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Changing Financial Flows During Afghanistan's Transition The Political Economy Fallout

“Just as the enormous increases in resources since 2001 profoundly affected Afghanistan's political economy, drastic declines in international military expenditures and aid during transition will do the same...in the short run, sharp declines in resources could prove destabilizing and conflict-inducing, especially at the local level.”

Summary

- Massive amounts of money flowing into Afghanistan since 2001 (foreign military spending, aid, domestic revenues, opium profits, land takeovers and development, informal mineral exploitation, theft of funds such as at Kabul Bank) have had profound political economy impacts, not least by further entrenching factionalized politics and fragmented patronage networks.
- The ongoing transition involving the drawdown of international troops and Afghan takeover of security responsibilities will be accompanied by drastic declines in international military expenditures and aid.
- Total resources for patronage will fall sharply; the Afghan government's share in remaining funds will increase; declines will be greatest at local levels, especially in insecure areas in the south/east which had heavy international military presence and high aid; and drug money will become increasingly important.
- At lower levels of patronage, competition over declining resources may intensify, so even in the absence of major armed conflict at the national level, localized conflicts may continue and even proliferate, aggravated by taking revenge and “settling accounts” by currently excluded and marginalized groups.

Introduction: Financial And Political Economy Developments Since 2001

Afghanistan since 2001 has seen massive inflows of financial resources. The most important of these—with significant portions available for patronage and vulnerable to corruption—include:

- International military expenditures, which surpassed \$100 billion per year at the peak. Although the bulk has not been spent in Afghanistan, local expenditures around U.S. military bases for security, transport, and other services have been very large.
- International aid to Afghanistan (civilian plus support to Afghan national security forces—ANSF), reaching a peak of around \$16 billion in 2010 (equal to Afghanistan's GDP in that year), compared to roughly \$200-300 million annually in humanitarian assistance during the pre-2001 Taliban regime.

- Afghanistan's domestic budgetary revenues, which have grown from less than \$100 million per year immediately after 2001 to more than \$1.5 billion annually in recent years.
- Opium gross revenues, which fluctuate greatly but increased from well under \$1 billion per year in the late 1990s to an average of close to \$3 billion per year during 2006-2011.

Other funds of a smaller or irregular nature have substantially augmented resources for patronage and corruption. Prominent examples include:

- Kabul Bank, a massive theft of close to \$1 billion of the Afghan public's deposits.
- Informal exploitation and illicit export of Afghanistan's minerals, gemstones, timber, etc., hard to estimate with precision but in aggregate amounting to many hundreds of million dollars per year.
- Takeover of public lands, urban and peri-urban land development, etc., much of which has occurred illegally and has generated enormous profits.

These resource flows have had profound impacts on Afghanistan's economy, governance, and politics. Economic growth has averaged nine percent per year, but corruption has dramatically increased and is now among the worst in the world according to international indicators. Key political economy patterns and developments over the past decade include the following:

Decentralized control over armed violence has continued to be an important factor in patronage—financial resources have often accrued to those linked to militias and other armed groups. While the expansion of ANSF has altered this picture somewhat, ANSF are still far from having a monopoly of organized violence in the country (even aside from the Taliban insurgency).

Patronage has been personalized and transactions-based, with very little systematic "institutionalized patronage" through organizations such as political parties.

Patronage has inordinately benefited those with access while excluding and marginalizing other groups, and therefore has been divisive, especially at the local level. At the center, a "division of spoils" has occurred among the loose anti-Taliban coalition that came into power in 2001, albeit with some factions and groups left out. Patterns of exclusion have been more severe and often deadly at local and provincial levels, and some excluded groups joined with the Taliban or other anti-government elements due to their marginalization and lack of access to government patronage.

Political alignments and associated patronage have been shifting and unstable, typically involving short-term deals, with re-opening of bargaining and changing alignments (sometimes through threatened or actual violence).

Most of the larger financial flows over the past decade have been outside the direct control of the national government. This is very different from pre-1978 foreign funding where control was typically centralized with the government and its leader.

Formal government positions have played a lynchpin role in patronage. Allocation of senior government posts has been a vehicle to reward allies and followers, representing an important part of the "spoils" at central (ministers, deputy ministers, other top appointees) and sub-national levels (provincial governors, district heads, provincial and district police chiefs, etc.). Moreover, government positions have been important for dispensing patronage through other means, including within ministries and departments as they have built up capacity and carry out regulatory, service delivery, and other roles.

Contracting of politically-connected private businesses has been a crucial mechanism for patronage. Contract issuers include foreign military entities, development and security aid donors, and the government itself (small amounts initially, increasing over time). Contracts range from security, transport for the military, and logistical services for bases, to construction, roads, and other services.

Overall, these trends—superimposed on underlying fragmented, conflictual patronage politics—make for a complex picture characterized by considerable fluidity, fragilities, and risks. Factionalized politics appears to have become further entrenched, with heavier distortions induced as more funds became available for patronage. Based largely on its appointment authority and other formal powers under Afghanistan's constitution, the central government comprises the apex of patronage networks in the country, but there are also centrifugal tendencies fueled by the fragmentation of aid and linkages between international military and local powerholders.

Changes And Implications During Transition

Afghanistan's ongoing transition, involving drawdown of international troops and ANSF taking over full responsibility for security, is being accompanied by major changes in financial flows. Just as the enormous increases in resources since 2001 profoundly affected Afghanistan's political economy, drastic declines in international military expenditures and aid during the transition will do the same. Key changes will include:

Total resources for patronage will decline to much lower levels than in recent years. The fall will be especially sharp for international military contracting and off-budget civilian aid.

The share of the national government in remaining funds can be expected to increase. This reflects declines in off-budget resources, efforts to increase on-budget aid, and the increasing relative importance of domestic revenues.

Declines will be especially severe at the local level, particularly where there have been international troops and bases. This is a natural consequence of foreign troop withdrawals, base closures, and phasing out of associated spending.

The impact of declining resources will vary across regions. More insecure areas in the south and east, where there was heavy international military presence and very high aid, will suffer the most.

Drug money will become increasingly important in relative and most probably absolute terms. As other financial inflows decline, and with increases in opium cultivation and production expected in 2013 and subsequently, the role of drug money in patronage and politics will increase.

The balance of armed power is likely to shift in favor of regional/local levels. Departure of most international military forces will leave local power vacuums many of which ANSF will be unable to fill, giving local and regional strongmen a freer rein.

What are the likely political economy implications of these major financial changes? Given uncertainties about elections, political transition, and dialogue/reconciliation with the Taliban, making any predictions would be hazardous, but some provocative questions can be raised.

Control over senior government appointments most likely will continue to be a lynchpin of patronage. However, it is not clear whether a greater share in much smaller financial inflows will enhance the importance of central authorities and top politicians in providing patronage, or whether the overall decline in funding, and possibly worsening insecurity, will on balance weaken the central government's role in this regard.

A related question is whether and how sustainably the loose patronage "network of networks" centered around the current government leadership will hold together during the political transition. This will depend in large part on how the 2014 presidential election plays out—namely, whether a candidate from the current president's entourage and endorsed by him wins.

ABOUT THIS BRIEF

William Byrd is a development economist and has worked on Afghanistan in various capacities over the past decade and longer. His publications include numerous reports and articles on Afghanistan's economy, public finance management, aid issues, governance and corruption, security sector financing, extractive industries, and opium economy. He is currently a senior expert at the U.S. Institute of Peace, where his work focuses on the country's economic transition including the political economy and conflict implications of the major changes in financial flows that are underway. The views expressed in this brief do not necessarily reflect the views of the U.S. Institute of Peace, which does not take policy positions.

Given the importance of the central government in patronage, the formal powers vested in Afghanistan's presidency, and hence the "winner takes all" character of the 2014 presidential election, political economy-based incentives to manipulate the election by those who can do so will be very strong. The key question is whether countervailing factors would allow a reasonably successful election to occur. These could include: emergence of a "consensus candidate" and team that brings together a critical mass of elite groups; a small number of credible competing candidates/groupings that would effectively exercise checks and balances vis-à-vis each other (but refrain from resorting to violence after an election loss); public and civil society oversight, supported judiciously by the international community; or some combination of these.

How will patronage groups adapt to much lower levels of funding and changes in its composition? The decline in international assistance may well increase dependence on drug money, diversion/misuse of domestic revenues, and on-budget expenditures by patronage networks seeking to survive, with problematic consequences.

Another question concerns whether the enormous wealth already built up (particularly wealth anchored in Afghanistan and not easily expatriatable, e.g. real estate) will have a stabilizing impact because the beneficiaries have much to lose from instability and conflict, and whether this will offset possible adverse impacts of sharply diminished financial inflows that will squeeze new resources for patronage.

It should not be presumed that declining resources inevitably will cause political and security deterioration. If the enormous recent financial inflows have been correctly viewed as temporary "windfalls" by Afghan elites, the impact on behavior of their decline may be more limited than expected, particularly for those at the top who have already made fortunes.

However, at lower levels of patronage, competition over declining resources, on which livelihoods depend, may intensify. So a possible scenario is avoidance of major armed conflict at the national level, but continuation and perhaps proliferation of localized conflicts. Moreover, changing power balances may lead to taking revenge and "settling accounts" by currently excluded and marginalized groups at the local level, where exclusion has often been severe and violent.

Conclusion

Burgeoning inflows of funds since 2001 have had profound, often problematic political economy consequences for Afghanistan. Much lower, more "normal" and less volatile resource inflows post-transition may be stabilizing over the longer term—less to contest over, and less egregious wealth differences between beneficiaries and those excluded. But in the short run, sharp declines in resources could prove destabilizing and conflict-inducing, especially at the local level. A broader question is whether central elites and their patronage networks can hold the state together in the face of declining funding and amidst continuing and possibly increasing local conflicts, or whether these changes will further undermine and put at risk weak state structures.



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