted the challenges of financial sector reforms and the limitations of international donors' efforts, including those of the United States and its decade-long support to build DAB's supervisory capacity. It also highlighted the unreliability of project-generated information, including reports that consistently noted the successful completion of tasks. Moreover, the Kabul Bank crisis further eroded Afghans' confidence in formal financial institutions, as evidenced by the continued widespread use of the informal hawala system.

After the Kabul Bank collapse, the U.S. government reduced its engagement with DAB and focused on creating new and strengthening existing financial institutions for the purpose of making financing more available to small and medium enterprises. While the financial institutions provided much needed financing, the U.S. expectation that these institutions would become self-sustaining was unrealistic. The U.S. experience showed that setting up financial

Field Story #1: Poultry Farm in Herat Province

Easy access to grants and subsidized loans does not always lead to profitable businesses. In 2011, a poultry farm in Herat Province started a hatchery business with the owner's own contribution of $1.1 million and a $254,000 ASMED grant. The ASMED grant was used to purchase hatching machinery and an initial batch of breeder chickens imported from the Netherlands. The owner anticipated that, with this support, he would be able to increase his employees from 18 to 50.[468] The owner also expected that once the first batch of chickens stopped laying eggs, ASMED would provide him with more chickens; he submitted a request for this to the project, but was rejected. Unable to operate on imported eggs from Pakistan, which proved to be costly and inefficient, he had to close the hatchery arm of his poultry business in 2013.

The same year, the owner applied for an ADF loan to purchase broiler chicks and feed for the purpose of reselling the chicks in Herat's local market. He could sustain operations for another year but had to entirely shut down the business in 2014 for a variety of reasons, including reduced demand as a result of political uncertainty and fierce competition from Pakistani imports. To repay the ADF loan, the owner had to sell some of his property.

The owner's next investment plan was to purchase chickens from Herat markets, then sort and package them for sale in Kabul, where he believed the demand would be higher. While this shows the resiliency of some entrepreneurs, it is also an indication that easy access to free or subsidized financial support may create businesses that are not feasible in the long run.[469]

institutions with unclear ownership and management mechanisms could have serious implications later. Additionally, while the main objective for creating these financial institutions was to provide alternative financing sources to firms not served by commercial banks, they remained concentrated in urban areas serving larger businesses. As was the case with the microfinance experience, financial institutions could not afford to effectively administer loans to and ensure repayment from a large number of smaller and rural enterprises with limited collateral in uncertain environments.

Financial institutions such as ARFC and ADF continue to be dependent on donor assistance due to operational sustainability challenges. ADF was intended to become an independent financial institution by early 2018, the year in which its supporting project, ACE II, was scheduled to end. However, in the second half of 2017, USAID reported that "political uncertainty about the future of the ADF, given MAIL and [the government of Afghanistan's] determination to re-launch an Agricultural Credit Bank, has diverted High Council attention from its responsibilities to manage and to oversee the ADF, resulting in insufficient guidance and supervision." Furthermore, this organizational uncertainty also delayed the management transition intended to "reinvigorate ADF" and distracted the High Council from focusing on issues that were key to the sustainability of ADF.[470]

Similarly, after 10 years of operation and multiple restructuring efforts, ARFC is exploring options to merge with another company because it cannot operate independently. Other institutions such as AGF that mainly rely on their own revenue and have to ensure they remain profitable, continue to limit themselves to maintaining only a small portfolio of borrowers, a prudent choice given the volatile and unpredictable market conditions.

While the provision of direct loans encouraged some U.S. companies to invest in Afghanistan, in some cases insufficient onsite monitoring and overreliance on information provided by borrowers led to nonpayment of loans and failed investments.

While the provision of direct loans encouraged some U.S. companies to invest in Afghanistan, in some cases insufficient onsite monitoring and overreliance on information provided by borrowers led to nonpayment of loans and failed investments. The U.S. government also complemented its direct loans with the provision of loan guarantee schemes, which are viewed by international financial institutions as an important additional method to encourage investment in developing countries. However, USAID's long-term loan guarantees to four financial institutions in Afghanistan have not yet resulted in increased lending to small and medium enterprises.

More importantly, U.S. government programs to strengthen the private sector highlighted an apparent paradox. While constraints to financing were one of the most pressing problems mentioned by firms in all major surveys, there seemed to be a low demand for loans, despite high rates of participation in project-supported matchmaking events. There was less interest in actually applying for loans, as was evidenced by the low number of applications submitted. As discussed in chapter 8, this low loan application rate was partly because some firms or entrepreneurs had grown accustomed to receiving grants or "free money," with no requirement for repayment and minimum accountability and legal repercussions. Attempts by financial institutions such as ADF to incentivize borrowers by offering grants in return for a loan not only exacerbated that culture of dependency, but also may have made it more difficult for other financial institutions to lend. On the one hand, businesses were given free capital; on the other hand, some of the same businesses were encouraged to apply for a loan by USAID projects that were supporting financial institutions.

World Bank photo by Abbas Farzami

CHAPTER 6

PROMOTING INVESTMENT

The U.S. government saw fostering private foreign and domestic investment as the cornerstone of both economic growth and private sector development, especially in a developing transitional economy with limited state resources and a need for increased productivity. USAID's 2002 Afghanistan Recovery and Reconstruction Strategy acknowledged this, noting that "trade and investment [are] drivers of sustainable economic growth."[471] The strategy's main intent was to create a desirable investment climate through physical and institutional infrastructure and legal frameworks, in addition to creation of an investment support institution; clarification of property rights; and privatization of state-owned enterprises.

The U.S. government additionally sought to promote investment through a variety of formal and informal means, including a number of USAID projects, DOD's TFBSO, and other ad hoc efforts. Most economic growth and agriculture projects sponsored investment "road shows" and business matchmaking events to establish direct contact between Afghan and U.S. or other international companies. Encouraging investment by Afghanistan's neighbors was part of the push for regional integration. While there were some achievements, investment failed to sustain itself due to the lack of success of some of the means, but more fundamentally, because ongoing insecurity and uncertainty made Afghanistan an unattractive place to invest.

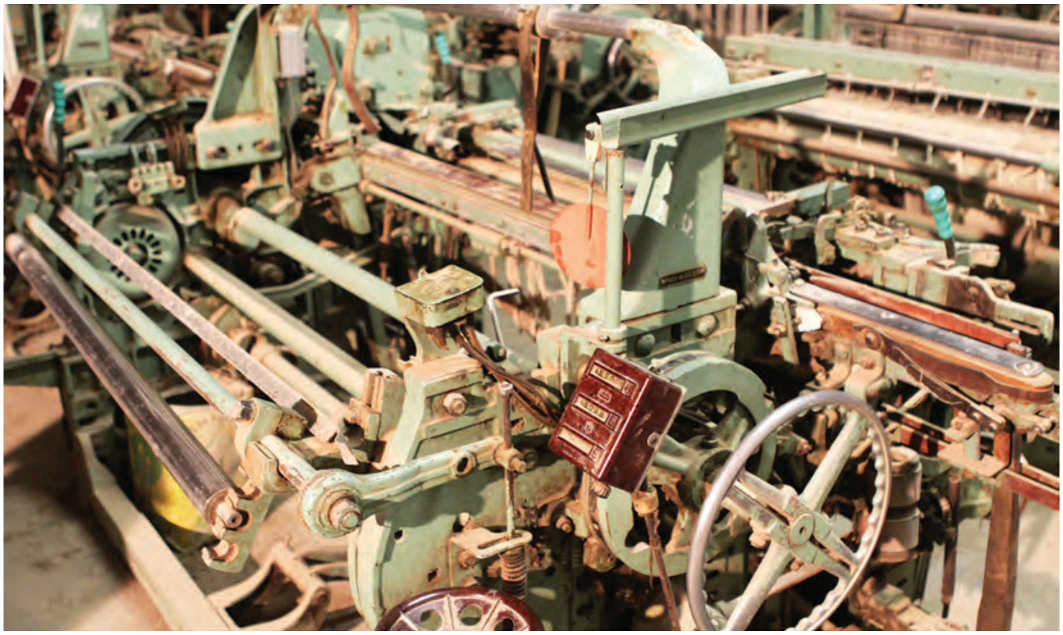
PRIVATIZATION AND PROPERTY RIGHTS

One of the most important, early initiatives of U.S. support to private sector development was the privatization or liquidation of the majority of the 65 Afghan SOEs, which were considered moribund and inefficient. Assuming that enterprises owned by the state would become more productive if owned and operated by private companies that were subject to competition, the privatization of these SOEs was seen as a means to promote private investment, especially from foreign investors willing to enter the Afghan market. Privatization was also envisioned as generating revenue for the government and, at the same time, as a means to limit opportunities for corrupt activities by government officials and well-connected business owners.[472] With all of these factors in mind, DFID, GIZ, and USAID launched privatization-focused programs in Afghanistan early in the reconstruction period.[473]

Privatization was one of the two primary goals of the USAID Land Titling and Economic Restructuring in Afghanistan program launched in 2004.[474] Firms and entrepreneurs consistently reported the availability of titled land as one of the most serious constraints to economic activity. Privatization of the SOEs was not, however, on many Afghans' list of urgent priorities. The LTERA program consisted of a group of advisors from Emerging Markets Group, housed within the MOF and several other Afghan government institutions.[475] Because the majority of the SOEs were degraded due to more than two decades of conflict, neglect, and plunder, many state assets were underutilized; LTERA sought to have the Afghan government sell these assets to the private sector for industrial and commercial purposes. As the SOEs were historically one of the few sources of employment in the formal sector, the program was also tasked with developing a "social safety net program" to ease the transition to private sector or other employment for the more than 14,000 SOE personnel (55 percent of the estimated 25,406 total employees) who were to be laid off during the process. LTERA reported that 1,380 former employees received a total of $1.7 million in severance payments.[476]

Disposal of the SOEs faced a number of challenges, starting with establishing rightful ownership, which was far from straightforward due to the often-conflicting ownership deeds, many of dubious legitimacy, which had been issued by successive governments. Because in many cases the most valuable component of the SOEs' assets was land, it was also necessary to implement land titling programs to formalize property rights and validate land records for settlements. While these two issues were rightly recognized as linked, the rush to privatization often happened before land ownership was clarified. And, because of the complex ownership issues, questions arose as to how the assets should be valued.

The government of Afghanistan was officially committed to privatization; however, because the process was controversial and political support was



Machinery at Herat Textile Company in Herat in May 2011. (USAID Afghanistan photo)

minimal, progress was slow.[477] In 2005, the Afghan government finally adopted a privatization program, but its single-page guiding document lacked the needed details.[478] That same year, the cabinet approved the amendment of the existing SOE law granting the MOF authority to divest.[479] This was done in advance of the election of the parliament, whose members' interests were expected to complicate any reforms. After convening in early 2006, the parliament further slowed the process by conducting drawn-out reviews of amendments to the enabling laws, including an additional clause stipulating that members would have to approve any proposals to liquidate SOEs.[480]

USAID reported a few success stories from the privatization program. For example, the old headquarters of the Industrial Development Bank was sold to a company that imported computer hardware and software and employed more than twice the number of people who had been employed by the bank. The program completion report also noted that the assets from the Power Construction Enterprise were transferred to the national electric company, Da Afghanistan Brishna Sherkat, which was subsequently corporatized and regarded as one of the successes in restructuring government institutions.[481]

While all but nine of the 65 SOEs that existed in 2002 were eventually privatized or liquidated, much of the liquidation of publicly owned assets consisted of selling the land and assets, often to individuals with connections to government officials.[482] The fact that many formerly productive assets were liquidated and land was sold for nonindustrial purposes exacerbated the sentiment in the population that the free market economy as being practiced in Afghanistan

SELL-OFF OF GHORI CEMENT

For many Afghans, the disposition of the Ghori cement factory in Pul-e Khumri in northern Afghanistan was emblematic of much that went wrong with post-2001 private sector development: degradation of formerly productive state assets, backroom deals among an inner circle of officials, failed promises of the extractives sector, and opportunities lost to rival Pakistan.

The original Ghori cement factory was built in 1962. During the 1980s, a second plant was partially built alongside it, although never completed due to ongoing conflict. In addition to producing cement, the complex included mines that produced the coal used to power the kilns. Degraded, but still partially functioning in the years after 2001, the factory was on the list of 65 SOEs to be disposed of.

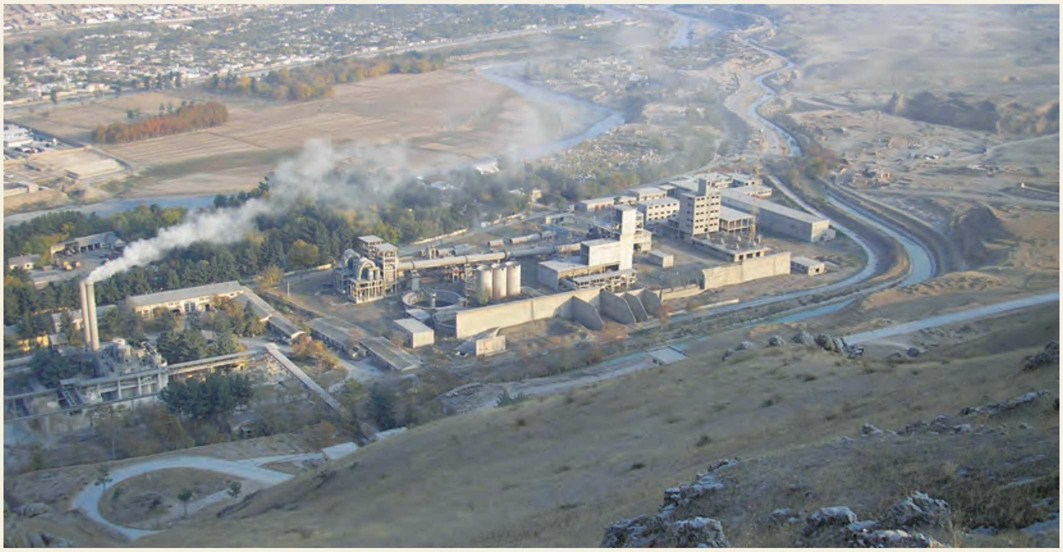
In 2005, at the request of the Afghan government, USTDA provided a grant to MOMP to fund a feasibility study for Afghanistan's cement sector. The study forecast that, with ongoing and planned reconstruction projects, the consumption of cement would rise by an average annual rate of 5.8 percent between 2005 and 2020.[483] With Afghanistan having no significant cement production of its own, the study produced a strategy that focused on the revitalization of the Ghori plant.

Ghori was selected for revitalization because other pre-1978 plants to the south of the 11,000 foot high Salang Pass did not have sufficient proximity to raw materials (limestone) and fuel (coal), and were also considered vulnerable to competition from Pakistan and Iran, which were in the process of aggressively expanding their own production capacity. Moreover, in addition to the 800 workers in Pul-e Khumri with cement plant experience, the population of the area had relatively greater familiarity with industrial processes due to the location of several factories there before 1978.[484]

During and after the factory's privatization in 2006, a number of irregularities were identified, including: (1) provisions in the tender document that favored the Afghan Investment Company (AIC) associated with Mahmoud Karzai and Sherkhan Farnood, the brother of President Karzai and the head of Kabul Bank, respectively; (2) lack of any stipulated penalties for noncompliance with contract terms; (3) intervention by Mahmoud Karzai and the brother of former Vice President Marshall Fahim who had allied to win the contract; and (4) intervention by President Karzai. At least one former MOMP official claimed MOMP awarded the contract to AIC two days in advance of issuing the government's tender. According to the NGO Integrity Watch Afghanistan, "Some of the favors granted to AIC border on flagrant violation of even the most basic standards." There were also allegations that the previous minister of MOMP was fired from his job because he raised questions about the AIC bid.[485]

Since its privatization, the factory has not delivered on promises to turn around the former SOE, modernize the factory and the affiliated coal mines (which are now unable to provide enough coal to run the factory), complete the second plant and build a third plant and new power station, and create thousands of local jobs with significant amenities and benefits.[486]

Mahmoud Karzai sold his shares in 2011, supposedly to repay loans to the defunct Kabul Bank. He blames the government for not attracting foreign investors, for not taking action



Ghori cement factory in Pul-e Khumri in September 2005. (Box International Consulting photo)

against Pakistan for dumping subsidized cement in the Afghan market and obstructing the transit of needed equipment, and for actively trying to sabotage the private sector. For their part, government officials claim that Karzai and other investors lost interest and moved their resources to invest in Dubai real estate. In February 2017, the government canceled the contract with the operators and announced plans for international tender due to allegations of unauthorized changes in ownership and $3.5 million in unpaid royalty taxes, allegations which are, in turn, claimed to be politically motivated.[487]

As the only significant cement factory in Afghanistan, Ghori should have been well placed to capitalize on the huge demand for cement, which can be produced almost completely with local inputs, during the boom years of reconstruction. Yet, between 2002 and 2012, Afghanistan imported on average four million tons of cement per year, most of which came from Pakistan. At its peak in 2011 before the drawdown, Afghanistan was importing $243.63 million in cement from Pakistan alone.[488]

According to the USTDA-funded study's development impact analysis, the benefits of building the cement manufacturing sector would be "both broad and profound" and "difficult to overestimate." Direct and indirect impacts would be increased supply of cement and that "Afghanistan will no longer be subject to complete domination of its cement market by international suppliers," improved quality, more stable pricing, impetus for the domestic coal sector, job creation and skills development, both in the manufacturing sector as well as in management, and new downstream commerce and industries, especially in construction, transport, and local business.[489]

According to the lead consultant:

> If you were in Afghanistan, you could see that building materials were going to be a highly desirable commodity. You could see this coming. The construction materials sector should have been huge. This was a tremendous opportunity, because skills would be required to sustain operations, including downstream and ready-mix. Trades and skills would then follow from developing the cement industry. There would be great employment creation; this stuff is extremely labor intensive. Cement was low-hanging fruit. That was an opportunity that was lost and never should have been wasted. The lift would have been endless.[490]

only benefited well-connected individuals. Therefore, privatization not only fell short on achieving the goals of reallocating whatever productive assets existed within the SOEs and generating the anticipated investment in productive ventures, but also fostered corruption through resource capture, rather than limiting possibilities for corruption by government officials. According to a later analysis, "The privatization of SOEs came before any major business environment reform. . . . [After privatization,] the enterprises still did not generate activity and most were liquidated."[491]

The LTERA final evaluation acknowledged the process had gone more slowly than expected, and certain issues, including proper valuation of the SOEs' land and clarification of land titles, had to be resolved in order for privatization to proceed in a way that benefited the state.[492] A 2009 USAID internal audit drew similar conclusions about the protracted nature of the process—that it was due, in part, to the lack of clarity on valuation of assets and legal status. It also appeared the government was focused primarily on maximizing the revenue it would receive from privatization, which meant other objectives, such as creating working industrial assets that would generate employment, were secondary. Additionally, the audit noted the lack of capacity within the MOF's State Owned Enterprise Department, which was responsible for all aspects of the process, and drew the conclusion that "USAID investment in privatization was not always successful."[493] The follow-on LARA project concentrated only on land reform, and did not continue LTERA's work on privatization.[494]

BUILDING AND SUPPORTING INSTITUTIONS

The U.S. government and other donor nations provided support for the creation and reform of various agencies and institutions which were intended to play a role in encouraging domestic and international investment.

In September 2003, the Afghan government established the Afghanistan Investment Support Agency to help facilitate foreign investment and business. This was done with assistance from German GIZ, which provided support for creating the institution, writing procedures, completing construction, providing equipment, and fronting many of the initial costs for creation and maintenance.[495] Previous bureaucratic processes for investment were cumbersome and subject to rent-seeking by officials, so AISA was presented as a "one-stop shop" to assist would-be investors in securing necessary licenses and permits and provide information on opportunities, standards and regulations, and acquisition and leasing of land.[496] As an additional motivation for firms to register with AISA, U.S. and other international agencies made registration a requirement to be eligible to bid on contracts. In addition to its central office in Kabul, AISA maintained regional offices in five key provinces. Between 2003 and

2005, AISA reported approximately $1.3 billion in investments.[497] However, this figure is taken from the original registration form and only some portion of these intended investments actually occurred; AISA had no capacity to monitor and track those intended investments to see which had been fulfilled.[498]

During its first several years, AISA was hailed as a great success for helping firms register, although that was apart from its intended mission of facilitating and encouraging investment, especially from overseas. Later, allegations of corruption within the agency became widespread, ultimately leading to the July 2012 mass resignation of a group of officials in protest.[499] In recent years, AISA was revitalized, and in April 2016 it was named the best investment promotion agency in Central Asia at the Annual Investment Meeting sponsored by the UAE.[500] Despite this recognition, however, the same month, after a protracted discussion, AISA was folded into the Ministry of Commerce and Industry.[501]

With USAID funding, the Center for International Private Enterprise joined with the Afghan-American Chamber of Commerce to try to create a truly independent Chamber of Commerce, which would be able to support itself by selling services to its members and would encourage investment. In 2001, there were two chambers, each with its own constituency of traders or producers, with diverging interests and the inability to speak with one voice. The highly bureaucratic pre-1978 Afghanistan Chamber of Commerce and Industry (ACCI) was linked to MOCI, and had little private sector involvement. CIPE tried to push the moribund ACCI to play a more proactive role in supporting and advocating for the private sector as a chamber would do in the United States. At the same time, however, German GIZ was providing financial and technical support to the state-affiliated chamber, and U.S. and German views diverged on what a chamber should look like. The resulting uncertainty about who would represent the interests of the private sector detracted from the effectiveness of the chamber.[502]

The Virginia-based Afghan-American Chamber of Commerce was founded in 2002 as a Section 501(c)(3) organization with the mission of "improving and strengthening business relationships and trade among Afghan- and American-owned businesses" and promoting "the ideals of a market economy in Afghanistan free from corruption in which U.S., Afghan, and other businesses can operate successfully."[503] Originally partly funded by USAID through CIPE, its main activity has been organizing an annual matchmaking conference in Washington, but it has also sponsored or participated in trade shows and conferences in Kabul, Dubai, and elsewhere.

The UK's DFID provided funding for the Afghanistan Investment Climate Facility (Harakat), whose mission was to "remove and reduce barriers to doing business by providing grant funds to government, civil society, and the private sector in order to increase or create opportunities for investment in Afghanistan." Harakat provided guidance and funding for practical research across a range of areas, including business development services and government regulations. It also served as a link between Afghanistan's business community, Afghan government institutions, and international donors. At the end of 2015, Harakat was renamed the Harakat Investment Climate Organization and launched a new strategy intended to take it through the next seven years.[504]

INDUSTRIAL PARKS

Industrial parks were intended to promote investment by removing a number of constraints facing Afghan businesses, including the lack of reliable and cheap power, unstable land tenure, and physical insecurity. The parks were also touted by USAID's AEGP, the World Bank, and others as a way of stimulating domestic and foreign direct investment. Technical assistance provided by AEGP resident advisors helped construct amendments to Afghanistan's Investment Law, which "provided further incentives for the industrial park concept." These incentives included: (1) depreciation of machinery by 25 percent per year, (2) the ability to carry losses forward, and (3) a two-year period for taking profits out of Afghanistan.[505] The latter incentive was intended to reassure firms they would be protected from potential Afghan government attempts to appropriate their profits.

Starting in 2003, USAID funded the development of three industrial parks (Bagrami near Kabul, Gorimar in Balkh Province, and Shorandam in Kandahar) which were intended to be transferred to AISA oversight. The $10 million initial contract with the firm Technologists Inc. was increased to $21.1 million when power generation and other infrastructure were added to the scope.[506] In 2005, USAID also funded an industrial park in Helmand Province, which was taken over by DFID two years later as part of its overall assistance to Helmand, although support for the park was terminated in 2013. The World Bank also worked with AISA in 2005 to form two industrial parks, in Kabul and Jalalabad, although this support was terminated in 2011. The PRTs, notably the U.S.-led PRT in Jalalabad, also contributed to development of industrial parks. As of mid-2017, there were nine operational industrial parks in Afghanistan, including several pre-2001 state-owned industrial properties, with an additional ten under construction and six planned.[507]

The results from the parks have been mixed. A 2013 assessment report for LARA noted that "of all the parks funded and sought to be developed in Afghanistan, the Bagrami industrial park in Kabul is ultimately the sole going industrial concern."[508] A 2012 assessment by the Adam Smith Institute documented the sorry state of the other industrial parks, noting inactivity, deterioration, land grabbing by powerholders, and some parks that existed in name only.[509] Plots have remained empty or have been purchased by speculators. Work on the

Main entrance to Shorandam Industrial Park in Kandahar in June 2014. (SIGAR photo)

physical infrastructure remains incomplete, as do, critically, hookups to public power. Further, the inability to deter speculators from buying up plots that would be used for some other activity and unavailable for active businesses was another shortcoming of the parks.[510]

Plots have remained empty or have been purchased by speculators. Work on the physical infrastructure remains incomplete, as do, critically, hookups to public power.

The parks were insufficient to attract investment due to a number of factors, some of them institutional. USAID supported the 2007 formation of AISA's Industrial Parks Development Department (IPDD) in order to give AISA the capacity to manage the parks, as well as to provide justification for taking the management away from the ineffective MOCI. Yet, "the establishment of a functionally separate government structure still failed to address the real issues developing sufficient park [capacity] and resulted in years of stagnation within the sector."[511] The main problem was the competition between MOCI and AISA's IPDD over which agency had authority. Donors' attempts to reconcile or merge these two institutions met with little success. As one report noted, "A palpable lack of will within . . . the Afghan government to change the status quo in how [the] government handled industrial park development resulted in inaction that has been detrimental to both the sector and Afghan manufacturers."[512] In November 2012, the cabinet decided to transfer all MOCI industrial assets to AISA. Despite an ambitious two-month transfer period, the mechanisms remained "under process" for years. In the meantime, MOCI Industrial Parks Department staff continued to allocate plots of land for future parks, which ended up not furthering development aims but rather went to speculators or for other uses.[513]

Another institutional factor that contributed to the parks' lower than expected performance was the lack of laws and contract and regulatory mechanisms to ensure agreements were enforced, and that individual owners weren't vulnerable when other owners decamped or failed to meet their obligations. In the older parks, some of the land parcels were occupied by squatters or were under ownership dispute, as land title documents given out by successive governments were inaccurate, invalid, or outright fraudulent, a widespread and pervasive problem in post-2001 Afghanistan. Obtaining titles and fulfilling other legal requirements also required a significant amount of business owners' time, which didn't allow a quick response to time-sensitive investment opportunities.[514] A 2015 report attributed the poor functioning to "the lack of business prospects in the general economy and corruption," and noted that independent management of each park by its own beneficiaries would "place the interest of beneficiaries above all else and avoid corruption and bureaucracy that comes from government maintenance."[515]

In theory, the plots were distributed free or sold at a nominal price in order to encourage investment. However, would-be users faced significant additional costs. Power was the most common problem, despite being a primary reason for building industrial parks in the first place. In some cases, the delay or ultimate lack of a connection to central power required the use of expensive diesel generators, the shared costs of which were excessive for most firms and which would have made their products less competitive with imports. Also, the plots were simply pieces of land, and companies were often not in a position to construct the buildings required to run an enterprise.[516] Moreover, there was no viable mechanism for adequately covering maintenance on common facilities and equipment, especially over the long term. This was partly due to a lack of trust among business owners that discouraged putting money into a fund for the future, and partly because owners were operating on thin margins and could not afford it.[517]

Unlike in the booming residential and commercial property sectors, private sector developers were absent from the industrial property sector due to the perceived poor profit margins and the costs and headaches of developing and maintaining facilities. To encourage the involvement of the private sector, the World Bank designed its park in Jalalabad as a public-private partnership which would be self-sustaining. To justify the use of public money and to guard against land speculation, the World Bank proposed that prospective purchasers document their commitment to create a certain number of jobs and procure goods and services locally, commitments that would be monitored after purchase.[518] Yet, according to one analysis of the Jalalabad park, "The attention has not resulted in an established, economically viable park."[519]

Clearly, the industrial parks have not reached the level of functionality that was originally planned. In addition, the question remains as to whether the parks could have addressed the fundamental issues of Afghan competitiveness if they had succeeded. However, even in cities where the current parks are mostly empty, for example, Mazar-e Sharif, there is enthusiasm for developing additional ones, as they create construction activities and the potential for individuals to benefit from the sale of plots within the industrial park.

In 2015, discussions were held on the possibility of using abandoned coalition military bases as economic assets to encourage investment, similar to the industrial park model. These discussions ended, in part, because the U.S. military presence was extended beyond 2016 and the most attractive bases were no longer available for consideration.

SECTOR-FOCUSED INVESTMENT PROMOTION

The U.S. government recognized early on that a key to Afghanistan's economic growth would be adding value to historically low-value agriculture and other primary commodities such as fruit, wool, and marble. This would lead to production of value-added goods for domestic consumption and potentially for exports. Rather than using state resources as had been the case prior to 2001, the United States aimed to attract domestic and foreign investment for processing, packaging, and other elements that added value to basic commodities.

The United States chose to support certain key sectors in order to make them more attractive to potential investors by improving the enabling environment and increasing financial returns on investment in various stages of the chain. Although these sectors were not specifically included in Afghan national strategies until 2010, the U.S. government provided significant support through a variety of its agriculture and enterprise development projects. Acknowledging the significance of the agriculture sector, which provides one-quarter of GDP and employs 40 percent of the national workforce, USAID has supported the sector since 2002 by implementing 68 projects of varying scale and emphasis, worth more than $2.3 billion.[520] USAID's agriculture-led economic growth model addressed a number of related areas, including food security, agricultural productivity, market and value chain linkages, improved government services to the agriculture sector, gender issues, and water and watershed management.

USAID employed a value chain model which aimed to increase the productivity, processing, and sales of higher-value agricultural products, for example, moving from raw wool to carpets, raw cashmere to yarn, fruits to preserves, or rough marble block to finished slabs. For many of these commodities, value was being added in Pakistan, which was a missed opportunity for Afghanistan to generate income for processors and to reinforce its national brand. In the agriculture sector, USAID's projects aimed to strengthen linkages between farmers, input

A value chain is "the value-creating flow of a good from raw materials, production, commercialization, and ultimately delivery to end-users or consumers."[521]

suppliers, processors, and the Afghan government by focusing on various elements of the value chain, such as improving irrigation infrastructure, building farm to market roads, improving seed distribution, providing loan capital, and helping develop export markets.

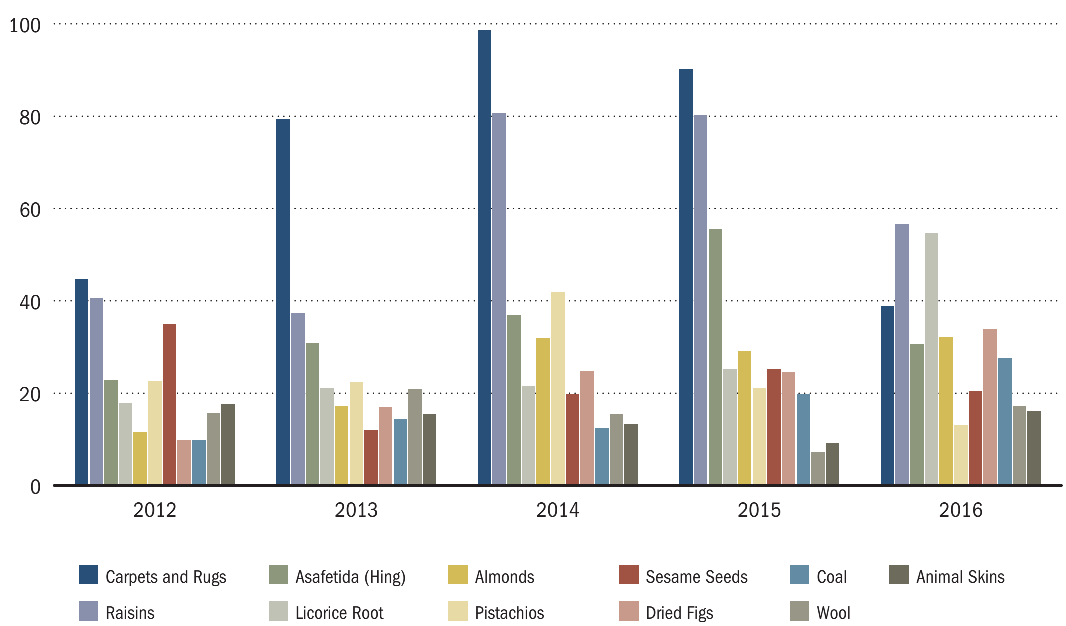
As seen in figure 7, Afghanistan's most valuable exports between 2012 and 2016 were carpets and agricultural goods.

In the production stage of an agriculture value chain, for example, USAID promoted investment in input supplies, commercial farms, orchards, and green houses. In the processing stage, the agency encouraged investment in cold storage facilities and food processing and packaging. USAID's support to agribusiness included technical and financial assistance in the form of in-kind grants for equipment, inputs, training, marketing, and market linkages.[522]

USAID's efforts to encourage investment in and expansion of agribusiness experienced some success. A 2015 assessment of USAID-supported agribusinesses, for example, showed that some businesses (59 percent) were still operational and profitable, especially medium and large enterprises with

FIGURE 7

AFGHANISTAN'S TOP EXPORTS OF SPECIFIC COMMODITIES, 2012–2016 ($ MILLIONS)



Note: Similar commodities were grouped together for the purposes of comparison. For example, wool includes fibers from both sheep and goats, and animal skin includes skins from cows, goats, qarakul, and sheep.

Source: SIGAR analysis of compiled data reported by the Central Statistics Organization, "Exports by Countries & Commodities," data for Fiscal Year 1391 to 1395 (2012–2016), accessed on March 12, 2018.

THE MARBLE SECTOR IN AFGHANISTAN

Afghanistan's significant mineral wealth includes numerous high-quality marble deposits, which have been targeted by both Afghan government and international development partners as a potential source of exports. Marble is a specialty product in which Afghanistan has an advantage in terms of the aesthetic quality of its raw product, if not its price or quantity. As noted during his presidential campaign, Ashraf Ghani saw marble as a key component of his vision of creating in Afghanistan "one of the biggest construction industries in the region."[523]

In 2016, the UN Commodity Trade Statistics Database (Comtrade) reported that Afghanistan exported $5.3 million worth of marble, all in rough block form. Most of these exports ($3 million) went to Pakistan, followed by Iran and China, at $1.3 million and $567,000, respectively. These numbers do not capture mineral smuggling or exports that circumvented customs.[524]

Getting the marble out of the ground and into the market has been a challenge. Quarrying marble is capital-intensive and requires specialized, expensive equipment, such as drills and diamond wire saws, to produce quality blocks for processing. Without this technology, many quarry operators rely on black powder explosives, which damage the stone and result in significant waste and reduction in the value of the product.[525] In addition to difficulties in extraction, the industry suffers from smuggling and border corruption, illegal mining operations, lack of facilities to produce finished marble products, and competition with lower-priced marble from Pakistan.[526]

The U.S. government supported the marble industry in Afghanistan through programs led by Commerce, USAID, and OPIC. For example, both Commerce and USAID sponsored Afghan marble industry delegations at international trade shows. USAID provided grants, specialized equipment, and technical support to marble firms. The Equity Capital Mining Group (ECM), founded in 2006 by brothers Nasim and Adam Doost, opened its $6 million Doost Marble

Worker with finished marble slabs in Herat in April 2010. (USAID Afghanistan photo)

Plant in 2011 in Herat with a $15.8 million loan from OPIC and additional support from USAID and other international donors.[527] The plant was equipped with modern machinery to process marble into slabs and tiles. While the Doost brothers produced quality marble and secured trade partnerships with other countries, they made limited profits. Poor roads and infrastructure, problems with fuel, and numerous regulatory barriers burdened the company.[528] While Doost Marble was lauded as a success, it later became defunct.[529] In June 2017, one of the brothers was indicted in the United States on a number of criminal charges related to obtaining and later defaulting on the $15.8 million OPIC loan for improving the plant, with charges including major fraud, making false statements on the loan application, and money laundering.[530]

Afghanistan has only limited facilities to process and finish marble slabs and other products. Until recently, many, if not most, Afghan mining firms exported marble blocks to Pakistan and Iran for processing. Afghanistan's domestic market for marble is satisfied by cheaper Pakistani products, some of which are re-imports of the stone from Afghan quarries. To encourage more value added within Afghanistan's borders, early in his presidency, Ashraf Ghani issued an executive order that banned the export of unprocessed minerals, requiring them to be processed within Afghanistan.[531] Although many firms had called for protectionist measures, this directive hurt business for firms without processing equipment. A 2016 change in mining laws and regulations was similarly disruptive, delaying or suspending many contracts and creating confusion over whether existing contracts and extraction rights were still valid.[532]

While the legal marble industry has struggled, illegal mining and trafficking in minerals has become a big business. Illegal mining is prevalent across Afghanistan, and the Taliban control especially lucrative marble reserves in Helmand and Badakhshan Provinces.[533] From these provinces, marble is smuggled into Pakistan, along with other contraband. Marble, like other bulky resources, including talc and coal, is smuggled by the ton on trucks, with little interference from customs or law enforcement.[534] Illegal mining operations are profitable, despite producing inferior products, because operators are able to use low-wage, unskilled labor while circumventing taxes, royalties, and costly environmental and safety regulations.[535]

Afghanistan's marble resources could potentially create jobs and drive growth, but the environment is currently not conducive to legitimate mining companies that seek to produce quality marble at competitive prices.[536] Nonetheless, China is currently negotiating trade deals for Afghan marble, among other Afghan products, as it pursues its One Belt, One Road initiative to build trade and transit infrastructure across Asia.[537]

Display of fruit juice from USAID-supported enterprise in Kabul in October 2011. (USAID photo)

20 or more employees, while the rest (41 percent), which mainly included small and micro enterprises with fewer than 20 employees, had either gone out of business or were on the brink of closing down.[538] Regardless of size, some agribusinesses, such as cold storage facilities, failed because they were "prohibitively expensive" and, due to high electricity costs, were "extremely hard to run at a profit."[539] With private investors reluctant to invest, many cold storage units were built by donors but couldn't continue to be operational, despite receiving good quality machinery and equipment.[540]

The 2015 assessment further pointed to a combination of factors that positively affected the performance of the USAID-supported agribusinesses. These factors included the existence of the enterprises prior to USAID's intervention, local demand and linkages to stable markets, and competent and experienced management. The imperfect and risky nature of Afghanistan's markets posed challenges to businesses, especially smaller players.[541] Traders continued to struggle with market access, inconsistent and unfair trade practices of neighboring countries, and the high cost of logistics and transportation.[542] Projects weren't able to address the considerable problems smaller enterprises faced with exports, including border-crossing procedures, required documentation, and inspections that caused delays and losses. However, some large firms or traders, such as those in the poultry sector, with sufficient economies of scale, were better positioned to sustain operations and be competitive.[543]

However, the 2015 assessment concluded there were many factors within USAID's control that determined the success of the agribusinesses it supported, particularly the selection of the business itself, the focused areas of intervention, carrying out vigorous feasibility studies, and the ability to deliver quality equipment to the business.[544]

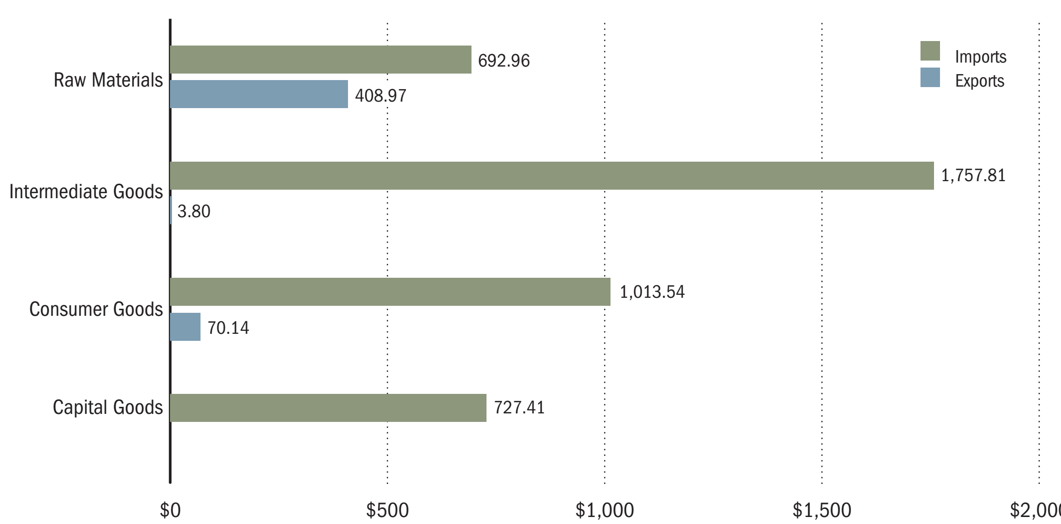
As seen in figure 8, in 2016 the majority of Afghanistan's exports were raw materials, while the majority of imports were intermediate or consumer goods. This suggests Afghanistan still lacked the ability to turn raw materials into goods ready for purchase.

The sector-focused approach was also part USAID's non-agricultural programs such as ASMED, which incorporated a value chain model as early as 2007. ASMED supported the Afghan government in identifying and selecting six sectors—construction, marble, carpets, gemstones, agribusiness, and handicrafts—and developed value chain strategies for each sector.[545] ASMED's value chain and sector-focused approach was short-lived, however. In 2010, as part of the increased emphasis on COIN, the project expanded to ISAF-designated key terrain districts, areas that suffered from insecurity and weak physical and economic infrastructure and were therefore challenging places for enterprises to thrive.[546] Partly as a result of this shift, ASMED supported enterprises that were not necessarily part of any specific sector or value chain.[547]

While the value chain approach for key sector development has been perceived as effective by USAID and international donors in other settings, in Afghanistan it

FIGURE 8

AFGHANISTAN IMPORTS AND EXPORTS BY TYPE, 2016 ($ THOUSANDS)



Source: SIGAR analysis of data from UN Comtrade, "Afghanistan Exports and Imports by Type (Value and Product Share)," data for 2016, World Integrated Trade Solutions, accessed on March 12, 2018.

Dried fruit and nuts in Kabul bazaar in April 2012. (Mariam Jalalzada photo)

has had mixed success. Evaluation reports of some agriculture projects criticized USAID's value chain approach, noting that instead of an integrated intervention, the value chain activities remained "a combination of infrastructure projects, cash for work, and agricultural projects," failing to develop the value chains beyond the farm level or address poor linkages between various value chain elements, such as farmers, processors, and buyers.[548]

Similarly, ASMED's approach to the development of key sectors was also criticized by the project's final evaluation report, noting that the sector-led approach was implemented "rather casually," with activities informally assumed by existing staff who, with the exception of those working in the marble sector, had no particular sector expertise.[549]

Other U.S. government bodies also adopted variations on a sector-focused approach to encourage investment, including DOD's TFBSO, which promoted investment in the energy and minerals sectors by conducting geological assessments and providing technical and financial assistance to relevant technical Afghan ministries and private companies. (For more details, see Extractives in Afghanistan, page 114.)

The U.S. Commerce Department's Afghanistan Investment and Reconstruction Task Force also adopted a sector-focused model to encourage investment in the priority sectors of Afghanistan: dried fruits and nuts, carpets, and mining, with particular emphasis on marble and gemstones. AIRTF created

EXTRACTIVES IN AFGHANISTAN

Often touted as Afghanistan's greatest economic hope for the future, minerals offer an industry that could be more valuable than opium poppy. Many hope the extractives sector can create jobs, replace foreign aid as a revenue source for the government, and build needed physical infrastructure.

However, the sector has been slow to take off. Reasons for this include the precedence of other reconstruction priorities, the continued absence of required Afghan institutions and laws, poor transportation infrastructure, lack of access to electricity, and overall insecurity and uncertainty. Interest in developing the sector has come in waves. The momentum to tender and award major contracts, especially to foreign firms, was often followed by minimal attention and, in the case of signed contracts, a lack of follow-through to begin exploration and extraction. Foreign investments, in particular, have lagged due to the uncertainty created by a weak regulatory and legal environment and, since 2015, persistently low international commodity prices.

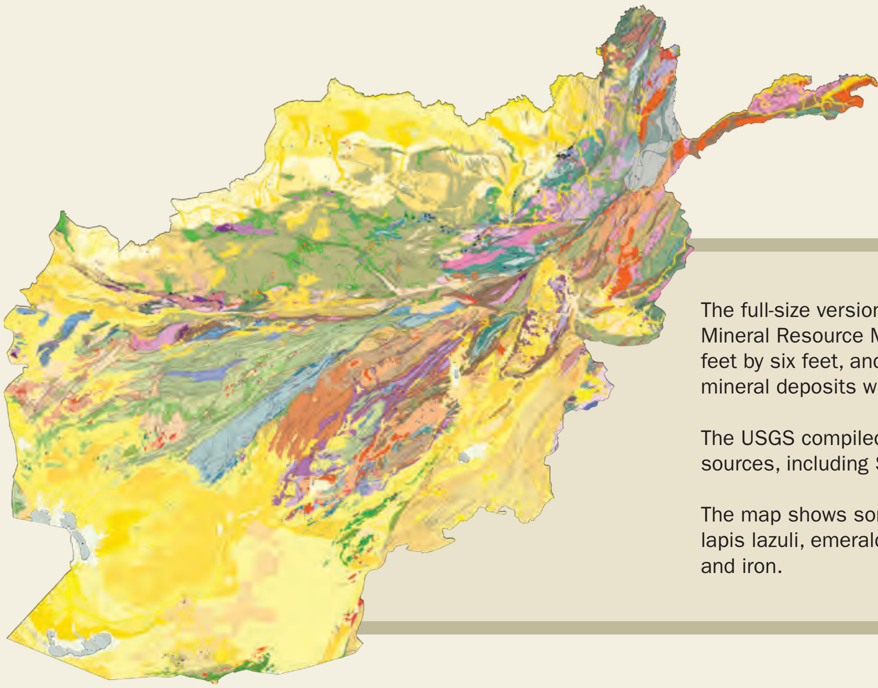
Afghanistan's mineral deposits—most notably copper, iron, gold, chromite, lithium, talc, marble, and semi-precious stones, including lapis lazuli—were initially surveyed by Soviet geologists during the 1970s. Mining has been a part of Afghanistan's development strategies since the 2002 National Development Framework, but was largely overshadowed by other priorities, specifically agriculture and critical infrastructure, including water, energy, and telecommunications. The NDF included mining with the energy and telecommunications development sub-programs under "Physical Reconstruction and Natural Resources" due to their similar regulatory requirements, but mining itself was not one of the six most urgent priority programs.[550] While commodities such as cement and energy, including coal and natural gas, were in great demand during the early reconstruction period, mining for export was considered an aspiration for the future.

The need to establish a regulatory environment for minerals was affirmed in subsequent national development strategies as a critical first step in attracting private investment to the sector.[551] Work to establish this environment, however, was slow. The Afghan government did not adopt the first minerals law until 2005, and several later iterations attempted to resolve ambiguity and add safeguards against fraud and corruption. The most recent law, enacted in 2014, still lacks supporting regulations and implementation plans, in large part because a number of the conditions of the law are being contested by interested parties.[552]

Although the U.S. Geological Survey was tasked in 2002 with identifying natural resources and their potential contribution to Afghanistan reconstruction, it did not begin work within Afghanistan until 2004.[553] The surviving Soviet surveys, recovered in 2004 by USGS and returning Afghan Geological Survey employees, provided a basis for aerial surveys conducted that year with support from USAID. Additional surveys were completed in 2006 (see figure 9).[554] Yet, these surveys did not capture the wider attention of the U.S. or Afghan governments until TFBSO began its minerals program in 2009.[555] This was, in part, because the United States did not yet consider the conditions right for mining. According to an advisor at MOMP in 2004, "When I attempted to attract USAID funding for the Afghan mining sector to complement World Bank and ADB funding, I was told by the USAID manager that mining was not on the U.S. agenda. The U.S. Embassy was more interested in TAPI. No one at USAID understood the mining issues; no one in the U.S. government was demonstrably aware of or interested in assisting the mining sector."[556]

FIGURE 9

MAPPING AFGHAN MINERALS



The full-size version of the U.S. Geological Survey's "Geologic and Mineral Resource Map of Afghanistan" measures more than four feet by six feet, and displays the locations of nearly 150 types of mineral deposits with swathes of color.

The USGS compiled the map from its own work and from other sources, including Soviet General Staff data sheets.

The map shows some of the more significant minerals, including lapis lazuli, emeralds, limestone, marble, granite, coal, copper, and iron.

Source: USGS, "Geologic and Mineral Resource Map of Afghanistan," USGS website, accessed on April 4, 2018.

In 2010, TFBSO estimated the potential value of the country's mineral deposits at $908 billion, a figure which was rounded upward to $1 trillion and widely cited.[557] Also in 2010, Afghanistan joined the Extractive Industries Transparency Initiative as a candidate (For more details, see Afghanistan and the Extractive Industries Transparency Initiative, page 76.) The next year, USGS and TFBSO completed an extensive survey of Afghanistan's mineral deposits using sophisticated hyperspectral technology, making Afghanistan the only country in the world that has been completely mapped geologically.[558]

The first major mining sites targeted by the Afghan government and its international supporters were the Mes Aynak copper deposits south of Kabul and the Hajigak iron ore deposits in Bamyan Province. With support from the World Bank, Mes Aynak was tendered in 2007 and awarded to the Metallurgical Group Corporation of China in 2008. Extraction has been delayed by insecurity, but also by low international commodity prices, the complexity of planning operations, debate over how to document and preserve a Buddhist archaeological site situated above the copper deposits, and the need to relocate local communities. The contract contains unusually high royalty payments, as well as extensive commitments by MCC for construction of supporting infrastructure, including roads, power plants, and training institutions. Some observers feel MCC is content to wait to begin extraction, with the intention to eventually renegotiate the contract.[559] The Hajigak iron mine tender was released in 2010, but, although two Indian companies were selected the following year, an agreement remains elusive due, in part, to regional politics.[560]

At Afghanistan International Marble Conference in Herat in May 2011. (USAID photo)

The Afghan government's 2012 Towards Self-Reliance strategy estimated that by 2020, minerals and hydrocarbons would contribute $650 million annually to government revenue, and that by 2025, that number would rise to $1.7 billion annually.[561] These lofty projections, which did not foresee an imminent drop in international mineral prices and assumed a more permissive security environment, were factored into IMF and Afghan government forecasts for long-term economic growth, which failed to materialize. Mining revenues in 2016 were reported as $20 million, which accounted for only 0.3 percent of the government of Afghanistan's $6.5 billion national budget that year.[562]

The current environment for private investment in extractives remains unpromising due to a combination of several factors: limited Afghan government capacity, involvement of corrupt powerholders, low world commodity prices, political instability, and insecurity.

In 2015 and 2016, two SIGAR audits found the Ministry of Mines and Petroleum still lacked the capacity to tender, award, and manage contracts for resource exploitation.[563] A recent Afghanistan Research and Evaluation Unit (AREU) analysis of Afghanistan's mining governance was also critical of the slow pace of reforms and the limited improvements in the regulatory environment, noting MOMP had "lost most of its capacity that it had acquired in the last 10 years."[564] The report also highlighted how the sector had increasingly become attractive to "political heavyweights and insurgents" in recent years.[565]

This low ministerial capacity remains, despite U.S. assistance totaling about $488 million.[566] For example, TFBSO's $51 million minerals support program assisted MOMP with the demarcation, prioritization, and marketing of mineral areas of interest and the provision of technical, legal, and financial advice to establish international criteria for tender, bid evaluations, and contract award.[567] While TFBSO's work, especially in collaboration with the USGS, is still regarded favorably within the MOMP, a recent audit by SIGAR found that these successes were not transferred to a following project by USAID, and that the four major mining tenders shepherded under the program have yet to be awarded.[568]

Similarly, USAID's only mining-specific program, the $38.7 million 2013–2017 Mining Investment and Development for Afghanistan Sustainability project, focused on helping the Afghan government build the capacity to conduct geological exploration and manage mines throughout their lifecycle, develop a "pipeline" of minerals projects, reform the legal and regulatory environment, and provide training to strengthen the private sector.[569] According to a final evaluation of the program, MIDAS was able to provide some useful training and legal assistance to MOMP. However, only a few of the project objectives were achieved because of changing priorities and personnel at MOMP, to which MIDAS was not able to adapt, and the Afghan government's inability to pass a "workable" replacement of the 2014 minerals law.[570]

Optimistic projections by Afghan and U.S. governments consistently underestimated the time and costs, both in terms of capital and political will, required to get the mining industry going, while overestimating revenue projections despite low international demand. The hope is that private sector investment will bring money and infrastructure, but investment might not come given low commodity prices and the high risk presented in Afghanistan. International mining companies are unwilling to commit risk capital in Afghanistan when it is more efficient and profitable to mine elsewhere.[571]

Optimism was further tempered by the limited capacity of the Afghan government to manage and control the mining areas and the entrenched corruption in the sector. Illegal mining is conducted by local residents and smugglers, insurgents and other armed groups, and even some parliamentarians, who use their political connections to obtain and abuse mining contracts.[572] The Afghan government estimates it loses $300 million in revenues annually from illegal mining.[573] More alarmingly, reports have indicated that, after drugs, minerals are the Taliban's second largest source of income.[574]

A 2016 report by corruption watchdog Global Witness warns that the "battle for the lapis mines [in Badakhshan] is set to intensify and further destabilize the country, as well as fund extremism."[575] Although Afghanistan banned the mining of lapis lazuli in 2015, exploitation continues, with local police and politicians benefiting from illegal extraction and export. The report proposed that Afghanistan's lapis lazuli be categorized as a "conflict mineral," and criticized the Afghan government and its international partners for not making the protection of minerals their "first-order priority."[576]

President Ghani included MOMP as one of the top three corrupt ministries in his 2016 anticorruption strategy priority list.[577] In November 2016, Ghani ordered two substantial changes to minerals contracting procedures, requiring contracts to be routed through the presidential office and shifting tendering duties to the National Procurement Authority instead of MOMP.[578] By adding a new review and approval process, these anticorruption measures have created confusion and further delays in an already slow process.[579]

In September 2017, MOMP released a Roadmap for Reform that identified major weaknesses in the extractives sector and presented a framework to address them.[580] The U.S. government is currently supporting the ministry's reform and a "market transition" for the sector through interagency agreements with Commerce's Commercial Law Development Program and the USGS.[581]

"excellence centers" for the marble and carpet industries, in coordination with the MOMP and the Export Promotion Agency of Afghanistan, respectively. (For more details, see Marble Sector in Afghanistan, page 109.) The main objective of these centers was to build human capital and promote domestic production and exports in these sectors through training programs and facilitating the participation of businesses at international trade fairs.[582]

During the 2009 surge period, AIRTF's engagement expanded to include activities to enhance bilateral commercial cooperation through capacity building, business matchmaking, trade fairs for Afghan products, trade missions for U.S. and Afghan businesses in both countries, and other forms of business promotion.[583]

AIRTF also created business hubs in four provinces, collocated with the offices of the Afghanistan Chamber of Commerce and Industry. These hubs were created to provide multimedia services, including video-teleconferencing, and training to local chamber of commerce members to create opportunities for Afghan companies to conduct business with their counterparts in the United States and other regional trading partners.[584] Since no external evaluation of AIRTF was ever conducted, its efficacy and contributions to investment in the sectors it supported cannot be determined.

As with the Afghanistan Reconstruction Group and TFBSO, there were some rivalries and tensions with USAID and State over private sector development roles and responsibilities, which contributed to a lack of support for AIRTF within the U.S. Embassy. Although AIRTF ceased operations around the same time the embassy was going through a "normalization" process to reduce the number of people and the overall footprint in preparation for the U.S. 2014 drawdown, the lack of support was seen as a contributing factor to its termination.[585]

FINAL POINTS ON INVESTMENT PROMOTION

Encouraging domestic and foreign private investment was a key component of the U.S. government approach to private sector development in Afghanistan. Despite a multi-faceted approach, these efforts, including those focusing on the Afghan diaspora, fell short.[586] Aside from a few high-profile exceptions, foreign direct investment was limited. The main area for investment was the construction industry, where, especially during 2009–2012, large amounts of foreign funding for civilian and military infrastructure projects became available through contracts to local firms, which were then able to take advantage of the property and building boom.[587] However, this tailed off when international spending began trending down around 2012, and some of the engineering and construction capacity was deployed elsewhere in the region. Investment in the manufacturing and service sectors, meanwhile, was negligible from the very beginning, as was investment in agriculture, due in part to the lack of a clear, long-term strategy for developing the sectors. In early 2004, the head of AISA reported with disappointment that less than 1 percent of intended investment was in agriculture, the sector on which Afghanistan was most dependent.[588] Instead, funding went to small-scale projects with limited investment and little to no long-term benefit.[589]

Investment was limited for a variety of reasons, primarily uncertainty, insecurity, poor economic governance, and the lack of a comparative advantage in potential industries. Notwithstanding attempts to address constraints such as power, land tenure, and lack of information about opportunities, Afghanistan was simply not an attractive place to invest. The development of land, often on a speculative basis, was the main result of many of the privatized SOEs, not reuse of or reinvestment of their productive assets.

The 2010 announcement of the 2014 NATO troop drawdown heightened the sense of uncertainty, exacerbated the reluctance to invest, and spurred an increase in capital flight. For example, as a percentage of GDP, in 2015 estimated gross domestic investment was less than 20 percent, down from nearly 45 percent in 2005.[590] Afghans' recollection of past events, including above all the country's history of prolonged conflict and instability, likely further heightened the effects of uncertainty.

CHAPTER 7

PROMOTING REGIONAL AND INTERNATIONAL TRADE

Resolute Support photo

The United States and international community viewed regional and international trade as an engine of growth that, coupled with the market economy and strengthening of high-value agriculture, could become part of a virtuous circle, and therefore it received substantial attention during the reconstruction effort. While certain initiatives were successful in achieving, or at least working toward, their specific goals, trade outcomes indicate the trade initiatives did not result in actual gains to productivity or an improvement in Afghanistan's trade balance. Although the overarching strategy to promote exports and integrate Afghanistan into regional and world markets was reasonable and in line with prevailing development theory, the realities of war-shattered infrastructure, corruption and poor governance in customs, and an inability to rapidly increase productivity and make Afghan goods competitive while rapidly reducing trade barriers ultimately hindered success.

Given the informal nature of much of the Afghan economy, all trade data must be taken as approximate. Afghanistan did not start reporting on this data until 2008, and through 2014, over half of all imports and exports that were reported were not classified as to type. Moreover, the data do not include the large volume of goods consistently smuggled across the border. Still, it is apparent that trade has not been the driver of growth that was originally anticipated.

USAID's first, post-2001 economic growth project, AEGP, had trade-specific goals. Between 2002 and 2017, four USAID projects directly or indirectly targeted international trade (see table 1). In 2002, USAID had already identified horticulture and livestock as areas in which Afghanistan would have a potential comparative advantage and which would allow the country to export value-added products to global markets.[591] In its 2005 five-year strategy, USAID emphasized increasing productivity of livestock as an important component of accelerating market-led growth in agriculture.[592]

TABLE 1

USAID PROJECTS TO SUPPORT TRADE

Project	Project Dates	Project Overview	Trade-Specific Goals
Afghanistan Economic Growth Project	2002–2005	Catch-all economic growth program aligned with USAID's *Recovery and Reconstruction Strategy for Afghanistan* and the *National Development Framework*. Supported customs reform and strengthened DAB operations, the legal and regulatory sector, and trade policy.	Developed policy papers to define the mission of MOCI. Encouraged regional and global integration, as well as specific trade initiatives.
Economic Growth and Private Sector Strengthening	2005–2009	Assisted in structuring and implementing a legislative, fiscal, regulatory, and institutional framework. Provided technical assistance to MOF, MOCI, DAB, and various other ministries and institutions.	Supported MOCI and reform in international and regional trade agreements, reaching milestones for WTO accession, and public outreach for trade.
Trade Accession and Facilitation for Afghanistan	2009–2013	Supported the development of Afghanistan's economy "by fulfilling the trade potential of its strategic location on the historic Silk Route." The program also offered direct support to enterprises that were either currently exporting or producing high-value goods with export potential.	Promoted trade policy liberalization for WTO accession and regional integration, the introduction of the customs electronic payment system, and trade facilitation through direct support to enterprises.
Afghanistan Trade and Revenue	2013–2018	Intended to support Afghanistan "in realizing its full potential in the global trading market."	Sought trade liberalization and WTO accession, regional integration, and customs reform. Also continued implementation of the customs electronic payment system and encouraged public awareness of WTO accession.

Source: Bearing Point, *Completion Report: Afghanistan Economic Governance Program (AEGP)*, prepared under contract for USAID, December 2005, pp. 8–10; Deloitte, *Completion Report: Afghanistan Economic Growth and Private Sector Strengthening (EGPSS) Project*, October 2010, pp. 24–25; Chemonics International Inc., *Final Report: Trade Accession and Facilitation for Afghanistan (TAFA)*, prepared under contract for USAID, August 31, 2013, pp. 1–2; Chemonics International Inc., *Afghanistan Trade and Revenue Project: Annual Report Nov. 7 2013 – Nov. 6 2014*, prepared under contract for USAID, February 14, 2015, pp. 7–8.

REGIONAL INTEGRATION AND OPENING TO TRADE

Regional integration was prioritized from 2002 onward in the belief that increased regional linkages could create opportunities for trade and investment, generate revenue for the government through taxes, and lead to greater stability and security. The South Asian Free Trade Agreement was ultimately signed in 2007 when Afghanistan became the eighth member of the South Asian Association for Regional Cooperation (SAARC).[593] Establishing a trade relationship with SAARC nations, including Pakistan and India, was considered the first entry point into regional integration.[594] SAFTA was fully implemented in August 2011.[595] SAFTA was especially important because Pakistan and India were the two largest importers of Afghan goods, and a trade agreement further lowering barriers to trade with these economies was seen as beneficial for Afghanistan.[596] In total, Afghanistan has signed more than 30 bilateral trade and investment agreements since 2002.[597] These agreements, combined with the 2004 customs reform package, made Afghanistan one of the most open economies in the region.[598] The wider region, however, has remained relatively closed.

Regional integration was intended to foster trade relationships with neighbors, lower barriers to trade, and ease WTO accession for Afghanistan. Regional integration was actively prioritized as a way to promote export opportunities and increase foreign market access for Afghan firms, while also lowering prices for consumers and simultaneously increasing competition and investment.[599] USAID assisted in this complex process by helping the Afghan government negotiate and implement formal regional trade agreements (RTA) with its neighbors, build public institutional capacity for creating supportive legislative reforms, and increase coordination and cooperation both within the government and between the public and private sectors.[600]

TAFA and TAFA II were instrumental in supporting the Afghan government in negotiating and ratifying a number of RTAs, including SAFTA, the Afghanistan-Pakistan Transit Trade Agreement, the Cross-Border Transport of Persons, Vehicles, and Goods Agreement, and the South Asian Agreement on Trade in Service. TAFA and TAFA II also conducted benefits studies for other RTAs.[601] Subsequently, ATAR helped facilitate and implement RTAs, such as SAFTA and APTTA, which had been ratified with TAFA support.[602]

In 2009, USTDA launched the Regional Infrastructure and Trade Initiative in South Asia, which, while primarily focused on western Pakistan, was also intended to benefit Afghanistan in resolving complications in transportation logistics and trade. USTDA, in coordination with the State Department, was also active in assisting with regional integration across South Asia.[603] The U.S. Trade Representative also highlighted regional integration, making the New Silk Road an important talking point in its 2011 annual Trade and Investment Framework Agreement (TIFA) meeting. The New Silk Road initiative envisioned "an international network of economic and transit connections," which would help "link and integrate Afghanistan with its neighbors and regional" partners.[604]

The goal of a **TIFA** is to "provide strategic frameworks and principles for dialogue on trade and investment issues between the United States and the other parties to the TIFA."[605] Afghanistan signed a TIFA with support from the U.S. Trade Representative in 2004. The TIFA council meets annually with senior government officials, particularly in the MOF.

Inexpensive imports had some important welfare benefits and increased consumption of select consumer products and commodities. However, Afghanistan's rapid integration into regional and global markets also had adverse effects on domestic producers as inexpensive imports flooded markets, such as in Herat.[606] This occurred due to regional neighbors' relative comparative advantages and more developed industries, their unfair trade practices such as border closures and dumping, and their export subsidies and other protective measures.[607] These conditions led to a skeptical view of free trade by many Afghans.[608]

Afghan Government and Regional Efforts at Integration

Since 2005, the Afghan government, specifically the Ministry of Foreign Affairs (MOFA), has prioritized and taken more of a lead in pushing for regional integration. In December 2005, Kabul hosted the first Regional Economic Cooperation Conference on Afghanistan (RECCA), which was attended by delegates from 11 Central and South Asian countries.[609] There have since been seven RECCA conferences, with the most recent held in Ashgabat, Turkmenistan, in 2017. Each conference has focused on developing economic cooperation, integration, stability, and investment within the region.[610]

RECCA is a semi-annual conference held, rotationally, in the 11 participating Central and South Asian countries. An Afghan-led process, RECCA conferences serve as a political platform to promote economic cooperation, integration, and implementation of trade, transit, and transmission agreements.[611]

The continued negotiations on the Central Asia-South Asia Electricity Transmission and Trade project (CASA-1000) are important not only for the potential benefits for regional integration, but also for increased government revenues and job creation in Afghanistan. While news sources pointed to continued obstacles and difficulties, ground breaking for CASA-1000 took place in Dushanbe, Tajikistan, in May 2016, and construction is anticipated to begin in Afghanistan in early 2018.[612]

CASA-1000 aims to provide the means for the export of electricity from Tajikistan and the Kyrgyz Republic into Pakistan and Afghanistan during summer surpluses in the producing countries. Afghanistan has the option of consuming its portion of the transmitted electricity or re-exporting it to Pakistan.[613]

In February 2018, officials met in Herat to mark the inauguration of construction of the long-delayed Turkmenistan-Afghanistan-Pakistan-India pipeline, which had been under discussion since the 1990s. While TAPI has been touted as having the potential to improve regional relationships through mutually beneficial integration, concerns remain regarding security along the Afghan section of the pipeline, as well as where the funds will come from to pay for construction.[614] In February 2018, the Taliban reiterated earlier promises to support the safeguarding of both TAPI and CASA 1000.[615]

TAPI is a proposed 1,100-mile natural gas pipeline. It was conceived in the 1990s as a way to provide a steady supply of natural gas from Turkmenistan to Afghanistan, Pakistan, and India.[616]

Likely due, in part, to the ongoing contentious relationship with Pakistan, Afghanistan has recently been more actively pursuing trade relationships with other regional partners, especially India.[617] In 2016, after years of negotiations, India, Iran, and Afghanistan signed a trilateral agreement through which India would invest in further developing Iran's Chabahar port. The expanded port was inaugurated at the end of 2017, allowing India to trade more easily with Afghanistan and bypass the Pakistani port of Karachi.[618]

Launched in May 2017, the India-Afghanistan Air Freight Corridor allows Afghanistan to export goods more easily to India and circumvent the many difficulties of land routes and border crossings. These goods include carpets, saffron, and dried fruit and nuts. The Afghan government, along with ACCI and USAID, are working to make customs clearance procedures at Afghanistan's airports faster, simpler, and less expensive. According to an ACCI vice chairman, Afghanistan exported over 1,000 tons of goods between the opening of the air corridor and January 2018.[619] USAID supported developing the air corridor through the ATAR project.[620]

In November 2017, Afghanistan and five other countries signed the Lapis Lazuli Corridor agreement, which seeks to create a system of road, rail, and maritime transport routes to move Afghan goods to Europe via Turkmenistan, Azerbaijan, Georgia, and Turkey.[621] Pakistan announced its intention to join the corridor agreement later that month.[622]

The hope is that these agreements will increase market access and export potential for Afghan firms. Trade between Afghanistan and India has increased over the last few years, and India became Afghanistan's most important export market in 2017, following the significant reduction in trade with Pakistan.[623]

PURSUING WTO ACCESSION

The United States, other international donors, some aid organizations, and a number of senior Afghan officials viewed joining the WTO as a way for Afghanistan to reap the benefits of opening to trade. Many believed WTO accession could provide Afghanistan with specific advantages and benefits, including nondiscriminatory access to global markets for Afghan exports, control over unfair treatment through the WTO dispute resolution processes, access to WTO grants, and WTO-sponsored capacity-building initiatives.[624] Pursuing WTO accession also acted as a positive forcing function for Afghan firms to adopt efficiencies and abide by international quality and health standards.[625]

Afghanistan's official entrance into the WTO on July 29, 2016, was the culmination of a process that began in 2003. Under USAID's AEGP project, an inter-ministerial group was created to hold preliminary talks with the WTO. However, because of complications in the division of tasks between MOFA and MOCI, the process was delayed. After Afghanistan gained WTO observer status in December 2004, accession was given additional support by the EGPSS program, which included in its goals the achievement of the milestones required for full WTO membership. While the TAFA programs primarily supported WTO accession through increasing trade liberalization and regional integration, the ATAR program specifically prioritized WTO accession because, by 2013, formal negotiations and meetings of the WTO working party had already begun.[626]

ATAR also tried to alter historically skeptical Afghan public opinion and create domestic support for Afghanistan's WTO accession by raising awareness of potential benefits from free trade and WTO membership.[627] USAID and ATAR project officials were aware of public perceptions and overall skepticism of WTO accession specifically, and on an open trade regime more generally, among the Afghan population and businesses. While a 2010 TAFA public opinion survey indicated that the majority of Afghans viewed trade positively—in theory—and understood the potential benefits of an open economy, many cited corruption and a lack of government support as reasons why Afghanistan's economy was not actually functioning under the conditions necessary to reap these benefits.[628] Many also believed the government was not fulfilling its role with regard to trade, and blamed the government for poor tariff structures, lack of opportunities, and continued corruption leading to smuggling.[629] Because of the behind-the-border trade barriers and other market distortions, including predatory trade practices by neighbors, many Afghans felt the government should be doing more to support and promote domestic producers.[630]

Other U.S. agencies also took an interest in Afghanistan's WTO status. In 2014, the U.S. Trade Representative visited Afghanistan for the annual TIFA meeting and signed a bilateral market access agreement, including tariff schedules, bringing Afghanistan further into the multilateral trading system and closer to WTO accession.[631] In 2016, the Trade Representative noted optimistically that WTO membership would "facilitate deeper engagement on regional connectivity and economic cooperation."[632]

Upon taking office in 2014, President Ghani tried to dispel skepticism by insisting that WTO accession would "serve as a catalyst for domestic reforms and transformation to an effective and functioning market economy that attracts investment, creates jobs, and improves the welfare of the people of Afghanistan."[633] Amid concerns that "the benefits of World Trade Organization membership [could] come at a substantial cost," Ghani's rhetoric exacerbated feelings that the government was not providing adequate support for its businesses and people.[634]

> *WTO accession would "serve as a catalyst for domestic reforms and transformation to an effective and functioning market economy that attracts investment, creates jobs, and improves the welfare of the people of Afghanistan."*
>
> —Afghan President Ashraf Ghani

Anticipated Benefits of WTO Accession

As is common elsewhere in the world, WTO accession was controversial in Afghanistan. The only available academic study of the potential economic effects of Afghanistan joining the WTO was produced in 2016 and used a simulation methodology to tentatively project that WTO accession would have mixed consequences. With the required tariff reductions, accession would have a negative effect on government revenue, but a positive effect on consumers and general welfare. However, due to inefficient domestic production, some important sectors would be hurt. The study also noted the challenge of establishing institutions capable of managing a "rule based trading system."[635]

Proponents of accession noted that Afghanistan would benefit from WTO's "special and differential treatment provisions," such as "protection of trade interests by other members," flexibility of commitments, use of policy instruments, transitional time periods, and access to technical assistance. These provisions also included efforts aimed at increasing trade opportunities for least-developed countries and encouraged developed WTO member nations to safeguard the interests of least-developed countries (LDC) members.[636] The provisions were written in order to ease the transition for LDCs into free trade, protect nascent industries in the short term, and provide a buffer for global competition.

However, in 2016, Afghanistan was not yet in a position to fully benefit from these provisions. First, while WTO accession and trade liberalization were pursued in tandem with the promotion of certain agricultural products and extractive industries in the hopes that both would be developed enough to begin exporting by 2018, changing conditions inhibited their growth. Second, the WTO

LDC provisions expire on July 1, 2021, at the latest. While these deadlines have been extended twice previously, and could be further extended, WTO members' governments are expected to work toward compliance.[637] Even if Afghan producers are able to develop Afghan goods for export in the future, they will not receive the full 10 years' benefit from the LDC provisions that were intended to help nascent industries. Finally, Afghanistan continued to suffer from a lack of proper infrastructure and relied on capacity building and technical assistance to negotiate regional agreements and its accession to the WTO. This indicates that trade policy implementation should have been more flexible, allowing adequate time for industries with a potential comparative advantage to grow, relevant government institutions to mature, and sustainable infrastructure to develop.

WTO Accession: Global Experiences

While the international community generally supported the idea of Afghanistan's accession to the WTO, there was a clear divide between those who believed WTO membership would bolster economic growth and those who feared that rushed trade liberalization would bring more harm than good. Afghan proponents of accession, who were in the minority of Afghans, saw the accession process as having additional benefits, such as forcing the country to reform, upgrade, and modernize its processes and institutions, including export certification, to meet international quality standards; this, in turn, would make the country more competitive and attractive to foreign investment. Opponents, on the other hand, claimed that rapid and further opening of Afghanistan to unrestricted trade would hurt Afghan companies and reduce jobs.

While some Afghans were open to the possibility of benefits from trade, the pace of lowering barriers to trade and seeking WTO accession was concerning because the necessary improvements in infrastructure, productivity, and value added would take time. As certain economists have noted, benefits from increased trade can be better "facilitated through a more gradual approach in [least-developed countries], with increasing degrees of import liberalization coupled to an industrial policy that strengthens local productive capacity."[638]

At the international level, the relative benefits and drawbacks of accession to the WTO, which required, among other things, the elimination of most tariffs, is controversial. While conventional economic theory maintains that all countries gain from trade, studies indicate that there can be certain negative consequences for least-developed countries. The benefits of free trade do not necessarily accrue to the poor, and therefore can exacerbate income inequality, rather than promoting broad-based growth.[639] LDCs cannot always compete in key sectors on the global market and often lack the capacity necessary to negotiate and implement trade agreements.[640] As a result, LDCs do not always see the anticipated benefits of accession and can sometimes suffer consequences in income distribution and market access.[641]

In sum, if extractive industries become productive and are able to develop with protections offered through the LDC provisions, then Afghanistan may more clearly benefit from WTO accession in the coming years. Without developed industry, however, it is unlikely it will be able to compete in global, or even regional, markets once the LDC provisions expire. While some benefits from accession still exist, certain international trade specialists have suggested LDCs may be better off postponing accession until their government capacity and markets are better developed.[642] While post-2001 Afghanistan had become one of the most open economies in the region, WTO negotiations encouraged the lifting of non-tariff barriers and further lowering of tariffs to be more consistent with WTO rules.[643] One analysis noted, "The narrowing policy space derived from membership in the WTO . . . continues to curtail independent state action in addressing the simultaneous challenges of economic, social, and human development, despite the special provisions for [LDCs]."[644]

At the same time, WTO accession had the positive effect of forcing Afghan firms to seek efficiencies and meet international standards for quality and health that they might otherwise not have sought. It also provided Afghanistan with a platform through which it could air grievances about unfair trade practices, although legal recourse only applies to other WTO members. As a WTO member, Afghanistan is also allowed to apply anti-dumping and countervailing duties to protect against predatory dumping and domestic subsidization, as well as temporarily exceed WTO-bound tariff rates in case of sudden and excessive imports.[645] It will take years after accession for these impacts to be fully felt, however, and financial benefits will only accrue in the future.

STUBBORN BARRIERS TO TRADE

The largest inhibitor to growth in export markets has been the lack of substantial progress in product diversification, value-added processing, production scalability, and quality control across all sectors. However, other factors, such as government capacity and infrastructure, lack of productivity, and difficulties with customs reform, have posed stubborn obstacles to trade and made it difficult for Afghan producers to export.

Government Capacity and Infrastructure Development

Despite significant U.S. and international effort to build the capacity and infrastructure of the Afghan government, as related to trade, success has been constrained to date by factors such as high staff turnover, insecurity, poor maintenance of facilities, and corruption.

As the initial catch-all economic development program, USAID's AEGP provided only indirect support for trade, targeting its efforts toward building the capacity of the Ministry of Commerce and Industry, which was responsible for the formulation and implementation of policy regarding international trade.[646] AEGP staff helped with reforming MOCI's existing component institutions, including disbanding the Department of Domestic Trade, providing technical assistance to the Department of International Trade, Department of Export Promotion, and various other MOCI departments, and advising on business license reform. Specifically, AEGP staff helped draft the MOCI mission and strategic goals, which called for the ministry to seek opportunities to liberalize trade, increase exports and imports, maximize benefits of preferential market access agreements for Afghan exporters, strengthen transit agreements, and develop policies and programs to facilitate trade.[647] Following AEGP, USAID programs continued to work on building the capacity of MOCI.

TAFA government capacity building focused primarily on increasing the ministries' knowledge of regional trade agreements and improving negotiation skills for the WTO accession negotiations.[648] Much of TAFA's focus, however, was on improving the capacity of businesses through facilitating participation in business exhibitions, and providing training on marketing, exporting, and other relevant topics for business owners.[649]

Unlike TAFA, and in light of the reduced U.S. presence starting in late 2013, ATAR took a slightly more hands-off approach, focusing only on building Afghan institutions' capacity to conduct negotiations, draft legislation, institute the necessary reforms to enhance the trade regime, and join the WTO. ATAR personnel reported that successes were, in part, due to the improvements in MOCI capacity that had taken place in previous years.[650]

Phytosanitary inspection is the process of verifying that agricultural products are free of harmful pests and plant diseases, a requirement for export to many countries and regions around the world.

Lack of institutional capacity discouraged the development of some of the key capabilities needed to support the expansion of exports. For example, the Ministry of Agriculture and Animal Husbandry lacked the means and capacity to build or maintain facilities for grading agricultural products and conducting basic phytosanitary inspections.[651] Without the necessary certifications for international food safety organizations, certain Afghan agricultural products were valued lower than those of neighboring countries or could not be exported.

Despite significant efforts to improve it, poor infrastructure continued to inhibit businesses' abilities to compete through 2017. For example, an October 2016 SIGAR audit of Afghanistan paved road infrastructure estimated that more than half the roads in Afghanistan that had been constructed with U.S. funding required serious rehabilitation and suffered from a lack of maintenance.[652] This meant that the implicit costs to trade for Afghan companies across sectors remained high, and the poor quality of roads impacted their ability to move goods across the border. For example, in addition to roads, the lack of infrastructure for the carpet industry resulted in much of the value being added in neighboring Pakistan. In some cases, wool was imported into Afghanistan, carpets were woven and then transported to Pakistan for cutting and washing, and the finished rugs were exported with a Pakistani label, undermining the Afghan brand and removing important sources of income and employment.[653]

Productivity and Trade Facilitation

To complement the projects that targeted international trade, such as TAFA and ATAR, USAID had a number of agricultural projects that aimed to increase productivity and value added for Afghan products that could potentially be exported. These projects addressed productivity in the agriculture sector and value chain linkages with direct and indirect support to agribusiness producers, processors, and traders. As WTO accession was ramping up, however, the TAFA projects worked directly with firms already exporting Afghan goods, including agricultural products, in an effort to increase the firms' external market access. This included identifying companies producing high-value goods and forming relationships between these companies and potential international buyers. The 2013 TAFA final report specifically identified marble and saffron as potential exports.[654]

ATAR, the follow-on project to TAFA, gave less direct support to enterprises in favor of capacity building. This meant it did not work hand in hand with individual companies as its predecessor did. Trade facilitation efforts, therefore, focused on increasing the capacity of MOCI to help exporters expand their markets.[655] Both TAFA and ATAR supported MOCI's Export Promotion Agency of Afghanistan through capacity building and support. The EPAA is a MOCI executive agency created in 2006 with the support of GIZ. The agency's mission includes "assisting exporters and producers of export goods to overcome bottlenecks in order to achieve higher levels of export performance and foreign exchange earnings."[656] Even a fully functional MOCI and EPAA might not have made a substantial difference, given the uncompetitive nature of Afghan products and the other challenges facing exporters.

Difficulties in Customs Reform

The U.S. government and other international donors emphasized customs reform in an effort to enable the Afghan private sector to more efficiently explore regional markets while simultaneously increasing customs revenue for the Afghan government.[657] Based on an early IMF recommendation, the MOF revised customs law to streamline and reduce tariff rates to make procedures more efficient for traders. In 2002, there were 25 tariff bands, with rates ranging from 7 to 150 percent across 888 tariff headings, which was well outside of international best practices and a source of significant confusion.[658] In 2004, the Afghan government, supported primarily by DFID resident experts and a USAID expert provided through AEGP, passed a new customs reform package that reduced the number of tariff bands from 25, ranging from 7 to 150 percent, to 6, with assigned rates of 2.5, 4, 5, 8, 10, and 16 percent. This reform lowered tariff rates considerably across the board and made Afghanistan one of the most open economies in the region.[659] EGPSS built on this work, primarily training officials in tariff valuation and classification.[660]

Under the TAFA project, USAID continued to work toward improving customs laws, streamlining customs procedures, removing redundant steps at six border crossings, implementing the Automated System for Customs Data (ASYCUDA), and instituting an electronic payment (e-payment) system. The ASYCUDA and e-payment systems were intended to reduce opportunities for corruption at border crossings by eliminating cash-based transactions between traders and customs officers.[661] The effort was continued under the ATAR project, which specifically worked to improve customs administration by supporting the Afghan Customs Department (ACD) and DAB in launching e-payments at two border crossings.[662] ATAR also included an outreach component to educate traders on the new e-payment system.

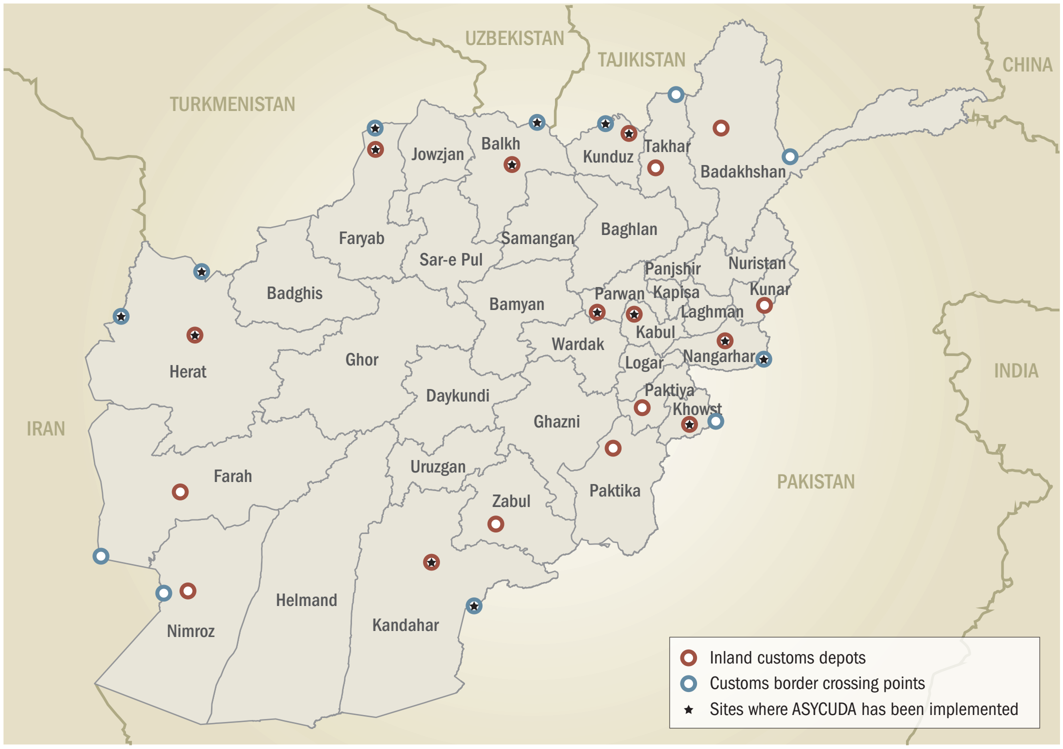
However, these efforts have had limited impact, for reasons that go beyond the narrow technical improvements. According to a 2014 SIGAR audit of Afghan customs, “The future of customs revenues as a stable source of income for the Afghan government remains unclear” due to issues with customs data and persistent corruption.[663] As of 2015, ASYCUDA had been implemented at 11 of 17 inland customs depots and seven of 11 border crossing points (see figure 10), but electrical outages, connectivity problems, and limited oversight meant that customs officials were often entering inaccurate information and that trade data remained unreliable.[664] The audit further noted, “Corruption impacts all levels of the customs process and is the biggest problem affecting Afghan customs processes and revenues.”[665] As the *New York Times* reported in 2014, based on a candid interview with a customs official:

> Border guards pocket a small fee for opening the gate, but that is just the start. Businessmen and customs officials collude to fake invoices and manipulate packing lists. Quantity, weight, contents, country of origin—almost every piece of information can be altered to slash the customs bill, often by up to 70 percent.[666]

Businesses continued to report that customs officials used their own discretion in both valuation and inspection procedures, leading to delays and perpetuating corruption.[667] They also reported further delays due to poor infrastructure, unnecessary bureaucratic processes, and occasional closing of border crossings due to regional disputes.[668] According to the World Bank’s Ease of Doing Business (EODB) indicators, the estimated time to import and export has risen since 2012.[669] While the TAFA programs were successful in reducing the number

FIGURE 10

MAP OF AFGHANISTAN BORDER CROSSING POINTS AND INLAND CUSTOMS DEPOTS



Note: The Afghanistan Customs Department lists 11 border crossing points on its website, but shows 12 border crossing points on the same page, as reflected in the map above.

Source: UN Conference on Trade and Development, "Afghanistan Implementation Map," ASYCUDA website, January 2015, accessed on February 22, 2018; Government of Afghanistan, Afghanistan Customs Department (ACD), "Inland Customs Depots and Border Crossing Sites," ACD website, accessed on February 22, 2018.

of processing steps at nine inland customs depots and the Kabul International Airport, which together account for 98 percent of total customs revenues, delays remained.[670] Much of this increased import and export time was likely due to issues and delays in documentary compliance and domestic transport, two of the factors included in the EODB indicators.[671]

The 2014 SIGAR audit therefore recommended that, following the completion of WTO accession, the ATAR project should focus on reducing discrepancies in customs data and increasing the focus on anticorruption measures, including continued rollout and effective use of the ASYCUDA and e-payment systems.[672] In 2017, however, SIGAR published a report concluding that both TAFA and ATAR failed to achieve their goals of implementing the e-payment system. The report noted that the system had not been implemented at the majority of border crossings and was "unused at most of the locations where it [had] been implemented."[673] While ATAR targeted increasing the percentage of customs revenues collected through the e-payment system to 75 percent, in 2016 e-payments accounted for less than 1 percent of customs duties collected.[674] In its response to SIGAR's report, USAID noted difficulties in software and connectivity between DAB, commercial banks, and the Afghan Customs Department; the severe lack of political will to move away from the cash-based system; involvement of DAB in areas where commercial banks should be operating; and capacity issues hindering use of the e-payment system. In addition to these significant obstacles, corrupt actors benefited from the lax regulatory controls of the cash-based system and therefore encouraged its continued use.[675]

FINAL POINTS ON PROMOTING REGIONAL AND INTERNATIONAL TRADE

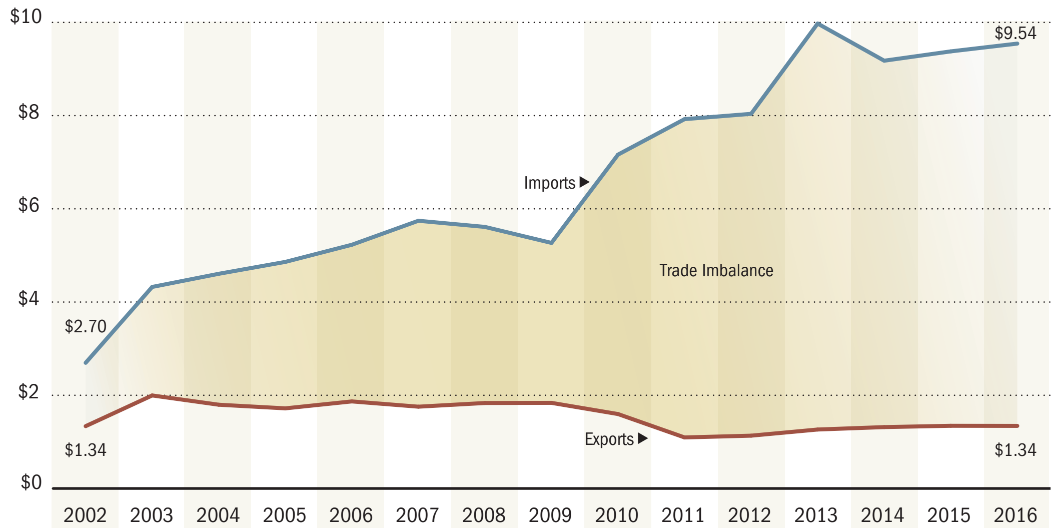
Despite the country's opening to trade and encouragement of exports, Afghanistan's trade imbalance has continued to grow steadily since 2002, with imports tripling by 2015, while exports remained stagnant and low (see figure 11). Trade has not been the engine of growth and employment the U.S. government assumed it would. Unfortunately, it seems unlikely that the trade balance will start to improve in the coming years as export markets remain slow to develop and Afghanistan has not greatly increased its industry or value added to productive sectors, such as agriculture.

Afghan firms and industries might have been better able to take advantage of the LDC provisions if they had had more time to develop.

Given these disappointing trade outcomes over the past decade and a half, a number of important conclusions regarding programs, implementation, and realities of the Afghan economic and business climate become evident. First, Afghanistan might have benefited from a more delayed accession to the WTO. While there were certainly benefits to accession, including a political platform for negotiations, a legal framework for disputes, and a forcing function for international best practices, Afghan firms and industries might have been better able to take advantage of the LDC provisions if they had had more time to develop. Temporary protection of potentially exportable industries might have allowed for more Afghan firms to compete in regional markets and ultimately benefit from the increased competition as state support slowly dwindled. Trade policy implementation and accession processes should therefore have been more flexible, recognizing that Afghanistan would benefit more if certain domestic milestones were first met. Also, trade facilitation efforts were not sufficient by themselves to increase Afghan traders' ability to export; more

FIGURE 11

AFGHANISTAN TRADE IMBALANCE, 2002–2016 ($ BILLIONS)



Source: SIGAR analysis of data from the World Bank, "Imports of goods and services: Afghanistan (current US$)" and "Exports of goods and services: Afghanistan (current US$)," data for 2002–2016, World Bank, World Development Indicators database, accessed on January 12, 2018.

time and attention was needed to grow export markets and facilitate trade at the various chokepoints. Furthermore, corruption at border crossings is still rampant, and it has hindered growth in trade, in addition to dampening necessary government revenues. The implementation of the ASYCUDA and e-payment systems encountered significant challenges and has failed to significantly reduce corruption or increase revenues.

Still, WTO accession and opening to trade produced benefits for Afghanistan. For consumers, lower trade barriers meant cheaper consumer goods, which can lead to increases in consumption and standard of living. For producers, WTO accession acted as a forcing function, pushing industries to achieve certain health and sanitation standards. Membership also provided a platform for trade negotiation, and a legal means to apply countervailing tariffs against unfair trade practices from member countries. Since Afghanistan only joined the WTO in 2016, the impacts on producers and the economy will continue to be seen over the next decade, when more financial benefits may also accrue.

CHAPTER 8

PROVIDING DIRECT SUPPORT TO ENTERPRISES

UNAMA photo by Fardin Waezi

From the start of the reconstruction effort, the U.S. government focused on building an enabling environment that would support the creation or expansion of firms. From 2006, however, the United States began to place greater emphasis on direct support to individual enterprises. In part, this was because some of the basic economic infrastructure had been put in place, but also because much more was known about the characteristics of the Afghan private sector from a number of surveys that had been done in urban areas. These surveys identified obstacles to development: the lack of cheap and reliable power, insecure land tenure, lack of clarity about government policies, and, relatedly, widespread corruption.

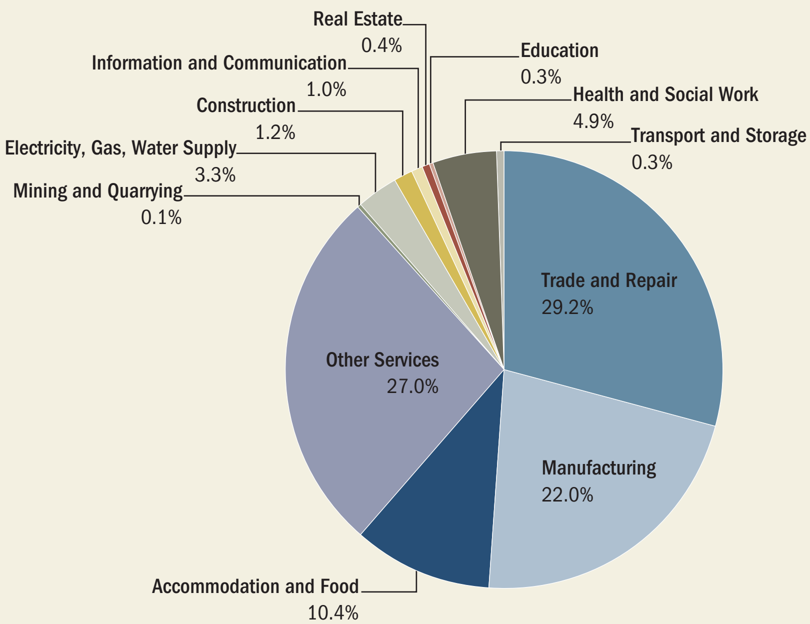
While the Afghan and U.S. governments acknowledged the existence of these obstacles and viewed developing enterprises as critical to overall economic development, neither government had a specific long-term enterprise development strategy that would guide programming in the field. USAID, as part of the U.S. whole-of-government approach, at times was directed to align its programming more with the military's stabilization and counterinsurgency objectives, and less on long-term private sector development. This was most significant during the surge period. However, the shift in the agency's strategy from short-term stabilization to long-term activities starting in 2011 didn't lead to any major shifts in design and implementation of projects in the field.

THE AFGHAN PRIVATE SECTOR: GENERAL CHARACTERISTICS AND CONSTRAINTS TO GROWTH

The majority (90 percent) of Afghan private sector activities have historically been informal, with only slightly more than 5 percent of households earning an income from industrial activities.[676] A survey conducted by the Afghan Central Statistics Office in 2009 highlighted that 90 percent of enterprises in Afghanistan were small (five or fewer workers), new (less than four years old), and had a single owner. Additionally, the majority (70 percent) of the enterprises were rural, with trade and repair being the dominant business type (29 percent), followed by manufacturing (22 percent), accommodations and food (10 percent), and other services (27 percent) (see figure 12). The survey also found that more than half of enterprises had received some form of international donor support, including loans and subsidies.[677]

FIGURE 12

ENTERPRISES BY BUSINESS TYPE



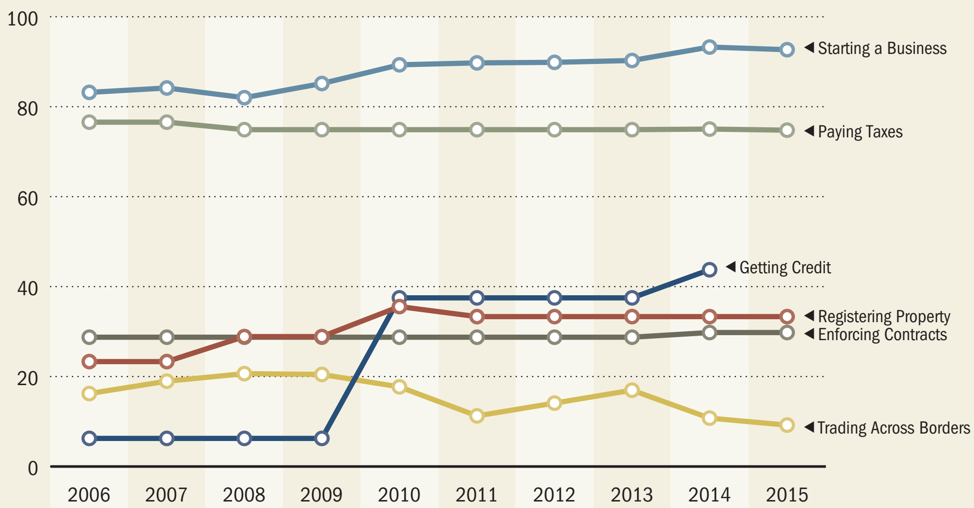
Source: Asian Development Bank and Central Statistics Organization Afghanistan, "Integrated Business Enterprise Survey in Afghanistan 2009," 2009.

While many of the critical elements of the enabling environment for the private sector—for example, registration policies and mechanisms, money transfer systems, and banking laws—were put in place after 2001, some of the major constraints have largely remained unchanged. These constraints, as highlighted in three enterprise perception surveys conducted by the World Bank and the Center for International Private Enterprise between 2005 and 2014, include security, lack of infrastructure, limited access to electricity and factors of production (land, labor, and capital), corruption, lack of policy enforcement, government regulations (especially taxes, customs, and trade regulations), and crime and theft. While the significance of these obstacles varied by year and size of enterprise, they were consistently seen as factors that adversely affected the growth of the private sector.[678]

These difficulties are also reflected in the World Bank's Ease of Doing Business indicators, as shown in figure 13. These indicators measure regulations, enforcement, and how they affect standard business operations. On the positive side, it is relatively easy to open a business in Afghanistan and the country ranks just above the regional average for South Asia (even after a lower score for 2018) at 107 out of 190 total economies represented in the EODB studies. Afghanistan also saw marked improvements in access to credit and steady improvements in registering property between 2008 and 2010. However, Afghanistan has low scores in getting electricity (omitted from the graph because of lack of data before 2010) and enforcing contracts. Trading across borders remains one of the nation's poorest performance areas.[679]

FIGURE 13

EASE OF DOING BUSINESS IN AFGHANISTAN: DISTANCE TO FRONTIER FOR SELECT INDICATORS, 2006–2015



Note: The "distance to frontier" measures a country's economic performance relative to the "frontier," or the best performance observed across economies. An economy's distance to frontier is shown on a scale from 0 to 100, where 0 represents the lowest performance and 100 represents the frontier. Data after 2015 are omitted because they are not comparable to previous scores due to a change in EODB methodology.

Source: SIGAR analysis of data from World Bank, "Ease of Doing Business Indicators: Afghanistan (Distance to Frontier ratings)," data for 2006–2015, World Bank Historical Data Sets and Trends Data, accessed on December 1, 2017.

Although the Afghan government devised a small-medium enterprise strategy in 2009 and introduced new National Priority Programs to consolidate private sector development activities, the NPPs remained scattered and underfunded. Despite this lack of strategic direction—but with an acknowledgment of enterprises being vital to employment creation and, therefore, an important element in counterinsurgency efforts and increasing domestic revenue—the U.S. government increased direct support to enterprises by launching a number of initiatives.

USAID'S DIRECT SUPPORT TO ENTERPRISES

In addition to its support to building the enabling environment for private sector development, USAID also provided direct technical and financial support to local enterprises through a variety of initiatives. While this chapter of the report covers only the USAID Economic Growth Office's two large-scale programs specifically designed to provide direct support to enterprises, the agency also supported enterprises, including agribusinesses, through many of its other projects, especially agriculture and alternative livelihoods (counternarcotics) projects.

In 2006, after determining that access to capital and limited business development skills at the enterprise level were two of the most important obstacles to growth for businesses, USAID launched the first of two projects which provided financial and technical assistance to individual entrepreneurs to set up new or expand existing enterprises. The Afghanistan Small and Medium Enterprise Development project, a $114 million effort implemented by Development Alternatives Incorporated from 2006 to 2012, and the Assistance in Building Afghanistan by Developing Enterprises project, implemented by Chemonics from 2012 to 2017, had similar aims and approaches, although those evolved over time.

Both projects aimed to support individual enterprises, with the overall objectives of increasing domestic and foreign investment, stimulating employment, and increasing the sales of Afghan products. ASMED also supported business associations and nonprofit organizations, while ABADE worked more closely with Afghan technical ministries, such as MOCI.

Forming Investment Alliances

USAID's two main enterprise-support projects both used elements of the agency's Global Development Alliance (GDA) model, created in 2001 as part of efforts to strengthen the private sector in developing countries, to form partnerships with enterprises. The model, which specifies "public-private alliances," requires prospective partners to match or exceed USAID's investment.[680]

WOMEN'S ECONOMIC PARTICIPATION

Promoting women's rights has been a visible part of the U.S. reconstruction effort in Afghanistan since 2001. All major U.S. and Afghan government strategies from 2002 through 2017 emphasized the importance of women's social, political, and economic participation in the overall development of Afghanistan. While some progress has been made, especially in improving measured maternal mortality rates and female literacy, women still face significant barriers to economic participation, including lack of human and financial capital, insecurity, corruption, inadequate access to domestic and international markets, lack of demand for products, and social barriers to their participation in public spheres.[681]

From the start, the U.S. government sought to promote women's rights in Afghanistan, partly as a response to the oppression women faced under the Taliban. In the following years, women's rights were consistently included as part of the broader U.S.-led reconstruction agenda, along with democracy and civil liberties. The U.S. government's programs for women's economic empowerment have been a mix of initiatives that were either embedded within larger development programs, for example, in agriculture, rule of law, education, and health, or programs that were designed specifically for women. USAID, for example, promoted women's participation in rural income-generating activities, including backyard poultry farms, food processing, and beekeeping, as part of its projects in the agriculture sector, and supported individuals or associations of women-owned businesses through its enterprise development projects. The agency also provided support to microfinance institutions to increase women's access to finance.[682] The agency's ABADE and other projects supported initiatives to provide alternative workplace models for women, including working from home, offsite services, or all-women facilities, and trained more than 200 women in business skills, including information and communications technology, business systems, marketing, and advertising.[683]

Similarly, DOD's TFBSO supported women's involvement in ICT and local industries, such as carpet weaving and jewelry making. TFBSO also financed the construction of a Center for Afghan Women's Economic Development at the American University of Afghanistan as a platform for public and private coordination of efforts to advance women's roles in the private sector.[684]

In 2015, USAID launched its largest ($280 million) gender program in the world: the Promoting Gender Equity in National Priority Programs Project, or PROMOTE. The five-year program aims to educate, train, and enable Afghan women to participate more fully in politics, civil society, and the private sector, with one of its four components being "Women in the Economy."[685]

Despite significant support to Afghan women, neither the amount of funding that went to women-specific activities nor the impact of these programs on women's status can be precisely determined. A 2014 SIGAR audit report highlighted the lack of a comprehensive analysis of the gains claimed as a result of these programs. The report also noted that, while more than $64.8 million had been spent on projects, programs, and initiatives to support Afghan women between 2011 and 2013, that amount doesn't reflect the full extent

Women working in a garment factory in Kabul in January 2014. (Asian Development Bank photo by Jawad Jalali)

of U.S. efforts, mainly because agencies lacked effective mechanisms for tracking funding associated with these programs.[686]

While the impact of U.S. government activities on Afghan women's status cannot be measured, some measurable progress has been made in women's participation in the formal economy, especially in the urban areas. For example, a 2013 survey conducted by Building Markets of 1,424 women, including female enterprise owners and employees, along with women and men from the business community and government institutions across the country, found that the majority of respondents had entered the public sphere (either as an employee, government official, or business owner) in the last decade.[687]

At the same time, however, a synthesis report by AREU found that economic participation of women hasn't seen any significant improvement, and women continue to be at the lower end of value chains and lack access to many resources that would allow them to upgrade their skills and incomes.[688] Importantly, the AREU report highlighted that donor-funded projects tended to focus on occupational training and neglected to support the higher parts of the value chain, such as post-harvest processing, marketing, and sales—issues that were identified as major obstacles by women in the 2013 survey.[689]

Both projects tried various ways to select partners. ASMED initially took a sector-driven approach using the value chain model. Based on sector assessments conducted in 2007 and 2008, ASMED selected six sectors—construction, marble, carpets, gemstones, agribusiness, and handicrafts—and developed value chain strategies for each. In assessing these sectors, ASMED reported that businesses failed to thrive because of their inability to reach markets, their limited access to suppliers and inputs, and the absence of other players in the market to take a product through all the value-adding steps of processing or manufacturing.[690] Therefore, ASMED recognized the need to focus on supporting complete value chains in each sector to create growth on a larger scale.

However, ASMED's implementation of this sector-driven value chain model was criticized by the project's evaluation, which noted that the project's approach to development of key sectors was implemented "rather casually," with activities informally assumed by existing staff who, with the exception of those in the marble sector, had no particular sector expertise. While the project's work plan listed a number of broad interventions along various value chains, the project didn't develop action plans that would guide prioritization and implementation of these activities.[691]

ASMED's sector-driven approach was short-lived. In 2010, ASMED was restructured to align better with the COIN approach by selecting enterprises in the military-designated key terrain districts, where security, infrastructure, and the overall business climate were poor. The project no longer required partners be part of priority sectors or value chains at all.[692]

Similar to ASMED's revised strategy, ABADE didn't follow a value chain or sector-led approach, but focused on individual enterprises selected based on a determination of the businesses' prospects for expansion, productivity, and job creation. To assess the feasibility of these businesses, ABADE relied on business plans and financial reviews, as well as the knowledge and analysis of the business owners themselves.[693] While ASMED was not specific about the size of their partner enterprises, ABADE focused specifically on small enterprises, defined by the project as enterprises with fewer than 50 employees and total annual revenue of less than $3 million, and medium enterprises, with 50–300 employees and total revenue between $3–15 million. To support women's business development, however, ABADE also accommodated micro enterprises of fewer than 10 employees and annual revenue up to $100,000 that were owned or operated by women or employed more women than men.

Because ABADE attempted to be more selective in choosing its partners, the process took several months to a year or even longer, as project personnel had to "hold the hand" of each applicant through the application, feasibility assessment, skills training, and machinery and equipment purchase.[694] One ABADE senior official noted:

> When we started ABADE, we were overly optimistic. Practice showed that developing a full application request and getting all approvals for even the smallest partners took months. . . . The process of supplying companies [with machinery and other equipment] sometimes took months. For bigger companies, it could take years. The longest was three and one-half years.[695]

As the U.S. government became more concerned about how its funds were potentially being diverted to Taliban elements, in 2010 the selection and approval process was further slowed by a requirement that U.S. government agencies vet Afghan companies. In 2011, the USAID mission in Afghanistan created a new vetting support unit to annually vet non-U.S. contractors to ensure "neither USAID funds nor USAID-funded activities" provided support to "prohibited parties," defined as an individual or entity that supported terrorist activities. The vetting information collected by the vetting unit was forwarded to USAID staff in Washington for a final decision.[696] This process caused considerable delays in the first year of the project. When the threshold for vetting contracts was lowered from $150,000 to $25,000 in January 2013, the understaffed vetting support unit was overwhelmed, resulting in a process that could take more than nine months.[697] According to an ABADE official, vetting was a fairly new concept and previously was rarely needed because of the relatively high threshold; under the new requirements, "everybody was still learning."[698] While vetting was essential to ensure funds were not diverted, the requirement to vet almost 300 partners and their associated vendors was a huge task. It was only in 2015 that USAID increased the number of personnel in its vetting unit, which shortened the response time from months to weeks.[699]

Leveraging Private Sector Investment

ASMED and ABADE reported that the majority of their Afghan partners exceeded the target of 50 percent of total investment by providing 60 percent. ASMED reported helping create 1,300 new enterprises and leveraging over $94 million in private sector investment for new firms.[700] As of mid-2017, ABADE had more than doubled that, reporting around $257.4 million (86 percent) in partner contributions, with ABADE's contribution being only $40.7 million (14 percent).[701]

ABADE partner contributions were mostly in the form of land, assets, or operating capital. To verify the accuracy of the reported value of these contributions, ABADE conducted ad hoc site visits and analyses of the market value of the relevant assets and in-kind contributions. For example, to verify the value of land contributed by a partner, the ABADE team would assess the value of the existing land or facilities in the neighborhood to confirm the value range of the partner's contributed land. However, verification of this information was problematic for several reasons. Partner contributions were documented by the partners themselves, and it was not always possible to verify due, in part, to the implementing partner's inability to conduct regular onsite visits and cross-check references provided by the alliance partners. Relatedly, verification of information on the value of in-kind contributions by enterprises is difficult, given that Afghanistan doesn't have official systems for land registration or price benchmarks and that there are mutual incentives for grantees and donors to overstate values. Finding the time to verify numbers reported by partners was especially challenging, as staff came under pressure to quickly form partnerships in order to spend the allocated budget and thereby show progress.[702]

ASMED's mid-term audit highlighted the unreliability of data on contributions, noting that data for performance indicators were not reliable and "therefore not useful in managing for results or credible reporting."[703] ABADE's mid-term evaluation did not examine the value of the partner contributions to confirm whether they reflected the true value, but did caution that ABADE should ensure that the partner contributions were not inflated.[704] According to an implementing partner official:

> You do your best with what you have. For the new partner contributions, we did request and receive copies of invoices and purchase agreements or contracts so we would verify the actual amounts invested by the partners. For pre-existing partner land, facilities, or equipment, partners rarely had any kind of financial documentation to indicate their value. We therefore did some research on the price ranges of local land and buildings and, from our own equipment procurement efforts, we were aware of possible price ranges of various types of equipment. We therefore could only do best estimates for partners' existing contributions. We don't know if the numbers were exact. You can say that these numbers were more indicative, than exact.[705]

Post-Award Support To Partners

Given low levels of business literacy and the complicated and bureaucratic grant application process, ABADE organized conferences and workshops and offered one-on-one assistance to provide information about the program and assist enterprises in developing business and financial plans. ABADE also provided post-award support that included training on industry-specific technical skills, operating machinery, accounting, public relations, marketing, health and safety, and hygiene and sanitation. In some cases, ABADE also facilitated access to finance by assisting growing firms with their financial management processes and offering referrals to loan providers.[706]

While the technical support provided by ASMED and ABADE helped companies develop plans and improve management systems, often these actions were more to fulfill the requirements of the project than to address the real business needs of the company. A business owner in Kabul with experience in working with various donor projects in the private sector noted:

> At the least, [donors] created a culture and promoted appreciation and value for using better financial systems by the private sector companies. But even that utilization of better financial systems was mainly to attract donor money. For example, if a company wanted to apply for a grant, they were required to have proper financial reporting systems in place. These companies hired consultants to develop the system just to get the grant. The emphasis was not so much on the profitability and sustainability of the business, but more on how to fulfill a donor's requirement.[707]

Once approved, the partners faced additional delays in receiving equipment and services because of the long and complicated process of sourcing, purchasing, and importing machinery from overseas. While some of the partners found the approval process to be appropriate and not excessive, others found the delays frustrating; some partners even had to withdraw because machinery had become obsolete by the time of its delivery.[708] Some of ABADE's partners also found it challenging and costly to complete all the necessary paperwork and other procedures, and some found the process too time-consuming, and so dropped out of the program. Nevertheless, while many recipients of ABADE grants criticized the procurement process and the associated delays, they reported increasing sales and were grateful for the machinery and equipment that helped them expand their businesses.[709]

Strengthening Business Associations

One of ASMED's major components was supporting hundreds of new and existing local business associations to build their capacity to access national and international markets, secure financing, and advocate for changes in the business enabling environment on behalf of their members. However, according to a survey in 2009, while many firms knew of business associations and the benefits they could provide, relatively few actually participated. Around three-fourths of members were either occasionally or never in contact with business associations or chambers of commerce. One explanation for this was that nearly half of the members reported not receiving any services from these associations.[710] Therefore, after three years of supporting local business associations, ASMED recognized that expecting associations to perform strategic planning and advocacy was "overly ambitious" and concluded that "support to associations in a broad sense did not significantly improve their services to members or their sustainability, and did not result in tangible benefits to [small and medium enterprises]" and therefore discontinued its support.[711] Learning from this experience, ABADE did not support business associations.

Support to Business Development Services

In addition to business associations, ASMED also supported new or existing business development services (BDS) providers. The intent of ASMED's support to BDS providers was that small firms could avail themselves of BDS expertise and advice to plan their expansion or diversification. ASMED viewed its BDS support as a success because it had "transformed these companies from first generation donor-driven operations limited to providing basic business management services, to capable independent market actors able to provide [small and medium enterprises] with innovative and valuable services." The project claimed it had increased the client base of its 50 supported providers by 118 percent.[712] The ASMED evaluation report, however, questioned this claim by stating that many of the local BDS providers could only deliver business-related training and produce basic business plans, but weren't capable of providing the high-quality, credible, actionable, insightful, and fairly priced services domestic enterprises were seeking.[713]

A **BDS** provider is an entity that provides services ranging from training, consulting, and advisory services on a fee basis to marketing assistance, business linkage promotion, and information technology development and transfer.[714]

The realities of the Afghan business environment and structure of Afghan enterprises also limited the possibilities for the BDS providers to become self-sufficient. The majority of local enterprises were small-scale, informal, or unregistered, and had insufficient levels of business literacy to understand or articulate their real needs and how to graduate to the next level of enterprise size and sophistication. This limited understanding of business needs on the demand side, combined with the low quality of services provided on the supply side, led to enterprises' negative perceptions and unwillingness to purchase such services.[715]

By its third year, ASMED realized that enterprises were unwilling to pay for BDS because they didn't see the value, couldn't afford it, or could get similar services for free, often through other donor projects.[716] In most cases, the clients of the BDS providers were firms that paid for the services with USAID or other donor funds that were dedicated for that purpose. As those funds dried up, most BDS providers were unable to continue to find paying clients and the providers ceased operations; for example, by 2012, of the 12 BDS providers that had been established in Mazar-e Sharif, only two could be located.[717]

DOD'S SUPPORT TO ENTERPRISES

The U.S. military provided support to private sector development in three main ways: CERP micro grants, the Afghan First procurement policy, and TFBSO. With the adoption of COIN and the elevation of stability operations to an equal status with combat operations, the U.S. government attempted to improve the unity of effort of various U.S. agencies, which was viewed as critical to the effectiveness of stability operations.[718]

Women's Empowerment Coordinator for Agricultural Development Team examines a bee hive in Kapisa Province in July 2010. (U.S. Army photo)

Commander's Emergency Response Program

Originally introduced in Afghanistan from Iraq in 2004, CERP was viewed as an "excellent enabler of winning hearts and minds," allowing military commanders "to respond to urgent humanitarian relief and reconstruction requirements within their areas of responsibility" by carrying out programs that would "immediately assist the people of Afghanistan."[719]

The U.S. military's rationale for the program included the belief that the resources civilian agencies could mobilize were inadequate to the task at hand and that those agencies, especially USAID, were unable to execute reconstruction activities in insecure environments. Given the military's ability to operate in non-permissive environments, and to quickly and efficiently deploy resources there, military officials believed they were better suited to meet the most pressing needs of the local communities.[720]

CERP funds were used by various military units for a wide range of projects that included agriculture, infrastructure (including roads), transportation, power, and telecommunications. A very small percentage of CERP funds was also used in the form of micro grants to businesses to incentivize entrepreneurship. The 881 projects labeled as micro grants totaled $6.5 million, or only 0.44 percent of total CERP disbursements.[721] Additional CERP projects, such as marketing assistance, construction of roads and culverts, and refurbishment of bazaars and market buildings were complementary activities that stimulated the local economy.[722]

The program initially prohibited funding of private businesses, but starting in 2009, an exception was made for micro grants.[723] According to CERP guidelines, a micro grant was financial assistance provided in kind, cash, or both, with a value of less than $2,500, given to disadvantaged entrepreneurs engaged in small and micro business activities, who lacked "independent wealth or were otherwise unable to access sufficient business credit at commercially reasonable terms."[724] The 2009 guidelines initially set the limits for micro grants at less than $2,500, although greater amounts were allowed with approval from progressively higher levels of command. The limits were later increased to allow grants greater than $30,000 with the approval of the USFOR-A commander.[725] The intent of the micro grants was to increase economic activity, particularly in areas where small businesses had suffered because of insurgent violence. The micro grant program expanded the flexibility of CERP and authorized commanders to provide cash, equipment, tools, or other material support to small businesses that lacked available credit or financial resources.

The process of awarding micro grants to businesses was deliberately bureaucratic to ensure appropriate use of CERP funds. The process required approvals from senior officers, who were typically PRT commanders, in addition to vetting the businesses in close consultation with the district government officials and follow-up assessments of the businesses. However, the officers could only monitor the process within the short timeframe of their tours, which were typically 9–12 months. Also, the inclusion of Afghan government officials in the selection process didn't ensure the appropriate use of funds, but instead created an opportunity for corrupt officials to demand payment in return for their approval.[726]

Partly because of the way CERP was structured and administered, it is hard to find evidence of the effectiveness of micro grants.

The use of micro grants paralleled an overall increase in small-scale CERP projects because of the perceived failure of large-scale ones. Some members of Congress had grown increasingly skeptical of CERP's large-scale infrastructure projects and believed CERP was not well designed for such projects because they were largely "unsustainable and led to waste, fraud, and abuse." The members felt CERP should focus on quick and small projects, with an emphasis on military, not development, objectives, and not turn into a "development bank."[727] CERP projects were subject to additional criticism for the lack of evidence that they were successful in promoting even short-term stabilization.[728]

Partly because of the way CERP was structured and administered, it is hard to find evidence of the effectiveness of micro grants. Some civil affairs officers who were skeptical of micro grant effectiveness noted they didn't use micro grants for various reasons, including the cumbersome and slow bureaucratic process for approvals, "no mechanism for follow-up" due to lack of project turnover to the government, and "no way to create metrics of effectiveness."[729] While not specifically assessing micro grants, multiple assessments—by GAO in 2009, U.S. Army Audit Agency in 2010, and SIGAR in 2018—consistently reported there were limited metrics or means by which CERP's overall effectiveness could have been determined, and where there were established metrics, data weren't collected from the field consistently.[730]

In the absence of sufficient data, an assessment of CERP's effectiveness by RAND in 2016 used proxy measures, including nighttime light data, and found a statistically significant correlation between CERP projects and economic activity in the area.[731] However, the report also cautioned that the study design didn't allow RAND to provide any clear insights about CERP's effectiveness, and cautioned that such cause and effect relationships in complex operating environments like Afghanistan are difficult "due to the range of actors and developments and their interactions that can affect local conditions."[732] One of the factors not listed in the RAND report is the presence of military forces, which can have a significant impact on economic activity. For example, a 2012 empirical study found that entrepreneurship and economic opportunities in high-conflict Afghan villages tended to increase merely as a result of the foreign military's presence, which created a demand for goods and services and therefore contributed to increased economic activity.[733]

Delivering financial support to small businesses without an effective mechanism for monitoring the selection, implementation, and impact, especially when a do-no-harm analysis of CERP wasn't conducted to assess how interventions might have generated unintended consequences such as grievances, can prove to be counterproductive, as it promotes a culture of dependency and distortion in the market.[734]

Afghan First

First launched in 2006 and expanded during the 2009–2012 surge period, the Afghan First procurement initiative was an explicit policy for how the military should contract with local companies to stimulate the economy. The impetus for this initiative originally came from the Peace Dividend Trust (PDT), funded primarily by Canada, and its "Afghan Marketplace," which tried to link international buyers of goods and services with Afghan sellers through an online directory of businesses. PDT also provided technical assistance to Afghan businesses in Kabul, Mazar-e Sharif, Jalalabad, and Kandahar to increase

Workers at the Kabul Milli Trading Company factory assemble combat boots for the Afghan National Army in Kabul in September 2010. (U.S. Air Force photo)

their ability to win contracts.[735] Initiated and subsequently codified in the FY 2008 NDAA with the purpose of infusing money into the local economy, the Afghan First policy was expanded beyond DOD when the 2009 Supplemental Appropriations Act stipulated that State and USAID could award Economic Support Funds to Afghan entities with limited competition.[736]

The main rationale behind the Afghan First policy was that much of the money donors spent on goods in Afghanistan went to Pakistan, China, Turkey, and other countries where the purchased items were produced. Therefore, the initiative aimed at having Afghan companies make as many of the products the United States and its coalition partners were buying as possible, instead of importing them from other countries. This way, more money stayed in the country and more jobs were created. The U.S. government also wanted to prove that quality goods could be made in Afghanistan at reasonable prices. As part of the Afghan First initiative, U.S. agencies worked with Afghan businesses to help them improve the quality of their products and develop the business management skills to eventually compete in the commercial and international markets.[737]

While the official policy was solidified in 2009, there were previous, similar efforts. In 2006, the Afghan Beverage Industries, the company that produced Cristal Water, was the first Afghan company to win a contract to supply bottled water to the U.S. military. In 2016, the company signed a bottling agreement with PepsiCo Inc. to manufacture and distribute PepsiCo products in Afghanistan.[738] This contract allowed the company to sustain and diversify its operations beyond only bottled water, for which the demand came mainly from the foreign military and civilian presence.

Between 2008 and 2011, U.S. government agencies reported awarding $654.4 million in contracts directly to 214 Afghan companies. The majority of the contracts were in construction, followed by commodities and services.[739] While in theory this represented money going into the Afghan economy, Afghan First's impact on employment cannot be assessed because of the lack of a suitable methodology, accurate data from the field, and standard definitions of employment.[740]

In 2009, shortly before U.S. spending peaked, concerns began to surface about where the money was going. The 2009 report of the Commission on Wartime Contracting and media reports of U.S. contracting practices that unwittingly funded the Taliban led to increasing concerns about contract oversight.[741] Making contracting "commanders' business," the COIN Contracting Guidance issued in 2010 by USFOR-A and ISAF Commander General David Petraeus directed military and civilian personnel of NATO, ISAF, and USFOR-A to hire Afghans first, buy Afghan products, and build Afghan capacity, but also highlighted the necessity of establishing systems and standard databases to ensure contracts were not awarded to malign actors.[742] Also in 2010, the U.S. Embassy established an Afghan First Working Group to coordinate U.S. and international military and civilian efforts in implementing the Afghan First policy. The same year, DOD established a vendor vetting cell, mainly vetting contracts equal to or greater than $100,000. However, the cell didn't routinely vet subcontractors, even when their contracts exceeded that threshold.[743]

Despite consistent efforts to improve contracting and accountability, vendor vetting remained a challenge. A SIGAR audit conducted in 2012 found U.S. contracting authorities used various methods of announcing contract opportunities, instead of a single repository. They also did not consistently use information available in various databases to vet Afghan companies for Afghan ownership, licensing, and past performance. As a result, access by Afghan companies might have been limited and contracts might have been awarded to companies that were not eligible.[744]

Task Force for Business and Stability Operations

DOD's most direct and large-scale engagement with the private sector in Afghanistan was through TFBSO, which was created by DOD in Iraq in 2006 and expanded to Afghanistan in 2010. While TFBSO was initially conceived as a group of "expeditionary" business specialists intended to improve DOD's contracting practices and facilitate contracts with local vendors in Iraq, by 2010 it had expanded to take on a broader economic stabilization role, with the mission to "promote economic stabilization in order to reduce violence, enhance stability, and restore economic normalcy" in Afghanistan.[745] A former TFBSO senior official noted that TFBSO was critical of USAID's "development approach" to the private sector, such as providing grants, and viewed its role as a "bridge to the private sector" or "a private equity firm," by promoting private sector investments in key sectors, such as cashmere and natural gas.[746]

Expeditionary Economics

Common usage of the term "expeditionary economics" arose from a 2010 *Foreign Affairs* article that called for the military to actively engage in private sector development in conflict environments as "part of any successful three-legged strategy of invasion, stabilization or pacification, and economic reconstruction."[747] This approach advocated a dominant role for the military because, as the best-resourced institution, it could quickly deploy and get results in non-permissive environments. Advocacy for expeditionary economics often contains implicit and explicit criticisms of traditional U.S. aid programs, which are seen as sluggish, ineffective, top-down, and not sufficiently focused on the task at hand: stability.

TFBSO's mission in Afghanistan ended in December 2014, concurrent with the security transition and withdrawal of U.S. troops. Between 2010 and 2014, TFBSO obligated more than $675 million for various projects in agriculture, banking, investment facilitation and business support, indigenous industries, energy, mining, and women's advancement.[748] While TFBSO implemented large-scale projects in natural gas and the extractive industry, this report focuses on their direct support to private enterprises that took place under TFBSO-defined project categories of *investment facilitation and business support* and *indigenous industries*, as highlighted in table 2.

TABLE 2

A SNAPSHOT OF TFBSO PROJECTS

Programs	Value ($ MILLION)	Description
Energy Projects	$112.4	Hydrocarbon exploration and production, expanding Afghanistan's natural gas assets
Mining Projects	89.2	A geological survey, technical training, and business tender support and promotion
Investment Facilitation and Business Support	63.5	Investment facilitation, business incubation, and business acceleration
Indigenous Industries	16.2	Carpets, cashmere, gemstones, and jewelry
Agriculture Projects	15.3	Capacity building and infrastructure development, support for two agricultural colleges
Banking Projects	13.6	Training in finance and international standards of banking
Women's Advancement	6.1	Vocational training center for women, Center for Women's Economic Development

Note: Shaded cells indicate areas discussed in detail in this report.

Source: SIGAR analysis of TFBSO documents obtained from DOD, contract administration offices that supported TFBSO, and TFBSO former contractors.

Investment Facilitation and Business Support

One of TFBSO's initiatives was to facilitate private investment in Afghanistan by identifying promising small and medium enterprises that were vetted and assessed to be commercially viable, then presenting them to potential investors and financial institutions. Serving as an intermediary, TFBSO sought to reduce transaction costs and assist with negotiations by facilitating meetings and conducting market and feasibility studies. For example, the task force facilitated around $5 million of investment in small and medium enterprises.[749] It also facilitated loans from domestic and international financial institutions to Afghan companies, including a local media company and an ice cream factory in Herat. TFBSO also organized multiple visits to Afghanistan for foreign investors and assisted a natural gas producer by facilitating negotiations between the Afghan government and foreign financiers, including the International Finance Corporation and a U.S.-based investor.[750]

Field Story #2: The IT Startups

TFBSO's technical support helped young Afghan entrepreneurs set up small IT companies in Herat. However, some of these companies found it challenging to generate revenue in the absence of any external support.

One IT startup provided webhosting services to local businesses in Herat. TFBSO provided the company with office space at the Herat incubator and mentored the company's founder in business and marketing planning, financial tracking, and project management. TFBSO introduced the founder to a U.S. investor, but the hoped-for investment did not materialize. The founder also participated in an exposure trip to the United States that was facilitated by TFBSO, after which he opened another small IT company that provided digital marketing services. The company trained and then hired Herat University's IT graduates as interns, who received a small monthly stipend from a USAID project. However, despite this extensive training, financial infusion, and opening of doors to potential backers, deteriorating security and lackluster demand made it challenging for the startup to remain profitable without outside support.[751]

Another IT startup, founded by an Afghan woman with assistance from TFBSO, gained international recognition for the woman's pioneering work in the technology sector. However, the company's promising start and involvement in a range of activities, including software development, IT support, and building network and internet facilities inside businesses, was later reduced to developing one educational software product. Some of the reasons for this dwindling operation were the cumbersome bureaucracy of Afghan government contracting, a threatening environment for women-run businesses, and the departure of key staff.[752] When the company couldn't generate revenue through sales, the owner had to resort to creating a nonprofit organization to raise funds to provide mentoring for other aspiring female entrepreneurs.[753]

Another TFBSO initiative aimed at developing the commercial information technology (IT) sector by creating an IT incubator in Herat, where TFBSO believed there were a number of "experienced computer scientists." The goal was to turn Herat into the "Bangalore of Afghanistan" by identifying promising Afghan startups and providing them with support, such as office space, internet access, and business advisory and consulting services, as well as connecting these companies with U.S. and international investors.[754]

After a TFBSO internal analysis of its program and its increasing familiarity with and adaptation to the realities of Afghanistan, it expanded the recipients of its business advisory services to include not only IT startups, but also more mature small to medium enterprises from other sectors, such as food processing, light manufacturing, and chemicals. The IT incubator was renamed as business accelerator.[755] TFBSO reported that by the close of the program in 2014, 62 entrepreneurs and 13 companies (out of 34) graduated from the business accelerator.[756] Some of the beneficiaries believed the initial support and networking services were beneficial, but others said TFBSO's consultants provided Western-based marketing advice that could not be applied to traditional Afghan markets.[757]

The business accelerator was eventually dissolved in 2014, concurrent with the closure of TFBSO. By this time, TFBSO had awarded American University of Afghanistan with two grants to create and manage Business Innovation Hubs in Kabul and Herat. The hubs were to continue the business advisory program begun with the Herat incubator effort.[758] By partnering with AUAF, the TFBSO team aimed to improve the long-term financial stability of the hubs and ensure their continuity after TFBSO's termination. However, despite the introduction of a fee for formerly free advisory services, the hubs were unable to become self-sufficient, because of insufficient demand and staff who weren't qualified.[759]

Indigenous Industries

In addition to providing business consulting services, TFBSO supported enterprises in the carpet, cashmere, food processing, and artisanal products sectors. To promote potential exports, TFBSO facilitated the visits of international companies and investors to Afghan companies, organized international trade shows, promoted Afghan-made products, and established processing centers. For example, TFBSO, with support from a worldwide carpet trade show organizer, held an International Carpet Design Competition to inspire students and young designers to create modern designs using traditional weaving techniques. TFBSO also facilitated partnerships of 15 international companies with Afghan carpet weavers and distributors to produce their designs.[760] One of TFBSO's successful projects included the construction of a facility in Herat to cut and wash carpets, turning them into finished products that could be sold for higher prices in international markets. Today, this company continues to be operational, employs between 12 and 30 people, and plans to expand services to meet increasing demand.[761]

However, another TFBSO project that established a carpet hub in Istanbul failed to deliver on its goals, which included training Afghans in carpet washing and finishing, and identifying and developing export routes for Afghan carpets. Similarly, in another TFBSO project that supported the participation of Afghan producers of carpets, cashmere, and jewelry in approximately 16 trade shows, it was unclear whether the trade shows resulted in increased sales of the Afghan products.[762]

TFBSO's Overall Effectiveness

TFBSO's support to enterprises in different sectors may have contributed to creating jobs, increased exports, and improved skills. However, as a January 2018 SIGAR audit report highlighted, TFBSO suffered from major shortcomings with the overall program design, implementation, and oversight. TFBSO's problems included poor record keeping; no clear articulation of mission and objectives; inconsistent coordination with U.S. and Afghan agencies; poor planning, contracting, and oversight; and insufficient planning to hand over completed or ongoing projects to other agencies.[763]

Because TFBSO didn't consistently collect data and develop objective performance measures to monitor progress, it is not possible to assess TFBSO's claims of job and revenue creation. A 2014 DOD-commissioned "economic impact assessment" projected that the combined effects of TFBSO projects alone would double Afghanistan's GDP by 2025.[764] However, that assessment was viewed by RAND as limited by TFBSO's failure to collect performance data from the start.[765]

In addition to these problems, TFBSO suffered from funding uncertainty during its initial years. Immediately after TFBSO was introduced to Afghanistan in 2010, State challenged TFBSO's authority to use Title 10 (military) funding for its programs, arguing that its development and foreign assistance activities fell under State's purview. While Congress resolved the issue in the FY 2011 NDAA by authorizing TFBSO to use Title 10 funding, DOD interpreted the NDAA as requiring TFBSO to shut down and transfer its remaining projects and assets to State by end of 2011. TFBSO's founding director, operating under the assumption that TFBSO was "basically going away," resigned, followed at about the same time by much of TFBSO's senior leadership, eliminating much of the agency's institutional knowledge and experience.[766]

While the belief that the agency would have to shut down as early as 2011 was based on a misunderstanding of the NDAA, Congress required TFBSO to

Restaurant supported by TFBSO and ABADE in Herat in April 2016. (SIGAR photo by Mariam Jalalzada)

prepare annual transition plans highlighting that all projects would transition to an Afghan ministry, private business, or other U.S. government agency by 2014. These plans were unrealistic in their assumptions about TFBSO's ability to either hand over or complete projects by that date.[767]

TFBSO was often not well-informed of intra- and inter-ministerial politics, parliamentary politics, and local or tribal politics. The task force consistently underestimated how Afghanistan's bureaucracy could cause significant delays. Although TFBSO conducted a country-wide assessment to identify development opportunities prior to its operation in Afghanistan, there was limited pre-award planning for individual projects. TFBSO also suffered from rivalries and generally poor relations with other U.S. development institutions. Officials from USAID, State, the embassy, and TFBSO all stated that coordination meetings were casual and brief and had eventually fallen apart by the time TFBSO activities concluded in 2014. According to these officials, TFBSO's perception was that it didn't have to coordinate with other U.S. government agencies and chose not to share information with USAID on multiple occasions. As a SIGAR audit found, "One senior TFBSO official stated that the task force viewed coordination with the embassy officials as a 'courtesy' rather than a requirement, and that they answered to the DOD chain of command, not the ambassador."[768]

A 2018 SIGAR audit report assessed TFBSO's 35 discrete projects as incomplete, partially complete, or mostly to fully complete, based on SIGAR's determination of the extent contract deliverables were completed. While a number of TFBSO projects were well planned, scoped, and managed, they amounted to only

Field Story #3: The Cashmere Farm

In 2009, cashmere was recognized by the Afghan government for its potential to create sustainable jobs and contribute to high-value exports. At that time, the two largest producers of cashmere were China and Mongolia, with Afghanistan the third-largest producer at 6 percent of global cashmere production. Afghanistan had 7.8 million cashmere-producing goats, but only 30 percent of them were harvested. Furthermore, Afghan cashmere was of an inferior quality and much of the exported Afghan cashmere was unprocessed, commanding a lower price in international markets. The Afghan government's plan for the cashmere sector was to move the industry up the value chain, increase processing of raw cashmere, enable producers to obtain higher prices for the raw fiber, create sustainable jobs, and reduce the cost of inputs for the carpet and textile sector.[769] While the majority of the cashmere goats were in Herat and Badakhshan Provinces, most of their wool was exported from Herat.

Recognizing the importance of the cashmere sector, TFBSO primarily focused on creating a breeding farm to produce high-quality, light-colored cashmere that was in high demand in international markets. At the same time, TFBSO planned to add value to local processing and increase the return on exported cashmere by introducing new breeding and husbandry techniques to improve goat herds, harvesting, cleaning, and spinning activities, and connecting Afghan producers with international buyers. TFBSO predicted that, with these interventions, Afghanistan could increase its output of raw cashmere fiber by 1,000 tons annually, adding an estimated $13.5 million revenue to exports per year. TFBSO also anticipated that half of Afghanistan's raw cashmere fiber could be domestically processed, rather than shipped abroad in its raw, low-value state.[770]

For this purpose, TFBSO obligated $2.3 million to Colorado State University (CSU) in 2013 to create a sustainable cashmere-producing farm of 2,000 goats in Herat. Some of these goats were flown in from Chianti, Italy, to breed with the native stock. The farm was intended to become the source of high-quality cashmere for the processing centers that had been established in Herat, with support from USAID-funded projects. Once completed, the farm was to be handed over to a private company.

In 2015, CSU reported that it had completed construction, breeding, and training at the farm and laboratory. After failing to reach agreement with the Afghan Cashmere Manufacturers Association, the university located another Afghan company, the Noor Agro Group, willing to take over operations and management. The university was ultimately unable to facilitate a required memorandum of understanding between the Ministry of Agriculture, Irrigation, and Livestock and the Noor Agro Group, putting the sustainability of the farm at risk, especially given the high cost of maintenance of the farm. This is an indication that TFBSO did not take sufficient measures to ensure a handover agreement was in place prior to setting up the farm.

When SIGAR's lessons learned team visited the goat farm in April 2016, the facilities appeared to be in operation. In a subsequent visit one year later, SIGAR auditors found the farm abandoned and stripped of all animals and equipment. MAIL officials told SIGAR they were not in contact with the Noor Agro Group and did not know what it had done with the facility.[771]

$70 million, or 22 percent of the total TFBSO direct costs.[772] Among the projects assessed as having mostly to fully achieved their contract deliverables was the Amu Darya and Western Afghan-Tajik Basin seismic reflection survey, which was lauded by an Afghan government senior official as TFBSO's most useful contribution. The official believed that this type of technical survey provided critical information and helped the Afghan government in its investment promotion efforts.[773] TFBSO also removed landmines near hydrocarbon wells in the Amu Darya Basin that opened opportunities for public-private investment. Other TFBSO components that were assessed as mostly or fully achieving their contract deliverables were the construction of a building to house the Agriculture College of Herat, a compressed natural gas station in Mazar-e Sharif, and a carpet cut-and-wash facility in Herat, all of which remain operational.[774]

However, the sustainability of some of the partially successful TFBSO projects, such as the Women's Economic Center and Business Innovation Hubs, are questionable. These projects depend heavily on external aid and often do not have sufficiently qualified staff to provide competitive and professional services to private sector clients.

Some TFBSO projects, such as the cashmere farm in Herat and a pomegranate cold storage facility in Kandahar, have either disappeared or weren't constructed at all. Other projects, such as an industrial site west of Mazar-e Sharif that included the establishment of a sophisticated glass manufacturing plant, remain incomplete. The industrial site hasn't attracted any intended investment, and the glass plant is unable to manufacture glass, primarily because it depends on a gas supply that was supposed to become available as a result of another TFBSO project to rehabilitate a nearby natural gas pipeline. However, TFBSO could not finish the pipeline before its disestablishment in 2014, and the company, after a series of discussions with MOMP, was not able to negotiate access to a reliable source of gas, which is required for the glass-making processes. A secondary plant, intended to finish the manufactured glass, was established with partial support from ABADE, and in 2016 was using imported glass while construction of the main plant awaited resolution of the natural gas connection.[775]

The recent SIGAR audit of TFBSO recommended that, if DOD or Congress authorized another TFBSO-like entity to develop the private sector, the entity should, among other things, have a defined mandate with clear objectives and measurable outcomes and develop a management system that can effectively track project progress, expenditures, and results.[776] In addition to adopting effective project management mechanisms, DOD's development initiative should also aim to complement, not compete with, other U.S. government projects. While TFBSO didn't fully coordinate with other U.S. agencies, and at times even avoided collaboration, some of TFBSO projects however, helped its beneficiaries seek assistance from other U.S. government-supported initiatives. For example, TFBSO's IT incubator consultants, who provided business development advice to entrepreneurs, also helped develop applications for USAID's ABADE grants. Similarly, TFBSO's consultants, as part of their investment facilitation, helped secure loans from OPIC. However, in other areas, such as the cashmere and carpet sectors in which various USAID projects had previously provided support, TFBSO did not adequately coordinate with USAID or other agencies to ensure the sustainability of its facilities, including the cashmere farm in Herat and the carpet hub in Istanbul.

FINAL POINTS ON SUPPORT TO ENTERPRISES

The U.S. government's decision to provide support to individual enterprises was based on the belief that local companies needed direct financial and technical assistance to expand in the formal economy, access external markets, and mitigate risk. External factors, such as political insecurity and uncertainty, weak commercial rule of law and contract enforcement mechanisms, bureaucratic and opaque tax and customs processes, costly and unreliable transportation, and limited availability of power, land, and capital constrained the performance of the private sector. In addition, in some cases, the way the U.S. government support was designed and implemented limited the impact of that support and promoted dependency.

Many companies that received direct grants became dependent on these sources of "free money."

Many companies that received direct grants became dependent on these sources of "free money." Some enterprises received support from both ASMED and ABADE, or from other projects such as DFID's Afghanistan Business Innovation Hub. Of a sample of 55 enterprises, 30 had received a grant from two or three projects funded by the same or different donors. At least six enterprises had received support from four or more projects.[777] In one example, a salt producer in Mazar-e Sharif was connected to the city power supply with support from ASMED, then received technical training from the World Bank's New Market Development program, that also facilitated its ISO certification. In the meantime, the company was waiting for ABADE-supported machinery to arrive. The company, faced with fierce competition from imported salt, expressed the need for better marketing and outreach, for which it anticipated even more donor assistance.[778]

Agencies overestimated their capacity to implement projects, especially within the aggressive timeframes often required by Washington. Internal obstacles, such as limited capacity and high staff turnover, along with external obstacles, such as government bureaucracy, corruption, and poor infrastructure, delayed operations, affected quality, hurt timeliness, and increased the cost of service delivery. Hands-on work with partner enterprises in evaluating their situation and developing their financial and technical capacities, as well as in purchasing, importing, and delivering equipment, was extremely time-consuming. Moreover, project staff often lacked the appropriate technical capacity and knowledge of the complicated local environment and its traditional ways of doing business, which resulted in delays and misallocation of resources. The project cycle, in which typically the first year was spent in start-up and the third year was spent in closing down, left limited time for actual implementation.

Finally, partly due to the security environment, U.S. agencies and their implementing partners were unable to obtain adequate and reliable information on partner firms. Aggressive vetting starting in 2010 was driven mainly by the military's concern that funding was reaching the insurgency and not by a need to verify the accuracy of information reported by companies. Documents such as registration, tax filings, basic accounting statements, and business development plans were prepared solely to obtain donor grants, and there was no way to verify their accuracy. After the process of financial and technical service delivery was complete, projects typically didn't have the means to adequately track the recipients' performance, especially after the project ended. Local companies that received U.S. technical and financial support rarely faced any legal or financial repercussions for forging documents or providing inaccurate financial information about their businesses.

CHAPTER 9
FINDINGS

Hand in Hand International photo

This report described U.S. government support to private sector development and economic growth in the context of the overall reconstruction effort in Afghanistan from 2001 to 2017, examining in depth the five main areas of economic intervention. Our analysis yielded the following Afghanistan-specific findings.

1. **Afghanistan's significant economic gains in per capita income and growth in sectors such as telecommunications, transport, and construction were largely the result of post-conflict recovery and substantial foreign spending, and were therefore not sustainable.** Despite double-digit growth in GDP, an increase in per capita income in the first decade of reconstruction, and the robust expansion of sectors such as telecommunications, construction, and transport, reductions in growth in the run-up to and after the 2014 political and security transition confirmed the lack of sustainability of an economy largely dependent upon the presence of international military and civilian personnel and money.

   A number of factors limited progress in a country trying to rebuild its shattered economy. Above all else, uncertainty and insecurity discouraged economic activity, including domestic and foreign investment, trade expansion, and formalization of the informal economy. Moreover, corruption in Afghan government institutions, weak regulatory and contract enforcement mechanisms, and changing administrative and tax policies posed significant challenges for private sector growth. While physical infrastructure, such as electricity and telecommunications, has improved since 2005, private sector growth continued to be inhibited by limited access to factors of production, including land, capital, and labor, and by poor infrastructure, such as roads.

Significant U.S. and other donor investment in economic governance contributed to the Afghan government's commendable progress in tax collection and expenditure management. However, foreign aid still financed more than 67 percent of Afghanistan's budget expenditures in 2016.[779] Progress on increasing exports and attracting domestic and foreign investment was also limited. Even the most cautious projections for post-2014 GDP growth were based on highly optimistic assumptions for both security and the expansion of the extractive industries, none of which has been realized.

2. **Establishing the foundational elements of the economic system, including sound macroeconomic policies and capacity for public financial management, at the start of reconstruction allowed some successes and set the stage for future development.**
Early investments in the foundational elements of the economic system enabled many of the successes that did take place and set the stage for future development. These necessary building blocks included the creation of the new currency, establishment of instruments for currency and exchange rate management, reform of tax and customs policies, agreements to avoid deficit spending, and establishment of an effective system for public financial management, along with institutional reforms and laws that reduce structural and procedural bottlenecks to private investment.

3. **Optimistic projections for the pace and level of progress did not reflect the realities of the Afghan economy and operating environment, the ongoing conflict, and the capacity constraints of Afghan and U.S. institutions.**
Afghanistan was not the post-conflict country it was labeled in 2001. At that time, aid officials assumed a positive trajectory of progress and did not anticipate the lingering Taliban elements would regroup and grow into an insurgency that kept the country in a state of insecurity and uncertainty, which was not an environment in which the private sector or stable government institutions could be developed. Economic activities were also affected by shortcomings in other parts of the overall state-building agenda

on which private sector development was dependent, most seriously, rule of law.

Moreover, U.S. officials' optimistic expectations for the pace and level of progress did not always reflect the realities of the Afghan economy and the operating environment, nor the capacity constraints of both Afghan and U.S. institutions. This led to overly ambitious targets and unrealistically short timeframes for projects and results.

4. **Afghans have benefited from a more open trade policy, and future benefits from trade agreements and increased regional integration may continue to accrue; however, Afghanistan's physical and institutional infrastructure and political relationships with its neighbors have limited its ability to become a trade hub benefiting from regional commerce and sustainable export markets.**

From the start, the United States and its Afghan partners had a vision of Afghanistan as a trade hub benefiting from regional commerce and exports, and encouraged trade liberalization and regional integration through agreements intended to lower barriers to trade. Unfortunately, however, given the country's situation, as well as slow progress in increasing productivity, adding value, and removing barriers to competition, Afghanistan has not fully benefited from trade as intended.

Instead, the value of imports has more than tripled, while the value of exports has seen no substantial change. Afghanistan's imports in 2017 outweighed its exports by a ratio of seven to one due to factors such as poor trade governance, institutional dysfunction, poor infrastructure, low productivity, low levels of human capital, and low value added.[780]

Afghanistan's poor trade performance is the consequence of a number of factors that make production noncompetitive and increase implicit and explicit costs for both exporters and importers. Specifically:

a. Infant industries, especially in a conflict-affected environment such as Afghanistan, require time and support to develop and compete in regional and world markets.
b. Bureaucratic processes for imports and exports, especially related to customs, have worsened over time, as have the costs of corruption. Despite reforms and technical assistance, corruption at all levels of the customs process leads to delays and raises the costs of goods and services.
c. The inability of the state to provide key capabilities, including grading, certification, and phytosanitary inspection, has likewise hurt exports.

d. Poor physical infrastructure, especially roads and power, raises costs for transport, production, and storage, and discourages investment in activities dependent on them.
e. Predatory or unfair trade practices by neighboring economies hurt Afghanistan's already struggling regional competitiveness and dampened exports. Rather than becoming destinations for Afghan exports, Iran and Pakistan saw Afghanistan as a market for their own production. Border closings and insistence on transshipment of goods have not been offset by the signing of the Afghanistan-Pakistan Transit Trade Agreement in 2010. Substantial trade with the Central Asian republics remains constrained by geography, history, mutual suspicion, and their fear of "pollution" from the narcotics and violence prevalent in Afghanistan.[781]
f. A combination of the 2003 tariff reform and the movement away from the old inflated currency and artificially low exchange rate for tariff calculations raised the price of goods, including intermediary goods, which made Afghanistan's products even less competitive.

5. **The persistence of corruption within the Afghan government, along with uncertainty about and uneven enforcement of tax and regulatory policies, discouraged economic growth.**
Despite investments by USAID, Treasury, and other development partners, well-documented corruption, along with cumbersome administrative processes and uncertainty about government tax and other policies, continued to pose obstacles to investment, business expansion, and collection of revenues by the government. Fear of government regulatory and tax-collecting institutions reinforced Afghan firms' historical inclination to stay informal and small rather than risk expanding, hampering both government revenues and private investment. The opportunities for rent-seeking were additionally enhanced by archaic regulations and vague and contradictory policies. Corruption exacerbated the constraint to growth most consistently reported by private enterprises: the lack of clear, titled land.

Especially as the 2014 drawdown approached, the government responded to increasing international pressure for revenue generation by stepping up tax collection, increasing taxes on businesses, and improving customs collection, all of which provoked negative reactions among companies and created an opportunity for corrupt officials to extract additional payments from businesses. It is not surprising that, in its 2017 Ease of Doing Business rankings, the World Bank ranked Afghanistan number 183 out of 190 countries.

6. **Inadequate understanding or mitigation of the relationships between corrupt strongmen and other powerholders limited the effectiveness of U.S. support to private sector development in generating broad-based economic growth.**
   While less well documented than corruption, the influence exerted by the political economy networks established during several decades of conflict, war, and dislocation had significant negative effects on private sector development. Many of the business elite who dominated the Afghan market were strongly connected to political power, enabling them to access contracts, tax exemptions, trading security, and money-laundering channels.[782] There is evidence, especially from the transport, logistics, private security, and extractive sectors, of how politically connected strongmen acted, sometimes violently, to quash competition and gain benefits for themselves.[783]

   These strongmen and their networks exerted undue influence over assets such as land and also affected the outcomes and perceptions of the disposition of the state-owned enterprises, as former state assets often went to a small group of players. Such capture was almost inevitable given the rush to privatize and the weak state of Afghanistan's institutions, a phenomenon consistent with other international experiences.[784]

7. **Neither the Afghan government nor society was adequately prepared for the sudden introduction of a Western-style market economy.**
   The introduction of a market economy and the opening of the Afghan economy to the world helped create opportunities and entrepreneurial dynamism, especially for a new generation of mostly urban Afghans. At the same time, these changes imposed a massive change on Afghan government and society, which was accustomed to the state taking a direct rather than stewardship role in economic activities and which was inadequately prepared for the rapid transition. This new order was not welcomed by many in the Afghan civil service, leading to obstruction and derailment of initiatives intended to strengthen the enabling environment for business.

   Many Afghans, including those in the private sector itself, did not fully understand the functioning of a market economy and the respective roles played by the private sector and the state. Due to this common lack of understanding and uneven enforcement of market principles, the market economy was conflated with unfair competition, monopolization of markets by politically well-connected firms, unfair trade practices by regional neighbors, and administrative corruption.

Some critics claim that the haste with which the market economy was pursued hampered success in competing in the regional or international market. As one critic noted, "The restrictive monetary and fiscal framework, in conjunction with a dogmatic belief of the economic authorities and their foreign supporters in trade liberalization, privatization, and private sector–led development, severely restricted the role of the state in reactivating investment and employment."[785] When disillusionment set in, even President Karzai disavowed the system he had previously praised, stating, "I think we went toward a free market economy in too much of a hurry as it was what the West wanted. It was our biggest mistake."[786]

Because of its ambivalence toward the market economy, the Afghan government had a hard time articulating and implementing an effective overall private sector development strategy as part of its economic reforms or even identifying a single counterpart institution with which U.S. agencies could work.

8. **The U.S. government's provision of direct financial support to enterprises sometimes created dependent, commercially nonviable entities, as well as disincentives for businesses to use local financial and technical services.**

Many recipients of grants and subsidized loans reported the financial resources had helped them with their businesses. Some businesses came to expect continued financial and technical support, however, which led to the creation of dependencies. In other cases, grants from donor projects, which were essentially "free money," created ambiguity, confusion, or false expectations.

Some grants and technical assistance also ended up supporting businesses that were not commercially viable because their products or services weren't in high demand or they couldn't compete with cheap imports. These businesses survived only by obtaining support from other donor projects. The availability of such sources of funding contributed to "pop-up businesses" and the creation of a class of "grantpreneurs" who kept their businesses afloat through a succession of grants from different donors and projects.

9. **Insufficient coordination within and between U.S. government civilian and military agencies negatively affected the outcomes of programs.**

The Afghanistan reconstruction was the first in which military institutions played such a central role in development activities, especially during the height of the COIN era. The level of civilian-military coordination varied over time, and was most extensive during the surge period, when USAID was drawn into stabilization activities.

Coordination *within* the U.S. government departments and agencies responsible for private sector development was sometimes problematic. According to former DOD Comptroller Dov Zakheim:

> The Pentagon remains a stove-piped operation in which each major agency, department, or even branch of the Office of the Secretary jealously guards what it considers to be its two most valuable resources: money and information. . . . If parts of DOD are reluctant to work in a collegial manner among themselves, what can be expected when DOD is asked to work alongside other departments?[787]

Civil-military coordination was made more difficult by institutional and cultural differences. Personnel often had very different views of their own roles and missions, and lacked understanding of or confidence in the other's expertise and capabilities. Part of the impetus for military involvement came from the belief within DOD that USAID was not nimble or capable enough to effectively support private sector development in an insecure environment. At the senior level, many held the belief that "USAID is simply not up to the job. . . . USAID's limitations resulted in greater pressure on the military to take on more reconstruction work."[788]

Nangarhar, Incorporated, the Jalalabad PRT's plan for "jump-starting" the economy of the region, criticized USAID for focusing on long-term development to the exclusion of counterinsurgency, which, ironically, mirrored the criticism of the military levied by USAID: the military was focused on short-term aims rather than long-term development.[789] According to the document:

> Although the [United States] is fighting a counterinsurgency campaign in Afghanistan as part of the War on Terrorism, USAID (the primary U.S. development agency operating there), is focused on 'developing Afghanistan.' . . . USAID's objective of 'developing Afghanistan' can move forward in many ways and does not always contribute to the kind of effects desired in a COIN environment. Department of Defense doctrine indicates 'reinforcing success,' while agencies such as USAID typically go where the need is greatest, sometimes for short-term gain at the expense of long-lasting effects that strike at the heart of insurgencies.[790]

In some cases, civilian personnel and implementing partners were reluctant to be associated with military counterparts out of fear that a visible association with the military could compromise their security or activities. On the one hand, civilian personnel were sometimes reluctant to share too much planning information with the military, which was alienating to the PRT military personnel. On the other hand, especially in insecure areas, USAID personnel at PRTs often felt subservient and beholden to the commander's priorities due to his or her control of transportation and therefore mobility.

10. **Within U.S. government agencies, organizational factors and human resource policies constrained the implementation of private sector development projects.**
    Capacity and organizational constraints within U.S. institutions were often at odds with their program and overall objectives. While some of these constraints were inherent to the Afghanistan environment, others were the consequences of policy. This was especially true during the surge, for example, when aid officials struggled to fill field positions.

    The major human resource constraint was short tours of duty (typically less than one year for civilian and military positions) and the resultant staff turnover rates. The short civilian tours meant that agencies had to do more frequent recruiting from an increasingly limited pool of qualified applicants, raising the probability of delayed activities when positions were not filled. This also meant that positions were sometimes staffed with personnel who were unqualified and consequently ineffective in their work. In that regard, this was most evident from 2010 to 2012 during the height of the civilian and military surge.[791] The most important consequence of short tours, however, was the lack of continuity and institutional memory. Ambassador Neumann reflected the views of many officials when he said, "If we could do one thing, it would be to lengthen tours, at least for senior personnel."[792]

    A further human resources constraint was the low institutional tolerance for risk that precluded allowing development personnel to leave their offices and bases to monitor projects and assess general conditions. As the insurgency spread and security deteriorated, these constraints became more serious as mobility restrictions limited the ability to implement and monitor programs in conflict areas.

11. **Despite economic growth, estimated poverty, unemployment, and underemployment were not substantially reduced.**
    The United States and the international community followed a core theory of change that economic growth would help reduce poverty, increase employment, and enhance overall well-being for the population, thus contributing to stability and security. While poverty is hard to measure, it has been persistent. Based on available data, the double-digit GDP growth throughout the first decade of reconstruction did not translate to better living standards for a substantial majority of the population. Post-2001 returns have primarily gone to those with assets, such as land, financial capital, and social capital. The challenge of providing employment and social services for the population was also made worse by the repatriation of over six million Afghans from Pakistan and Iran, nearly two million in 2002 alone. This would have been a challenge for most governments, let

alone one trying to rebuild a shattered state and economy. The World Bank estimated that had growth been more equally shared among the population, poverty could have been reduced by up to 4.4 percent.[793]

In large part due to contracting and management incentives, U.S. and other economic programs focused on outputs rather than outcomes, measuring success in the number of jobs created, regardless of their stability, and other discrete measurable outputs. A 2012 UN International Labour Organization report noted there was too much creation of casual and short-term jobs, and there were poor linkages between training and capacity-building programs on the supply side and job creation and the labor market on the demand side. The ILO also noted that underemployment was a larger problem than unemployment; given the loose definition of employment, almost everyone was employed. The ILO classified more than 90 percent of jobs in Afghanistan as "vulnerable employment," a situation likely to worsen given the country's young population and high growth rate.[794]

In a broader sense, there was no overarching mechanism for targeting endemic poverty. The lack of focus on poverty alleviation was not just a characteristic of U.S. assistance, though; it has also been cited as a critique of the strategy documents of the Afghan government. The ANDS, for example, specifies targeting growth "where the income and livelihoods of the poorest rise faster than the average growth of the economy;" yet, this has not been achieved, nor is it clear that it was even attempted.[795]

CHAPTER 10
LESSONS

UNAMA photo by Zakarya Gulistani

The following lessons are drawn from the U.S. experience promoting sustainable private sector development and economic growth in Afghanistan, but have a more universal application to development work currently being done in Afghanistan and elsewhere, as well as to future contingency operations.

1. **It is not realistic to expect robust and sustainable economic growth in an insecure and uncertain environment.**
   Although in early 2002 Afghanistan was considered a post-conflict nation, by 2006 it had become apparent that it was not, and today it remains a country very much in conflict. In retrospect, it was unrealistic to expect sustainable economic growth in an environment in which an insurgency and other forms of insecurity and uncertainty were increasingly present. In addition, as uncertainty in the business climate also came from poor governance and rule of law, the shortcomings in support to private sector development and in creating a thriving economy were at least in part related to the negative trends in the larger state-building enterprise and the inability to achieve a political settlement. An unrealistic view of what was possible in a conflict environment encouraged the setting of unrealistic goals, which in turn resulted in inefficient use of resources in projects which did not deliver on their objectives.

2. **Establishing the foundational elements of an economic system at the beginning of a reconstruction effort sets the stage for future success.** In Afghanistan, the early investments in the foundational elements of the economic system enabled many of the successes that did take place and set the stage for future development. Depending on conditions and needs, foundational elements can include the stabilization of the currency, strengthening of monetary policy and instruments, reform of tax and customs policies, agreements on levels of government spending, and the development of an effective system for budgeting and public financial management. Institutional reforms and laws that reduce structural and procedural bottlenecks to private investment and ensure property rights should be undertaken concurrently with these other foundational efforts. Another important foundational element is establishing mechanisms that make corruption more difficult, such as oversight of resources that are available for potential corrupt activities.

3. **Any new economic system which represents a break with a host nation's past knowledge and practice must be introduced carefully and with sufficient time to ensure adequate buy-in and development of the robust institutions required to maintain it.** The U.S. government sought to encourage the development of a robust, private sector-driven, open market economy with open external trade, with the Afghan government acting as a steward for the economy, rather than the lead. This was a sensible policy choice given the new Afghan state's limited resources, the tradition of trade, and general economic principles. However, Afghanistan's market economy was rolled out quickly and without adequate groundwork among key stakeholders, including mid-level officials and the citizenry.

   While at the highest level the U.S. and Afghan governments agreed on the desirability of a private sector-led development model, reforms were designed and formulated by a small, largely Western-educated, Afghan technical team working closely with U.S. and other foreign advisors. Mid-level government officials, as well as the population at large, did not adequately understand the concept of the free market economy and the respective roles played by the state and the private sector. Due to this lack of understanding, as well as weak enforcement of laws and regulations that were often not well understood, the market economy was conflated with unfair competition, monopolization of markets by politically well-connected strongmen, unfair trade practices by regional neighbors, and predatory corruption. As a consequence, there was limited buy-in and no national consensus. Opposing interests within the bureaucracy and ambivalence toward the market economy resulted in the lack of an effective overall private sector development strategy.

4. **Spending too much money too quickly can lead to corruption and undermine both the host nation and the goals of the United States, while too abruptly reducing funding can hurt the economy.**
While Afghanistan reconstruction was under-resourced at the start, there is evidence that at other times, such as during the 2009–2012 surge, the U.S. government tried to spend too much money, too quickly. This was sometimes due to policy decisions made by senior officials in Washington, often despite the concerns of aid officials in the field. Moreover, the complicated funding mechanisms, starting with the appropriations process, tended to create delays in money actually reaching the field. It might have been more effective to have less money per year over the course of more years, and to relax the pressure to spend—the "burn rate"—as a metric for commitment, progress, or engagement. Doing so could have reduced opportunities for corruption and may have contributed to creating more confidence in the future, something that is often lacking in a post-conflict environment.

Similarly, the steep reduction in funding at the tail end of the surge was counterproductive. The 2014 drawdown was foreseen several years in advance, but the potential negative impacts of the reduction in money were officially downplayed, even if they were anticipated by aid officials.

5. **Inadequate understanding and vetting of the webs of personal, sometimes criminally related, networks can allow elites to control economic activity at the expense of open and competitive markets.**
The technical and financial assistance provided to Afghan institutions and firms relied mainly on Western technocratic models that often failed to adequately consider how powerful Afghan social groups and institutions influenced public policy and the functioning of markets. Especially in the early, chaotic days of the reconstruction, some individuals and groups developed "special relationships" with military and civilian institutions that provided them with political support and legitimization and in turn enabled them to receive multiple contracts, grants, and loans for projects. Because these groups and their influences were often opaque to outsiders, strongmen were able to establish themselves in the economic realm and exert a negative effect on competition and access to markets; this reinforced patronage networks and discouraged new firms.

Similarly, because of insufficient understanding of or interest in mitigating the networks of well-connected individuals, privatization of the state-owned enterprises not only failed to generate the investment in productive ventures that was the main rationale for privatization, it also fostered corruption by enabling the capture of resources by those individuals and allied government officials. These networks limited the strengthening and reform of government institutions that were meant to ensure a fair enabling environment for the private sector. The examples of the Kabul Bank collapse and the Ghori cement factory disposition illustrated how political forces can overwhelm institutions and established processes. Furthermore, the implicit toleration of corruption and often unintentional U.S. support for corrupt officials undermined support for private sector development initiatives from the Afghan population.

6. **Successful private sector development efforts must be nested within the development of the rule of law and overall good governance.** Private sector development cannot be seen as isolated from the development of the rule of law and good governance; they go hand in hand. Perhaps as much as the unstable political and security situation, weak and corrupt institutions were a source of uncertainty that discouraged economic activity. Corrupt practices by strongmen, predatory government officials, unreformed courts, and other institutions were consistently identified as the most significant factors discouraging economic activity. Many U.S. officials recognized these factors; however, they were either unable to do anything about them or else security or political objectives took precedence.

7. **The choice of a model for economic growth must realistically acknowledge a country's institutional and political environment and its physical endowments.** Considering the significant physical and institutional challenges facing Afghanistan, as well as the high levels of uncertainty, the quick lowering of barriers to trade was likely to have some negative consequences. While U.S. government officials understood Afghanistan's disadvantages in infrastructure, human capital, geography, and weak institutions, interventions were insufficient to enable the country to overcome them and ramp up production to meet domestic needs. The quick opening of borders and reduction in other barriers to trade without simultaneous support to domestic industries essentially allowed imports to flood into the country from regional neighbors. A more flexible, pragmatic approach with greater allowances for promoting priority Afghan sectors might have allowed more competition and domestic production for the internal market, eventually allowing Afghanistan to become more open and able to compete in regional and global markets.

8. **The provision of grants and below market rate loans can undermine commercial banks and other market-oriented institutions and create unsustainable businesses.**
While provision of finance allowed economic activity, grant programs sometimes acted as "free money" for unprofitable enterprises, which then expected continued financial or technical support and led to firms making investment decisions that were not economically viable or sustainable. Many firms stopped operations or went into "hibernation" once funding stopped.

Grant and loan programs created disincentives for firms to borrow from market-based financial institutions. While some of these market interventions may have been justified on perceived pragmatic grounds of wanting to jump start enterprises, continuing support without adequate reference to performance was inconsistent with the market principles the United States espoused and with the policy advice it was dispensing to the Afghan government.

9. **Support to businesses and government institutions needs to be tailored to the environment.**
Much of the enterprise-level support was not well suited to the Afghan environment. Especially in the early years after 2001, projects and approaches were often imported from other recent post-conflict countries, such as Kosovo, with minimal adjustments for Afghanistan. Especially outside of the major cities, most of the private sector in Afghanistan remained in the nascent stage, with business operations conducted at a traditional level.

The business development service firms that were created, trained, and supported by USAID projects were expected to become self-sufficient by providing the same services to other firms on a fee basis; however, they were unable to sustain themselves due to low demand from Afghan businesses. Small Afghan companies did not have a tradition of using these specialized services, while larger firms didn't trust the quality and expertise of these newly created providers.[796] Despite the translation of materials into local languages, much of the content and logic of business development services, executive coaching, and the technical advice provided to firms relied heavily on a Western model of professional services that was often mismatched to the environment and did not fit well with the needs and operating styles of Afghan small enterprises, especially in rural areas. Senior technical experts often lacked experience in Afghanistan or even in post-conflict or developing economies, and therefore were unable to provide effective guidance and support.

Technical innovations such as computerized customs management and sophisticated bank monitoring had the potential to improve the efficiency of government institutions, but were insufficient in themselves to resolve one of the most fundamental constraint to private sector development: ensuring a reasonably facilitating, minimally corrupt, enabling environment.

10. **Clear agreements on institutional roles, responsibilities, and lines of authority, reinforced by human resource policies that fit a post-conflict environment, are necessary for an effective private sector development strategy and for overall development.**
While U.S. officials were in overall agreement on a private sector-led development model at the strategic level, different views at the more tactical and operational levels, combined with unclear mandates and competing institutions' inter- and even intra-institutional rivalries, made it more difficult to translate that model into results. This was especially true between civilian and military agencies, where the lack of understanding and appreciation of competencies across civil-military lines fueled rivalries and reduced agencies' ability to work harmoniously. Coordination mechanisms were developed over time, but particularly in the immediate post-2001 period, there was often no space, time, or incentive for agencies or even projects funded by the same agencies to work together. Frictions were further exacerbated during the 2009–2012 surge period by the pressure to spend funds.

Human resource policies, especially short tours of duty and security restrictions that limited mobility, impeded the ability of U.S. government personnel to implement and monitor projects, as well as constrained understanding of the environment and building relationships with local partners. Motivated personnel were hamstrung by strict security protocols, even in the early years when there were objectively fewer risks.

11. **Rigorous monitoring, evaluation, and analysis—which transcend individual projects and programs—are necessary to understand the effectiveness of private sector development interventions.**
Assessing the effectiveness of private sector development support in generating economic growth, including whether that support led to increased stability, was extremely challenging. This is partly because, in the complex and data-poor environment of Afghanistan, outcomes were the result of numerous factors, all of which could be changing at one time. Moreover, the security environment and its effects on the mobility of field staff made rigorous monitoring and evaluation a challenge. While the information base is much better now than in 2001, partly because agencies

invested in improved technologies and varied methods, monitoring and evaluation remains a challenge in the Afghan environment.

Most private sector development-related monitoring and evaluation was tied to specific projects and therefore didn't capture the long-term or lagged impact, especially where there was a change in the contractor or NGO implementing an activity. This not only limited understanding of effectiveness, but also encouraged aid officials and implementing agencies to focus resources on outputs that could be counted within a project period.

12. **Investments in human capital have significant returns, although it may be years before they are realized.**
In both the public and private sectors, the combination of available opportunities and the training and educational opportunities provided by the United States and its international partners led to increased human capital and institutional capacity. Capacity building was imperfect, but it yielded results. Today, a class of young, mostly urban, entrepreneurs, including some who went to the United States and elsewhere for higher education, are able to use these skills and techniques in higher-end private enterprises. In addition, one positive outcome of an otherwise often corrupt system of subcontracting in development projects was the burgeoning business capacity of some of the participating companies. While individuals benefited, the full, long-term return for Afghanistan awaits the establishment of peace and stability.

CHAPTER 11

CONCLUSIONS

UNAMA photo by Fardin Waezi

The preceding analysis discussed U.S. support to private sector development and economic growth from 2001–2017. It highlighted the difficulties of promoting economic development in a war-shattered economy, but also noted some of the successes.

Afghanistan's early economic gains were largely due to an immediate post-conflict recovery and the large infusion of foreign spending, and therefore were not sustainable at those initial levels. Early optimism was deflated by the fact that Afghanistan turned out not to be a post-conflict nation, after all. At the same time, the U.S. government's initial efforts to set up basic economic infrastructure, laws, and policies—undertaken in concert with allies and international organizations—helped set the stage for the progress that did take place. Successes included building Afghan government capacity in public financial and macroeconomic management, the dynamic growth of sectors such as telecommunications and construction, and Afghanistan's accession to the World Trade Organization. The opening of the Afghan economy to the world, as well as the building of human capital in a new generation of mostly urban Afghans, provided opportunities for young entrepreneurs.

The U.S. government helped to build institutions that supported private sector growth, although it overestimated the speed at which Afghanistan could transition to a Western-style market economy with sustainable and accountable institutions that were not under the influence of corrupt strongmen. Rapid opening up to trade allowed Afghan consumers access to cheaper imported goods, but the opening of the country's borders before Afghan goods were competitive with imports hurt domestic producers.

Sharp changes in funding levels and spending too much money during some periods encouraged corruption and complicated the challenges of coordination within and between U.S. agencies. In some cases, the U.S. government's provision of direct financial support kept non-viable Afghan enterprises afloat. Above all else, the private sector needed stability and certainty to develop, and the overall absence of these factors limited foreign and direct investment. It would have been very difficult for robust and sustainable economic growth to take root in an environment with such pervasive uncertainty.

Based on the preceding analysis, SIGAR identified recommendations for the executive and legislative branches that can inform support to private sector development in Afghanistan and other nations.

USAID photo

CHAPTER 12
RECOMMENDATIONS

All country situations are different, and future interventions may involve countries with stronger institutions, higher levels of human capital, and a more diverse economy. Nevertheless, certain broad recommendations can be drawn from the Afghanistan experience.

EXECUTIVE BRANCH

1. **At the start of any major reconstruction effort, the National Security Council should direct the creation of an interagency working group led by USAID and staffed at the appropriate levels to plan and coordinate private sector development activities across civilian and military agencies.**

    a. **The interagency working group should include members from all agencies with a significant private sector development role and be given a clear mandate.**
    The working group should comprise personnel from USAID, State, DOD, Commerce, Agriculture, Treasury, Trade and Development Agency, and other technical agencies, as appropriate. It should have a clear administrative mandate, with defined responsibilities

and accountability mechanisms. The group should have access to sufficient technical expertise and local knowledge to provide sound programmatic advice, and should include staff who will maintain their involvement over as long a period as possible.

b. **The interagency working group should reach consensus on the respective roles and responsibilities of civilian and military institutions in private sector development, as well as the role development plays in contingency operations.**
At the start of a contingency operation or at an inflection point in an ongoing one, key civilian and military institutions should reach consensus on what conditions and in what ways economic growth can contribute to stability and what the institutions' respective roles will be. There is a gulf in understanding between civilian and military institutions, partly the result of cultural and functional differences. Working together under the right direction and mandate would provide an opportunity for bridging this gulf. If the military is to continue to play a role in development, a clearer mutual understanding will reduce the probability that either DOD or USAID—or other civilian agencies—will be asked to take on tasks for which it is not well suited. This will also help to set realistic limits on what investments in private sector development are expected to achieve in stabilization. The respective roles, responsibilities, and projected achievements will be specific to each contingency operation. Furthermore, if the military is going to have a CERP-like program, USAID or other development professionals should be formally incorporated into the planning and implementation of its activities.

c. **The interagency working group should draw on existing analysis, supplemented by a rapid but in-depth assessment, to outline a strategic approach to rebuilding the host nation economy and to anticipate the likely impact of U.S. funds and material resources.**
One initial task would be to oversee a comprehensive economic assessment of the host nation's economy and then to devise a unified private sector development approach in which the roles of and expectations from relevant agencies are clearly defined, so that agencies complement each other's work and do not duplicate efforts. This approach would help to set realistic projections and evaluate the capacity of the host nation to absorb aid and other financial flows.

Massive international spending transformed the Afghan economy, including by producing negative side effects. While an operation of a similar scale is unlikely in the foreseeable future, even smaller amounts of money can affect a national or regional economy through wage and price inflation and other dynamics. Because more is not always better, an initial comprehensive assessment of the macro economy and the state of the private sector would allow more strategic planning of types of policies and programs, as well as identifying where levels of funding are likely to have negative consequences in order to try to mitigate those effects. Resisting the inevitable pressure to spend large amounts of money at the start of operations will pay dividends in higher-quality programming over time.

d. **The interagency working group should draw from intelligence and other sources to understand the host nation's political economy networks, and should use that information to make an informed decision regarding the tradeoffs and implications for who receives financial and other support.**
The provision of financial resources to local partners on the ground can have long-term consequences, both in terms of creating or reinforcing economic power, as well as in the broader distribution of political power. Short-term relationships of convenience can lead to unintended long-term consequences of market power and lack of equity. Some of the anticompetitive and antisocial behavior in Afghanistan might have been reduced by not empowering strongmen, or at least by negotiating limits on them. At the same time, there will inevitably be unpalatable tradeoffs to achieve political and security aims.

e. **The interagency working group should take the necessary steps to understand the host nation's historical and social conditions and traditions, and to identify and mitigate possible areas of contention, resistance, and circumvention.**
The adoption of conventional free markets or other principles should be tempered by consideration of pragmatic and well thought-out mechanisms that provide domestic firms a reasonably level playing field. Post-conflict or conflict-affected countries such as Afghanistan almost by definition suffer from inherited disadvantages. Above all else, pragmatism toward long-term objectives and a realistic roadmap for moving toward a market economy, rather than adherence to ideology, should be the guiding principle.

2. **To the extent possible, State and USAID should focus market interventions at the industry or sector level, rather than selecting and supporting individual firms.**
While enterprise-level support can be provided for strategic considerations or to target the poor or disadvantaged groups, it is more effective to

create incentives at the industry or sector level. Instruments can include tax breaks, temporary tariffs on imports, and subsides on electricity or other inputs.

USAID should eliminate or reduce its use of grants and below-market loans to enterprises, which sets up perverse incentives and dependency. Instead, the agency should increase funding for market-oriented, flexible models, such as loan guarantees to private commercial banks. Mechanisms such as loan guarantees may be more effective in eliciting more market-driven enterprises. USAID programs should tolerate greater risk to encourage innovation with different approaches to private sector development.

As risk reduction is key to encouraging domestic and foreign investment in an uncertain post-conflict environment, USAID, State, DOD, and OPIC should more explicitly address the need to mitigate risk and uncertainty. Although USAID (through its grants) and OPIC (through its financing support) did aim to mitigate risk, additional mechanisms, such as companies that would provide war and disaster insurance, should be explored, as should the experience of institutions such as Afghan Growth Finance. Where possible, USAID or other financing entities should partner with a local, established financial institution that has an understanding of local market dynamics, as well as the ability to assess and verify the eligibility of the borrower and regularly monitor performance.

3. **USAID and State should assist the Afghan government in reviewing the effectiveness of all Afghanistan's regional and bilateral trade agreements, especially the Afghanistan-Pakistan Transit Trade Agreement, and then engage with trading partners to resolve constraints to Afghan exports and imports.**
Afghanistan adopted an open economy, but leaders in the Afghan private sector accused Pakistan and Iran of product-dumping and other unfair trade practices. The U.S. government should examine the veracity of these claims and, as appropriate, support the Afghan government in pursuing diplomacy, policies, and programs to mitigate them. The National Unity Government has belatedly looked to domestic demand creation through import substitution to support strategic sectors; the U.S. government should assist the Afghan government in promoting labor-intensive and value-chain investment, which could eventually lead to increased exports, in accordance with its National Peace and Development Framework.

The U.S. government should support the Afghan government technically and diplomatically in its attempt to use WTO-allowed tariffs to promote domestic production for internal consumption and export in areas of comparative advantage and consistent with good economic policy.

4. **USAID officials working in private sector development should continue to participate in mission-wide anticorruption initiatives, and ensure these initiatives are reflected in technical and policy work at the ministry level.**
Private sector development and good governance go hand in hand. The simple existence of laws and regulations is insufficient; it is how they are implemented by the courts, government officials, and police that matters. Addressing corruption may be inconvenient in the short term, as it may challenge strongmen who have economic interests and on whom the United States is dependent for political and security objectives, but doing so has long-term benefits. Early attention to anticorruption is crucial; leaving it until later risks that it will become entrenched. Addressing corruption and promoting transparency will increase the return on significant investments that are made in building and strengthening institutions. For projects that provide technical and financial support to key ministries, such as MOCI and MOF, USAID should require proof that they have taken proactive measures to tackle corruption in taxes, certification, and other regulatory processes. All project staff should be held accountable for anticorruption measures within their projects.

5. **USAID should continue to closely team with a host nation's local institutions, such as universities, think tanks, and business associations, to provide technical assistance and training tailored to the local environment and its modes of doing business.**
"Tailored to the local environment" does not mean simply translating curricula and training materials into local languages. Rather, international best practices need to be filtered, modified, and presented in accordance with local knowledge and perspectives. In Afghanistan, many of the training manuals and other technical material were primarily a translation of theories and concepts applicable to more advanced economic systems. Many Afghan businesses simply were not able to translate their marketing and business plan development training into medium or long-term sales and marketing strategies. USAID and other agencies should support the development of material that reflects the unique constraints and opportunities of the recipient market. The desire for speed in implementation should not be an excuse to skip the sometimes time-consuming process of local consultation.

6. **USAID should continue to invest human, financial, and time resources in rigorous monitoring, evaluation, and analysis, including establishing a long-term framework that transcends individual projects.**
   USAID should devise a framework for evaluation that allows the U.S. government to fully understand the long-term outcomes of projects and programs, allowing for the inherent lag in impact. It is impossible to evaluate impact at the end of a project when the ultimate impact may be several months or even years down the road. As a consequence, programming often focuses on outputs rather than outcomes. A mechanism should be found that overcomes the fact that money for evaluation typically ends when the project does. Assessments typically take place at the start of a follow-on or new project, mainly to set baseline numbers; instead, these assessments should occur earlier, perhaps as part of the evaluation of the previous project, when they can inform the design, implementation strategy, and timeframe of the next one. USAID should be prepared to advocate for taking sufficient time to plan rigorous monitoring and evaluation, which may be difficult at the start of an intervention when there is intense pressure to "do." Finally, USAID should find technical solutions for cases where it is not able to physically monitor projects, rather than relying on third-party monitoring.

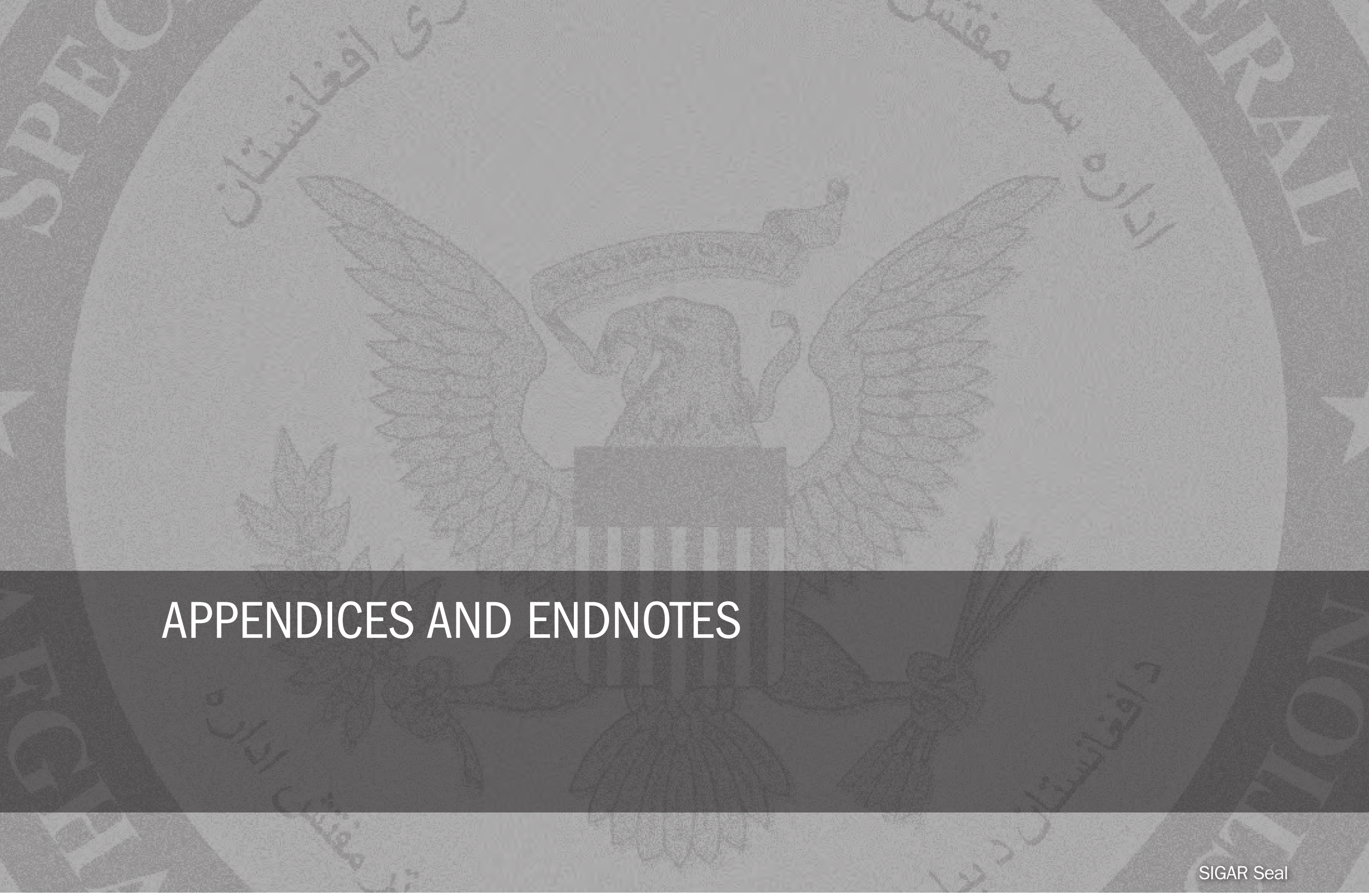
7. **State and USAID should review human resource policies to make them more suitable for conflict environments, ensure continuity, and maintain institutional knowledge.**
   Current human resource policies acknowledge the personal stress of being posted in a conflict environment and attempt to mitigate this stress with short tour lengths; at the same time, however, it is widely accepted that short tours have an impact on effectiveness. In a complex contingency operation such as in Afghanistan, one-year tours of duty in the field are inadequate, especially at the senior level. While balancing considerations of effects on families and market competition for skills, policies should be reviewed and revised to eliminate or mitigate short tours of duty and the annual mass transfer of personnel. Agencies should consider a three to five-year period of commitment, although only some of that time would be spent in country. Additional regional and language study preparation time should be built into schedules. A pool of dedicated and experienced personnel using the "Afghan Hands" model should be considered.

LEGISLATIVE BRANCH

8. **Congress may wish to consider creating a long-term private sector development fund to reduce the pressure to use spending levels as a measure of progress and avoid sharp funding fluctuations during reconstruction efforts.**

   For economic growth and private sector development initiatives that require long-term engagement, Congress may wish to consider creating a long-term fund. The way in which funding is currently appropriated and obligated creates uncertainty among implementing agencies and the host country. Although it would still be subject to periodic consultation between Congress and executive agencies, a long-term fund would allow U.S. government agencies and their host nation counterparts to plan the volume and pace of spending based on careful examination of local conditions and the capacity of U.S. and host-country institutions to responsibly implement programs. This would also help avoid the funding droughts and floods agencies experienced at various times during the Afghanistan reconstruction effort, which made implementation difficult. The fund would guarantee a predictable stream of support and potentially ease the pressure on the implementing agencies to spend quickly, which often led to inefficiency and waste, as well as assure recipient local institutions of an enduring source of support.

APPENDICES AND ENDNOTES


SIGAR Seal

APPENDIX A: METHODOLOGY

SIGAR conducts its lessons learned program under the authority of Public Law 110-181 and the Inspector General Act of 1978, as amended, and in accordance with the Council of the Inspectors General on Integrity and Efficiency's *Quality Standards for Federal Offices of Inspector General*. These standards require that we carry out our work with integrity, objectivity, and independence, and provide information that is factually accurate and reliable. SIGAR's lessons learned reports are broad in scope and based on a range of source materials; to meet the required standards, the reports are subject to extensive review by subject matter experts and relevant U.S. government agencies.

Looking at the effectiveness of U.S. government support to private sector development and economic growth in Afghanistan posed significant research challenges. First and foremost, it was difficult to isolate the influences of policies and programs from larger dynamics, primarily uncertainty and insecurity. Second, due to the broad nature of what could be considered private sector development, the research team focused on a select subset of activities that fit certain criteria, including those that represented a significant amount of

U.S. government funds. Third, it was often difficult to separate perceptions from reality, especially given the countervailing influences of the pervasive narrative of failure on the one hand and the pressure for good news and success stories on the other. Finally, Afghanistan was a data-poor environment that lacked reliable, hard economic data, especially at the subnational or sectoral level.

To prepare this report, the lessons learned research team consulted a wide array of publicly available sources. Government agency documents from DOD, State, USAID, GAO, Congressional Research Service, and congressional committees included strategies, program and policy documents, cables, project documentation (e.g., assessments, design papers, progress reports, evaluations), statistical reports, audits, and other reports. The research team also benefited from SIGAR's access to material that is not publicly available, including a range of unclassified documents provided by U.S. government agencies; no classified material was used in the preparation of this report. The team also drew from SIGAR's own work, as embodied in its quarterly reports to Congress, investigations, audits, inspections, and special project reports. Finally, the team reviewed non-U.S. government documents, including policy and strategy documents and analysis produced by the Afghan government, economic reporting from multilateral institutions, think tank and academic analysis, books, statistical databases, journal articles, international conference documentation, media reports, web sites, and unpublished reports.

The research team interviewed more than 90 individuals with direct involvement in or knowledge of U.S. government efforts in private sector development, including current and former U.S. civilian and military personnel; current and former Afghan government officials; current and former international and multilateral aid officials; experts from academia, think tanks, and NGOs; contractors and implementing agency personnel; individuals from Afghan private sector firms and business associations; and Afghan entrepreneurs.

Interviews were primarily conducted using prepared, semi-structured instruments and, in most cases, by two or more team members who compared written notes upon completion. Due, in part, to the sensitive nature of the topic, particularly for those persons still working in the U.S. or Afghan governments, most of the interviewees wished to remain anonymous. Therefore, to preserve anonymity, interview citations often cite, for example, a "senior U.S. official" or "senior USAID official." Interviews were conducted in person or by phone in Washington, Boston, New York City, and Afghanistan. Documentary research was performed in SIGAR's offices in Arlington, Virginia.

In April and May 2016, the research team conducted fieldwork in Kabul and the primary cities in the major economic zones of Afghanistan. Separate, semi-structured interview instruments were developed for the several types of respondents: Afghan government officials, U.S. government implementing partners, private sector firms and entrepreneurs, and trade associations. Instruments were modified according to the area of experience and knowledge of each respondent. In addition to key informant interviews conducted in Kabul, Mazar-e Sharif, and Herat, a survey was conducted of 59 firms in Kabul, Kandahar, Herat, Mazar-e Sharif, and Jalalabad. Informants and firms were chosen based on their experience or affiliation with U.S. government private sector development programs, including those who were government counterparts on key projects or who had received grants, loans, or other support from a U.S. project or program. A local consulting firm was contracted to identify consultants and surveyors, select interviewees and set up appointments, assist with interviews, conduct the survey, perform initial analysis, consolidate and tabulate findings, and manage logistics.

The report underwent an extensive process of peer and agency review. First, we sought formal feedback on a draft of the full report from eight subject matter experts, including Americans and Afghans, all of whom had substantial experience working on private sector development in Afghanistan. These reviewers provided significant, detailed comments on the report, which we incorporated, as possible. We also held informal consultations with other experts on specific aspects or sections of the report.

USAID, OPIC, USTDA, USTR, and the Departments of Defense, State, Commerce, and Treasury were then asked to review and comment on the draft report. We received helpful and substantive comments from USAID, State, and Defense, and briefer responses from Treasury, Commerce, and USTDA. In addition, we met with USAID, State, USTDA, and Treasury representatives to receive their feedback on the report firsthand. After revising the report in response to agencies' concerns and insights, we shared a near-final draft with USAID. We incorporated agencies' comments where appropriate, but the analysis, conclusions, and recommendations of this report remain SIGAR's own.

APPENDIX B: SELECT U.S. GOVERNMENT PROJECTS

U.S. DEPARTMENT OF DEFENSE

Project Title	Start Date	End Date	Appropriated ($)	Obligated ($)	Cumulative Disbursements through 2015 ($)
Task Force for Business and Stability Operations (TFBSO)	2009	2014	$822,850,000	N/A	N/A
Commander's Emergency Response Program (CERP)	2004	Ongoing	3,689,370,000	$2,658,877,936	$837,913,634
Of CERP, micro grants	2009	2015		6,549,533	3,722,196

Note: Numbers have been rounded. Obligations and disbursements for TFBSO were unavailable. TFBSO was authorized to conduct a 90-day assessment of economic development opportunities in Afghanistan in 2009, but did not began operations in Afghanistan until 2010. To determine the number and disbursement amounts for the micro grants, we analyzed project and funding data from CERP annual fourth-quarter reports to Congress from FY 2004 through FY 2015. We consolidated the data into a single, aggregated dataset that joined project information with expenditure data current as of the date on which the report was sent to Congress. We understand that obligation and disbursement data may have changed after the quarterly reports were provided to Congress, but, in coordination with OUSD-P on a separate CERP project, have decided to use the information provided to Congress in mandatory quarterly reporting only. We used the consolidated CERP dataset to identify 881 projects described as micro grants by conducting keyword searches of project titles and descriptions.

Source: SIGAR, *Quarterly Report to the United States Congress*, January 30, 2018, p. 226; U.S. Department of the Army, *Money as a Weapon System in Afghanistan, Commander's Emergency Response Program (CERP) SOP*, U.S. Forces–Afghanistan Publication 1-06, December 2009, p. 45; DOD, "Commander's Emergency Response Program (CERP)," Financial Management Regulation 7000.14-R, Volume 12, Chapter 27, January 2009, p. 8; SIGAR analysis of CERP data from DOD, OUSD-P, in response to SIGAR data calls, January 2014, April 2014, and July 2015; SIGAR, *DOD Task Force for Business and Stability Operations*, SIGAR 18-19-AR, January 2018, p. 1.

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (IN CHRONOLOGICAL ORDER)

Project Title	Implementer (Prime)	Start Date	End Date	Total Estimated Cost ($)	Cumulative Disbursements as of 12/31/2017 ($)
Afghanistan Economic Governance Program (AEGP)	BearingPoint, Inc.	11/7/2002	12/15/2005	$94,496,057	$94,495,834
Rebuilding Agricultural Markets Program (RAMP)	Chemonics International Inc.	7/3/2003	09/30/2006	142,334,207	142,268,021
Initial Natural Resources Assessments	U.S. Geological Survey (USGS)	3/24/2004	09/30/2005	5,000,000	4,996,078
Promoting Sustainable Private Sector Development	Center for International Private Enterprise (CIPE)	4/29/2004	04/28/2007	5,991,233	5,991,233
Afghanistan National Innovation and Competitiveness Program	On The Frontier (OTF) Group	7/1/2004	08/31/2006	5,791,089	5,750,414
Land Titling and Economic Restructuring in Afghanistan (LTERA)	Emerging Markets Group (EMG)	9/15/2004	09/29/2009	56,328,775	55,496,124
Afghanistan Trade and Commercial Law Assessment under Business Climate Legal and Institutional Reform Project	Booz Allen Hamilton	9/30/2004	09/12/2007	450,000	450,000
Economic Governance and Private Sector Strengthening (EGPSS)	Deloitte Consulting LLP	9/26/2005	09/30/2009	79,379,622	78,388,908
Afghanistan Rural Investment and Enterprise Strengthening (ARIES)	Academy for Educational Development	09/16/2006	12/31/2009	99,999,219	99,131,992
Afghanistan Small and Medium Enterprise Development (ASMED)	Development Alternatives Inc. (DAI)	10/26/2006	11/30/2012	114,003,159	113,435,323
Afghanistan Treasury Advisors	U.S. Department of Treasury	1/15/2007	06/30/2011	4,287,540	3,381,637

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U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT (IN CHRONOLOGICAL ORDER) (CONTINUED)

Project Title	Implementer (Prime)	Start Date	End Date	Total Estimated Cost ($)	Cumulative Disbursements as of 12/31/2017 ($)
Afghanistan Vouchers for Increased Production in Agriculture (AVIPA)	International Relief and Development (IRD)	9/1/2008	04/22/2013	469,701,416	469,421,481
Incentives Driving Economic Alternatives-North, East, and West (IDEA–NEW)	Development Alternatives Inc.	3/2/2009	09/30/2015	159,878,589	156,427,449
Economic Growth and Governance Initiative (EGGI)	Deloitte Consulting LLP	8/15/2009	08/31/2013	92,371,523	81,961,362
Trade Access and Facilitation for Afghanistan (TAFA)	Chemonics International Inc.	11/18/2009	11/15/2012	63,962,156	63,962,156
Agricultural Credit Enhancement (ACE)	Development Alternatives Inc.	7/15/2010	02/25/2015	75,175,296	73,548,101
Land Reform in Afghanistan (LARA)	Tetra Tech, Inc.	1/30/2011	11/02/2014	41,800,000	41,159,733
Financial Access for Investing in the Development of Afghanistan (FAIDA)	Chemonics International Inc.	2/7/2011	02/05/2017	112,706,532	111,707,001
Commercial Law Development Program (CLDP)	U.S. Department of Commerce	9/10/2012	03/31/2015	4,894,260	4,894,260
Assistance in Building Afghanistan by Developing Enterprises (ABADE)	Volunteers for Economic Growth Alliance (VEGA)	10/16/2012	07/15/2018	104,997,656	104,949,972
Trade Access and Facilitation for Afghanistan II (TAFA II)	Chemonics International Inc.	10/16/2012	08/31/2013	19,791,053	19,271,038
Mining Investment and Development for Afghanistan Sustainability (MIDAS)	ECC Water and Power LLC	3/31/2013	03/31/2017	38,718,320	34,105,674
Afghanistan Trade and Revenue Project (ATAR)	Chemonics International Inc.	11/7/2013	02/28/2018	77,754,266	73,910,183
Commercial Law Development Program (CLDP)	U.S. Department of Commerce	3/1/2014	09/30/2019	13,000,000	8,179,161
Agricultural Credit Enhancement II (ACE II)	Development Alternatives Inc.	6/24/2015	06/23/2018	18,234,849	10,763,682
PROMOTE– Women in the Economy (WIE)	Development Alternatives Inc.	7/1/2015	06/30/2019	71,571,543	25,392,990
Extractive Technical Assistance by USGS	U.S. Geological Survey	1/1/2018	12/31/2022	18,226,206	N/A

Source: SIGAR analysis of detailed USAID Pipeline Report dated December 31, 2017.

APPENDIX C: ABBREVIATIONS

Acronym	Definition
AACC	Afghan-American Chamber of Commerce
ABADE	Assistance in Building Afghanistan by Developing Enterprises
Acap	Afghan Capital Partners
ACCI	Afghanistan Chamber of Commerce and Industry
ACD	Afghan Customs Department
ACE	Agricultural Credit Enhancement
ADB	Asian Development Bank
ADF	Agriculture Development Fund
AEGP	Afghanistan Economic Governance Program
AFA	Afghani (pre-September 2002 currency)
AFN	Afghani (post-September 2002 currency)
AF-PAK	Afghanistan-Pakistan
AGF	Afghan Growth Finance
AIB	Afghanistan International Bank
AIC	Afghan Investment Company
AIRTF	Afghanistan Investment and Reconstruction Task Force
AISA	Afghanistan Investment Support Agency
ALCS	Afghanistan Living Conditions Survey
AML	Anti-Money Laundering
ANDS	Afghanistan National Development Strategy
ANDSF	Afghan National Defense and Security Forces
APTTA	Afghanistan-Pakistan Transit Trade Agreement
ARD	Afghanistan Revenue Department
AREU	Afghanistan Research and Evaluation Unit
ARF	Afghanistan Renewal Fund
ARFC	Afghanistan Rural Finance Company
ARIES	Afghanistan Rural Investment and Enterprise Strengthening
ARTF	Afghanistan Reconstruction Trust Fund
ASMED	Afghanistan Small and Medium Enterprise Development
ASYCUDA	Automated System for Customs Data
ATAR	Afghanistan Trade and Revenue
ATRA	Afghan Telecom Regulatory Authority
AVIPA	Afghanistan Vouchers for Increased Production in Agriculture

Acronym	Definition
BDS	Business Development Services
CASA-1000	Central Asia-South Asia Electricity Transmission and Trade
CERP	Commander's Emergency Response Program
CFT	Combatting the Financing of Terrorism
CIPE	Center for International Private Enterprise
COIN	Counterinsurgency
Comtrade	UN Commodity Trade Statistics Database
CSU	Colorado State University
CWC	Commission on Wartime Contracting in Iraq and Afghanistan
DAB	Da Afghanistan Bank
DCA	Development Credit Authority
DFID	UK Department for International Development
DOD	U.S. Department of Defense
ECM	Equity Capital Mining Group
EGGI	Economic Growth and Governance Initiative
EGPSS	Economic Governance and Private Sector Strengthening
EITI	Extractive Industries Transparency Initiative
EODB	Ease of Doing Business
EPAA	Export Promotion Agency of Afghanistan
E-Payment	Electronic Payment
ESF	Economic Support Fund
FAIDA	Financial Access for Investing in the Development of Afghanistan
FinTRACA	Financial Transactions and Reports Analysis Center of Afghanistan
FSD	Financial Supervision Department
FTE	Full-time Equivalent
FY	Fiscal Year
G8	Group of Eight
GAO	U.S. Government Accountability Office
GDA	Global Development Alliance
GIZ	Gesellschaft für Internationale Zusammenarbeit
GSM	Global System for Mobile Communications
HIPC	Heavily Indebted Poor Country
I-ANDS	Interim Afghanistan National Development Strategy

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Acronym	Definition
ICT	Information and Communications Technology
IDEA-NEW	Incentives Driving Economic Alternatives–North, East, and West
ILO	UN International Labor Organization
IMF	International Monetary Fund
IPDD	Industrial Parks Development Department
IRD	International Relief and Development
ISAF	International Security Assistance Force
IT	Information Technology
LARA	Land Reform in Afghanistan
LDC	Least-Developed Country
LTERA	Land Tilting and Economic Restructuring in Afghanistan
MAIL	Ministry of Agriculture, Irrigation, and Livestock
MCC	Metallurgical Group Corporation of China
MCIT	Ministry of Communications and Information Technology
MFI	Microfinance Institution
MIDAS	Mining Investment and Development for Afghanistan Sustainability
MISFA	Microfinance Investment Support Facility for Afghanistan
MOCI	Ministry of Commerce and Industry
MOF	Ministry of Finance
MOFA	Ministry of Foreign Affairs
MOJ	Ministry of Justice
MOMP	Ministry of Mines and Petroleum
NATO	North Atlantic Treaty Organization
NDAA	National Defense Authorization Act
NDF	National Development Framework
NGO	Nongovernmental Organization
NPP	National Priority Program
NSC	U.S. National Security Council
NSR	New Silk Road
NUG	National Unity Government
ODA	Official Development Assistance
OPIC	Overseas Private Investment Corporation
PDPA	Peoples' Democratic Party of Afghanistan
PDT	Peace Dividend Trust
PROMOTE	Promoting Gender Equity in National Priority Programs
PRT	Provincial Reconstruction Team
RAMP	Rebuilding Agricultural Markets Program
RECCA	Regional Economic Cooperation Conference on Afghanistan
RTA	Regional Trade Agreement
S/CRS	State/Office of the Coordinator for Reconstruction and Stabilization
SAARC	South Asian Association for Regional Cooperation
SAF	Securing Afghanistan's Future
SAFTA	South Asian Free Trade Agreement
SEAF	Small Enterprise Assistance Funds
SEED	Supporting Employment and Enterprise Development
SOE	State-Owned Enterprise
SOM	Senior Officials Meeting
SRAP	Special Representative for Afghanistan and Pakistan
TAF	The Asia Foundation
TAFA	Trade Accession and Facilitation for Afghanistan
TAPI	Turkmenistan-Afghanistan-Pakistan-India (Pipeline)
TFBSO	Task Force for Business and Stability Operations
TIFA	Trade and Investment Framework Agreement
TMAF	Tokyo Mutual Accountability Framework
TRB	Telecom Regulatory Board
UNDP	UN Development Program
USAID	U.S. Agency for International Development
USFOR-A	U.S. Forces–Afghanistan
USGS	U.S. Geological Survey
USTDA	U.S. Trade and Development Agency
USTR	U.S. Trade Representative
VAT	Value Added Tax
WTO	World Trade Organization
VAT	Value Added Tax
WTO	World Trade Organization

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ACKNOWLEDGMENTS

SIGAR acknowledges the invaluable contributions to this report from a number of individuals.

We thank Malyar Sadeq Azad, journalist; Frances Z. Brown, fellow at Carnegie Endowment for International Peace; Kim Corthell, former acting director of SIGAR's Lessons Learned Program; David Garner, former advisor to the Ministry of Mines and Petroleum; David Katz, former State Department senior advisor; Michael Leach, international legal consultant; David Mansfield, senior fellow at London School of Economics and Political Science; Richard Scarth, chartered real estate surveyor and advisor on industrial park development; Scott Worden, former director of SIGAR's Lessons Learned Program and current director of Afghanistan and Central Asia Programs at the U.S. Institute of Peace; and a number of people who wished to remain anonymous.

We thank the following peer reviewers, several of whom also provided comments throughout the review process: Nematullah Bizhan, research fellow at Blavatnik School of Government, Oxford University, and former Deputy Minister of Youth; William Byrd, senior expert on Afghanistan at the U.S. Institute of Peace; Matiullah Faeeq, former director general of the Financial Supervision Department, da Afghanistan Bank; Richard Ghiasy, researcher and project manager at the Stockholm International Peace Research Institute; Steve Landrigan, independent consultant; Richard Ponzio, director of the Just Security 2020 program at the Stimson Center; Mary Beth Theisen, consultant in private sector development; and Mary Louise Vitelli, President, Vitelli and Associates.

We thank Murtaza Edries and Pearl Horizon Consulting, which assisted in the design of the Lessons Learned Program's field research, helped identify key informants, participated in interviews, conducted a survey of Afghan firms, and analyzed the survey results. We also thank the Afghanistan Research and Evaluation Unit for providing logistical and office support during our field visit.

In addition, we thank the more than 90 individuals who gave generously of their time and insights during formal interviews and follow-up conversations.

Finally, we are grateful to all those who provided written and in-person comments on the draft report, especially those in the USAID Office of Afghanistan and Pakistan Affairs, the Departments of State, Defense, and Commerce, and USTDA.

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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.

As required by the National Defense Authorization Act for FY 2018 (P.L. 115-91), this report has been prepared in accordance with the Quality Standards for Inspection and Evaluation issued by the Council of the Inspectors General on Integrity and Efficiency.

Source: P.L. 110-181, "National Defense Authorization Act for FY 2008," January 28, 2008; P.L. 115-91,"National Defense Authorization Act for FY 2018," December 12, 2017.

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SIGAR-18-38-LL

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