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**Working Paper 4**
**for**
**Afghanistan Public Expenditure Review 2010**
Second Generation of Public Expenditure Reforms

# Security Sector

Co-produced with the UK Department for International Development

# Security Sector[1]

### Key Findings

- **The need to use security sector resources as effectively and efficiently as possible is even greater now than before.** Security is an essential public good and a co-condition for development and poverty reduction. For a security system to produce the desired outcomes, long-term affordability is essential. Affordability in turn requires that attention be paid to financial management. These issues have taken on increased importance in the current environment. The deteriorating security situation since 2006 has given rise to demands for larger security forces, which in turn entails greater sustainment costs increasing the fiscal burden of the sector.

- **Afghan National Army (ANA) and Afghan National Police (ANP) are major actors in the security sector.** The security sector in Afghanistan consists of defense, internal security, intelligence, policy/coordination and justice. Expenditures allocated to ANA and ANP account for approximately 80 percent of the security-related outlays. As of November 2009, ANA had 95,000 personnel and ANP had 97,000 personnel.

- **The security sector is the biggest sector in the national budget.** Between 2003/04 and 2008/09, security sector expenditures were US$19.4billion, 58 percent of the total national expenditures (including core and external expenditures). The security sector accounted for 46 percent of operating expenditures in the 2008/09 core budget, and one percent of development expenditures. Except for salaries and wages, most expenditures have been funded by external sources (mainly the Combined Security Transition Command-Afghanistan (CSTC-A)).

- **Progress in the security sector since 2005 has been limited.** The 2005 PFM Review identified six key messages including "integrate the security sector into all aspects of Afghanistan's PFM system". Progress has been very slow in all six areas.

- **The five major constraints on budget formulation are:** (i) absence of strategies/policies and operational plans; (ii) very weak government input on decisions regarding the size of the security sector and the equipment it requires; (iii) limited budget formulation capacities in MoD and MoI; (iv) inadequate timeframe for budget formulation, and (v) weak linkage between the Medium-Term Fiscal Framework (MTFF) and security budgeting, in particular on non-wage security costs.

- **Wages and salaries,** especially for 'ghost' policemen and soldiers, are key issues in budget execution and auditing. Salary payments are processed manually in both the Ministry of Defense (MoD) and Ministry of Interior (MoI) and audit capacities are underdeveloped. MoD and MoI have introduced an electronic database linked to an electronic payments system. Though a positive step, the electronic system by itself will not fully solve the problem. The ongoing capacity development of MoD's internal audit function is a commendable step.

- **Fiscal sustainability analysis** suggests that expenditures on the ANA and ANP financed by CSTC-A/external sources and the state budget are likely to gradually decline as a share of GDP and domestic revenues. However, ANA and ANP expenditures are not fiscally sustainable from domestic revenues alone. In fact, ANA and ANP expenditure levels will actually exceed domestic revenues into the foreseeable future and Afghanistan will require sustained international support to maintain the force levels currently envisioned, not to mention meeting other essential expenditures such as infrastructure, health and education.

[1] This working paper was produced by Nicole Ball (DFID Consultant) and Yoichiro Ishihara (World Bank, SASEP) for Afghanistan Public Expenditure Review based on information available as of March 31, 2010.

- **Six priorities to improve the security sector Public Financial Management (PFM) are:**
  (i) Pursue current entry points for developing a more strategic approach to ANA and ANP.

  (ii) Integrate MoD and MoI more fully into the government-wide financial management systems, including the Law and Order Trust Fund Afghanistan (LOTFA).

  (iii) Continue efforts to enhance the capacity of MoD and MoI staff to engage effectively in all parts of the budget cycle.

  (iv) Intensify efforts to eliminate vulnerabilities to corruption especially on wages and salaries in MoD and MoI.

  (v) Strengthen external oversight.

  (vi) In consultation with donors, arrange predictable medium-term financial support from the international community for the fiscal sustainability of the security sector.

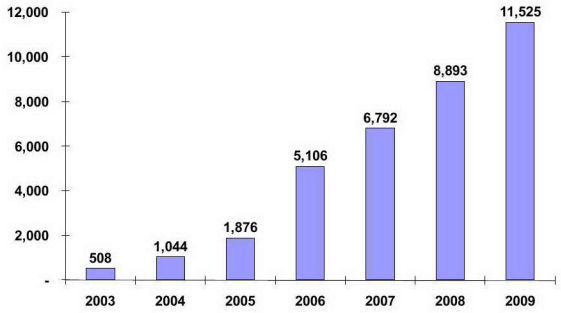
## A. Introduction

1. **Security is an essential public good and a co-condition for development and poverty reduction.** The Afghanistan National Development Strategy (ANDS) recognizes the linkages between security and sound governance, the rule of law, the protection of human rights and social and economic development. "Implementing development policies outlined in the ANDS is possible only if there is peace and security in the country; security and sustainable development go hand in hand."[2]

2. **Long-term affordability is critical** for a security system to produce the desired outcomes. Without long-term affordability, the country will not be able to achieve its priority security objectives. Additionally, an under-funded security sector can itself pose significant threats to the stability of the state and security of its people. Attention must be paid to the financial management of the security sector to ensure the required long-term affordability. In Afghanistan, the security sector accounts for a very high proportion of the core budget, 29 percent in the 2008/09 preliminary budget realization. Additionally, the vast majority of security-related expenditures is part of the external budget and therefore not administered by the government. These expenditure patterns raise major PFM concerns.

3. **The issues highlighted in 4.2 are not new.** Many of the challenges identified in the 2005 PFM Review's security sector analysis continue to confront Afghanistan and its international partners in 2009. These issues have taken on increased importance in the current environment. The security situation has deteriorated significantly since 2006 (Figure 1) giving rise to demands for larger security forces. This in turn entails higher sustainment costs, increasing the fiscal burden of the security sector.

**Figure 1 Number of Security Incidence**




*Source: UNDSS*

4. **The need to use security sector resources as effectively and efficiently as possible is greater now than before.** This in turn requires attention to the processes by which expenditure decisions are made, how the budget is executed, and the capacity of oversight mechanisms, notably internal and external audits, and parliamentary oversight.

5. **The structure of the security annex.** This annex begins by briefly discussing the composition and features of the security sector, followed by a short overview of its expenditures. It then reviews progress to date establishing PFM systems in defense and internal security by examining: (i) the link between policy/strategy and budgeting, (ii) budget formulation, (iii) budget execution and, (iv) audits. Following this, the fiscal sustainability of ANA and ANP is assessed. The annex concludes with proposals for next steps for strengthening the security sector budgeting process.

[2] Islamic Republic of Afghanistan, Afghanistan National Development Strategy 1387-1391 (2008-2013): A Strategy for Security, Governance, Economic Growth & Poverty Reduction, Kabul: 2007, p. 54.

## B. The Current Status and Linkage of the Security Sector

6. **It is essential from a financial management perspective to adopt a broad definition of the security sector**, as argued in the 2005 PFM Review.[3] When different components of the security sector are individually allowed to develop their own priorities, synergies are lost and capacities duplicated. This invariably raises costs. It is therefore important to be cognizant of the linkages among the different components of the security sector when making choices about how to allocate scarce resources. Focusing separately on individual security or justice providers in a fragmented manner, or one at a time, encourages a focus on outputs – establishment of an army or development of a civil police force – rather than outcomes – a safe and secure environment for all Afghans.[4] As with any part of the bureaucracy, all security bodies seek to maximize their access to state resources, even if creating a safe and secure environment requires a priority focus on another part of the sector. A good example of the adverse impacts that can result from such a fragmented subsector-oriented approach is the "lead donor" approach taken to security sector reform beginning in 2002. This experience shows that problems can be further aggravated when different donors "specialize" in working with individual security agencies. Experience also indicates that a focus on developing the operational effectiveness of security services can also mean that financial management, along with other components of security sector governance and oversight, will not receive adequate attention.

7. **Therefore, all actors providing law and order, justice, defense and intelligence services should be included when policies are formulated and implemented, and budgets are prepared.** The delivery of sound governance, the rule of law, human rights and poverty-reducing social and economic development are tightly linked to the ability to provide a safe and secure environment for all Afghan citizens. For example, sound intelligence is essential for ANA and, increasingly, for the effectiveness of ANP. Successful policing requires a strong, effective and impartial justice system.

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[3] World Bank, *Afghanistan: Managing Public Finances for Development. Volume V: Improving Public Finance Management in the Security Sector*, Report No. 34582-AF, Washington, DC: Poverty Reduction and Economic Management Sector Unit, South Asia Region, December 22, 2005, p. 3, paragraph 1.11.

[4] It is widely agreed that this has been an outcome of the system established in Afghanistan following the Bonn Agreement in 2002. See for example, Mark Sedra, "Security Sector Reform and State Building in Afghanistan," pp. 193-217 in *Afghanistan: Transition under Threat*, ed. Geoffrey Hayes and Mark Sedra, Waterloo: Wilfrid Laurier University Press, 2008.

8. **The components of the Afghan security sector at the end of 2008 are shown in Box 1.** Expenditures allocated to ANA and ANP account for approximately 80 percent of the security-related outlays in 2008/09[5]. Expenditures allocated to the MoD/ANA and MoI/ANP accounted for 44 percent of the core operating budget, the only part of the security budget to which the government contributes its own resources. While it is difficult to calculate the precise size of the external budget, it is believed that roughly two-thirds of the external budget was allocated to the security sector between 2003/04 and 2008/09.

**BOX 1 AFGHANISTAN SECURITY AND JUSTICE ACTORS, 2008**

**Defense:**

- Ministry of Defense (MoD)
- Afghan National Army (ANA), including General Staff, Sustaining Institutions and Intermediate Commands, Combat Forces, Afghan Air Corps

**Internal Security:**

- Ministry of Interior (MoI)
- Afghan National Police (ANP), including Uniformed Police, Border Police, Civil Order Police (ANCOP), Criminal Investigative Division, Counter Narcotics Police, Counter Terrorism Police
- Special Narcotics Force
- Presidential Protective Services

**Intelligence:**

- National Directorate of Security (NDS)

**Policy / coordination:**

- Office of the National Security Council (ONSC)
- Ministry of Counter-Narcotics

**Justice:**

- Attorney General's Office
- Ministry of Justice (MoJ)
- Judiciary, including Supreme Court and lower courts
- Afghan Central Prisons Directorate
- Criminal Justice Task Force
- Customary and traditional justice bodies

*NOTE: The MoI, supported by the US government, is piloting the Afghanistan Public Protection Program (APPP), which will form local "Afghan Public Protection Forces", under the command of the local police chief. MoI will provide weapons for the APPP.*

**9.** In view of their fiscal impact and importance in creating a safe and secure environment for all Afghans, and the difficulty in obtaining information on all components of the sector, this annex focuses on the military and police and the two ministries responsible for their activities, MoD (ANA) and MoI (ANP). The current sizes of ANA and ANP are as follows (Table 1).

[5] Afghanistan uses a narrower definition of the security sector based on the ANDS. The justice sector is included in the Good Governance sector. Therefore, the figures for "security expenditure" in this Annex exclude all expenditures on justice. In contrast, the Ministry of Foreign Affairs is also categorized in the security sector.

**Table 1 Afghan National Security Forces**

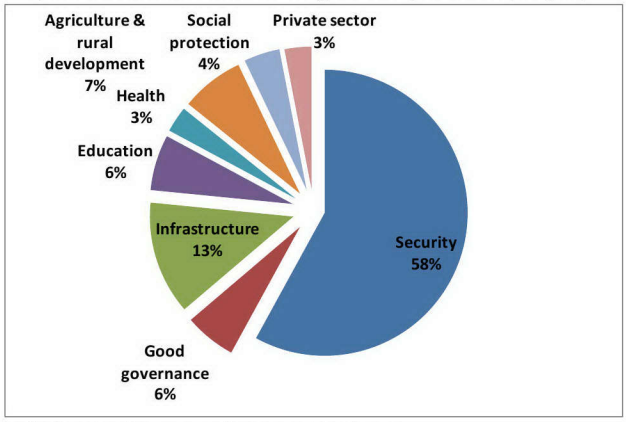
| | Personnel | Budget (2008/09 Estimated Actual) |
|---|---|---|
| **ANA** | 100,000 as of December 2009 (including MoD and sustaining institutions); two increases in authorized level approved 2008, first to 80,000 plus 6,000 trainees; second to 128,000 plus 6,000 trainees. | US$3.2 billion (o/w US$0.3 billion from the state budget, US$2.9 billion from external budget) |
| **ANP** | 95,000 as of December 2009; | US$1.5 billion (o/w US$0.3 billion from the state budget, US$1.2 billion from external budget) |

*Source:"GAO-10-178R Afghanistan's Security Environment,GAO-09-473SP Afghanistan: Key Issues for Congressional Oversight, MoF, LOTFA and* World Bank.

## C. Security Sector Expenditures

**10. Security sector expenditures account for a quarter of the national budget.** The national budget (i.e. including both core and external budgets) between 2003/04 and 2008/09 was US$33.6 billion. Security sector expenditures were the highest of eight key sectors, amounting to US$19.4 billion or 58 percent of the total (Figure 2). Although security sector expenditures in the core budget have increased in absolute terms since 2003/04, the sector's core budget share fell from 43 percent in 2003/04 to 25 percent in 2007/08 before going up to 29 percent in 2008/09. The security sector increased in both as a share of total and absolute spending in the external budget in 2007/08, largely because of massive investments in equipment and facilities for the ANA and ANP (Table 2).

**Figure 2 Security Sector Share in the National Budget**
(Share in the national budget 2003/04-2008/09, %)




*Including both core and external budgets*
*Source: MoF. World Bank*

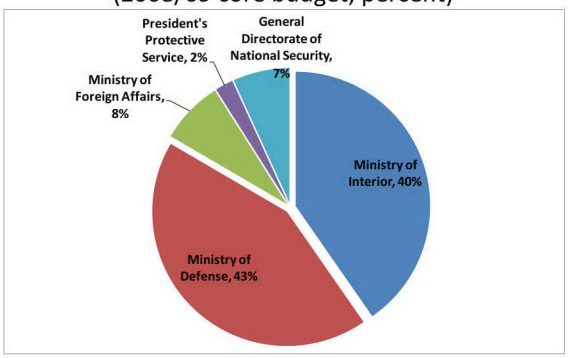
**Table 2 Security Sector Expenditures and Share 1/**

| | 2003/04 | 2004/05 | 2005/06 | 2006/07 | 2007/08 | 2008/09 | Total |
|---|---|---|---|---|---|---|---|
| **1. US$ billions** | | | | | | | |
| (1) Core Budget | 0.3 | 0.3 | 0.3 | 0.4 | 0.5 | 0.6 | 2.4 |
| (2) External Budget | 0.5 | 1.2 | 3.1 | 2.0 | 7.7 | 2.4 | 16.9 |
| (3) National Budget (=1+2) | 0.8 | 1.5 | 3.4 | 2.4 | 8.2 | 3.0 | 19.4 |
| **2. Share in total expenditures** | | | | | | | |
| (1) Core Budget | 43 | 30 | 30 | 26 | 25 | 29 | 29 |
| (2) External Budget | 31 | 53 | 74 | 56 | 83 | 57 | 67 |
| (3) National Budget | 34 | 47 | 65 | 47 | 73 | 47 | 58 |

*1/ Based on ANDS classification including MoI, defense and foreign affairs, President protective service and General directorate of national security.*
*Source: Ministry of Finance, World Bank*

11. **Composition of security sector expenditures.** While the security sector comprises more than just the army and internal security, these two sub-sectors account for most sectoral expenditures. In the 2008/09 core budget, total security expenditures were US$652 million (including US$639 million for core operating expenditures and US$13 million for core development expenditures). These consist of spending by MoI, MoD, Ministry of Foreign Affairs (MoFA), the President's protective service, and the National Directorate of Security (NDS). The shares of MoI and MoD in total core budget security expenditures are 40 percent and 43 percent, respectively (Figure 3). However, the above figures do not capture external budget expenditures on the security sector that are many times larger than core budget spending. Most external security budget expenditures are also on ANA and ANP[6].

**Figure 3 The Composition of Security Sector**
(2008/09 core budget, percent)




*Source: MoF, World Bank*

12. **ANA and ANP expenditure structure.** Total expenditures (including both core and external budgets) on ANA and ANP in 2008/09 are estimated at US$4.7 billion (Table 3). There are three angles from which to assess these expenditures: (i) core budget versus external budget; (ii) ANA versus ANP and, (iii) operating expenditures versus investment. The external budget accounts for 87 percent of total security expenditures: ANA accounts for 68 percent of the core budget outlays on security, and the operating budget (including wages and salaries) accounts for 51 percent[7].

**Table 3: ANA and ANP Expenditure Structure**
(Preliminary actual in 2008/09)

| **Core State Budget** | **External Budget** |
|---|---|
| US$0.6 billion (13%) | US$4.1 billion (87%) |
| **ANA** | **ANP** |
| US$3.2 billion (68%) | US$1.5 billion (32%) |
| **Operating Exp.** | **Investment** |
| US$2.4 billion (51%) | US$2.3 billion (49%) |

*Source: Ministry of Finance, CSTC-A, World Bank staff estimates*

13. **ANA and ANP wages and salaries.** Wages and salaries are by far the largest expenditure items for both ANA and ANP in the core government budget. In 2008/09, wages and salaries at MoD and MoI accounted for 89 percent and 85 percent of their respective budgets.

14. **High operating budget and low development budget execution rates** (Table 4)**.** In 2008/09, execution rates of MoD and MoI operating budgets reached 107 percent. The rate of MoD was 111 percent, while that of MoI reached 103 percent. By contrast, execution rates for the MoD and MoI development budgets were only 36 percent, slightly lower than the overall average of 43 percent. Development budget execution rates by MoI only reached 18 percent, although the core development budget itself is very small. Lower development budget execution rates may reflect the weak PFM capacities of these ministries.

[6] Data on the external budget is not always consistent depending on data sources.
[7] Investment includes both external and core development budgets.

**Table 4 Execution Rates in 2008/09 (US$ million, percent)**

| | Operating Budget | | | Development Budget | | | Core Budget | | |
|---|---|---|---|---|---|---|---|---|---|
| | Budget 1/ | Actual | Exe. Rate | Budget 1/ | Actual | Exe. Rate | Budget 1/ | Actual | Exe. Rate |
| Ministry of Defense | 251 | 278 | 111% | 5 | 3 | 52% | 256 | 281 | 110% |
| Ministry of Interior | 255 | 262 | 103% | 4 | 1 | 18% | 259 | 263 | 102% |
| MoD and MoI Total | 506 | 541 | 107% | 9 | 3 | 37% | 515 | 544 | 106% |
| All Sectors | 602 | 639 | 106% | 36 | 13 | 36% | 639 | 652 | 102% |

*1/ Mid-Year Review Budget*
*Source: Ministry of Finance, World Bank*

## D. Progress Establishing PFM Systems in Defense and Police between 2005 and 2008

15. **Progress in six key PFM areas in the security sector.** The 2005 PFM Review identified six areas that required attention in order to strengthen security sector PFM. Taken together, the priority actions identified in the 2005 PFM Review point to the need to:

- Strengthen the link between policy/strategy and the budgeting process, by developing policies and strategies that were completely non-existent in the security sector in 2005.
- Develop the capacity of key ministries and agencies to play their role in budget formulation, execution and oversight.
- Give due attention to key drivers of fiscal sustainability in the security sector, including access to external funding.

Limited progress has been made implementing the security sector PFM recommendations (Table 5). For instance, "the integration of the security sector into Afghanistan's PFM system" shows only limited improvement. The government does not have full authority to determine the size of security forces and its payrolls (the main part of core budget security sector expenditures) because these decisions are made by the US government in discussion with only MoD and MoI. For example, the US$20 monthly salary increase for ANA and ANP in 2008 was decided without prior consultation with MoF.

**Table 5 Progress on Six Main Messages in the 2005 Afghanistan PFM Review Security Sector Analysis**

| | Main Messages from the 2005 PFM Review | Progress as of end-2008 |
|---|---|---|
| 1 | **Integrate the security sector in all aspects of the PFM system:** The MTFF, annual budget formulation, staffing and payroll management, financial management and controls, and external oversight/scrutiny. | Limited integration via core budget, staffing/payroll management remains problematic, internal audit being strengthened but capacity and authority of new auditors untested. Lack of capacity to prosecute criminal cases. Limited integration into MTFF, and limited external oversight. |
| 2 | **Review fiscal implications of ongoing security sector development and reforms:** enhance the security expenditure information base and conduct integrated sector-wide review of fiscal implications over the medium-term. | Security sector expenditure information base remains very weak because of the opacity of the external budget; no sector-wide review on which to base fiscal analysis. Limited sustainability analysis by the international community. |
| 3 | **Develop National Security Council's policy-making capacity and finalize a National Security Strategy:** strengthen the link between policy and budget formulation, execution and oversight. | NSC has yet to finalize National Security Strategy, largely for political reasons. |
| 4 | **Ensure security is an integral part of the National Development Strategy:** accord security sector its due importance as a development issue and incorporate a developmental and fiscal perspective in the security sector strategy. | Security is one of the pillars of the ANDS and has been added as an MDG for Afghanistan, but no sectoral strategy is included in ANDS. |
| 5 | **Implement priority administrative reforms and develop security sector management and oversight capacity:** enhance human resource capabilities in line ministries, develop financial management capacity and practices in these bodies, with special emphasis on internal audit. | Priority Reform and Restructuring (PRR) largely implemented in MoI but problems with corruption especially at lower levels. No PRR has been implemented in MoD. |
| 6 | **Rigorously enforce staffing size guidelines and set salary increases based on fiscal absorption capacity:** key objective is to promote the affordability of the security sector wage bill. | Continuing problems with ghost employees, absenteeism, desertions; decisions on staffing size and salary increases not based on fiscal absorption capacity or a clear policy or strategy for ANA/ANP development. Most decisions regarding staffing/salary increases are made outside Afghan government circles and are non-transparent. |

*Source: Author, World Bank (2005)*

16. **The six gaps identified in these areas were not exclusive to the security sector as the 2005 PFM Review demonstrated.** The entire public sector in Afghanistan has exhibited weaknesses throughout the budgeting cycle, although the 2008 Public Expenditure and Financial Accountability (PEFA) analysis found that significant progress had been made[8]. In particular, the analysis noted insufficient linkage between policies and the budgeting process, and that line ministries had limited capacity to engage in the budgeting process. Dependence on external financing was also significant, raising concerns about the long-term sustainability of government operations. However, these problems are magnified in the security sector, due to its high aid dependence.

17. **While there has been less progress in the security sector, the current analysis suggests that there may be some entry points for strengthening financial management in the defense and internal security sub-sectors.** The international community's growing interest in prioritizing police reform provides an opening in that sector. CSTC-A mentoring on budgeting, planning and

[8] World Bank (June 2008) "Afghanistan: Public Financial Management Performance Assessment"

audits for MoD and MoI offers an additional opportunity to focus Afghan and international community attention on strengthening financial management in the security sector.

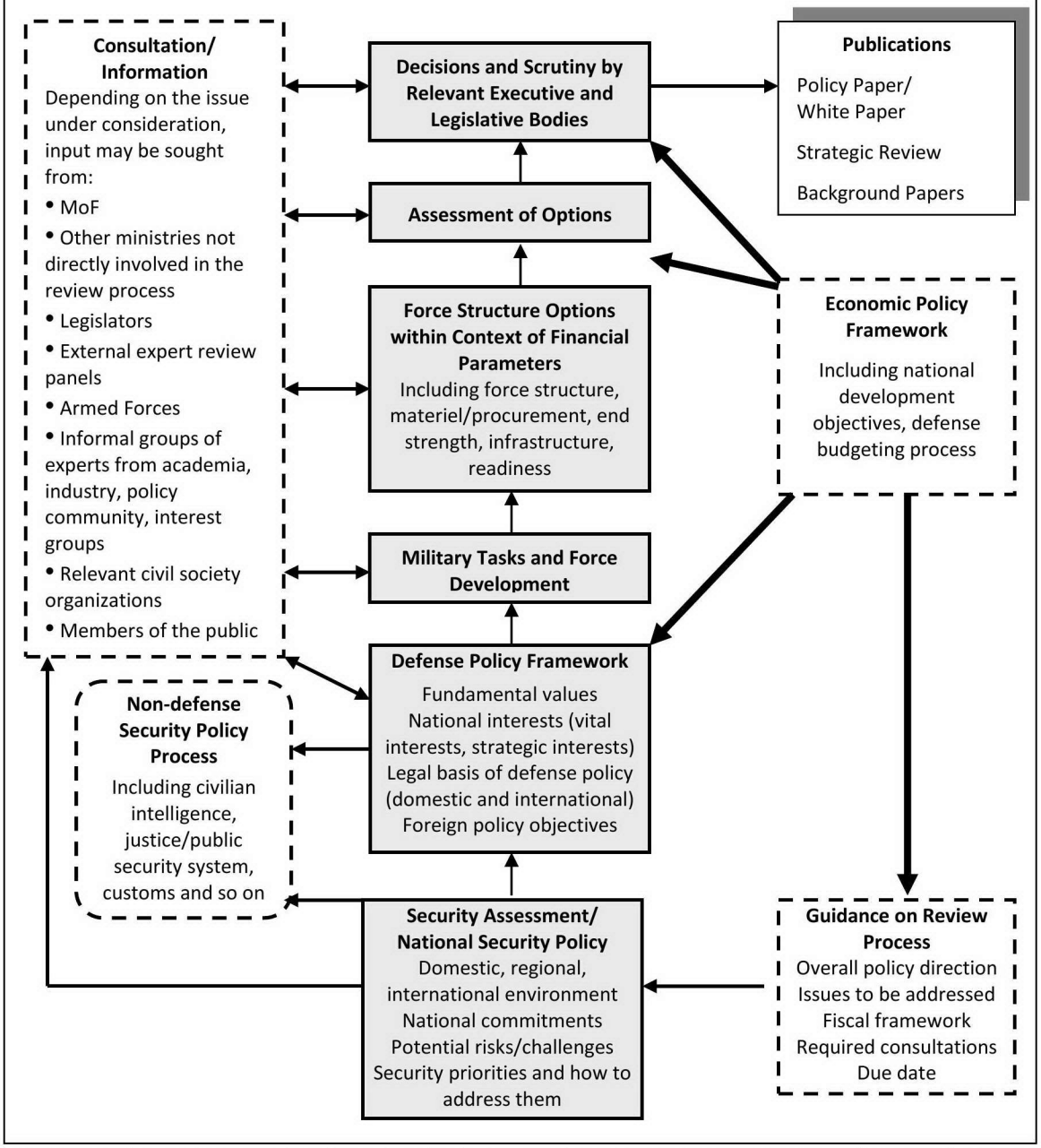
**Linkage between Policy/Strategy and Budgeting**

18. **Good PFM principles imply that resources are allocated according to strategic priorities both within the security sector and across all sectors.** Sectoral strategies are critical in this regard, as are the broad priorities indicated in the overall national development strategy. It is also important that the budgeting process be informed by information on performance in order to ensure that the priorities identified to promote government objectives are adequately funded.

19. **Additionally, good practice suggests that all sectors (including security) must compete on a level playing field for funding during budget planning and formulation.** Even where security requirements change unexpectedly, the resource implications should be managed through the budget process. Resource allocation decisions always involve political trade-offs. In resource-poor countries, these trade-offs are particularly difficult, so the decision-making process must be facilitated by the existence of agreed policies/strategies that are translated into costed plans and programs. At the same time, the capacity to develop and implement strategies and plans often requires strengthening, as will be discussed below.

20. **From an efficiency perspective, it is particularly important to strike a balance when allocating operating and development budgets.** Within operating expenditure, it is also important to strike an appropriate balance between wages and salaries, and operations and maintenance. Without this balance capital investments may not be properly maintained. For equipment procurement, it is critical to evaluate up-front the full life-cycle costs of proposed purchases.

**Figure 4 Processes for Conducting Security Reviews and Developing Security Policy Frameworks**




21. **A good-practice model for developing security strategies.** A close linkage between policy/strategy and budgeting in all parts of the budget cycle is as essential in the security sector as in all other parts of the public sector. Ideally policy/strategy development starts with a national security strategy and then flows to sub-sectoral strategies (defense, internal security including linkages with justice, and intelligence). These sub-sectoral strategies are then the basis of costed plans for each of the security services. Figure 4 demonstrates how the defense force development process should function with linkages to other elements of the security sector.

22. **When initiating a policy process, either the executive or legislative branches should provide guidance to the lead policy-development body, whether it be MoD, MoI, the National Security Council, or MoJ.** Such guidance should include the overall policy direction, issues to be

**Box 2 Analysis of a Proposal to Allocate Four Percent of GDP to Defense**

Steve Kosiak, incoming Associate Director for Defense and International Affairs at the Office of Management and Budget for the Obama administration, had this to say about proposals to legislate a requirement to allocate at least four percent of US GDP to the defense sector that surfaced during the last two years of the Bush administration:

> … focusing on this question may do more to obscure and confuse than to illuminate the critical and difficult question of "How much is enough?" to spend on defense.
>
> In the end, there is probably no workable substitute for the traditional approach to setting the defense top line: considering the range of military threats and challenges the country faces, and determining the strategy, forces and capabilities needed to counter those challenges and advance US interests, at an acceptable level of risk—as well as at an acceptable cost, in terms of other national priorities (including everything from homeland security to health care). The current defense debate would be better served by focusing on these kinds of key policy questions, the answers to which may indicate a need to spend more or less than four percent of GDP on defense, than on an approach that attempts to divorce defense planning and budgeting from such questions.

*Steven M. Kosiak, "Analysis of Proposals to Allocate Four Percent of GDP to Defense," Washington, DC: Center for Strategic and Budgetary Assessments, September 9, 2008, p. 1.*

addressed, fiscal framework, required consultations and due date. The guidance is also affected by the context within which policy is developed.

23. **A security environment assessment can be carried out once guidance is issued.** Based on this assessment, decisions can be made regarding which security problems each security body will address. Policies and operational plans can be developed, approved and implemented based on these decisions. As part of this process, decisions will be made about the way in which each security/justice body is structured and its size based on available funding (Box 2).

24. **For this policy process to be successful, it must be both transparent and participatory.** A wide range of official and non-governmental actors need to be consulted. To provide adequate input, they require good access to information and timely involvement in the process. The capacity and credibility of the actors to be consulted are also important factors. The outputs of the process should also be made public.

25. **In reality, policy processes can be expected to diverge, often significantly, from this ideal-type.**[9] In particular, states with weak capacity and incomplete political settlements can find it difficult to reach agreement on the policies and strategies that should underpin the budgeting process because they cannot agree on the rules of the game and national priorities. This is particularly common in the security sector where control over the means of force is a highly sensitive issue that often takes a long time to work out in these circumstances.

26. **Thus, these policy processes will have limited practical application in the years immediately following the cessation of hostilities,** while the good-practice approach outlined in Figure 4 demonstrates the type of processes that should be followed to develop effective strategies, policies and plans. The absence of the requisite level of agreement on national political priorities means that a formal, top-down approach and development of the skills to engage in policy/strategy will have to be fostered over time. This is especially true if the international community, which is supporting the security sector, is itself divided on how to prioritize the process of policy/strategy development. Under these circumstances, entry points for strategy development are likely to arise as stakeholders address concrete problems, and policy/strategy development will almost certainly be a repetitive process. Experience indicates that processes that progressively introduce capacities and skills, and provide a forum where political differences can be overcome is most likely to promote the development and implementation of goals and

[9] For more details on security sector policy processes, see for example, 'Kayode Fayemi and Nicole Ball, ed., *Security Sector Governance in Africa: A Handbook*, Lagos: Centre for Democracy and Development, 2004, http://www.ssronline.org/ssg_a/index.cfm, Annex 4.

priorities. Because both technical skills and the habits of political collaboration take time to develop, it will likely take several attempts to develop a solid product[10].

27. **Progress in developing security policy/strategy in Afghanistan has been more modest than other parts of the public sector.** The 2005 PFM Review security sector analysis documented a complete absence of formal strategies in the security sector. Since then, the government has developed a Counter-Narcotics Strategy and a National Justice Sector Strategy with support from international partners.[11] The impetus for the justice strategy came in late 2006 with the recognition that donor assistance was suffering from a lack of strategic orientation and coordination, duplication of efforts, lower sustainability and high transaction costs. The justice sector strategy was then developed as part of the ANDS process. It is linked to a National Priority Plan for the justice sector and supported by a combination of bilateral and pooled funding, the latter managed by the World Bank.

28. **An attempt in 2007 to use the ANDS process to promote a similar top-down development of a national security strategy was unsuccessful.** While the ANDS recognizes security as essential to development and the achievement of its goals, the discussion of security in the ANDS cannot be described as a 'strategy'. Even if a strategy had been included in the ANDS, it would have been impossible to cost due to data constraints and political sensitivities.[12]

29. **Efforts in 2008 to develop "a unified, integrated vision of the police" and "an action plan for supporting the institutional development of the Ministry of Interior" mandated by the Joint Coordination and Monitoring Board (JCMB) appeared to offer an entry point for security sector policy/strategy development (**Box 3**).**[13] However, it is symptomatic of the lack of a strategic approach on the part of the international community that the status of this effort has been difficult to ascertain. Similar documents are being produced by multiple actors, making it difficult not only to determine what is the key document but also which process is likely to prevail. Thus it is difficult to determine whether a developmentally-oriented process like that described in Box 3 will continue or succumb to the pressure for short-term results.[14]

30. **The JCMB process has several interesting features.** The process started with a discussion of personnel and payroll requirements, which pointed to the need for a plan that would address broader issues. As the statement of work for the police plan indicates, however, a plan requires clear objectives. As MoI's priorities and responsibilities paper highlights, clarity on objectives requires clarity on a number of policy questions. "These over-arching priorities will require the

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[10] Nicole Ball, Eric Scheye and Luc van de Goor, *From Project to Program: Effective Programming for Security and Justice*, The Hague: Conflict Research Unit, Clingendael Security and Conflict Programme, Clingendael Institute, December 2007,.

[11] Both strategies have important linkages with the security sector. The Government's Counter-Narcotics Strategy can be found at: http://www.president.gov.af/english/np/counternarcotics.mspx. The January 2008 consultation draft of the justice strategy can be found at: http://www.ands.gov.af/ands/jcmb/site/src/Meeting%20and%20Documents/seventh%20JCMB/files/IV.%20ANDS%20Documents/Justic%20Sector%20Strategy,%20Draft%20Summary%20-%20English.pdf.

[12] A National Security Framework was reportedly drafted in 2005/2006 by an international consultant to the Office of the National Security Council. This strategy has never been formally approved. A National Internal Security Strategy (NISS) is reportedly under development. It is said to have been developed primarily by international mentors and the degree of Afghan government involvement and buy-in is unclear. A NISS would be subordinate to a National Security Framework, should they be finalized.

[13] Joint Coordination and Monitoring Board, 7th JCMB Meeting, 5-6 February 2008, "Report to JCMB VII," paragraphs 18 and 9.

[14] It is important to understand that many of the "short-term," "quick win" priorities identified by the Minister of Interior are unlikely to be achieved in the short term given capacity constraints and the realities of institutional development in conflict-affected countries. See "Ministry of Interior and Police Reform: Priorities and Responsibilities," 30 November 2008.

government to make important policy choices…."[15] It is also noteworthy that the policy issues that emerged were not limited to the police sector. It was clear that decisions about the defense sector also are urgently required. This suggests not only that there are backward linkages from planning into policy/strategy development within the same part of the security sector, but that there may be important backward linkages into other parts of the sector as well.

[15] "Ministry of Interior and Police Reform: Priorities and Responsibilities," 30 November 2008, p. 1.

**BOX 3 JCMB POLICE PLANNING PROCESS**

In early 2007, the JCMB began to give increased attention to a coherent approach to strengthening and reforming the ANP and MoI. It was recognized that to be effective ANP would require clarity on size, appropriate deployment, and professional training, as well as a competitive pay scale and a reformed MoI. Initially much of the attention was focused on personnel numbers and payroll issues. In October 2007, JCMB VI mandated a review of the number of ANP personnel, their quality and the structure of the ANP "in order to provide the Government with a basis for developing a fiscally sustainable policing plan".

The review, completed in January 2008, concluded: "A unified, integrated vision of the Afghan police, addressing the requirements of both law enforcement and national security, should be agreed by stakeholders under the auspices of the International Police Coordination Board (IPCB). This vision should be elaborated in a basic 'Policing Plan' that articulates policing objectives across the country; gives strategic and operational guidance to police activity; and introduces clear accountability. It must be compatible with broader national security planning and take account of coordination with other security agencies."

By the end of 2008, MoI, working with international partners, had produced a Police Vision and a paper outlining priorities and responsibilities for ANP and MoI reform. The latter reflected the views of the recently appointed Minister of Interior. Interestingly from the perspective of strategy development, the priorities paper identified four policy choices that need resolution if police reform is to succeed.

- Determine the correct balance for ANP between paramilitary/counter-insurgency capabilities and law enforcement and other civilian police functions. As a precondition to this determination, assess the development of the security- and justice sectors.
- Complete the Police Vision by reconciling national and local models of police recruitment, while linking police more effectively to communities.
- Establish roles and responsibilities of ANP, ANCOP, ANA and other relevant institutions in internal security operations within the framework of the national security strategy.
- Define the role of the ANP in the wider justice system.

At the same time, in response to Action 1.2 of JCMB VII, a technical team under the auspices of the IPCB produced a statement of work for developing a police plan that was to be presented to JCMB X in April 2009. The technical team proposed a developmental approach to producing the plan to ensure Afghan ownership of the process and build their capacity to undertake planning in the future. It viewed developing a policing plan as a repetitive process. The first step would be a one-year plan to be revised annually as more detailed analysis became possible.

There was strong pressure from the government to turn this medium-term planning process into a short-term plan aimed at providing some "quick wins" in 2009. A short-term process would necessitate the plan being produced by international experts, not Afghan policy makers. While recognizing the desirability of improving security in the near term, completely discarding a medium term, Afghan-led approach would likely not only reduce Afghan ownership of the process but also waste an opportunity to create a tighter link between policy, planning and budgeting: "…the essence of the plan – setting out the application of available resources to identified objectives, to the standards required of documented achievable targets – in order to meet the strategic priorities of the plan owner, within the timeframe of the plan." Without a clear view of what the "identified objectives" for the ANP are, which requires resolution of various policy choices (like those identified in MoI Police vision/priorities paper) it is impossible to develop a meaningful plan that can be costed in a realistic manner.

*Sources: "Police Plan – Statement of Work," 7 December 2008; and "Ministry of Interior and Police Reform: Priorities and Responsibilities," 30 November 2008; Report to JCMB VI, 3 October 2007, "Afghanistan Compact Annual Report: March 2006-March 2007," 1 May 2007, Table 1: Summary of Past JCMB Actions and Decisions, "Status Update on Short-life Benchmarks and Follow-up Action Points," Report to JCMB IV, 30-31 January 2007,*

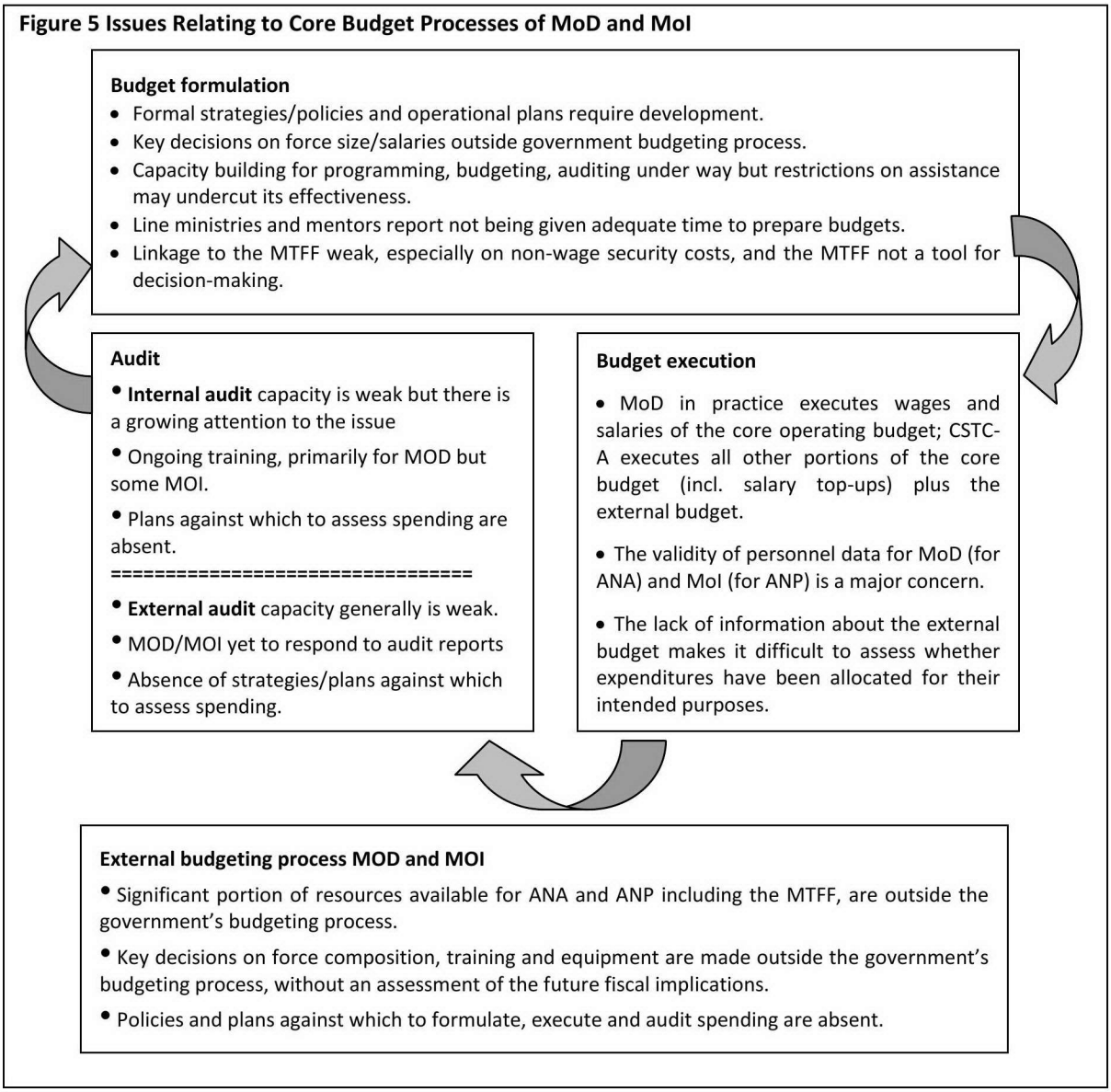
31. **The implications for the budget formulation process.** The tight linkage between policy, planning and budgeting that defines a sound public expenditure system does not currently exist as far as MoD and MoI are concerned. Their budgets are being developed in a vacuum due to

the absence of strategies and associated plans. Decisions affecting the availability of resources for the entire public sector and the sustainability of security bodies cannot be evaluated against an Afghan government statement of security-related priorities. As will be shown in Section E on Fiscal Sustainability Analysis, recent decisions on staffing size and salary levels are not sustainable in the long-term without significant external support. However, it is unclear how long the current external support will be maintained, and there is pressure to finance more of the costs currently covered by external assistance from Afghan resources through the core budget. MoI and IPCB agreed to increase the Tashkeel for Kabul by 4,800 subject to JCMB approval in April 2009. Further increase in Tashkeel is likely to be discussed after the completion of an ongoing EC study on this subject scheduled in June 2009. All of these have resource implications for the viability of existing security bodies in the short, medium and long term, as well as the amount of resources available to non-security portions of the Afghan state budget.

**Budget Formulation**

32. There are five major constraints on the ability of the government to formulate budgets within MoD and MoI (Figure 5).
    - Strategies/policies and operational plans to guide the work of MoD and MoI are largely absent.
    - The government as a whole does not decide force size, salary levels, training and equipment. Those decisions are largely in the hands of Afghanistan's major security sector donors and other members of the international community.
    - While attention is now being given to strengthening the capacity of MoD and MoI to engage in budgeting (including program budgeting) and audit, limitations on that assistance run the risk of undercutting its effectiveness.
    - Line ministries and their mentors report not being given adequate time to prepare the budget.
    - Linkage to the MTFF is weak, particularly relating to non-wage security costs, and the MTFF is not helping policy-makers link policy, planning and budgeting over the medium-term.

**Figure 5 Issues Relating to Core Budget Processes of MoD and MoI**




33. **MoD and MoI budgets submitted to MoF cover only the core budget, while most funding is channeled through the external budget.** Only about 10 percent of the total MoD budget was financed by government resources in 2008/09. Items covered by the budget include most MoD salaries and wages (including the food allowance), salaries, uniforms, and some fuel costs.[16] All other MoD operating expenditures, which are paid by the US government through CSTC-A, are not costed in the budget presented to MoF. Instead of an expenditure figure, items paid for by the US are reportedly followed by "USA". The US also pays all development costs in the MoD

[16] Top-ups for both ANA and ANP personnel paid by the United States appear in the budget. The exact number of ANA personnel to be paid by the government is under discussion. The approved ceiling for MoD-ANA personnel was increased twice in 2008, first to 86,000 and then to 134,000 (including supporting staff). The US has agreed that the international community will pay the additional costs incurred by expanding from 86,000 to 134,000. This implies that the Government of Afghanistan will be responsible for paying the first 86,000 troops. The government has only budgeted for 70,000 troops under MoD for the 2008/09 budget, and put additional resources in contingency funds that are subject to donor funding.

**Box 4 Law and Order Trust Fund for Afghanistan (LOTFA)**

In May 2002, UNDP established a Law and Order Trust Fund for Afghanistan to enable police to return to work throughout the country. LOTFA has five priorities: (i) ensuring police staff nationally receive their salaries; (ii) acquisition of non-lethal equipment; (iii) rehabilitation of police facilities; (iv) gender mainstreaming, and (v) institutional development. Of these, payment of salaries has been the highest priority over the past seven years. From its inception through mid-December 2008, LOTFA has reimbursed MoF $481.8 million for police salaries.

Source: UNDP website, http://www.undp.org.af/WhoWeAre/UNDPinAfghanistan/Projects/sbgs/prj_lotfa.htm.

core budget. CSTC-A plays a central role in developing MoI's core development budget. MoI wages and salaries – like those for MoD – are covered by the government budget. However, they are externally funded on a reimbursement basis by LOTFA (Box 4).

34. **Essential steps toward strengthening LOTFA are being implemented.** Between 2003/4 and 2007/08, LOTFA covered about half of MoI's operating expenditures. Although the security and non-security sectors are different, lessons can be learned from the Afghanistan Reconstruction Trust Fund (ARTF). Further strengthening of LOTFA is likely to achieve (i) transparency and accountability of MoI; (ii) capacity building of MoI over time, and (iii) donor coordination for financing and policy dialogue illustrated in Figure 4. LOTFA has significantly strengthened its accountability framework. An electronic reporting system (ESP) covers 97 percent of the Tashkeel, and salary transfers through bank account (EFT) cover more than 60 percent. However, ESP/EFT alone is not sufficient to address the accountability/transparency of LOTFA. The monitoring agent was hired in August 2009 is expected to strengthen monitoring and evaluation problems confronting LOTFA, as the monitoring agent will conduct will check financial documents and make field visits[17]. The planned hiring of HR controllers to monitor the situation in the provinces is also expected to lead to sustainable improvements in the HR system.

35. **Even responsibility for making decisions on key elements of the core budget, including the number of personnel and salary levels, is not in the government's hands.** The JCMB has formal responsibility for approving the size of ANA and ANP. In theory, salaries are determined by a Presidential decree based on a recommendation from the Ministers of Finance, Defense and Interior. In reality, MoF is rarely consulted: the US government in consultation with the Ministers of Defense and Interior, makes these decisions. Informed after the fact, there is often insufficient time for MoF to consider the implications of these costly security-related moves before they must be incorporated into the budget process. For example, MoF only learned about the US-funded US$20 monthly salary increase for ANA personnel a few days before the 2008 mid-year budget review was due to be sent to the Cabinet.

36. **Both MoF and donors are providing technical assistance to MoD and MoI for budgeting (including program budgeting).** Focal points for each sector help MoF prepare the budget. It has also provided training on program budgeting. CSTC-A provides mentors for budget formulation. This assistance appears to be of high quality and has the potential to significantly enhance the financial management capacity both ministries. At the same time, some words of caution are in order.

37. **Delays in the issuance of budget circulars have implications for the quality of budgeting.** As is the case in other line ministries, MoD and MoI and their mentors note that delays issuing budget circulars and indicative budget ceilings leave them insufficient time to prepare their budgets. In fact, the MoI's budget was not presented in time for the 2009/10 budget hearings because of changes requested by the minister to an earlier draft. Part of the problem can be traced back to the uncertainty about the size of operating grants for MoI and MoD, which makes it impossible

[17] Contract with the monitoring agent is planned to be finalized in early 2010.

to provide indicative ceilings.

38. **Program budgeting is important but requires a well thought-out implementation strategy.** The important shift to program budgeting currently being piloted, should help line ministries better identify priorities and allocate resources. However, as this differs greatly from current budgeting practice, it is essential that line ministries with varied capacities be given the support they need. This is especially the case for MoD and MoI. It appears that the training and documentation provided by MoF may be too advanced for MoD and MoI budget personnel. In part for this reason, program budgeting has not yet brought tangible results for MoD and MoI, and CSTC-A mentors have found it necessary to provide supplemental training.[18]

39. **Information constraints for programming and budgeting will affect the usefulness of CSTC-A mentoring**. Because of restrictions that the US government has placed on sharing information about its financial inputs to ANA and ANP development (through the core and external budgets) much of the budgeting and programming process can only be taught at a theoretical level. In other words, lack of information has prevented program budgeting for MoD and MoI from being as useful as it could be. On-the-job training – for example by shadowing CSTC-A personnel responsible for developing the US portions of the budget – will not be possible, further slowing the learning process.

40. **The weak linkages between the MTFF and the security sector reduce MTFF's potential**. Although the MTFF is supposed to provide policy direction and fiscal snapshots for the medium-term, the lack of information and MoF's limited involvement in the security sector reduces MTFF's ability to function as intended. This issue is common across the sectors, however the lack of information makes this issue even more serious in the security sector.

**Budget Execution**

41. **The twin objectives of budget execution are to ensure that money is spent in the amounts and for the purposes intended.** While MoD and MoI are making progress meeting these objectives, a number of concerns remain (Figure 5). They are:
    - MoD executes only the wage and salary portions of the core operating budget. CSTC-A executes all other portions of the core budget and the external budget.
    - The validity of personnel data for MoD (for ANA) and MoI (for ANP) is a major concern.
    - The lack of information about the external budget makes it difficult to assess whether expenditures have been allocated for the intended purposes.

42. **The issues of ghost soldiers/police officers and the diversion of pay by superiors have received much attention over the years,**[19] raising questions about whether MoD and MoI resources are spent for their intended purposes. The one security service that has apparently significantly reduced its ghost employees is the NDS. The NDS reportedly did this by verifying that people on the payroll were actually working. This underscores the importance of the commitment by the leadership in ministries and agencies to reducing corruption, and of senior government officials to making politically difficult choices.

43. **Estimates about the prevalence of ghost soldiers in the ANP and ANA vary considerably** because the verification methods employed to date have not been highly effective. The situation with MoD/ANA personnel is unclear, in part because of absenteeism, desertion and the payment of salaries of ANA soldiers and officers killed in the line of duty to their survivors (which goes

[18] CSTC-A mentors estimated that between four and six weeks of classroom training were needed; the MoF training lasted only a few days.

[19] See for example, World Bank, *Afghanistan: Managing Public Finances for Development. Volume V: Improving Public Finance Management in the Security Sector*, section 3.10, p. 35.

beyond the question of ghost soldiers). The US Government Accountability Office (GAO) found that in early 2008 some 20 percent of ANA combat troops were not present for duty, often because they needed to physically deliver their pay to their families. Mechanisms to address this problem have been instituted, although it is unclear how well they are working at present[20]. It will be important to determine whether this problem is being addressed as it has been an issue since the very beginning of the effort to develop ANA in 2002. A similar situation exists in MoI/ANP. The GAO found that "U.S.-supported pay system efforts are intended to validate MOI and ANP personnel rosters and ensure that wages are distributed reliably. Despite progress, these efforts face challenges that include limited ANP cooperation and a shortage of banks"[21]. In order to address this issue, MoI sent 300 inspectors to almost all districts to physically check the existence of ANP personnel by matching individuals with payroll records. The same exercise should be continuously conducted with the support of the international community.

**Audits**

44. **A strong internal and external audit capability is essential for managing public sector resources.** Three important security sector audit-related issues have emerged: (i) inadequate payroll controls, (ii) progress on developing internal audit capacity in MoD and MoI, and (iii) the lack of external security sector audits.

45. **Despite the introduction of verification mechanisms, payroll controls continue to be inadequate.** The lack of clarity about the number of individuals employed by MoD and MoI and the diversion of some portion of the payroll in both ministries underscores the importance of internal controls and audit. In common with the rest of the public sector, internal audit capacity in MoI and MoD is weak. The findings of internal audits are not reflected in the following year's budget and there is a lack of sanctions and accountability when problems are identified, in part because of prosecution-related weaknesses.

46. **MoD and MoI salary payments are processed manually.** Although MoF is responsible for paying salaries, there is reportedly almost no control over the expenditures that are paid through the government-financed portion of the MoD budget, particularly salaries. MoD salary payments are processed manually – 75,000 names are handwritten each month. Most MoD salary payments are made in cash. The MoF requests that MoD provide supporting documentation but it appears likely that this documentation does not give an accurate accounting of the number of individuals on the MoD payroll. The MoI payroll is also largely processed manually from districts, although

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[20] According to the US Government Accountability Office:

"… although approximately 32,700 combat personnel received training and were assigned to one of the five ANA corps, the number of combat troops on hand is less than those trained and assigned due to attrition, absenteeism, scheduled leave, and battlefield casualties. As of February 2008, Defense reported that about 20 percent of combat personnel assigned were not present for duty.

"Although some of those absent from the army may have scheduled their absence or been killed in duty, Defense assessment reports from November 2007 to February 2008 show between 8 and 12 percent of combat unit personnel were absent without leave (AWOL), with AWOL rates as high as 17 percent for soldiers in one ANA corps. … Officials attributed these absences to a variety of causes, such as soldiers leaving their units to take their pay home and the lack of significant penalties for such absences. To address these issues, the Afghan Ministry of Defense, assisted by CSTC-A, has initiated programs to allow soldiers to transfer their pay to family members and to facilitate the deposit of ANA salaries directly into soldiers' bank accounts. CSTC-A officials stated these programs should reduce AWOL rates."

United States, Government Accountability Office, *Afghanistan Security: Further Congressional Action May be Needed to Ensure Completion of a Detailed Plan to Develop and Sustain Capable Afghan National Security Forces,*" GAO-08-661, Washington, DC, June 2008, pp. 21-22.

[21] United States, Government Accountability Office (March 2009) "AFGHANISTAN SECURITY: U.S. Programs to Further Reform Ministry of Interior and National Police Challenged by Lack of Military Personnel and Afghan Cooperation (GAO-09-280)

more than 97 percent of the Tashkeel are enrolled in ESP, and EFT covers more than 60 percent. MoI payment requests based on attendance rosters are sent from the district personnel officer to the provincial financial officer, to the provincial Mustofiats and on to MoF. As with MoD, documentation provided to MoF may not give an accurate accounting of the number of individuals on the MoI payroll. What is more, ensuring that ordinary soldiers and police officers receive their pay remains a challenge as ANA and ANP commanders often take advantage of cash payrolls.

47. **MoD and MoI have introduced electronic databases linked to an electronic payment system** in an effort to address the problem of ghost workers and to reduce the ability of senior ANA and ANP officers to divert pay. As of March 2009, some 97 percent of the MoI Tashkeel was registered in the database and 65 percent of those had their salaries paid into bank accounts. MoD has also registered personnel, inputting their information into the database and signing ANA personnel up for bank accounts. In November 2008, it was estimated that about half of all ANA personnel were in database, and had a bank account with direct deposit.

48. **There are, however, several problems with an electronic verification process.** The banking system in Afghanistan is underdeveloped and many soldiers and police officers are stationed in places without banks, so electronic banking unfeasible. Secondly, as attendance records remain open to abuse, simply registering an individual in a MoI or MoD database is no guarantee that that person actually works. Thirdly, an electronic database and payment system can only go so far: there have been reports of commanders collecting bank cards, withdrawing and distributing the salaries, and withholding a portion of each person's pay.

49. **Neither CSTC-A nor LOTFA are in a position to verify numbers or attendance records**. The monitoring agent was hired in August 2009 and will be operationalized in early 2010. It is anticipated that the monitoring agent will be able to carry out spot checks. MoI also has a plan to conduct spot checks by itself. Although CSTC-A has mentors with every ANA unit that has been trained and there are police mentors with some ANP units, CSTC-A does not envision these individuals playing any monitoring role as far as payroll issues are concerned. Additionally, for the US$20 top-up payment, the MoD Finance Office provides the number of soldiers in the ANA, which is verified with CSTC-A (CJ-1). When the numbers match, reimbursement is provided. However, the problem of attendance remains. The number assigned to any given unit may not be the same as the number who actually show up for work.

50. **Both MoD and MoI are developing their audit capacity.** MoD has made significant progress since mid-2007 with the support of a CSTC-A mentor. The environment for addressing corruption in MoI has improved substantially with the appointment of a new minister in late 2008. The Minister announced that he wants the 700 most senior MoI officials to fill out financial disclosure forms to be checked against their assets. He has also begun to remove senior MoI officials found to be engaging in corrupt activities. While weaknesses in the legal system allow these individuals to escape prosecution, they are reportedly not being offered new public sector jobs as was often the case in past. Additionally, the minister has suggested that MoI conduct a personnel asset inventory in all districts, verifying that people on the ANP payroll are present and in possession of their weapons and other equipment. It is unclear where the capacity to carry out these activities will come from, as MoI's in-house audit capacity is currently very weak.

51. **MoD's internal audit capacity appears to be making good progress.** As part of the process of setting up an internal audit office in MoD, the CSTC-A mentor has developed a training program in collaboration with MoF. This five-and-a-half-month-long course is primarily for MoD officials, but five MoI auditors were also trained during 2008. By late 2008, the CSTC-A mentor had arranged for on-the-job training for 30 of the 59 MoD trainees. Their first project will be to verify that ANA and MoD personnel on the payroll actually report for work. An additional

objective of the MoD audit program is to help break down the lack of communication within MoD. Initially, each MoD section jealously guarded access to its information. Acceptance of the concept of a single audit office for MoD reportedly grew as the program progressed. The MoD inspector general (IG) oversees the MoD internal audit department in his capacity as auditor general.[22] The IG department is reportedly capable but experiences difficulties following up once problems are identified. The main problem in this regard is said to be the absence of a court martial system for senior officers suspected of corruption.

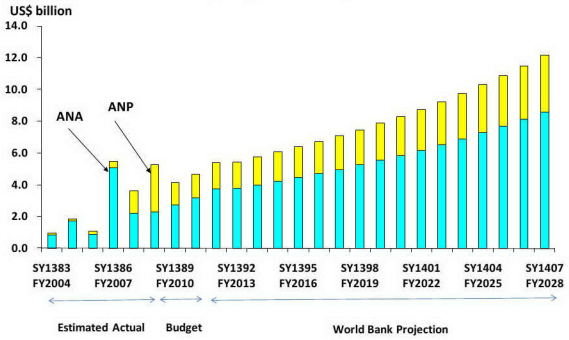
52. **External audits have not been given adequate attention to date.** The first US government audit of funding for Afghanistan was conducted in late 2006, however it focused on how US resources were used. It appears that the Afghanistan government has not carried out any effective external audits for the security sector.

## E. Fiscal Sustainability Analysis[23]

53. **The fiscal sustainability analysis rests on various assumptions.** In this fiscal sustainability analysis, ANA manpower is projected to increase to 240,000 in 2012/13 , while ANP is projected to increase to 160,000 in 2013/14. In addition to these manpower projections, the fiscal sustainability analysis makes the following assumptions:
    - Salary levels and food allowances are constant in real terms (i.e. adjusted for inflation rates).
    - The base salaries in 2008/09 include salary top-ups (US$20 a month for both ANA and ANP), but exclude incentive payments for ANP due to lack of information.
    - The target stock levels[24] for infrastructure and equipment are adjusted by the ratio of manpower increase from the previous exercise in January 2008.
    - Sustainment costs are adjusted by the outstanding stock equipment/infrastructure from the previous exercise.
    - Training costs are adjusted to match manpower levels.

54. **Preliminary results show a continuous increase in ANA and ANP expenditures in the next ten years.** Expenditures on ANA and ANP decreased to less than US$5 billion in 2008/09. However, expenditures are projected to increase over the next 10 years, reaching US$12 billion in 2028/29 (Figure 6 and Table 6). There are three angles from which to assess the total expenditures: (i) state budget versus external budget; (ii) ANA versus ANP and, (iii) operating expenditures versus investment. The external budget accounts for 74 percent of total expenditures, ANA accounts for 69 percent and operating expenditures account for 86 percent (of total expenditures) during the projected period between 2009/10 and 2028/29.

**Figure 6 Projected Expenditures on ANA and ANP**
(US$ billions)




*Source: MOF, CSTC-A, World Bank staff estimates*

[22] The IG reports his findings to the Defense Minister. The Defense Minister in turn reports to the President.
[23] The availability of security sector data is of great concern. This analysis has to rely on certain assumptions and therefore must be treated as rough estimates.
[24] Stock outstanding levels are estimated by a perpetual inventory method.

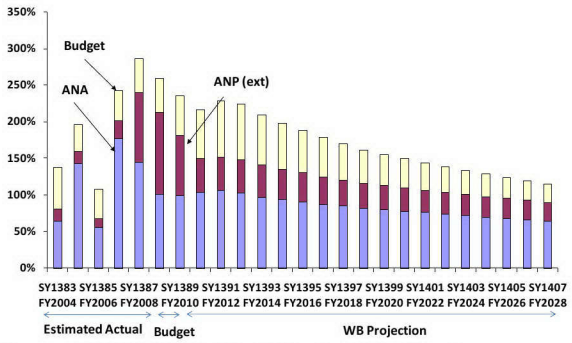
**Table 6 ANA and ANP Expenditure Projections**

| | 2008/09 (est. actual) | 2013/14 WB pro | 2018/19 WB pro. | 2023/24 WB pro. | 2028/29 WB pro | Average share in 09-28 |
|---|---|---|---|---|---|---|
| **1. US$ Billion** | | | | | | |
| State Budget | 0.6 | 1.7 | 2.0 | 2.3 | 2.7 | 26 |
| External Budget | 4.1 | 3.7 | 5.1 | 6.9 | 9.5 | 74 |
| | | | | | | |
| ANA | 3.2 | 3.8 | 5.0 | 6.5 | 8.1 | 69 |
| ANP | 1.5 | 1.7 | 2.1 | 2.7 | 3.4 | 31 |
| | | | | | | |
| Operating Expenditures | 2.4 | 4.5 | 6.2 | 8.3 | 10.6 | 86 |
| Investment | 2.3 | 0.9 | 0.9 | 0.9 | 0.9 | 14 |
| **Total** | **4.7** | **5.4** | **7.1** | **9.2** | **12.2** | **100** |
| | | | | | | |
| **2. % of GDP** | **31** | **27** | **23** | **20** | **17** | **-** |
| **3. % of domestic revenues** | **449** | **270** | **195** | **154** | **125** | **-** |

*Note: There is double counting on CSTC-A on salary top-up, but this is negligible.*
*Source: MoF, CSTC-A and World Bank staff estimates*

55. **ANA and ANP expenditures are not fiscally sustainable without significant external input over the medium- to long-term.** As a share of GDP, the ratio peaked at 56.8 percent in 2007/08 and is projected to decline to 17 percent in 2028/29. The high ratio in 2007/08 is due to the investment in ANP equipment and infrastructure by CSTC-A. In terms of share in domestic revenues (excluding grants), the ratio peaked at 813 percent in 2007/08 and is projected to decline to 125 percent in 2028/29. An indicator of fiscal sustainability (the share of operating expenditures – including both core and external – in domestic revenues) shows that the ratio peaked in 2008/09 at 286 percent and then decline to 115 percent in 2008/09 (Figure 7). A ratio greater than 100 percent means that ANA and ANP expenditures are not fiscally sustainable, as the government must find funding for things like infrastructure, health and education as well as the essential costs of maintaining the public administration.

**Figure 7 Fiscal Sustainability Indicator**
(share of operating exp. covered by domestic revenues, percent)




*Source: MOF, CSTC-A, World Bank staff estimates*

56. **Sensitivity analysis of the change in ANA and ANP manpower.** If manpower of ANA and ANP is increased by a further 10,000 each, it will add an additional US$203 million to annual expenditures. The ANA will account for US$113 million of this growth and the ANP, US$90 million. In addition to wage and salaries, training and medical costs will be very high (Table 7).

57. **Fiscal implication of fiscal sustainability analysis.** The fiscal sustainability analysis suggests that expenditures on ANA and ANP (financed by CSTC-A/external sources and the state budget) will likely decline as a share of GDP and domestic revenues. However, these costs will exceed domestic revenues throughout the projection period and likely for some years after. The following are key fiscal implications.

**Table 7 Sensitivity Analysis**

(Annual expenditures, per additional 10,000 manpower)

| Annual Expenditure Increase (US$ million) | ANA | ANP | Total |
|---|---|---|---|
| **1. External sources** | **84** | **61** | **145** |
| Salary top-Up | 9 | 2 | 11 |
| Medical and training | 75 | 59 | 134 |
| **2. Ministry of Defense/Interior** | **29** | **28** | **58** |
| Salary | 17 | 15 | 33 |
| Food | 7 | 7 | 14 |
| Goods & Services | 4 | 6 | 11 |
| **3. Grand Total** | **113** | **90** | **203** |

*Source: MOF, CSTC-A, World Bank staff estimates*

- **Need for continuing external assistance:** Assistance from CSTC-A accounted for between 76 percent and 92 percent of total outlays on ANA and ANP in 2004/05 and 2008/09 respectively. It is projected that assistance from external sources over the next decade will amount to between 75 percent and 85 percent. CSTC-A commitments for ANA expenditures are on an annual basis . Any further assistance and the level of such assistance is entirely subject to future discussions and the legislative budget process in the US. The analysis indicates that sustainment and recapitalization of equipment from external sources will require more than US$2 billion over the next ten years. Therefore, it would be impossible to cover these expenditures from domestic revenues.

- **MoD and MoI expenditures from the state budget**: As ANA and ANP rely on CSTC-A for most equipment and sustainment, the main expenditure item from the state budget is "wages and salaries". These will account for more than two-thirds of total ANA and ANP expenditures over the next ten years. The analysis shows that MoD and MoI expenditures as a share of domestic revenues are projected to be stable at around 30 percent each (including LOTFA for MoI). These ratios are very high in view of other demands on the government budget. Also, if external sources are not available in the future, MoF will have to bear additional costs. Given projected domestic revenues for the coming ten years, this is not fiscally sustainable.

- **Macroeconomic assumptions:** The macroeconomic framework used in this analysis is consistent with the latest HIPC document which assumes (i) a long-term average annual GDP growth rate of six percent; (ii) a decrease in inflation rates to three percent in 2012/13 and beyond, and (iii) improvement in the revenue-to-GDP ratio from 7.0 percent in 2007/08 to 13 percent in 2028/29. Departures in a negative direction from this macroeconomic scenario would further negatively affect fiscal sustainability of ANA and ANP. Although Afghanistan has not been affected much from the ongoing global economic downturn, the global macroeconomic situation might affect not only growth rates in Afghanistan but also security sector financing from the international community.

- **Pension liabilities:** Due to the lack of information, this fiscal sustainability analysis does not focus on pensions for ANA and ANP personnel and their families. As the size of ANA and ANP is projected to increase, pensions are likely to be large, long-term liabilities for the government. An analysis should be conducted and integrated into the MTFF.

## F. Policy Recommendations: Strengthening PFM in the Security Sector

58. **To a large extent, the budgeting challenges facing the security sector mirror those in the broader public sector.** These include:
    - Budgets are not grounded in long-term strategies or medium-term operational plans, and there is a need to improve the linkage between the ANDS and the budget/MTFF.
    - Donor funding is frequently non-transparent and decisions that affect funding levels are often not communicated to MoF in a timely fashion.
    - Donor funding often lacks predictability. It may arrive late and there is no guarantee that it will be maintained over the medium term.
    - Attention is focused on the core budget when most financing is channeled through the external budget over which the government has few controls.
    - Responsibility for budget execution (especially core development expenditures) resides primarily with external actors.
    - Weak audit capacity reflects a lack of attention to this function by the international community until fairly recently as well as a lack of resources (both financial and human) on the government side.

59. **At the same time, the security sector exhibits several special characteristics.**
    - Its size magnifies its impact on the fiscal sustainability of the entire government.
    - Decision-making on key issues (security assessment, mission, force structure, size and sustainment in the security sector) resides primarily with external actors. The government as a whole is not included in the decision-making process and different external actors have different priorities. Unlike other branches of government, MoD and MoI operate with great autonomy from MoF, which often finds itself cut out of the information loop.

60. **The last characteristic poses serious obstacles to improving the security budgeting process in Afghanistan.** The heightened security threat makes it all the more important that building the capacity of Afghan organizations to manage and oversee the security budgeting process is accorded high priority. If the government and its international partners want to build effective and sustainable security services capable of meeting the multiple security challenges confronting Afghanistan, these forces must be appropriate to their tasks, accountable to elected authorities and the people, and affordable.

61. **A first priority in achieving these objectives is to pursue the entry points that create a more strategic approach to the development of ANA and ANP**. As Figure 5 illustrates, a more strategic approach will have implications for all parts of the budgeting cycle, and facilitate a linkage with the MTFF. The current entry points for developing a strategic approach appear to be in the policing sub-sector: the policing plan and the policing priorities and responsibilities paper.
    - The 2005 PFM Review called for the development of a National Security Strategy, which would have been the building block for sub-sectoral strategies for defense and police/internal security. While in principle this top down approach would have been desirable and appeared to be underway in 2005, it is now clear that it was not feasible politically. Developing a progressively more strategic approach based on addressing concrete needs is more realistic given the political realities of Afghanistan; and
    - The development of a medium-term approach should in no way contradict efforts to improve security in the short term. Indeed, every effort should be made to link short-term

activities to medium- and longer-term objectives. If, however, the focus remains solely on the short term as it has for the past seven years, increasingly scarce resources will not be used in the most effective and efficient manner, and important synergies – with other parts of the internal security sector (including justice) and with defense – will be lost.

62. **A second priority is to integrate MoD and MoI more fully into the government-wide financial management system**. The 2005 PFM Review also identified this as a priority but relatively little progress has been made to date. Both MoI and MoD have tended to chart independent courses, developing closer relations with the office of the president and key donors than with other parts of the Afghan government, notably MoF. While it would be difficult for MoF to exert more discipline over these two ministries given the dependence on external financing and the way in which the external budget in particular is managed, MoF should at a minimum receive more timely information from both ministries.

    - One way to achieve this would be for senior officials in all three ministries to meet regularly. MoF, MoD and MoI, together with CSTC-A, have started an initiative to share information on MoD and MoI budgets on a regular basis. One objective of this process should be to move from bilateral MoF-MoD and MoF-MoI meetings, to tripartite meetings. If it were possible to add other security actors, for example the NDS and the ONSC, this mechanism could help facilitate discussions on a strategic approach to the entire security sector.

    - Another way to improve inter-ministerial dialogue on security issues is to second officials from MoF to MoD and MoI. In addition to improving the information flow, secondments could enhance the quality of PFM in MoI and MoD, improve MoF's understanding of security-related issues, and ultimately strengthening MoF voice in intra-governmental discussions.

63. **A third priority is to continue efforts to enhance the capacity of MoD and MoI staff to engage effectively in all parts of the budget cycle**. The 2005 PFM Review called for improvements in the capacity to manage and oversee the financial management of the security sector, with special emphasis on internal audits. Until recently, there were no serious efforts to enhance capacity in MoD and MoI. Now, however, CSTC-A's mentoring programs in the areas of budget formulation and auditing provide an important platform on which to build.

    - The support to MoD's internal audit appears to have been particularly effective. It is important to identify any lessons that might be learned from that experience and apply them more broadly. A greater emphasis in the CSTC-A mentoring programs on the transfer of capacity, rather than transfer of knowledge, will also be helpful. Similarly, a continuation and even intensification of the efforts to civilianize MoD currently supported by the UK will also strengthen capacity. Opening positions in MoD and MoI to the civil service will increase the opportunities to appoint experienced individuals and potentially reduce costs, since the pay scale for military officers is higher than that of civil servants.

64. **A fourth priority is to intensify efforts eliminate vulnerabilities to corruption, especially relating to MoD and MoI wages and salaries.** Efforts are already underway to eliminate ghost employees and to reduce the opportunities for bribes and kick-backs in procurement and in hiring decisions. The leadership shown by MoI has been extremely important in this regard and the MoD's efforts to focus the newly trained auditors on payroll issues are also a positive step. The mentoring program for MoD auditors is due to end in mid-2009. Given the success of this program to date, it is desirable for it to be extended for at least another year in order to give the new MoD auditors the support they will require in what is a highly sensitive job. It is essential for both MoI and MoD to resolve the problem of falsified attendance records. Electronic databases alone will not resolve this problem. Additionally, attention should be paid to

developing the capacity to prosecute senior officials who engage in corruption. The government should adopt and enforce a policy of removing offenders from their government positions and not rehiring them in other positions.

65. **A fifth priority is to strengthen external oversight.** The 2005 PFM Review recommended the development of security sector oversight. To date, external oversight for the security sector appears to have received little, if any, support. In particular, relevant parliamentary committees should understand their oversight roles and develop the expertise to carry them out. The Control and Audit Office should similarly be strengthened to address issues relating to security.

66. **A sixth priority is to acquire predictable financial support from the international community over the medium term.** Affordability is essential if a security system is to produce the desired outcomes. The results of the fiscal sustainability analysis show that the security sector of Afghanistan will not be fiscally sustainable for the foreseeable future without continuous support from the international community. As external budget investments affect future operational and maintenance costs financed through the core operating budget, the integration of the core- and external budgets (at least in terms of forecasting – through the MTFF – and reporting) is indispensable.