



Afghanistan's Aid Requirements

How much aid is required to maintain
a stable state?

Tobias Haque and Nigel Roberts

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Executive summary

Afghanistan is exceptionally dependent on donor grants. In 2018, the most recent period for which approximate data is available, these amounted to at least \$8.6 billion – almost 80% of the nation’s \$11 billion public expenditure programme¹. This degree of dependence reflects an unprecedented international commitment to any developing country, one which has been central to shaping the modern Afghan state, its political system and its economy.

Before the signing of the US–Taliban agreement on 29 February 2020, donors had already signalled their intention to reduce grant aid over the coming years; the impact of Covid-19 on donor economies makes a reduction all but inevitable. A gradual decrease in donor assistance is a feasible proposition – provided the process is coherently managed. It is critical to avoid rapid or uncoordinated reductions or for donors to hesitate about future commitments while the Afghanistan Peace Negotiations (APNs) are getting underway. Such signals would reinforce perceptions that donors are losing confidence in the very state they have helped create, and this would affect both the negotiation process and the conflict itself.

Donors, however, need a clear indication of how much they should be committing and how today’s high levels of assistance can reasonably be reduced over time. This briefing note seeks to identify a level of public expenditure compatible with a functioning Afghan state, whatever its precise form of governance, and to suggest minimum levels of civilian and military aid going forward.

We suggest that state functionality could be preserved if overall public expenditures are reduced from \$11 billion to \$8.6 billion per annum, and donor grants from \$8.6 billion to \$6.6 billion per annum, provided that these cuts are sufficiently gradual and properly targeted. As a caveat, we do not claim to know how reducing donor grants by \$2 billion will affect the distribution of economic rents, and the

extent to which this will impact patronage networks, political alliances and state stability.

On the **security** side of the ledger, aid could be reduced from \$4.8 billion in 2018 to some \$3.6 billion by 2025/26. Here, the only donor of consequence is the United States, which currently contributes some 95 percent of donor security funding (and 80 percent of all security spending in Afghanistan). With security expenditure the cornerstone of state stability and with few realistic burden-sharing prospects, substantial US security assistance will remain essential over the next five years.

Turning to **civilian aid**, developmental and humanitarian assistance could, we believe, be reduced from \$3.8 billion in 2018 to \$3 billion by 2025/26. Civilian contributions are much more widely shared; the US is the largest single donor, providing more than \$920 million in 2018, but 76 percent of the total that year came from other sources (including \$1.8 billion from European Union countries and institutions). Once again any reductions need to be gradual, and carefully planned.

The suggested reductions are predicated on two key factors. The first is rising Afghan domestic revenues. Recent revenue collection has been on a par with comparable developing countries, but future prospects have been struck hard by the impact of the Covid-19 crisis on the Afghan economy. Revenues are expected to decrease in the near-term, from \$2.6 billion in 2018 to \$1.8 billion this year; nevertheless, creditable recent revenue performance makes it reasonable to anticipate revenues of \$4 billion per annum by 2030. Second, major donors should not imagine that additional commitments from regional countries, earnings from mineral extraction or access to concessional lending will significantly reduce Afghanistan’s aid requirements in the short term. Sustaining a viable Afghan state will depend for some time to come on significant, predictable levels of assistance from current donors.

While gradual aid reductions are feasible, they must be properly targeted. This note argues that

¹ Data on off-budget aid to Afghanistan (especially on off-budget security grants) is fragmented, incomplete, and often inconsistent. This briefing note relies on best-available estimates through compilation of various data sources, including donor reporting and government and international databases. Estimates are subject to an appreciable margin of error.

most aid reductions should come from the plethora of current off-budget programmes: collectively these accounted for nearly 70 percent of all donor contributions in 2018 (\$5.8 billion of the \$8.6 billion total), and have been shown, as a general proposition, to offer less value for money and to be more prone to wastage and corruption than on-budget programming. But the Government of Afghanistan needs to raise its delivery game and address predatory corruption much more convincingly if donors are to buy into a strategy that channels the bulk of their funding into government programmes. Donors in their turn need to agree with the Government on a few realistic performance conditions, and then insist they be fulfilled.

The domestic fiscal uncertainties associated with Covid-19 and the unpredictable politics of the APNs suggest that donors should, as a prudent minimum, sustain 2018 levels of assistance in 2021, both to ensure that critical security and civilian expenditures are adequately funded and to underscore their continuing commitment to a peaceful settlement.

We are aware that donors are apprehensive that a future Afghan Government could roll back important human rights gains, particularly women's and girls' rights. It is important, however, that fear of suboptimal outcomes does not tempt donors to turn their backs on Afghanistan and, in so doing, precipitate the very outcomes they have been resisting for the past 20 years.

Financing Afghanistan's future

This note explores what it might cost to maintain a functioning Afghan state in its essential form – whether sustaining a peace agreement or functioning in the absence of one. The data used comes from the Government of the Islamic Republic of Afghanistan, the World Bank and the Organisation for Economic Co-operation and Development (OECD). Our reference year is 2018, the most recent period for which full data is available.

Over the past two decades, Afghanistan has gradually built a set of institutions capable of providing basic national services. They are of variable quality and, in many cases compromised by corruption and poor governance – but these shortcomings should be set against what we know about the creation of legitimate, capable institutions, a process that takes generations (even in the *absence of continuous civil war*)². The Ministry of Finance's domestic revenue receipts are on par with comparable developing countries, the Central Bank maintains a stable monetary policy, community development councils exist in many parts of the country, and access to health, education, sanitation, clean water and mobile phone networks have all improved immeasurably since the 2000s.

Yet public spending in Afghanistan is exceptionally high – around 55 percent of GDP, or \$1 billion per annum in 2018. So, too, is Afghanistan's aid dependency: grants finance \$8.6 billion, or almost 80 percent of this total. High public spending is driven

by a massive security sector, which accounts for half of all expenditure and almost 30 percent of GDP (the average for low income countries being 3 percent of GDP). More than half of the \$11 billion is spent by donors outside the Government budget: two-thirds of the security outlays, all humanitarian programmes and numerous development projects implemented through commercial contractors and international non-governmental organisations (NGOs).

In the run-up to the US–Taliban agreement, donor planning documents envisaged a gradual decline in external grants, from \$8.6 billion in 2018 to \$5 billion by 2024 (World Bank, 2019a). The impact of Covid-19 on donors' own economies makes these assumptions more brittle, although some additional Covid-19 emergency funding has been provided. Covid-19 also means that Afghanistan's domestic revenues will decline, putting further pressure on the state budget.

This creates a situation for Afghanistan unprecedented in the post-Cold War era: the country is entering a peace process with little prospect of sustaining recent aid levels, let alone realising any financial peace dividend. Given the state's unusual degree of dependence on donor grants, it is worth trying to identify the minimum amount of assistance needed if the state is to continue functioning. A broad-brush estimate is possible – with obvious caveats (see annexes A and B for details on our assumptions and calculations).

2 See, for example, World Bank (2011): 'How much time has it taken to move from current average levels around the world to "good enough governance"? The results are striking. It took the 20 fastest-moving countries an average of 17 years to get the military out of politics, 20 years to achieve functioning bureaucratic quality, and 27 years to bring corruption under reasonable control. This did not mean perfection, but rather adequacy.'

What would a ‘bare-bones’ state look like?

If, as a thought experiment, you were to deduct from the \$11 billion total (i) all security spending and (ii) all off-budget humanitarian and development spending, you would find that **Afghanistan is already a ‘bare-bones’ state, as defined in public expenditure terms.**

- On-budget civilian spending equals 17 percent of GDP – lower than 90% of low-income and lower-middle-income countries.
- Civilian payroll spending is around 5 percent of GDP – low relative to other developing countries (Haque, 2019).
- Net government revenues (of \$2.2 billion or 11.3 percent of GDP in 2018)³ are not far below the average for other low-income countries (around 14 percent of GDP), limiting the scope for additional domestic resource mobilisation. Whatever short-term scope for revenue expansion there was has been torpedoed by Covid-19.
- On-budget spending on health is only \$8 per person per year (compared to a World Health Organization benchmark of \$86 per annum for a basic package of health services) - meaning that Afghans must either pay a far greater proportion of their own healthcare than citizens in most low-income countries, or manage without.

If we accept that ‘core’ state expenditures are already minimal, and that humanitarian spending should not be reduced, cutting public expenditures

back close to the levels found in most other low-income countries (23-24 percent of GDP) would mean reducing off-budget development programmes and security spending. Eliminating all Government-financed and all donor off-budget development projects would save \$2 billion per annum. Halving security spending would save another \$2.7 billion. Overall expenditures would fall from \$11 billion to \$6.3 billion per annum (equal to 32 per cent of 2018 GDP), with external grants declining from \$8.6 billion to \$4.8 billion.⁴

This is obviously a ‘straw man’ scenario, since such massive reductions in public expenditures would be highly destabilising. They would lead to reduced economy-wide demand, fewer jobs, lower incomes and increased poverty – along with serious macroeconomic impacts (Afghanistan’s trade deficit of 35 percent of GDP is financed by current levels of external grants). Significant political disruptions are also likely to result from eliminating off-budget development and military procurement programmes: these support established patronage channels. Most importantly, security forces could not sustain cuts of this magnitude and expect to remain functional. Nor could Afghan society easily adjust to the massive demobilisation that would be required: the same economic crunch means that ex-combatants would have few employment opportunities outside the militias, jihadist groups and criminal enterprises for which their skill sets have prepared them.

³ Gross domestic revenues for 2018 totalled \$2.6 billion, or 13.2 percent of GDP – but this includes transfers to the budget of Central Bank profits (paper profits generated by depreciation of the Afghani) and other non-fee/profit transfers from state-owned entities; neither are reliably sustainable.

⁴ This assumes that gross domestic revenues would fall to \$1.5 billion per annum as a result of diminished economic activity.

What will it cost to sustain a ‘viable state’?

Can expenditures be cut without undermining core security and civilian institutions, and thereby destabilising the state? In the immediate term the scope for manoeuvre is very limited, but a bottom-up analysis does suggest that sustaining a ‘viable state’ is compatible with cutting total expenditure back, over time, to \$8.6 billion and external grants to \$6.6 billion⁵ – risky as this might be (see Annex B).

While we believe that a cut in aid of almost 25 percent should be feasible, the cuts would have to be *gradual*⁶ and carefully *targeted* at areas of known wastage – in particular, by reducing some of the payments to civilian and security contractors who work off-budget. Cuts in off-budget activities are unlikely to have major or immediate impacts on growth compared with cuts to on-budget expenditures, which directly drive a service economy that generates around 50 percent of GDP.

The arguments against off-budget assistance have been well-rehearsed in many international forums over the past two decades⁷ and have gained broad acceptance in Afghanistan, where the proportion of grants delivered on-budget has risen from 10 percent in 2008 to more than 33 percent currently. The advantages of on-budget spending include greater cost efficiency, enhanced economic multiplier effects, better alignment of donor contributions with core government priorities, and reinforced government systems (when properly supervised). In the Afghan context, the US Senate Committee

on Foreign Relations observed that off-budget assistance:

‘can weaken the ability of the Afghan state to control resources, which results in donor duplication, and can fuel corruption. It has also led to the creation of thousands of donor-driven projects without any plan for sustaining them ... Instead of creating additional off-budget assets like schools, clinics, and roads, our attention must turn to how the Afghan Government will sustain and staff what the donor community has already built’

—(US Senate Committee on Foreign Relations, 2011).

World Bank analysis shows that the proportion of each dollar reaching Afghanistan through on-budget assistance is much higher (\$0.58 versus \$0.20), and that ‘overhead’ costs associated with on-budget assistance are much lower (for selected road projects, 12 percent versus 60 percent – Beath et al., 2013). On the civilian side, for all of their well-known imperfections⁸, the development efforts with the best sustained impact record are on-budget programmes like the national health programme, the national agriculture programme and the National Solidarity/Citizens’ Charter Program, which supports a network of 23,000 community development councils that implement their own projects. Continuing to build

5 This assumes a Covid-19-related decline in net domestic revenues from \$2.2 billion in 2018 to \$1.8 billion this year, rising again slowly thereafter.

6 The pre-Covid-19 donor financing scenario mentioned on page 4 assumed a *gradual* decline in grant financing to \$5 billion by 2024 – and also assumed a gradual *increase* in, not severe disruption to, domestic revenues. The faster aid cuts are made, the greater the economic contraction and the higher the risks of chaos.

7 On the benefits of on-budget and budget-accountable assistance, and of using ‘country systems’, see for example Carnahan et al., 2006; CABRI, 2008; Peace Dividend Trust, 2009; Fourth High-level Forum on Aid Effectiveness, 2011; Chandy et al., 2016; and Roberts and Russell, 2020.

8 See, e.g.: World Bank, 2019b; and SIGAR, 2020.

on the success of these activities and sustaining the institutions behind them should be central to future donor support. What is unknown, however, is how cutting \$2 billion in aid would affect today's patronage networks and alliances, and what instabilities this could give rise to⁹.

9 For a discussion of the impact of economic rents on power balances in Afghanistan, see Clark (2020) and Smith (2020, forthcoming *Lessons for Peace: Afghanistan* report).

What does a viable state need from donors?

In concluding that donors would still need to provide \$6.6 billion out of a reduced total annual public expenditure package of \$8.6 billion – still almost 80 percent of the total – it is important to understand the limits to other sources of state income.

Non-donor revenue sources

Domestic revenues

In the short term, domestic revenues can do little to reduce donor contributions. Covid-19 is reversing encouraging recent increases in domestic revenues. Until a few months ago, the World Bank's 'business-as-usual' scenario presumed real GDP growth of around 3 percent per annum, with a 'full peace' scenario bumping growth up to 6.5 percent.¹⁰ Covid-19 has dampened these expectations. The Bank currently expects the economy to contract by 5.5 percent in 2020 and to recover only slowly in 2021, with 1 percent real GDP growth; per capita GDP levels are unlikely to reach pre Covid-19 levels until 2024 (Annex D). Similar assumptions inform the 'baseline' scenario in the draft of the new Afghanistan Peace and Development Framework, where projections also show growth contracting by around 5.5 percent in 2020, before gradually recovering to around 5 percent by 2026. Using relatively cautious assumptions, we anticipate domestic revenues of \$4 billion per annum by 2030. This compares with a more optimistic Government projection of \$4.8 billion per annum by 2030, predicated on rapid improvements in revenue compliance and the introduction of a value added tax in 2021 (it should be noted that the government

has now decided to delay the introduction of the VAT until at least 2022).

Regional donors

These donors include China, India, Iran, Pakistan, Russia and the Gulf States. China has so far shown no great wish to entangle itself in Afghanistan, although it is in principle interested in mineral extraction. The other countries mentioned here are unlikely to make significant additional contributions – particularly given the serious impact of Covid-19 on their economies. Even if substantial sums *were* forthcoming from these sources, most would likely arrive in the form of tied, off-budget projects with little local economic impact and questionable contributions to growth. We do not believe that potential new sources of aid should be relied on to reduce current donors' financing requirements.

New sources of growth

Afghanistan has two areas of real growth potential: agriculture and minerals. Again, near-term expectations should be kept modest¹¹. Significant agricultural growth will require major donor investments in irrigation – perhaps an additional \$500 million a year on top of any current plans. Nor will extractives bring substantial revenues in the short term: most major projects have a four- to five-year lead time, and this horizon will keep on slipping until Afghanistan's security situation improves and its policy and regulatory environments become more investor-friendly. Neither is the current external landscape conducive to investment in Afghanistan: global growth has collapsed in 2020, bringing major

10 It should be noted that 'full peace' relied on very optimistic assumptions: an almost complete halt in violence, substantial new public investments in irrigation (150,000 hectares of new irrigation each year), and the immediate mobilization of several major extractives projects – such as Aynak, Hajigak and Amu Darya, all of which are currently stalled.

11 In the medium to long term, a well-governed Afghan state can be expected to pursue growth strategies that will develop its potential in agriculture, energy, minerals, agro-processing and regional transit, thereby enhancing domestic revenue collection and gradually reducing the country's dependency on donor grants – and this has already been factored into our net domestic revenue projection of \$4 billion by 2030.

disruptions to supply chains and weak international demand for most raw materials.

Concessional lending

As one of the least indebted countries in the world, Afghanistan could begin to access debt financing. Some prudent borrowing could help meet the country's financing needs – through a combination of domestic bonds and concessional loans (Japan, for example, has provided long-term, low interest rates to several countries). Plausible initial levels, as reflected in World Bank and IMF analysis and Government of Afghanistan projections, would be in the region of \$200 to \$300 million per annum: certainly helpful, but not transformational (World Bank/IMF, 2020; GoIRA, 2020).

Covering security and civilian costs

Returning to the \$6.6 billion required from donors, it is worth considering security and civilian spending separately.

When it comes to **security**, the US is the only donor of real consequence. The Afghan National Security Forces' (ANSF) financial dependency on the US is very deep, and this will not change soon. In 2018, the US contributed \$4.5 billion out of a total estimated \$4.8 billion in security grants – 95 percent of donor security funding (and 80 percent of all security spending in Afghanistan). The 'viable state' scenario posited in Annex B would still require about \$3.4 billion per annum in security financing from the US, out of a donor total of \$3.6 billion. The downward adjustment needs to be handled with great care to ensure that the army remains a functioning entity and can serve as a key component in any future

counterterrorism architecture – with or without a peace process.

Is it realistic to expect other donors to increase their contributions to security? While it seems unlikely, it may be possible to enhance them somewhat if a strong financing instrument can be created. Pooled, on-budget funds (in particular, the Afghanistan Reconstruction Trust Fund) have shown their value on the civilian side of the ledger. A similar 'universal' instrument focused on paying security personnel salaries and operating costs, using well-established third-party monitoring and fiduciary control techniques, might be attractive. It should probably encompass and absorb the Law and Order Trust Fund and the Afghan National Army Trust Fund, neither of which have been performing well. A successful new fund could permit a modest reduction in US security sector obligations.

Turning to **civilian aid** – that is, developmental and humanitarian assistance – the contributions are much more widely shared. The US is the largest single donor, and in 2018 provided over \$920 million, but 76 percent came from other sources (including \$1.8 billion from EU countries and institutions). The 2018 total of \$3.8 billion in 2018 could, under the 'viable state' scenario, be reduced to perhaps \$3 billion by 2025/26. Once again, however, any reductions need to be gradual and carefully planned¹². It is also vital that donors not hesitate about future commitments while the Afghanistan Peace Negotiations are getting underway. Such signals would suggest a loss of donor confidence in the state that they have been so instrumental in creating and could impact both on the negotiation process and on the conflict itself.

12 When it comes to humanitarian funding, the pressures currently created by intensified violence in 2020 and the impacts of Covid-19 give urgency to at least sustaining the 2018 financing level of \$700 million. In 2019, according to the United Nations Office for the Coordination of Humanitarian Affairs' (OCHA) Financial Tracking Service (FTS), Afghanistan received \$614 million in humanitarian support, plus some additional assistance for flood relief; so far in 2020 (as of 29 September), FTS reports total humanitarian receipts of \$451 million.

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Annex A Afghanistan's public expenditure in 2018

Figure 1 Total spending composition – USD, billions

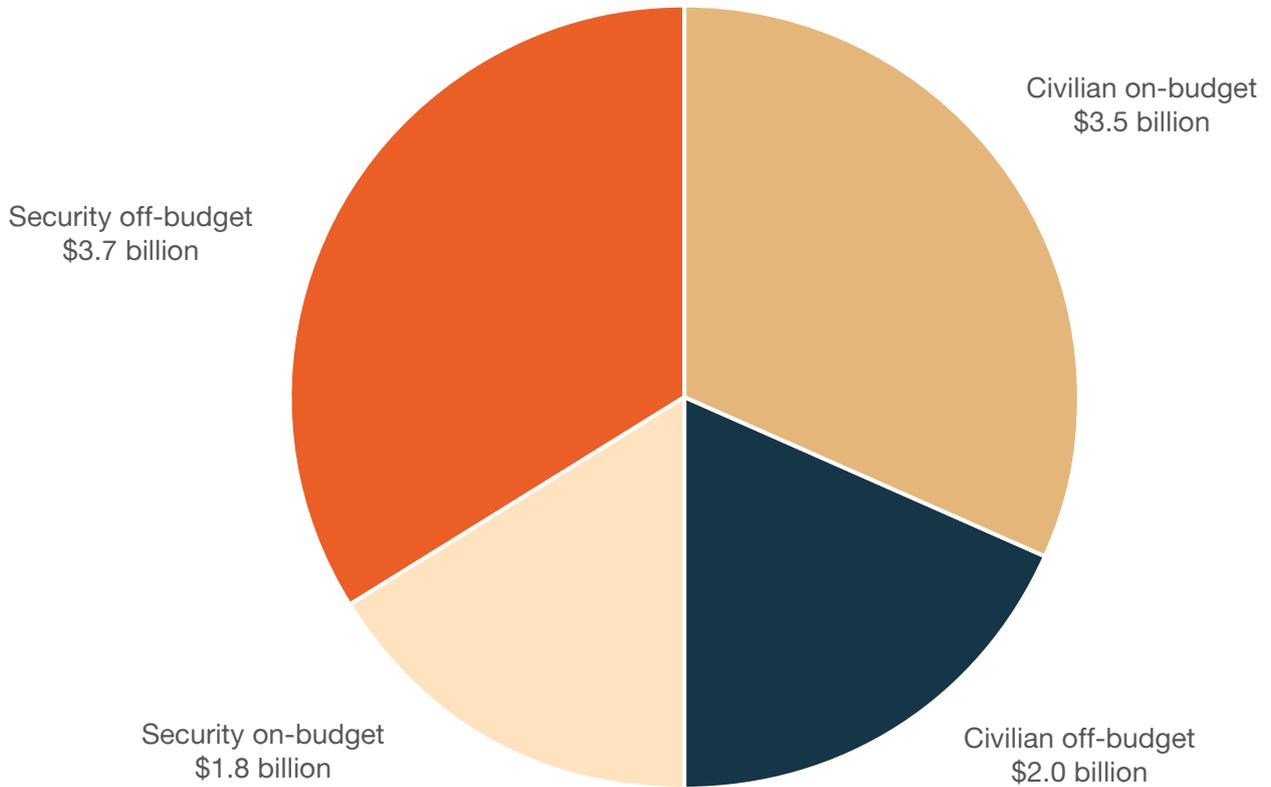


Figure 2 Security spending composition – USD, billions

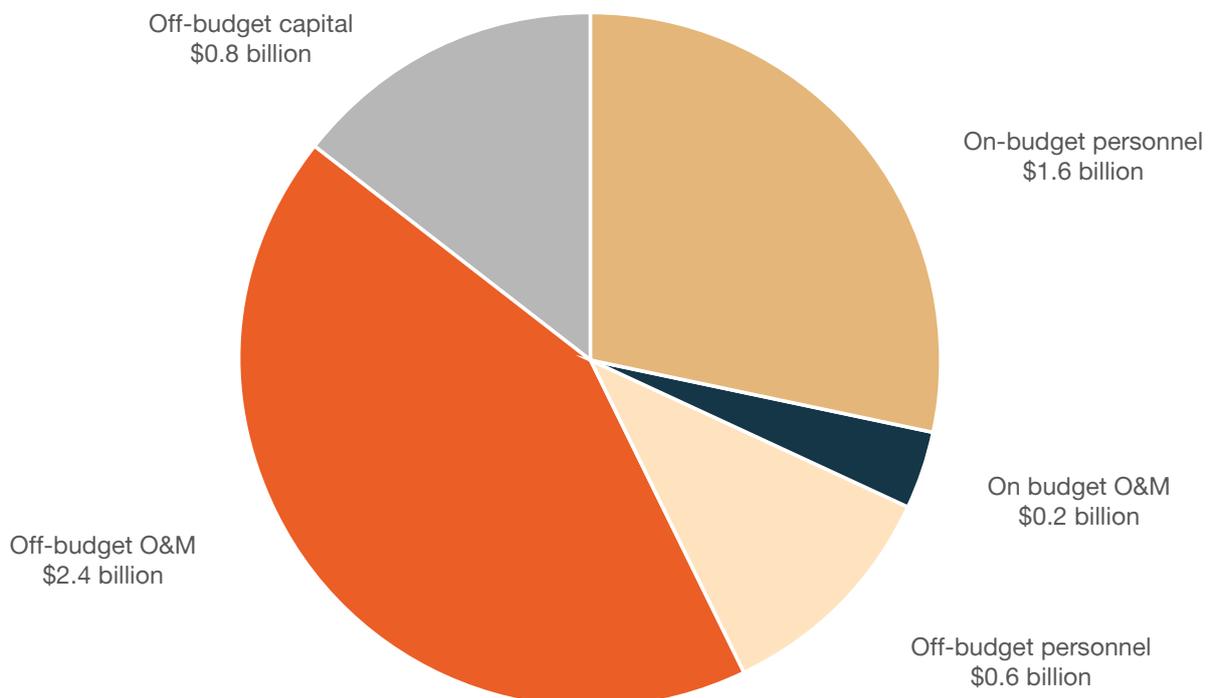
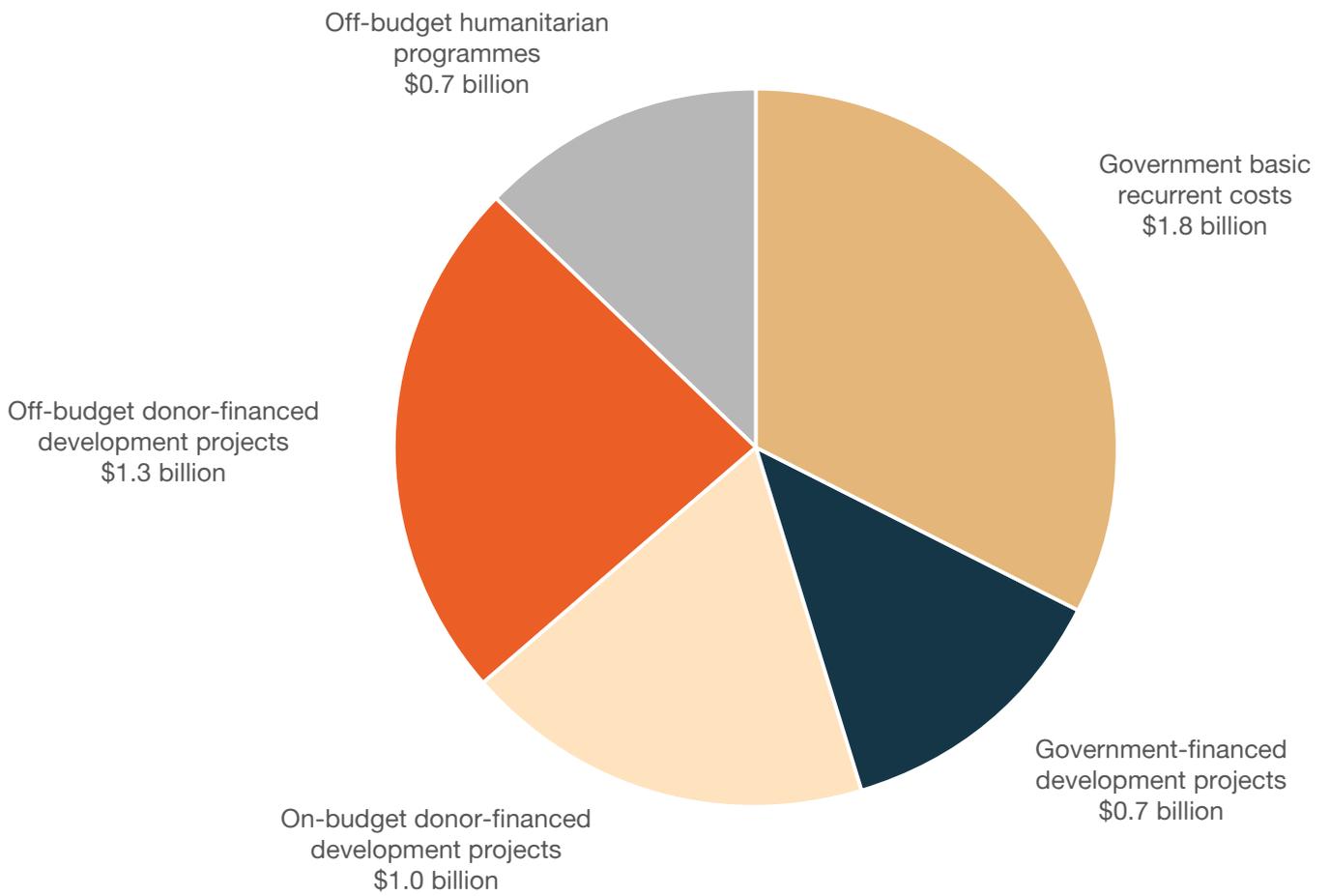


Figure 3 Civilian spending composition – USD, billions



Annex B Cutting public expenditure

1 A 'bare bones state' — from \$11 billion to \$6.3 billion per annum

Civilian

- Civilian payroll remains as is. Limited scope to cut civilian payroll spending: payroll and civil service are small and focused on basic services (of 400,000 non-uniformed civil servants, more than 250,000 are teachers).
- Civilian operations and maintenance (O&M) remains as is. Limited scope to cut civilian O&M given the need to maintain basic infrastructure. O&M is already inadequate to maintain existing assets.
- Substantial scope to cut Government-financed development projects. These projects are often politicized, small scale, poorly managed, and weakly aligned with Government priorities. They do, however, serve a political economy function as a mechanism of rent distribution to parliamentarians. **Eliminating the Government-financed development budget would free up US\$700 million per annum.**
- Donor-financed on-budget expenditure remains as is. Limited scope to cut since the majority of funds are used on a few large programs providing core health, education, and community development services. Cuts would have major impacts on service delivery, poverty, and development outcomes.
- Off-budget donor civilian spending in the pie-charts above include humanitarian spending (c. \$0.5 billion) and development spending (c. \$1.4 billion). Humanitarian expenditures remain as is. Off-budget development spending is often high-cost and has limited local economic impact; **its elimination would save US\$1.3 billion per annum.**

Security

- The bulk of on-budget security personnel costs are met by the international community. Halving the number of security personnel would allow **savings of \$800 million per annum.**

- On-budget O&M expenditures remain as is.
- The \$600 million per annum spent by donors on off-budget on security personnel is **cut by \$300 million**, associated with a reduction in personnel of 50 percent.
- Off-budget O&M costs, including for fuel, ammunition, training, repair and maintenance are more than halved, **leading to savings of \$1.3 billion.**
- Capital acquisition programs are halved, **saving US\$400 million per annum.**

2 A 'viable state' — from \$11 billion to \$8.6 billion per annum

Civilian

- Civilian payroll remains as is.
- Civilian O&M remains as is.
- Government-financed development projects are **cut from \$700 million to \$400 million per annum**, eliminating a good deal of waste without destroying all patronage possibilities.
- Donor-financed on-budget expenditure remains as is.
- Humanitarian expenditures remain as is.
- Off-budget development spending is **cut from \$1.3 billion to \$500 million per annum.**

Security

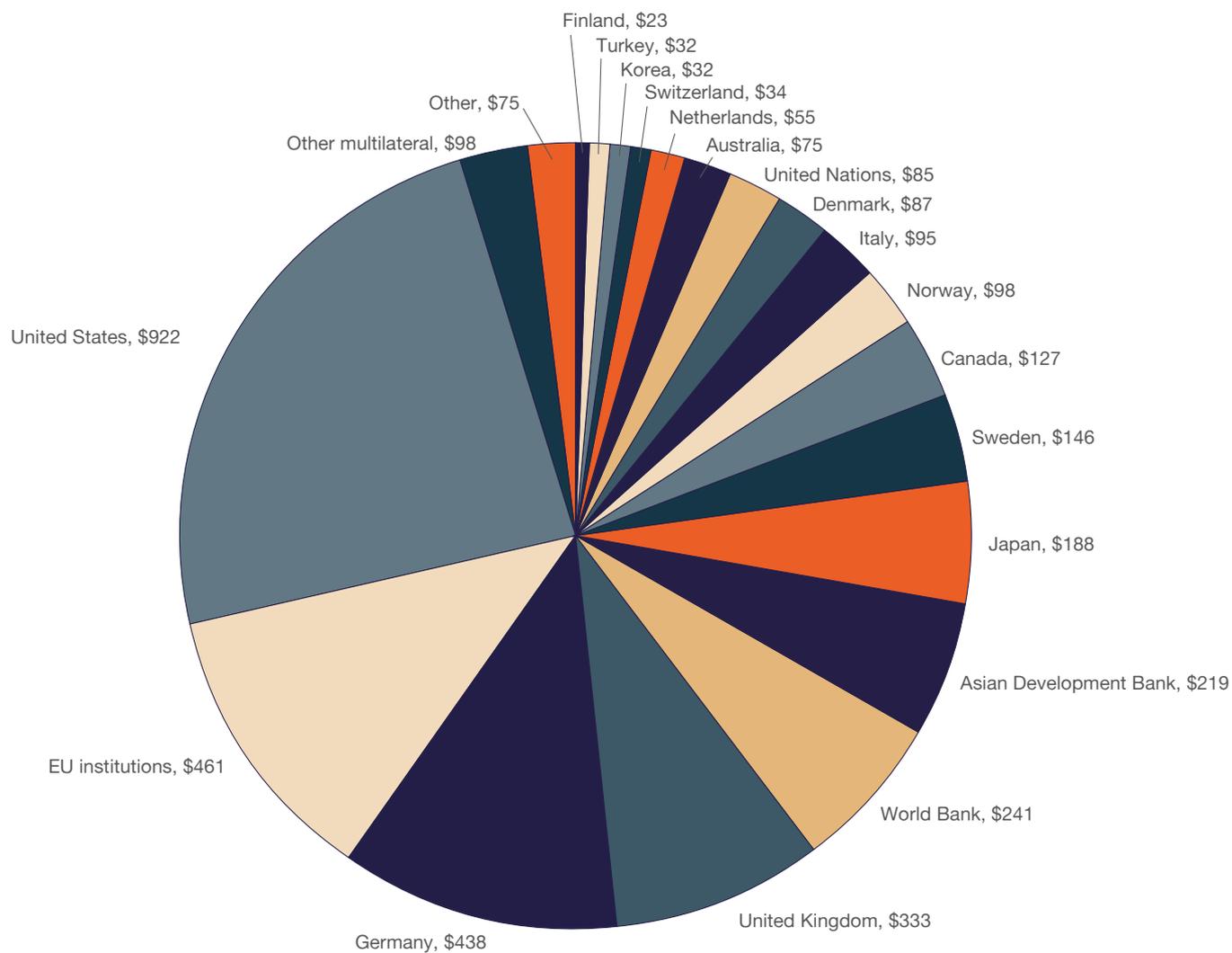
- On-budget security personnel costs of \$1.6 billion are **cut by \$0.2 billion**, associated with a 10 percent cut in personnel/ghost personnel.
- The \$600 million per annum spent by donors off-budget on security personnel is **cut by \$300 million**, associated with a cut in personnel of 50 percent.
- Off-budget O&M costs are **cut by \$500 million per annum.**
- Capital acquisition programs are reduced by 40%, **saving US\$300 million per annum.**

Table 1 Public expenditure scenarios (USD, billions)

Category	Expenditure item	2018 actuals	Bare- bones state	Viable state
Civilian	Government basic recurrent costs	1.8	1.8	1.8
	Government-financed development projects	0.7	0.0	0.4
	On-budget donor-financed development projects	1.0	1.0	1.0
	Off-budget donor-financed development projects	1.3	0.0	0.5
	Off-budget humanitarian programs	0.7	0.7	0.7
Security	On-budget personnel	1.6	0.8	1.4
	On-budget O&M	0.2	0.2	0.2
	Off-budget personnel	0.6	0.3	0.3
	Off-budget O&M	2.4	1.1	1.9
	Off-budget capital	0.8	0.4	0.4
Overall	Total Expenditure	11.0	6.3	8.6
	Total on-budget aid	2.9	2.3	2.8
	Total off-budget aid	5.7	2.5	3.8
	Total aid	8.6	4.8	6.6
	<i>Total domestic revenues/transfers</i>	<i>2.6</i>	<i>1.5</i>	<i>2.0</i>
	<i>Total expenditure as % of 2018 GDP</i>	<i>56</i>	<i>32</i>	<i>44</i>

Annex C Donor civilian grants 2018

Figure 4 Donor civilian grants, 2018 (USD, millions)



Note: The total in the wagon wheel is \$3.8637 billion; rounding errors give a total of \$3.854 billion.

Annex D Real GDP per capita projections

Figure 5 Current medium-term growth projections, assuming continued aid at current levels

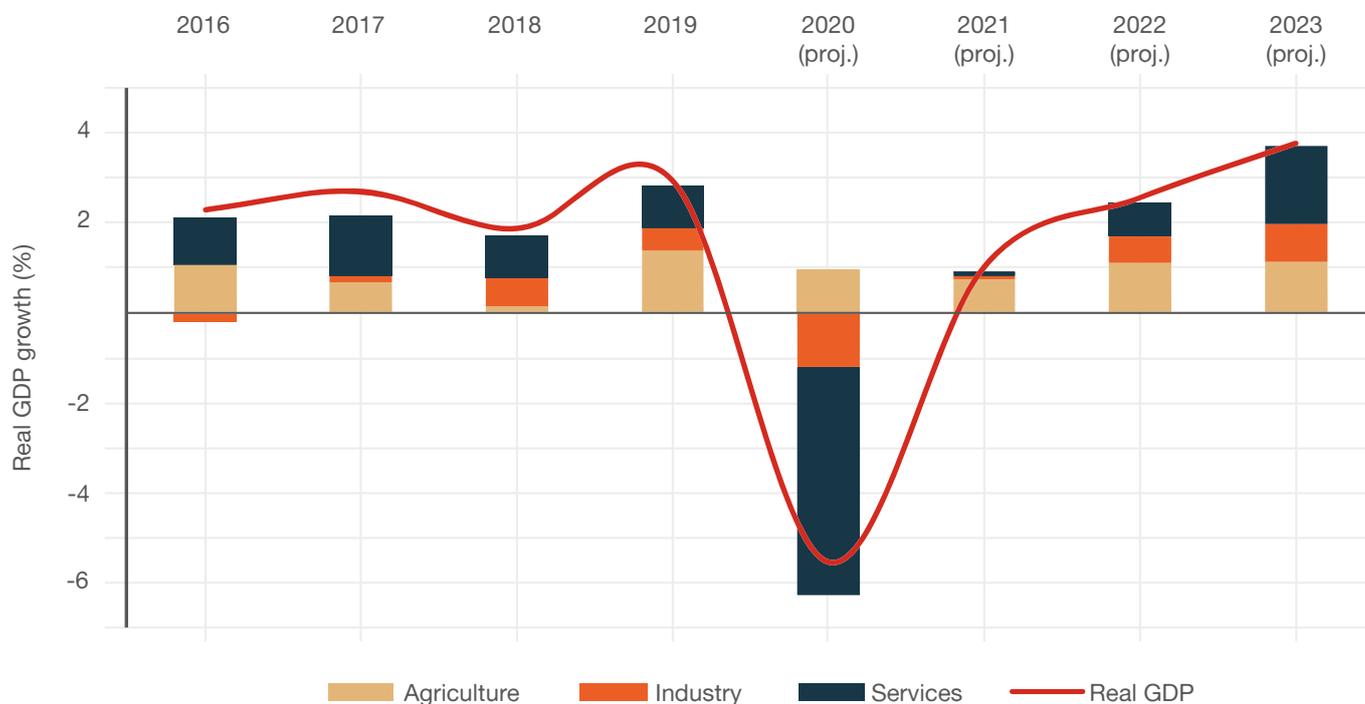
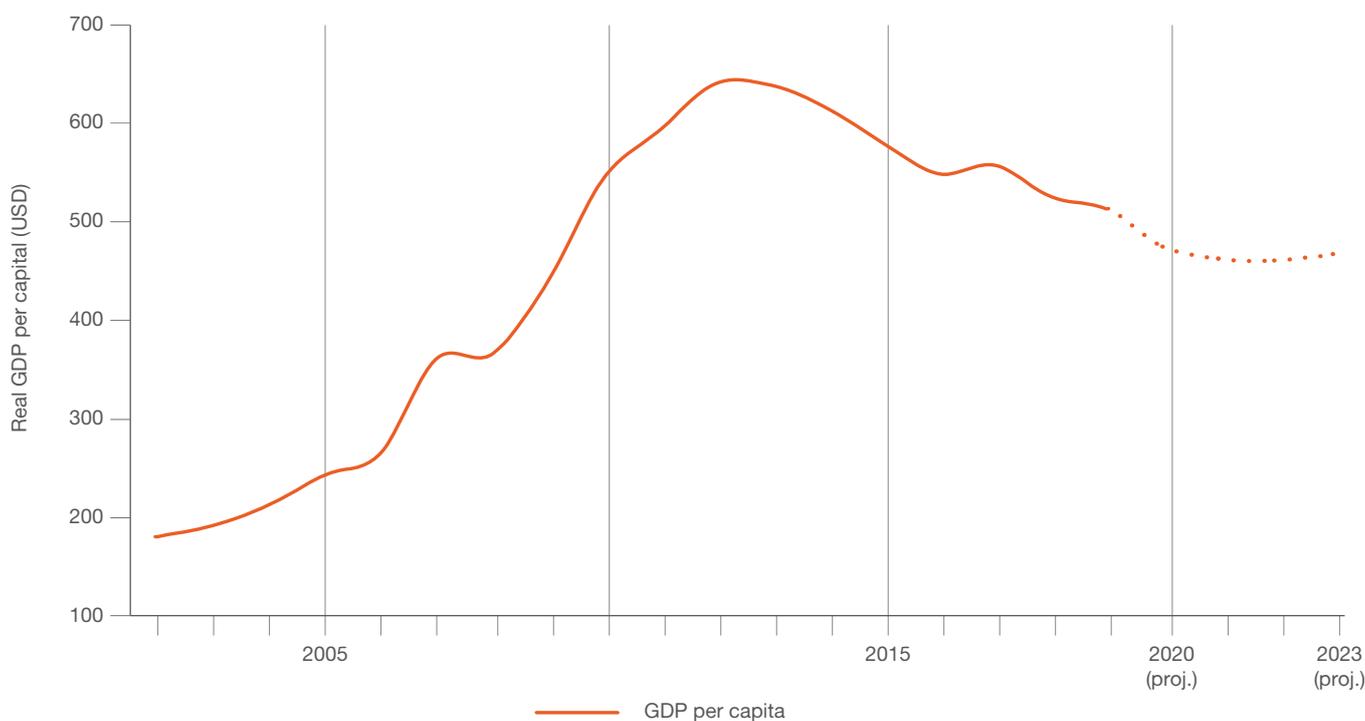


Figure 6 Per capital income projection





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