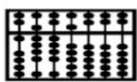


# \$PENDING THE DEVELOPMENT DOLLAR TWICE:

The Local Economic Impact of Procurement in Afghanistan



A REPORT BY:  
PEACE DIVIDEND TRUST  
July 2009



***Peace Dividend Trust***  
Building a Better Peace

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Peace Dividend Trust is a non-profit organisation dedicated to making peace and humanitarian operations more efficient, effective and equitable – thereby delivering a stronger peace and a larger peace dividend.

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8 July 2009

The United Nations Assistance Mission in Afghanistan (UNAMA) applauds Peace Dividend Trust and the UK Department for International Development for producing this important report. UNAMA launched a local procurement campaign for Afghanistan with Peace Dividend Trust in Kabul on 10 June -- to put more momentum behind the Afghanistan First initiative -- and challenged the international community, including the United Nations family, to increase local procurement by 10% in the coming year. Afghan firms are ready to supply much more of the needs of the international community. This will create much needed tax revenue for the national budget and jobs for young Afghans. We look forward to reading the next report and reading about increased local procurement from the international community. Congratulations on a job well done.

Sincerely,



Kai Eide

Special Representative of the UN Secretary-General for Afghanistan

## Preface & Acknowledgements

The research and writing of this report was funded by the United Kingdom's Department for International Development (DFID) and carried out by Peace Dividend Trust (PDT). PDT wishes to thank DFID for making this project possible through their generous support.

The results presented in this study are based on information provided to PDT by the Afghanistan Ministry of Finance, development donor participants and their implementing partners, and from surveys carried out with businesses located in Kabul. In preparing this analysis, PDT has relied on the accuracy of this information, and has not undertaken independent verification of the data. Accordingly, where there are errors or omissions in the data provided by donors or their implementing partners, these inaccuracies will be reflected in the results.

In some instances, the data received by PDT was of poor quality. This was the case in the previous study completed in 2007 and is a recurrent theme in this report. Where international donors believe the results presented in this study do not reflect the actual local economic impact of their spending, they should consider implementing new reporting systems that would allow for a more thorough analysis to be undertaken.

Importantly, this report focuses on the local economic impact of development spending in Afghanistan - that is, the economic impact of funds spent to carry out project work on the Afghan economy. It does not focus on the specific question of the direct effectiveness of that aid – that is, whether or not the aid spent delivered the outcomes it was designed to deliver. Assessing aid effectiveness remains a critical complementary body of analysis that suffers from the same data challenges as this work.

Field research for this project began on June 1, 2008 and concluded on September 4, 2008. Due to delays in the provision of data as well as gaps in reporting, attempts to solicit information continued remotely until November 2008.

The authors of this report wish to gratefully acknowledge the important contributions of the many individuals without whom this project could not have been accomplished: The Government of Afghanistan, including all members of the Aid Coordination Unit (Ministry of Finance), Megan Gray (Ministry of Finance, Treasury), and Mustafa Aria (Former Manager, UNDP Making Budgets and Aid Work Project). We would also like to thank Scott Gilmore (PDT Executive Director), Duncan Fitz and Katherine Katcher (Project Assistants); the Peace Dividend Marketplace staff in Kabul; and perhaps most importantly, all of the donors, partners, and local companies who contributed their time, expertise, and efforts to help see this project through to its completion.

## Executive Summary

This report measures the local economic impact of official development assistance (ODA) spending on Afghanistan during calendar year 1385 (2006).<sup>1</sup> Of the approximately \$2.1b<sup>2</sup> of ODA disbursed by the international donors covered in this study, an estimated 37.6% or \$788m entered the Afghan economy.

The major conclusions presented in this report are:

- The local economic impact of donors to Afghanistan has improved from 1384 (2005) to 1385 (2006) with an increase from 31.2% to 37.6%.
- From 1384 (2005) to 1385 (2006), the local economic impact of ODA nearly doubled from \$414m to \$788m. This can primarily be attributed to the inclusion of additional donors in the 1385 (2006) survey as well as an increase in local spending by some donors – both of which raised the average impact.
- The seven donors who provided data in both 1384 (2005) and 1385 (2006) increased their local economic impact from 31.2% to 36.3% - a significant improvement.<sup>3</sup> Five of the seven donors covered in both studies increased their local economic impact.<sup>4</sup>
- The local economic impact of ODA is dramatically higher when monies are channelled through trust funds or directly to the government (around 80%) relative to funds provided to international companies or organisations (over 15%).
- Even when funds are provided outside of trust funds or the government, the local economic impact of international spending can be increased significantly through the use of Afghan vendors – without compromising value for money outcomes.
- Donors' ability to report accurately, timely, and comprehensively on their disbursements has not improved appreciably since the analysis on 1384 (2005), with no donors able to fully respond to this study's queries about their 1385 (2006) disbursements. Donors, in other words, often do not know how their international aid money is ultimately spent in Afghanistan.

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1 The Afghan calendar year runs from March to March. For ease of reading, each Afghan year is presented with the closest western calendar year. So for 1385, which represents 21 March 2006 to 20 March 2007, the year is presented as 1385 (2006).

2 All figures are presented in United States (US) dollars.

3 The United Kingdom (UK), Canada, Germany, the Netherlands, the US, the European Commission (EC), and Norway.

4 This includes the UK, Canada, Germany, the Netherlands and the US.



## 1. Introduction

Plagued by centuries of conflict, Afghanistan presents even the most creative and coordinated donor efforts with a challenging and unforgiving path to success. Extreme poverty, insecurity, and rugged, harsh terrain invariably complicate the design and implementation of strategies that provide much needed services in the short-term while creating a foundation that supports long-term peace and sovereignty. The large-scale humanitarian and development projects that have been underway to rebuild the country since 2001 underscore these challenges. Despite eight years of work and billions of dollars of assistance, Afghanistan's infrastructure remains devastated, and its people, who have endured the effects of multi-generational poverty and violence, are growing weary.



Set against mounting concerns about deteriorating conditions within the country, in June 2008, more than 80 nations renewed their commitment to Afghanistan at the Paris International Conference – pledging an additional \$14 billion in support.<sup>5</sup> These new pledges bring the total amount of development assistance for Afghanistan to roughly \$55.7 billion.<sup>6</sup> In a time of economic uncertainty, this investment, along with the declining security situation, highlights the pressing need for effective and efficient spending to ensure that international efforts yield the highest possible impact on the ground.

## 2. Overview and Background

This is the second study of the local economic impact of development assistance spending on Afghanistan and is part of an ongoing process to support both the local government and the international community in their efforts to successfully implement Afghanistan's national development strategy.<sup>7</sup> The first study, which was carried out in 2006/7, assessed the local economic impact of the development assistance spending of eight of Afghanistan's key development partners in 1384 (2005). This study applies the same core methodology to consider the local economic impact in 1385 (2006); however, the coverage has been expanded to eleven development partners.

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5 The total of 21 billion originally announced includes approximately 7 billion in previously pledged monies. The period for disbursement is 2002-2013. Source: Government of Afghanistan Ministry of Finance. Donor Financial Review: Aid Coordination Unit Pledge Table. December 2008.

6 This number is based on verified donor conference pledges of 33.441 billion and supplemental pledges of 22.276 billion. Source: Government of Afghanistan Ministry of Finance. Donor Financial Review: Aid Coordination Unit Pledge Table. December 2008.

7 This report does not provide a detailed discussion of the important role that supporting local economic activity plays in entrenching good development outcomes, including the critical link between delivering a peace dividend to the local community and maintenance of short and long-term stability. Nor does it provide specific detail on PDT's expertise in this area. Both of these topics are covered in detail in the previous report (Carnahan, Michael and Jennifer P. Holt. "The Afghanistan Compact and Procurement Monitoring Project." April 2007.) and in the original study (Carnahan, Michael, Bill Durch and Scott Gilmore. "The Economic Impact of Peacekeeping." March 2006.).

## 2.1 Background

From 31 January to 1 February 2006, the Government of Afghanistan and over 60 nations gathered at the London Conference to endorse and sign the Afghanistan Compact.<sup>8</sup> The Compact, which succeeded the implementation of the Bonn Agreement,<sup>9</sup> was designed to support the Afghanistan National Development Strategy (ANDS)<sup>10</sup> by setting out a five-year plan for meeting goals in the areas of security, governance, and development. In addition, it contains specific targets and strategies that recognise the importance of how international aid is delivered and aims to increase the overall efficacy of spending.

### **Spending the Development Dollar Twice**

Using Afghan goods and services to carry out development projects provides the opportunity to spend a dollar twice. While funding the provision of essential services, the international community can simultaneously create jobs, generate revenue and develop the Afghanistan marketplace.

Under the Afghanistan Compact, donors agreed to channel an increasing proportion of their assistance through the core government budget, either directly or through trust fund mechanisms. Where this was not possible, the Compact acknowledges the significance of three things: using national partners rather than international partners to implement projects; increasing procurement within Afghanistan; and using Afghan goods and services wherever feasible rather than importing goods and services. The significance of these approaches to development spending is that they offer the opportunity to “spend a dollar twice” by funding the provision of vital services and relief to the Afghan people while at the same time creating jobs, increasing incomes and developing the local marketplace.

The international community has also committed itself to increasingly harmonise, align, and manage aid so that results can be evaluated against a set of measurable indicators. These commitments were confirmed in the Paris Declaration in 2005, and there have since been two reports on progress made in meeting these shared obligations in Afghanistan. The work in this study complements the work undertaken for and presented in the Paris Declaration reports. While local economic impact is not one of the twelve indicators monitored nationally and reported on internationally under the Paris Declaration, the data requirements for estimating local economic impact are very similar to those needed to measure the Paris Declaration indicators, particularly on alignment. In the recent Paris Declaration report on Afghanistan the poor quality of information available from development partners was noted. Work undertaken by both the Government of Afghanistan and the international community to collect and analyse disbursement data will support attempts to more accurately report on progress against the Paris Declaration indicators.

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8 London Conference on Afghanistan. “The Afghanistan Compact.” January 2006.

9 The agreement on provisional arrangements in Afghanistan, pending the re-establishment of permanent Government institutions – also known as the Bonn Agreement – was finalised on 22 December 2001.

10 The ANDS, which also serves as the national Poverty Reduction Strategy Paper, sets out the strategic policies, programs, and projects for development activities while providing the framework under which aid delivery is prioritized. It also provides a broader, more extensive framework for economic development and seeks to guide the implementation of commitments laid out in the Afghanistan Compact relating to aid effectiveness.



## 2.2 Setting a Benchmark: Previous Work to Assess Local Procurement in Afghanistan

The Government of Afghanistan has led efforts in previous years to assess the amount of money being spent on Afghan goods and services. In 2006, the Ministry of Finance administered a survey as part of the Organisation for Economic Co-operation and Development (OECD) project to monitor the Paris Declaration.<sup>11</sup> The survey was to be completed by all donors providing ODA to Afghanistan and contained questions on agency's local procurement for fiscal year 2005. However, responses revealed that only a handful of donors were able to provide quantitative data on their local purchases. As a result, a baseline understanding of local procurement by donor agencies could not be established – and without a baseline, progress to meet commitments related to enhancing aid effectiveness through an increased use of local goods and services could not be measured. To address this critical gap, the Ministry of Finance requested the support of Peace Dividend Trust (PDT) to assist them in both designing and executing a project that would produce a benchmark on the local economic impact of ODA so that these important shared obligations could be monitored in the coming years.<sup>12</sup>

In late 2006 and early 2007, PDT partnered with the Ministry of Finance's Aid Coordination Unit (ACU) to prepare and set this benchmark.<sup>13</sup> After reviewing the data available for 1384 (2005), PDT found that the local economic impact of reported donor spending was around \$424m. That is, of the \$1.36b reported by donors as spent in 1384, 31.2% entered the Afghan economy and generated a local economic impact. Data also showed that of the different ways in which donors spend their funds, by far the greatest local economic impact is obtained when resources are provided directly to the government (local economic impact around 80%) versus those funds provided to international companies and organisations.

In addition to successfully setting a benchmark on the local economic impact of ODA spending in Afghanistan, the first report also raised several key concerns about the difficulties in accessing ODA disbursement data as well as the poor quality of some of the information that was provided by donors. In many cases, there has been little improvement in this regard. Capacity and resources on the ground to carry out exercises like this, technical challenges, and political issues were all recurrent themes in this second study. However, these must be considered against the complex issues that donors and their implementing partners are faced with in Afghanistan, in particular the exigencies of the environment. That is to say that while donors must begin placing emphasis on tracking and following disbursement data if they want to understand the local economic impact of their spending, the proper resources must be put in place to support that process.

## 2.3 Structure of the Report

This report compares and evaluates progress against the benchmark set in the first study and is presented in three major sections. The first section estimates the local economic impact of donor development expenditure and includes a discussion of the methodological approach applied, the nature of the data collected, and the results of the analysis. It also provides a discussion of relevant challenges and possible ways forward. The following section then considers ways in which the local economic impact of development spending could be increased. This includes reporting on interviews with participants from the local and international private sector

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11 Organisation for Economic Co-operation and Development (OECD). "Monitoring the Paris Declaration." November 2008.

12 The Government of Afghanistan chose to partner with PDT in this exercise because of PDT's expertise in measuring local economic impact. This expertise was developed through its research on the local economic impact of United Nations Department of Peacekeeping Operations' spending on host economies.

13 Carnahan, Michael and Jennifer Holt. "The Afghanistan Compact and Procurement Monitoring Project." April 2007.

as well as with development partners. A series of recommended next steps and concluding remarks are presented in section five.

### 3. Estimating the Local Impact of Development Expenditure

#### 3.1 Research Approach

The methodology for this project was designed to measure the local economic impact of donor spending through an analysis of ODA disbursement.<sup>14</sup> For the purposes of this study, “local economic impact” is defined as the value of production undertaken by local workers and businesses, taking into account Keynesian multiplier effects, which are discussed in section 3.1.1. The overall economic impact of the international community is, of course, greater than the impact of spending covered solely by ODA. The full impact would also include spending by donors on their own operations (e.g. mission overhead costs such as local staff or locally purchased provisions) and assistance provided that is not ODA-eligible (e.g. through defence co-operation or intelligence agencies). For the purposes of this project, however, the focus was only on ODA-eligible expenditure. As was the case with the last study, the challenges in obtaining reliable data even in this narrow category supported the decision to limit the study in this way.

##### 3.1.1 Estimation Methodology

The methodology<sup>15</sup> takes as its starting point the total amount of ODA disbursed by a donor country. It then subtracts the amounts that are not spent locally, including the head office costs of international companies, or wages paid to international consultants. Of the money that is spent in the local economy, the methodology then considers how much of this is spent on locally produced goods and services versus how much is spent on imported goods and services. In sum, the local economic impact of the expenditure on the host economy can be estimated as follows:

$$E_{local} = \alpha.G \& S_{external} + \beta.G \& S_{local} + salaries_{local} + \varphi.allowances$$

$E_{local}$  = the local economic impact of expenditures;

$\alpha$  = the local content factor of externally procured goods and services;

$G \& S_{external}$  = goods and services procured externally (e.g. on systems contracts procured internationally);

$\beta$  = the local content of locally procured goods and services;

$G \& S_{local}$  = goods and services procured in the field (which may be from locally-owned companies, locally-based companies owned by foreigners, or international companies);

$salaries_{local}$  = wages and salaries paid to local engaged staff; and

$\varphi$  = the local content factor of spending from allowances paid to international staff.

14 ODA refers to official development assistance and is a term defined by the Development Assistance Committee of the OECD. It includes development assistance but does not include security or military assistance. All OECD member countries report the amount of ODA eligible expenditure to the DAC each year on a country-by-country basis.

15 The methodology used for this study is grounded in the methodology developed for the PDT Economic Impact of Peacekeeping project. Source: Carnahan, Michael. ‘Estimating the Fiscal Impact of UN Peacekeeping Missions,’ working paper, 2005.

The local economic impact of any particular donor's operations in Afghanistan would then be the local economic impact of each of the component parts identified above. In terms of a simple example, consider a donor with a \$50m programme that spent \$10m on their own operations, \$25m on community projects through a local Non-Governmental Organisation (NGO) and gave \$15m to Afghanistan Reconstruction Trust Fund (ARTF). As part of the project, the local content of each of these could be estimated, and for example, may be as follows: own operations – 15%, local NGO community projects – 40%, ARTF – 77%. The local economic impact would then be the following:

$$(\$10m \times 0.15) + (\$25m \times 0.4) + (\$15m \times 0.77) = \$23.05m \text{ or } 46\%.$$

### *Estimating the Keynesian Multiplier*

The Keynesian Multiplier measures how many times an additional dollar cycles through an economy. For example, a donor may spend \$1 on hiring an Afghan worker. He, in turn, spends a portion of that on buying locally grown rice. There is little quantitative analysis in Afghanistan that would allow for an accurate measurement of the Keynesian Multiplier. However, PDT has conducted research in other conflict and post-conflict economies, and based on this work, uses a multiplier of 1.5.<sup>16</sup> It is calculated as follows:

$$E_{total} = \lambda E_{local}$$

$\lambda$  = Keynesian Multiplier

$E_{local}$  = the local impact of expenditure

### *Funding Channels*

Once the total amount of ODA disbursed by a particular donor to Afghanistan is established, this money is then allocated to the funding channel it was provided through. Five channels were identified for the purposes of this study:

- Funds provided directly to the government or to a trust fund to support core budget operations (ARTF, Law and Order Trust Fund Afghanistan (LOTFA), etc);
- Funds provided to United Nations (UN) agencies;
- Funds provided to international companies or international NGOs;
- Funds provided to local businesses or local NGOs; and,
- Other funds.

The local economic impact of spending under each of these categories is then estimated based on the composition of the spending as well as information gained from field interviews with businesses that were awarded contracts. In terms of funds provided to both international companies and NGOs, the contracts were further broken down into five categories. These included contracts for:

- The supply of international technical assistance;
- The provision of construction or similar services;
- The provision of actual service delivery (e.g. health care);

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<sup>16</sup> For a more detailed explanation on this, please see an excerpt from the working paper "Estimating the Fiscal Impact of UN Peacekeeping Missions", (Annex 4).

- The supply of specific goods; and,
- Other contracts.

### *Local versus External Procurement*

The reports from donors generally do not distinguish between local and external procurement. Therefore, in order to split  $G&S$  into  $G \& S_{external}$  and  $G \& S_{local}$ , the spending channels were analysed to estimate the proportional allocations. As mentioned above, where donors provided specific information, this strengthened the broader estimation process as this data could then be applied to the specific projects in question.

### *Local Content of Procurement*

Estimating  $\alpha$  and  $\beta$ , the local content multipliers for procurement, involved a combination of extensive field-based interviews in Afghanistan, comparisons to local content multipliers for similar goods in other conflict or post-conflict economies, and detailed assessments of the types of goods and services that are being purchased in Afghanistan.

In the case of external procurement, the local content was minimal and information was limited. External procurement includes major purchases from systems contracts such as air and ground transportation, vehicles, IT supplies, and communications infrastructure. The vast majority of these contracts had no local content. Nonetheless, there was local content – albeit minimal – when international contractors hired local staff.

In the case of local procurement, however, vendor lists and other relevant information made available allowed for a more systematic assessment to be undertaken. Discussions were held with procurement officers and other officials, and where ever possible, vendors were categorised as either local or international companies. Purchases were then separated into goods contracts and services contracts. Based on the nature of the contract and following a review of the local economy's capacity to supply different goods, the local content of each type of contract was estimated based on direct interviews with Afghan vendors and other forms of analysis.

In general, goods contracts involved significant imports – in many cases, for instance, the item procured locally was diesel, which is imported, and therefore has minimal local content. In contrast, services contracts had a much higher local content. Outsourced security or cleaning, for example – predominantly labour-based service contracts – had a much higher local content. The local content for each type of contract was then multiplied by the value in that sector and averaged to provide an estimate of  $\beta$  across all local procurement.

## **3.1.2 Data Collection**

### *Data Requested*

In order to both measure progress and build on PDT's initial research, data collection for this project focused on the fiscal year in which information was most readily available 1385 (2006).<sup>17</sup> Applying the same methodology used in the previous study, the following details were requested from each of the 13 largest donors<sup>18</sup> contributing ODA to Afghanistan:

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<sup>17</sup> When this project commenced, the Paris Declaration survey for year 1386 (2007) was being completed and the more recent year was therefore considered. After a careful review, however, it was judged that sufficient data was not available to undertake a meaningful study of 1386 (2007). As a result, the research team reverted to fiscal year 1385 (2006).

- The total amount of ODA disbursed for Afghanistan during FY 1385;
- The amount disbursed from head office<sup>19</sup> to local and international companies and organisations for project work in Afghanistan, the name and contact details for each company, and a brief description of the nature of the work;
- The amount disbursed from contracts issued in-country to local and international companies and organisations – showing local companies and partners for local supply and international contracts for local supply, the name and contact details for each company, a brief description of the nature of the work; and,
- A list of contributions made to multilateral trust funds, UN agencies, NGOs, or directly to the Government of Afghanistan. This list included the amounts and names of agencies to which disbursements had been made.

By starting with the total amount of ODA disbursed and following it downstream in its entirety, the flow of funding from donor disbursement to project implementation is demonstrated. While funding arrangements can be more direct – donor to executing partner – a more complicated scenario that is common in Afghanistan would be a disbursement from donor to implementing partner to subcontractor(s) and to vendor(s).

Data collection was carried out collaboratively with the Afghanistan Ministry of Finance's Aid ACU from the beginning of the project. In order to ease the data collection burden on donors, PDT first worked with the ACU to generate specific donor data sheets indicating the Ministry of Finance's accounting of donors' total ODA, donor contributions to ARTF and LOFTA, and available information detailing project disbursements. Prior to engaging with each, ACU staff members reviewed the data sheets for accuracy, ensuring that all information made available to the Ministry of Finance was represented.

In spite of the assistance from the ACU and other Ministry staff, in all but a single case, information available through the Ministry did not come close to accounting for an individual donor's total ODA disbursements for the period under review. In most instances, only a handful of an individual donor's projects were available for review, and even then, those projects did not include comprehensive, detailed information that would enable a full assessment of local economic impact. To address these gaps, the donor data templates gathered by the Ministry of Finance were then shared with each respective donor. However, due to their incomplete and inconsistent information, these templates were not used by participating donors, but were instead replaced by the donor's own spreadsheets.<sup>20</sup>

Direct interviews were then carried out with each of the donors who had a physical office in Afghanistan to review data needs and answer relevant questions. For donors without representation in country, similar meetings

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18 The donors approached for this study were: the Asian Development Bank (ADB); Australia; Canada; the EC; Germany; Italy; Japan; the Netherlands; Norway; Sweden; the UK; the US; and, the World Bank. Australia and Japan were ultimately not included in the study as the level of detail provided was insufficient for an analysis to be undertaken. In addition, information was not sought from India as the field research for this project commenced shortly before the July 2008 bombing of the Indian Embassy in Kabul.

19 Head Office is defined as the headquarters of an organisation located outside of Afghanistan.

20 In an effort to support more coordinated and complete reporting by donors to the ACU, the Ministry of Finance introduced the Harmonized Reporting Format (HRF) in 2007. However, the ACU assessed that only about 50 percent of donors used the HRF during the period under review, with some of those reports containing insufficient information. On the donor side, while many say that they have welcomed the introduction of the HRF, many expressed frustration that they continue to find reporting mechanisms to the Ministry on their ODA expenditure cumbersome.

were conducted with officials in their respective capitals using email and/or phone communications. Following these initial contacts, a range of additional outreach activities were undertaken and information was requested



through various means from UN agencies as well as international and national NGOs. Of the seven UN agencies contacted, direct meetings were held with the five agencies that agreed to participate in this study.<sup>21</sup> The United Nations Mission in Afghanistan (UNAMA) facilitated as well as managed the process of gathering data from UN agencies. PDT held direct meetings with several international and national NGOs who agreed to provide data. Extra efforts were also made to collect information from the wider NGO community through a survey created by PDT, which was distributed electronically through the Agency Coordinating Body for Afghan Relief (ACBAR).

In summary, the data requested from UN agencies and international and national NGOs was:

- The total amount disbursed in Afghanistan in FY 1385;
- The total amount spent on goods and services, broken down by head office procurement and field office procurement;
- Detailed information on field office procurement. This included the amount of each contract, details on the supplier, and a description of the good or service provided; and,
- The number of international and national staff employed; and, where possible, the amount spent on staff costs, broken down by international and national staff expenditure.

Finally, based on the information provided to PDT by donors, the Ministry of Finance, NGOs, and UN agencies on awarded contracts, PDT met with both international and national vendors. Local businesses from a broad range of market sectors – including construction, building materials, engineering, medical services, printing, furniture, logistics, telecommunications, office materials, and fuel supply – were interviewed for the purposes of this study.<sup>22</sup> These businesses ranged in size from very large multi-service companies to single-person stores. Some operated solely in the capital while others provided goods and services throughout the country. Several international companies operating in Afghanistan, as well as numerous Kabul-based subsidiaries of international companies, were also interviewed and surveyed. During the initial interviewing process, some businesses declined to participate further, citing privacy and/or security concerns.

All business interviews were held with the owner, president, or most senior officer and were conducted in-person and on the firms' premises. During these meetings, the businesses were asked to fill out a simple survey on their operational expenditures as well as their purchase of goods and services during fiscal year 1385 (2006). About half of those interviewed were able to reply to all questions and provide the required data during the first on-site interview. Others, however, needed additional time to compile the information requested. While several international companies interviewed were new to the Afghan market, most local businesses had been in operation for a minimum of five years – with some having been in existence for 10 years or more. In addition to technical questions regarding their operational costs, project staff also inquired about the current condition of

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21 Nineteen UN agencies are represented in Afghanistan and requests were made to meet with seven of these agencies. Of these seven agencies, the following five agencies provided data: United National Development Programme (UNDP); United Nations Human Settlement Programme (UN-HABITAT) Afghanistan; United Nations Mine Action Coordination Centre of Afghanistan (UNMACA); United Nation Office for Project Services (UNOPS); and United Nations World Health Organisation (UN WHO).

22 A full list of businesses interviewed was made available to the funding donor but for security reasons is not being shared publicly.



the Afghan marketplace, changes observed during recent years, and their experiences with various procurement processes.

Information sought from businesses included:

- What types of goods or services were purchased throughout the year to operate the company?
- Where were these goods and services imported or purchased from?
- How much was spent on each of these goods or services in relation to the companies other operational spending?
- How many international and national staff were employed?
- What was the businesses experience with the procurement process in Afghanistan?
- Had they noted any changes in the Afghan marketplace or business climate?

## 3.2 Results

### 3.2.1 Overview

In 1385 (2006), approximately 37.6% or \$788m of the \$2.1b of ODA disbursed by the development partners covered in this study entered the Afghan economy. This represents a significant increase from the 31.2% or \$414m impact in 1384 (2005). This improvement can be attributed to two separate factors – both of which raised the average impact. First, donors who reported information in 1384 (2005) and 1385 (2006) on average increased their local economic impact from 31.2% to 36.3%; and second, four new development partners<sup>23</sup> were included in the 1385 (2006) study.<sup>24</sup>

The information presented in this report covers all ODA assistance provided by eight bilateral donors, the European Commission (EC) and the local economic impact of spending by two multilateral development partners (the World Bank and the ADB). These partners collectively contributed 70% of the ODA provided to Afghanistan in 1385 (2006). Again, a local economic impact is generated when funds are used to buy locally produced Afghan goods and services. This money is in the form of wages paid to Afghan labour, rents paid to Afghan landowners, and goods and services produced by Afghan businesses (less the value of any imported inputs used in that production). This study found that funds provided through trust fund and budget support arrangements have a considerably higher impact on the local economy (around 80%) than do funds provided to international companies or international NGOs (over 15%). Increasing the local economic impact, therefore, involves providing more funds through the channels that have a higher impact (i.e. trust funds and direct budget support) as well as putting in place mechanisms to increase the amount of funds that go to Afghan vendors or that international contractors spend in Afghanistan.

The remainder of chapter three explains and illustrates these results. In 3.2.2, information is presented on the ODA provided by participating donors, including a discussion of what funding channels donors used, and the estimates of the local economic impact of each of those channels. Following that, the results of these two parts are combined and the overall local economic impact of each country's ODA is presented. And finally, a set of recommendations are provided that identify ways in which the local economic impact of donor spending in Afghanistan can be increased and to inform future work in this area.

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23 Italy, Sweden, the World Bank, and the ADB.

24 The 1384 (2005) report covered \$1.36b in ODA and this report on 1385 (2006) covered \$2.1b in ODA – an increase of \$736m.

### 3.2.2 ODA Provided by Participating Donors

Table 1 provides a breakdown of donor disbursements by funding channel. This is based on information reported by development partners to the Ministry of Finance or directly to the PDT project team.<sup>25</sup> For each donor, the ODA is divided into: funds provided to the government either through trust funds and budget support (such as the ARTF, LOTFA, or World Bank support through the government budget); funds provided by donors to UN agencies; funds contracted to either international companies or international NGOs; funds contracted to local NGOs and businesses; and, other channels not covered by those categories listed.

**Table 1: Major Channels of ODA Disbursements by Donor (USD)**

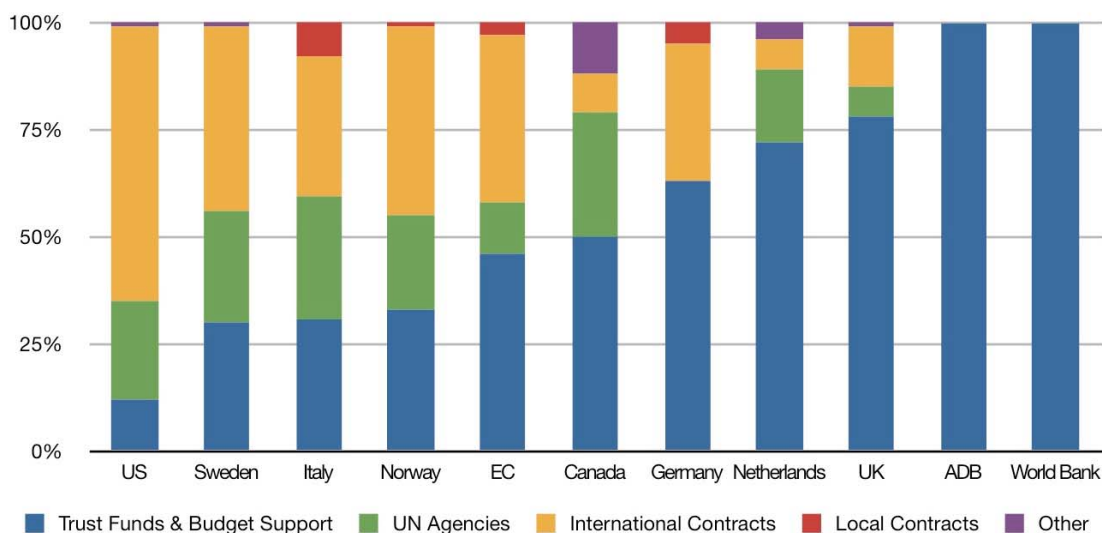
Development Partners	Trust Funds & Direct Budget Support	UN Agencies	International Contracts	Local Contracts	Other	Total
ADB	\$92,116,736	\$0	\$0	\$0	\$0	\$92,116,736
Canada	\$65,237,000	\$37,884,604	\$11,555,283	\$119,938	\$16,269,795	\$131,066,619
EC	\$83,974,750	\$22,604,696	\$71,543,742	\$5,926,069	\$0	\$184,049,257
Germany	\$52,337,000	\$0	\$26,303,375	\$4,574,500	\$17,514	\$83,232,389
Italy	\$10,926,000	\$10,262,129	\$11,790,000	\$2,805,234	\$0	\$35,783,363
Netherlands	\$63,416,000	\$14,870,430	\$6,335,100	\$0	\$3,294,072	\$87,915,602
Norway	\$22,915,913	\$15,046,223	\$30,692,105	\$1,023,876	\$0	\$69,678,118
Sweden	\$13,477,089	\$11,927,224	\$19,612,452	\$0	\$532,305	\$45,549,070
UK	\$153,000,000	\$14,276,688	\$26,911,726	\$0	\$1,690,424	\$195,878,838
US	\$119,031,656	\$226,367,357	\$642,627,104	\$1,939,560	\$7,756,458	\$997,722,135
World Bank	\$172,773,363	\$0	\$0	\$0	\$0	\$172,773,363
<b>Totals</b>	<b>\$849,205,507</b>	<b>\$353,239,351</b>	<b>\$847,370,888</b>	<b>\$16,389,176</b>	<b>\$29,560,568</b>	<b>\$2,095,765,489</b>

Source: Donor responses to Ministry of Finance/PDT survey requests. Figures are rounded.

The percentage shares for each development partner are presented below in Figure 1.

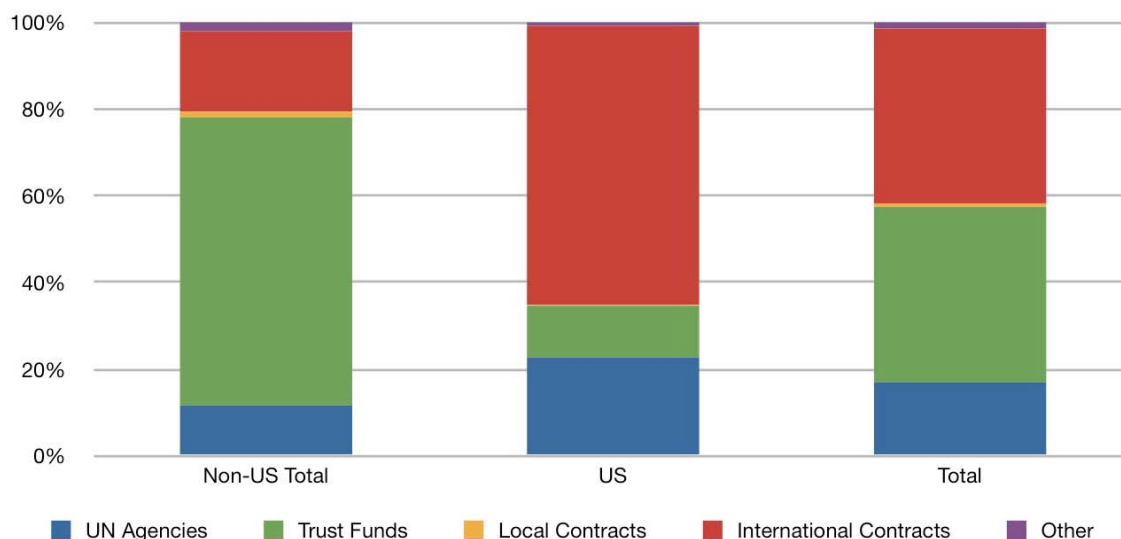
25 In several cases the information provided by donors on how funds were disbursed in 1385 (2006) was significantly below the total amount of ODA reported by donors as disbursed to both the Ministry of Finance and PDT. The fact that some donors were not able to report on how significant volumes of funds were spent reinforces the challenges in assessing both economic impact and aid effectiveness more broadly.

**Figure 1: Major Channels of ODA Disbursements by Donor (%)**



In Figure 2, the results for different funding channels are represented graphically for the donor community as a whole. Because of the size of its disbursements, and therefore its potential to skew the overall findings, the results for the United States (US) are presented separately from the rest of the international community.

**Figure 2: Aggregate Donor Spending Organised by Major Funding Channels (%)**



In the case of non-US donors, nearly 67% of the funds were allocated to multilateral trust funds and budget support, less than 12% to UN agencies, and 19% to international contracts. The US, meanwhile, allocated nearly 65% of its funds to international contractors, 23% to UN agencies (primarily to UNOPS for secondary road construction and to UNDP for Provincial Reconstruction Team “quick impact” projects), and 12% to trust funds. Moreover, of the reported funding to international companies by the U.S., around 36% of these funds –

or around 16% of total ODA funds to Afghanistan – were made in contract awards to seven large American companies.

### 3.2.3 Estimating the Local Economic Impact of Different Funding Channels

Table 2 sets out the estimated local economic impact of donor ODA spending by funding arrangement. As mentioned, the data demonstrated once again that funding provided through trust funds and direct government budget support has a much higher local economic impact than funding to international contractors. The disparity in impact between these two funding channels can be attributed to the very high local content of trust fund and budget support spending, which is primarily used to pay local wages and fund major programmes – such as block grants or micro-finance initiatives – all of which put money into the hands of Afghans. In contrast, contracts to international companies or NGOs have a large proportion of their funds spent on international staff or imported goods and equipment.

**Table 2: Estimated Local Economic Impact of Donor ODA Spending<sup>26</sup>**

Funding Arrangement	Estimated Local Economic Impact
Trust Funds and Budget Support	70-80%
International Contracts	10-20%
Local Contracts	35-50%

*Source: Estimates based on field surveys.*

Readers should note a departure from the methodology used in the prior report. In this study, information made available by donors on the local economic impact of expenditures was directly taken into account. This change led to a significant impact on spending through trust funds and budget support, for instance, with the incorporation of budget support from the Asian Development Bank (ADB) and the World Bank resulting in a drop in the average local economic impact to 70%. This included support for key projects and programmes such as the National Solidarity Programme, Emergency Power, Transport and the Emergency Irrigation Rehabilitation project. While these programmes are channelled through the government’s budget, they are also subject to ADB and World Bank procurement rules.

As discussed above, it is important to reiterate that the estimation of the local economic impact of funding activities through different channels is a complementary analysis to an assessment of the overall effectiveness of development assistance. When local contractors represent value for money, locally procuring goods or services equates to “spending a dollar twice” – as assistance is provided to the beneficiaries while at the same time supporting the local economy. This does not mean, however, that all development assistance should be delivered through the local economy. There will be other occasions when the most effective way to deliver services involves a low level of local impact – for example, if the most pressing health care need involves medical supplies that are not produced locally. While enhanced local economic impact is a factor, the purpose of international development assistance is to deliver goods and services to support sustainable growth, development, and poverty reduction in recipient countries. Thus, there is merit in further studies to determine which funding channels deliver the *best value for money*.

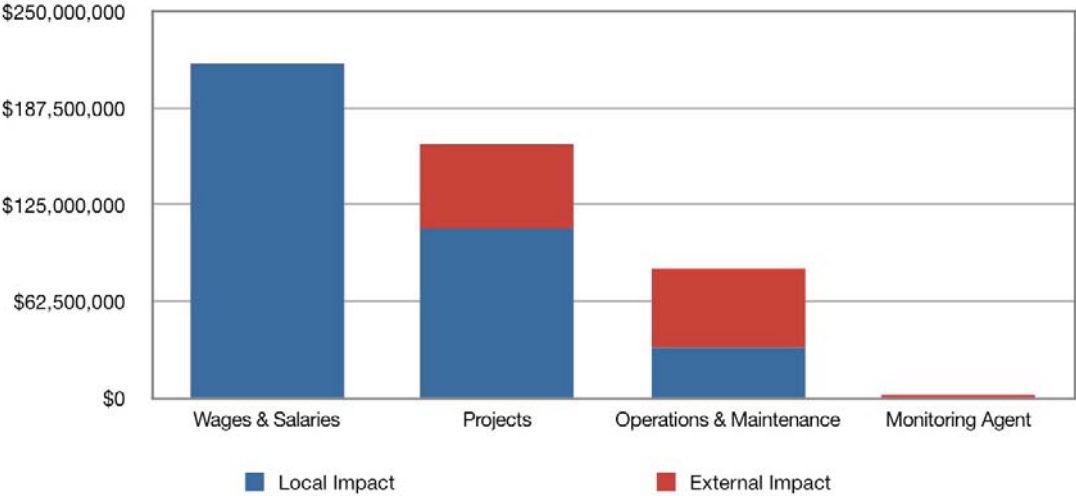
<sup>26</sup> It was not possible to review the local impact of UN operations from the information provided. Therefore, for the purposes of this analysis, funds provided through UN agencies are assumed to have the same level of local impact as international NGOs and international contractors.

*Trust Funds<sup>27</sup>*

Contributions provided to trust funds had the highest local economic impact – 70 to 80% – chiefly because these funds were used to pay local wages, purchase goods from predominantly local businesses, or fund programmes such as the National Solidarity Programme and micro-finance initiatives that involve cash payments to local communities and individuals. In addition, because this process requires that trust funds report to their contributors in a timely fashion, the data on disbursements from trust funds is of a higher quality than the data on funds disbursed by donors directly.

More detail on disbursements from the Afghanistan Reconstruction Trust Fund (ARTF), the largest of the three trust funds in FY 1385 (2006), is provided in Figure 3. These disbursements were the basis for the estimate of local economic impact from trust funds except where this information was available directly from donors. In the latter case, data from donors was taken directly into account.

**Figure 3: Estimated Local Economic Impact of ARTF Activities (USD)**



Next, the operations and maintenance expenditure represents goods and services purchased by the Government of Afghanistan to support the delivery of services from the budget. These were procured from both local and international sources. However, despite there being considerable local purchasing, in many cases imported goods were purchased locally – meaning that the local economic impact was a smaller fraction of the actual purchase price (perhaps only representing the transport costs in Afghanistan, the cost of the staff employed by the importer, and when the importing company was Afghan owned, the importer’s profit). In the case of project funds, the greatest proportion of local economic impact was 85% for the National Emergency Employment Programmes and the Civil Service Capacity Building programmes, both of which were characterised by high levels of local employment. In addition, just over \$80m was spent on the National Solidarity and Rural Water Supply and Sanitation Programmes. The local content of these programmes was estimated at approximately 70% because of the large cash grant component and also because there was considerable local em-

27 Most of the budget support to the Government of Afghanistan was provided through a trust fund. The small amount of budget support provided to the government outside of trust funds is assumed to have the same local impact as funding provided through trust funds.

ployment associated with the administrative overhead. The remaining projects had a much lower local economic impact because of the large amount spent on international staff.

### *International Contracts*

Contracts for the procurement of goods and services from international companies and international NGOs generally fell into four categories: construction contracts (including repair and rehabilitation of buildings and infrastructure); contracts for the provision of technical assistance; contracts for the direct delivery of services; and contracts for the supply of specific goods. Overall, the local economic impact of these contracts was around 15%. In other words, for every \$100 of the contract, just under \$15 was used to hire local labour or purchase locally produced goods and services. In contrast to the discussion above, the detailed disbursement data on these contracts was of an overall lower quality. As a result, this meant that the estimation process made more use of the qualitative information obtained through interviews with the contractors (discussed in detail below). The estimates have also been refined using the results from the broader Economic Impact of Peacekeeping study undertaken in 2004-05. Accordingly, these estimates are less precise than for the estimates of trust fund spending.

International construction contracts are approximated at a 10-15% local economic impact. The vast majority of funds are used to pay for international staff and the procurement of international materials – including capital equipment as well as inputs. These companies use a considerable amount of local labour, but since local wages are often much lower than wages paid to international staff, this figure does not represent a large portion of the overall expenditures. Over time, more goods have become available in country, but the vast majority of other materials needed for service and project delivery continue to be imported and purchased on the local market or imported directly from neighbouring countries.

Contracts for technical assistance are estimated to have a local economic impact of around 10%. The major expenses in these contracts are the salaries and allowances paid to international consultants, which constitute around 80-85% of the total expenditures under these contracts. The remaining funds are spent on translators and national staff, locally contracted labour, travel (including vehicles), accommodations and food, and general operating expenses. Of these expenditures around half is sourced from local production (e.g. local labour and accommodation) and the remainder is from imported goods and services (such as food, operating equipment and transport services).

Contracts for actual service delivery from international companies and NGOs (such as health care contracts) are estimated to have a local economic impact of around 15-20%.<sup>28</sup> This is higher than the impact for both technical assistance and construction contracts. Based on discussions with providers, there was slightly less use made of international staff and more use made of local staff, which would account for an increase in the local economic impact. While some equipment was manufactured locally (e.g. some disposable medical supplies), much of the equipment – including major medical supplies, vehicles and fuel – were imported.

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<sup>28</sup> The analysis in the first report into the local economic impact of development assistance elicited criticism from the NGO community because they were categorised with international contractors and companies and felt that this misrepresented the local economic impact of their spending in Afghanistan. In response to this criticism, a survey was designed and distributed to over 100 NGOs by ACBAR seeking additional information on NGO disbursements. Unfortunately, the survey had a very low response rate so a separate, more detailed analysis could not be carried out. Going forward there would be merit in the NGO community undertaking a more comprehensive quantitative assessment of their local economic impact using a methodology similar to the one applied in this study. The estimates presented in this report could then be refined.



The final category of international contracts considered was for the supply of specific goods (e.g. fuel or vehicles). In these cases, the local economic impact was negligible since the products were all imported.

#### Local Contracts

Like international contracts, the data on local contracts was not of a high quality. However, after building on discussions with local businesses, and again drawing on experiences in other post-conflict countries to calibrate and refine estimates, the local economic impact of locally procured goods and services contracts was estimated to be between 35% and 50%. It is worth noting that most of these contracts were of a small dollar value, highlighting the difficulty that local firms have in bidding for the larger contracts that are commonly awarded to international firms. The majority of contracts won by Afghan contractors, for instance, were for small construction work or the rehabilitation of buildings or other infrastructure. Compared to international companies and NGOs, these contractors did not have to worry about the cost of international staff. However, like international contractors, they still faced the local shortage of key construction inputs such as fuel, tools, plumbing, steel bars, and iron sheets. In many cases, construction equipment was also imported.

### 3.2.4 Overall Results

Combining the information on individual contracts with an estimate of the local economic impact of different types of contracts allows an approximation to be made of the overall local economic impact of spending by donors to Afghanistan. Overall, the local economic impact of the \$2.1b of ODA funds provided for Afghanistan by the international donors covered in this study was around 37.6% – equivalent to \$788m – compared to the 31.2% measured for FY 1384 (2005). In the case of those international donors excluding the US, the local economic impact was 51%, or approximately \$562m.

**Table 3: Estimated Local Economic Impact of Spending by Participating Donors**

Donor	1384 (2005)	1385 (2006)	Local Economic Impact (%)		Local Economic Impact USD	
			1384 (2005)	1385 (2006)	1384 (2005)	1385 (2006)
<b>ADB<sup>1</sup></b>	\$26,900,000	\$92,116,736	NA	51.3%	NA	\$47,259,437
<b>Canada</b>	\$100,259,187	\$131,066,619	42.7%	45.5%	\$42,796,006	\$59,653,558
<b>EC</b>	\$125,090,000	\$184,049,257	59.9%	45.5%	\$74,975,500	\$83,672,493
<b>Germany</b>	\$84,230,000	\$83,232,389	15.9%	57.2%	\$13,434,000	\$47,644,906
<b>Italy<sup>1</sup></b>	\$51,000,000	\$35,783,363	NA	36.8%	NA	\$13,170,713
<b>Netherlands</b>	\$46,520,000	\$87,915,602	48.3%	61.3%	\$22,478,000	\$53,913,629
<b>Norway</b>	\$50,216,540	\$69,678,118	44.5%	36.7%	\$22,349,695	\$25,603,030
<b>Sweden<sup>1</sup></b>	\$41,340,000	\$45,549,070	NA	34.1%	NA	\$15,512,623
<b>UK</b>	\$117,453,492	\$195,878,838	60.2%	71.0%	\$70,673,152	\$139,067,969
<b>US</b>	\$812,026,749	\$997,722,135	20.7%	22.7%	\$167,687,731	\$226,350,318

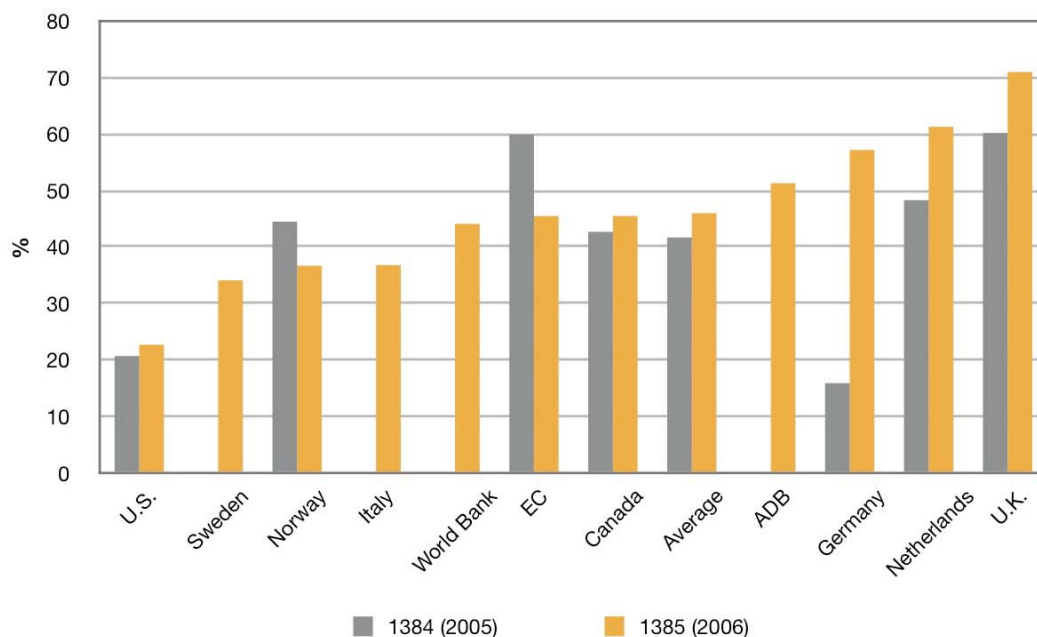
<b>World Bank<sup>1</sup></b>	\$210,000,000	\$172,773,363	NA	44.1%	NA	\$76,255,699
<b>Total</b>	<b>\$1,335,795,969</b>	<b>\$2,095,765,489</b>	<b>31.0%</b>	<b>37.6%</b>	<b>\$414,394,083</b>	<b>\$788,104,376</b>

Source: Donor data submitted to Afghan Ministry of Finance/PDT and PDT staff estimates.

Note: (1) Data not collected in 1384 (2005) analysis.

Figure 4 illustrates the change in the local economic impact percentage of each of the development partners where there is information for both 1384 (2005) and 1385 (2006). The US, Canada, Germany, the Netherlands and the United Kingdom (UK) all increased the local economic impact of their development assistance. In each case, this occurred because they directed a greater share of their funding through trust funds and direct budget support, where spending has higher levels of local economic impact. Conversely, the local economic impact of spending by Norway and the EC was reduced. In the case of the EC, this was because the funding through trust funds dropped from 68% to 46%, while funding through international contracts increased from 13% to 39%. Similarly, Norway reduced the share of its funding provided through trust funds from 44% to 33%.

**Figure 4: Estimated Local Economic Impact of Participating Donors (%)**

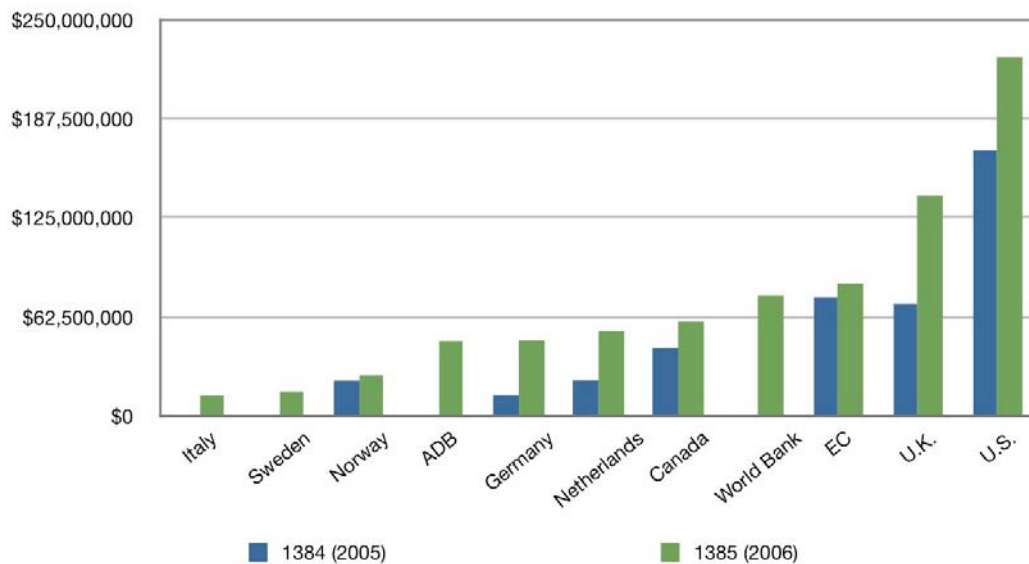


While the share of spending that went into the local economy did not improve for all development partners, each of the development partners increased the overall amount of spending that went into the local economy. This is represented in Figure 5 below.

In the case of the US and the UK, an additional \$130m was injected into the local economy due to larger disbursements and greater disbursement through trust funds. Importantly, the US is such a large donor that even an increase in funds allocated through trust funds from 9% to 12% led to an additional local economic impact of \$16m, while the remaining \$42m increase in local impact was associated with the increase in overall disbursements from \$812m to \$997m. However, the size of the US as a donor also means that if it increased the share of funds it channels through trust funds to a level closer to the overall donor average, the local economic impact of development assistance would be significantly improved.

As discussed above, both the EC and Norway reduced the percentage of the local impact of their expenditure by channelling a greater portion of funds to international contracts. Nonetheless, because there was an increase in their level of disbursements, between the two, the local impact of their development expenditure improved from around \$100m to \$110m.

**Figure 5: Estimated Local Economic Impact of Donor Spending (USD)**



### 3.3 Research Challenges

Many of the data challenges identified in the first report have not been addressed. Development partners, for example, were still unable to provide complete or comprehensive information on their ODA disbursements. More specifically, while some donors were able to account for how projects were executed using ODA funds during the period, others struggled to account completely for how and where projects funds were dispersed. Gaps existed in basic accounting along with a wide variance in the amount of detail that donors were able to provide in connection with specific projects. This can be attributed to several factors including the challenges of working in a difficult environment, the structural relationships within donor organisations, and a lack of focus on the issue of local economic impact, and in some cases, aid effectiveness more broadly.

#### 3.3.1 Data Provided

The data provided by development partners was often inconsistent with the information donors had previously provided to the Government of Afghanistan, or reported at a level of aggregation that prevented meaningful analysis. Where information was not sufficient enough to carry out an analysis, donors were excluded from the study. In two cases, donors were unable to provide full information on their actual disbursements. This included Germany, who provided data on 80% of its total expenditure; and the US, who provided information on 71% of its total expenditure. However, both were included in the study as the proportion of detail supplied was large enough for estimates to be made on the local economic impact of each country's expenditure. The fact

that the US was not able to present details on how \$400m of development assistance was spent raises far broader questions than are covered in this report.

Although UNAMA played a significant role in helping PDT by facilitating and managing the process of gathering data from UN agencies, there was limited co-operation from other UN agencies for this study. This resulted in only 32% coverage of total UN disbursements for Afghanistan. Furthermore, of the data supplied by UN agencies, there were major problems reconciling the data with official reports (and in some cases no data was supplied) to provide any basis for estimating local economic impact. Accordingly, for the purposes of this study the local economic impact of UN operations in Afghanistan was estimated at the same level as the local economic impact of international contracts.

### **3.3.2 Challenges and the Way Forward**

Donor agencies commonly had no staff designated to track aid effectiveness, procurement patterns, or local economic impact. Often the staff designated to provide available quantitative information were technicians responsible solely for managing databases and who lacked any knowledge of actual projects or disbursements. On the other hand, programme officers more familiar with daily operations and finances were only able to provide estimates compiled retrospectively. Also, it was common for data to be stored in donor capitals, which was frequently not accessible by field-based personnel.

Additional complications were presented for those donors that had more than one agency co-ordinating aid in Afghanistan or those that had an embassy in Afghanistan that was also responsible for aid disbursements and projects. Where there was more than one operational agency for a single donor, there was no mechanism through which these agencies could systematically communicate or pass data between one another, nor was there a central clearinghouse for information or data. In such cases, large unaccounted gaps for ODA spending resulted.

A key conclusion of this research is that donors have not yet put in place systems for either tracking or accounting their ODA disbursement spending or the spending of their implementing partners. This in turn limits a complete analysis of local economic impact, which makes measuring progress to meet international commitments on aid effectiveness challenging at best. A key issue here is that field personnel needed to participate in a study like this are often juggling competing tasks, within unrealistic timeframes, and with understaffed offices. This means that in many cases they simply don't have the resources to organise data or the ability to institute better reporting mechanisms so that information can be more easily retrieved. Moreover, decisions and priorities are not always made and set on the ground but rather in respective capitals.

Next, donors often focus project delivery assessments on project outcomes without a direct consideration of the local impact of their spending. Donors, in other words, commonly asked questions such as: Was a school built? Were vaccines administered? Was technical assistance adequately provided? Was this all done within the budget and timeframe? What was less frequently examined, however, were questions including: How were the funds spent? Who was contracted to provide services? What goods were bought, and from where? For this reason, in many cases donors did not view their lack of systems for accounting for ODA disbursements as a failure to meet their obligations under the Afghanistan Compact or other international agreements.

The first report into the local economic impact of development assistance made recommendations around these issues, including:

- International donors should provide information on disbursement of their funds in a timely fashion, reporting through a template agreed between the donors and the Ministry of Finance, to allow an accu-

rate estimation of the local economic impact of donor spending to be prepared on an aggregate and donor-by-donor basis.

- UN agencies and major multilateral development partners should provide similar information as bilateral donors to the Ministry of Finance on their actual disbursements in a timely fashion.

To date, action on these recommendations has not been taken by development partners. Until it is, a comprehensive assessment of the local economic impact of development assistance – which would allow for a more complete understanding of the effectiveness of that assistance – will not be possible.

#### *Other Considerations*

While outside the scope of this study, when looking at the impact of aid in aggregate, it should be recognized that there are impacts to the economy beyond those specifically related to procurement and private sector development. One issue that is often raised in relation to increased local spending is “Dutch Disease”. PDT’s earlier work on the broader economic impact of peacekeeping missions, however, demonstrated that this phenomenon is significantly mitigated by the higher factor productivity of reconstruction aid and increased demand for domestic goods and services. Furthermore, much of foreign assistance is provided as “in-kind” versus cash.

Inflation, too, is another important consideration. Anecdotal evidence within the expatriate community appears to show that donor spending can put severe pressure on the price of consumer goods and rental properties. This inflation, however, tends to be limited to a small basket of “high end” goods and data shows that it is relatively benign within the context of the local economy as a whole.

The issue of sustainability is also critical in evaluating the overall economic impact of aid. Relatively short planning horizons often lead to inefficient capital investment choices and increased costs for the host government after international donor funding is reduced. Such inefficiencies may be reduced to the extent that mission mandates incorporate economic objectives and recognize that some of those objectives must account for longer-term implications.<sup>29</sup>

## **4. Increasing the Local Impact of Development Expenditure**

### **4.1 Overview**

Consultations with donor participants, implementing partners, NGOs, and Afghan entrepreneurs revealed that a wide range of issues – varying from a limited manufacturing base, to insecurity, to complicated international procurement processes – have inhibited greater levels of local procurement in-country. While some of these challenges do not have easy solutions and will continue to push against higher levels of local procurement, evidence also indicates that there is an untapped potential often not reached due to a lack of understanding about the important role the domestic marketplace plays in the development process as well as how its limitations can be better supported to meet the demands of the international community. In addition, there are a number of steps that could be considered to further enhance the local impact of ODA that would not reduce – and in fact would often increase – the value for money in procurement.

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29 Examples include PDT’s Peace Dividend Marketplace project and the newly established Afghanistan Investment Climate Facility.

## 4.2 Perspectives on the Ground

### 4.2.1 The Afghan Entrepreneur Perspective

One challenge that prevents an increase in the local impact of development assistance are the barriers that the local private sector faces when trying to meet the demands of the international community. Discussions with Afghan entrepreneurs brought to fore a number of obstacles they encounter that inhibit their capacity and ability to deliver. This included the lack of domestically produced goods and the costs and quality of imports; uncertainty about the security, political, and other environmental factors; government corruption and inaction; lack of infrastructure; access to land and finance; complex international bidding and tendering processes; and weak capacity.

#### *Sourcing of Goods and Services*

Data from local businesses on the purchase of goods and services was consistent across firms varying in both size and focus. Almost all of the Afghan-owned businesses surveyed rely on in-house resources (i.e. on existing staff) for services needed to run day-to-day operations. Exceptions included transportation services, specialised consultants, and advertising/marketing services. For the purchase of goods, for instance, all businesses reported that the variety and quantity of goods available in the local bazaars had expanded greatly in recent years to include almost all necessary commodities required for running their operations.



In general, local businesses described the past seven years as a cycle beginning in late 2001 with the international intervention in Afghanistan. Most identified that business peaked at the mid-point of the operation and is now currently on a downward trend largely due to insecurity and government corruption. Some businesses specifically noted that 1384 (2005) was a more profitable year than 1385 (2006) at which time low-priced foreign competitors providing both goods and services entered the market, capturing market shares previous held by local businesses.

The domestic manufacturing base in Afghanistan has not developed along with the domestic demand for goods and services. It is estimated, for example, that approximately 90% of goods are imported. Goods reported by businesses to be in high demand – including fuel, cement, steel bars, iron sheets, other construction materials, IT equipment, machines, paper, printing supplies, electrical systems, and medical supplies – are all primarily imported, with most coming from Pakistan, India, Tajikistan, the UAE, Iran and China.

The continued lack of locally manufactured goods was noted by Afghan businesses as a major hindrance to business operations and growth, with added import costs reducing both profit and flexibility. The dependence on agents who imported machinery and spare parts, and are often responsible for future repairs, was also reported as cumbersome and costly. Furthermore, local businesses noted that the Afghan market was being flooded with cheap and low quality imports and that standards within Afghanistan needed to be established as well as enforced in order to be competitive and to ward off negative perceptions of Afghan goods held by the international community.

Businesses reported that the small and limited manufacturing base in Afghanistan does, however, generate items including small quantities of cement, rough bricks, PVC piping and other simple plumbing fittings, woollen products, foam, textiles, furniture, beverages and some food items, small capacity generators, marble, simple paper products and low grade medical supplies (gauze, dried pills, etc.). However, businesses noted that basic



high-demand manufactured goods – which require materials indigenous to Afghanistan, most notably cement – were not being produced in an amount close to current demand.

**Table 4: Sourcing Goods & Services**

Sector	Produced Locally	Sourced Internationally by Afghan Companies	Imported but Available Locally	Products Available via “Afghan First”
Construction Industry and Manufacturing	Yes	Yes	Yes	Building materials including cement, bricks, wood, PVC pipes, gravel; Building construction; Road construction; Metalworking; Furniture including doors, windows, tables, chairs; Security-related materials including barriers and relocatable buildings (RLBs).
Textiles	Yes	No (with the exception of fabric and equipment)	Yes	Clothing (including uniforms, boots, running shoes, showers shoes); Carpets.
Food & Beverage	Yes	Yes	Yes	Beverages including bottled water and soft drinks; Foods including fruits, vegetables, nuts, and vegetable oil.
Printing	Yes	Yes	Yes	Business cards, brochures, banners, posters, books, newspapers and magazines.
IT/Communications	Yes	No	Yes	Internet; Telephones.
Fuel	No	Yes	Yes	Petroleum; Natural gas; Fertilizer

#### *Security and Political Context*

Local vendors consistently referenced the poor security situation and general uncertainty in Afghanistan as the primary inhibitor of business operations and growth in Afghanistan. The increased threat of kidnappings was equally referenced as a central obstacle to growth. A fuel supplier, for instance, noted that his truck convoy had been ambushed in August 2008 on the Kabul/Jalalabad road, resulting in injury to several employees and causing tens of thousands of dollars in damage to equipment and products. Losses from security incidents (e.g. capital equipment) are often borne solely by the business itself. As a result, many businesses find it prohibitively risky to operate in areas of the country where the security situation is most volatile (the southern and eastern regions, in particular). It was reported that some business owners are arranging to manage operations from foreign locations, while others are even considering closing operations until the security situation improves.

Moreover, the tightening of security by international actors in response to these insecurities was also perceived as inhibitive and disruptive to local business operations. Long-time business operators said that they used to enjoy easy access to international buyers and could enter foreign bases. However, standard operating procedures and relationships with large international buyers have changed dramatically, with most Afghan businessmen unable to enter bases or access construction and other work sites. Complicating this issue is the fact that many internationals are prevented from leaving their bases, which makes conducting business with local companies increasingly difficult.

#### *Lack of Infrastructure*

Poor infrastructure in Afghanistan is one of the most complicating factors for Afghan businesses as it directly limits expansion of an Afghan manufacturing base due to the difficulty in transporting goods and the associated high costs of shipping. Firms of all sizes and across all sectors indicated that the business climate would re-

main stagnant without improvements to basic infrastructure including a consistent supply of water, electricity, and improved road networks. Every business interviewed lamented how the infrequency of electricity was proving to be a primary inhibitor to basic operations, as the cost of running diesel-fuelled generators was prohibitive for many participants. One printing company, for example, was forced to relocate its plant to a more expensive neighbourhood in order to obtain dependable city electricity. Similarly, another interviewee reported having to cut his operating hours by half due to fuel costs.

### *Corruption & Inaction*

Businesses consistently said that corrupt practices – most often described as the forced payment of bribes termed by government officials as “taxes” – were another inhibitor to their growth and success. Consistently, businesses reported having to pay this “tax,” which ranged from small amounts when completing a minor transaction during a mundane government office visit to very large sums (one reported a bribe of \$35,000 demanded for an operating license) when seeking new business licenses or other more complex operating agreements.

Additionally, vendors explained that these payments did not secure consistent support from the government to provide the necessary certainty for ongoing operations. One company owner, for example, said he had paid the government a large “fee” to arrange for an operating license on land in an industrial area near Kabul. After several months, although the company had already begun work on a large construction project, the government announced that they were “re-zoning” the plot. They then revoked the operating agreement and subsequently seized the land.

Many respondents also referred to the government as being absent, inactive, or simply ineffectual in addressing the primary challenges facing Afghan businesses. A major obstacle to growth that was reported, for instance, is the lack of government support or government incentives for local businesses to expand – including the absence of any real measures to protect them against influxes of low priced imports or to adequately ensure that government offices procure locally.

Other business owners suggested that, without concerted and effective action by the Afghan government to support local businesses by incentivizing growth and correcting the poor security and infrastructure situation, local market conditions would continue to decline. Some vendors cited basic government inefficiencies or lack of capacity as the reason for inaction. Much more frequently, however, business owners argued that government officials simply did not care about their needs.

### *Access to Land and Finance*

As noted above, companies attempting to acquire additional land for operations or buildings have considerable difficulties and significant delays. In addition, businesses often have trouble accessing or securing finance to support their businesses, which limits their capacity to expand operations. In some cases, businesses that win procurement contracts are not paid in a timely manner and are therefore forced to cash-manage their project work through core operational funds. This is a critical issue as it is not feasible for local Afghan businesses to bankroll international projects.

Similarly, some business owners noted that, in the past, they had been successful in gaining contracts with the municipal government in Kabul as well as the Government of Afghanistan. However, due to repeated difficulties in their working relationships, including negligence in payments, they would not seek future government contracts. One merchant who echoed this sentiment said about the situation: “When a problem arises or a decision is needed there is no one in charge; when money is to be paid out, there is no check book. But, when

money is to be collected, everyone is the boss.” Likewise, one large construction firm said that it would be phasing out contracts with the Kabul municipality after having encountered repeated delays in receiving payments, difficulties regarding land allocations, and finally unhelpful responses and untimely resolve when issues arose.

“When a problem arises or a decision is needed there is no one in charge; when money is to be paid out, there is no check book. But, when money is to be collected, everyone is the boss.”

-Afghan Supplier

#### *International Bidding & Tendering Processes*

Next, many local businesses noted great difficulty in obtaining large international contracts (with businesses ranging in size and services). Vendors and service providers alike viewed the international bidding process as inaccessible, confusing, and mysterious. Replying to tender, placing bids, or even locating notices of offers were frequently noted as major roadblocks. Local businesses also said that required paperwork to enter the bidding process can be overly complex and difficult. Another central obstacle reported is that companies often submit bids and never receive a reply or feedback even in cases where they believed they were in a final tier of candidates. While Afghan companies need to adopt more competitive behavioural practices as the private sector strengthens and expands, contracting teams must be more diligent about providing constructive feedback to local companies so that they may improve their overall business practices and ability to engage in the process in the future.

#### *Building Local Capacity*

Local suppliers of goods and services openly recognise the need to conform to quality and supply standards set by donors and international contractors. Across the spectrum of businesses interviewed, there was consensus that guidance and training is needed on how to better respond to tenders and win contracts – as well as on how to make their operations more competitive. Many businesses across different sectors also noted that they have been able to accommodate the need for technical improvements and quality refinement. In-house training provided either by full-time staff or by consultants hired by partners has become more common. Some companies offer training stipends to their employees, for instance, so that they can receive computer and technical training off-site. However, one medical services provider noted that the higher education system in-country would have to improve significantly in order to meet Afghanistan’s future needs as the current pool of local doctors and nurses had primarily been receiving their training in Pakistan. Similarly, several businesses noted the need for national certification programmes for technical professionals – such as engineers – so that local businesses could more easily ascertain the skills of these individuals before hiring them.

### **4.2.2 The International Perspective**

A second challenge to increasing the local impact of development assistance involves understanding the barriers that international businesses, international NGOs, and UN agencies face when trying to source inputs for their projects locally.

#### *International Businesses*

On the whole, the international companies interviewed for this report echoed similar sentiments relating to the market context as those expressed by local businesses, particularly in regard to the supply of goods. Several international companies using high-tech electronic and security devices noted that these were not available in the local market and needed to be imported directly from Europe or the US. Moreover, although the majority of these companies said that the bulk of the goods they needed could be obtained locally, they were in fact almost always imported.

With regard to services, international companies reported that their basic daily service needs such as cleaning, cooking, and driving were met through local staff or the hiring of local firms. Anecdotally, it appears that the longer an international firm or agency operates in Afghanistan, the more likely it is to procure locally. However, collecting data to test this hypothesis went beyond the scope of this research project. Internationally owned security firms employing both internationals and nationals were consistently hired to provide on-site or site-to-site security services. These companies reported that they were primarily employing Afghans as labourers to fulfil construction contracts throughout the country and that some Afghans were being employed and trained in-house as technicians. At the same time, it was noted that international technical assistance was used for large-scale and complex engineering tasks as well as fulfilling all capacity building needs.

#### *International NGOs*

As prime implementing partners of ODA funded projects, a concerted effort was made during this research to directly interview and gather data from NGOs and UN agencies. In the end, five UN agencies participated along with three international NGOs and two local NGOs.

With regard to the purchasing of goods, the responses of NGOs closely matched those of international businesses. Beyond the direct import of vehicles and a few speciality items, NGOs reported that they were able to obtain the vast majority of goods in the local markets. However, given the data on purchased goods provided by national businesses, it can be assumed that the vast majority of these locally purchased goods – including fuel, IT supplies, and communications equipment – are imported and not produced locally. These organisations reported that they also obtain basic services locally, including accounting and auditing, cleaning, translation, IT, and printing services. A key finding was that across the board, the vast majority of NGO staff was comprised of Afghan nationals, with only a few of the highest management positions held by internationals.

#### **4.2.3 The Development Partner Perspective**

The final challenge to increasing the local economic impact of development assistance involves identifying and understanding the barriers development partners face in making greater use of local suppliers. During the interview process, development partners identified several major obstacles to greater use of local suppliers including the limited capacity of local businesses to correctly follow tender processes, quality of standards, and the lack of progress on a legal and regulatory framework for the private sector.

Many donors noted in interviews that Afghan businesses continue to encounter difficulty when submitting bids and responding to tenders. Submissions, they said, are often incomplete, lacking necessary and basic information, as well as more detailed fiscal data. Donors pointed to what they referred to as a persistent “capacity threshold” in both goods and services, which limits their ability to buy or hire locally. This is especially difficult when donors are procuring large-scale or capacity-building projects.

A number of donors remarked that local suppliers of goods often fail to meet donors’ pre-established quality guidelines, as local merchants often fall short in their ability to supply the necessary quantities of goods within the agreed timeframes. Several implementing partners for large-scale donor projects reiterated this sentiment. The owner of an international construction company involved in large road building projects, for instance, said he would not have remained in operation if he had to rely on Afghan manufactured goods due to their limited

supply and irregular delivery. Much of this problem is attributable to the lack of standards, mandatory as well as voluntary, which currently exist in Afghanistan.<sup>30</sup>

In terms of services, donors noted that much of their funding goes to projects that carry out capacity-building or technical assistance programs in support of the Government of Afghanistan. In such cases, large numbers of international consultants with specialised technical expertise are hired. However, donors consistently commented, that Afghans are being employed in large numbers on construction projects and for other work for which low-skilled workers are needed.

Some of the largest donors said that local procurement is also hindered by the lack of progress in the creation of a legal and regulatory framework for private sector development. One donor pointed to the March 2008 report of the Joint Coordination and Monitoring Board (JCMB), which states that the lack of effective regulation of the private sector was “becoming the critical roadblock to reducing Afghanistan’s dependence on aid and creating a strong economy... [it is] affecting a number of critical areas, including infrastructure development, employment generation in the licit economy, the expansion of the tax base and improvements in revenue, and enabling corruption.”<sup>31</sup>

In this regard, donors acknowledged that the lack of legal and regulatory frameworks in Afghanistan are inhibiting the emergence of large, competitive companies that are able to take on complex contracts such as those involving road and engineering projects. Donors also said that this is inhibiting local companies’ ability to enter into transparent and appropriate legal agreements with local vendors.

## **5. Recommendations & Conclusions**

### **5.1 Increasing the Local Economic Impact of Development Assistance**

There are two ways to increase the local economic impact of development assistance – put more money through funding channels that have higher economic impacts and/or increase the economic impact of each of the different funding channels. This section presents recommendations to support each of these approaches. It also provides recommendations on how to improve the quality of data collection and analysis both in relation to the local economic impact of development assistance as well as measuring the overall effectiveness of that development assistance.

#### **5.1.1 Altering Funding Channels**

This study confirms the results of the previous study, which showed that the local economic impact of donor spending is dramatically higher when funds are channelled through trust funds or directly to the government. Moreover, providing increased funding via government channels or to the government via trust fund arrangements is a core benchmark in improving aid effectiveness as outlined in the OECD principles. A key element of this, for example, is spending funds under government procurement rules and budgetary practices.

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30 Nonetheless, there have been many impressive examples of Afghan businesses successfully improving quality to meet international standards. A notable illustration is the recent efforts by the U.S. military to find a local supplier for bottled water. It was first necessary to assist a local business with meeting the stringent standards placed on vendors providing food goods to U.S. Forces. Once this was done, however, local producers secured contracts worth approximately US\$10 million (2007). The bottling company, Afghan Bottling Industries, employs over 350 people in jobs ranging from security and production to sales and marketing. Moreover, the U.S. military estimates that buying water in Afghanistan will provide annual savings of 60 percent on water costs.

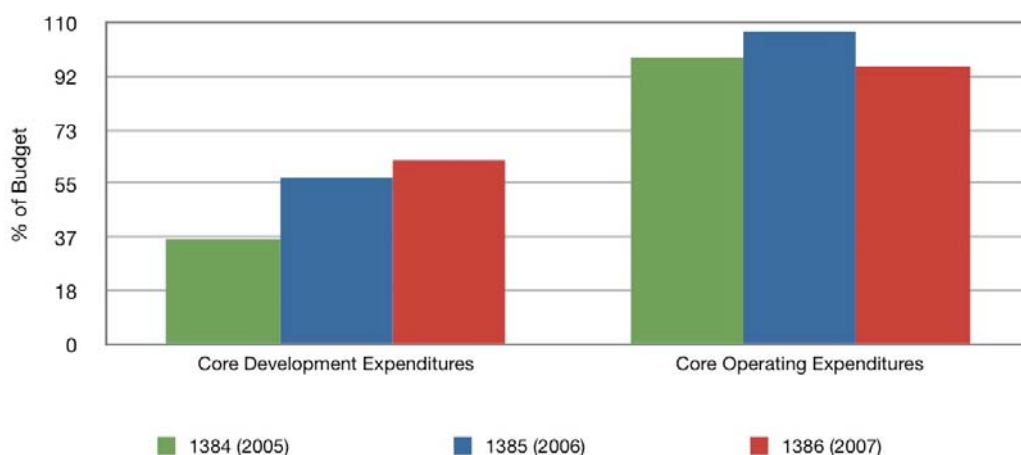
31 Joint Coordination and Monitoring Board (JCMB). “2007-2008 Annual Report,” March 2008: 14.

**Recommendation 1:** That all donors comply with the Paris Declaration on Aid Effectiveness and the Afghanistan Compact regarding increased direct budget support, funding through trust funds, use of government procurement regulations, and reporting of planned and actual expenditures.

Donors often raise concerns that the outputs and outcomes will not be as effectively or efficiently delivered if funds are channelled through the government or trust funds. In most cases this concern is assumed to be true, despite a lack of supporting evidence, when in fact one of the few studies of its type – a report undertaken by the Global Fund – found that in fragile states, 14 out of 19 grants managed by Principal Recipients (PRs) from the government sector performed equally well to those managed by non-government PRs.<sup>32</sup>

Concerns about the capacity of the government to effectively manage the expenditures to deliver goods and services to support sustainable growth, development, and poverty reduction in recipient countries is a valid concern. However, it does not take into account the initiatives and progress made to date to improve the effectiveness of government expenditures. Figure 6 below illustrates the increases in government disbursement in Afghanistan since FY 1384 (2005).

**Figure 6: Government of Afghanistan Disbursement Rates (%)**



### 5.1.2 Increasing Local Procurement

There is considerable room to improve the local economic impact of aid through higher volumes as well as higher frequencies of in-country procurement – in particular, procurement that has a manufacturing or value added component that will contribute to building domestic markets. As a first step, development partners could put in place practices and policies that promote greater use of the Afghan marketplace.

**Recommendation 2:** Development partners require all contractors and implementing partners, wherever practical and cost-effective, to procure goods and services locally for project work before sourcing offshore.

The second step to increasing local procurement involves development partners undertaking a series of related

<sup>32</sup> The Global Fund. Global Fund Investments in Fragile States: Early Results. 2005.



steps that were first identified in the Economic Impact of Peacekeeping study, which assessed the local economic impact of ten former and current United Nations peacekeeping missions.<sup>33</sup> These steps are equally relevant to the activities of bilateral and multilateral development partners.

**Recommendation 3:** Development partners consider implementing the following:

- Translate tenders into local languages and distribute widely to help facilitate bids by local small and medium enterprises (SMEs).
- Run and support seminars (either individually or jointly) for local SMEs that explain procurement procedures and expectations.
- Similarly, run seminars for international procurement officers that educate them on the economic benefits and consequences of mission spending in Afghanistan. This could also include the provision of tools and resources (e.g. vendor lists) that will give procurement officers greater access to the local marketplace.
- Whilst properly adhering to their procurement regulations when determining if the local vendor meets their “capital adequacy requirements,” development partners should assess, in that determination, prevailing local criteria such as “credit line” rather than solely “funds in bank”.
- Development partners should meet regularly with international counterparts, including the military, to share vendor lists, vendor assessments, and other relevant information to encourage both broad and well-informed use of the local marketplace.
- Establish the necessary procedures to ensure that payment of local vendors occurs within fourteen to thirty days of the satisfactory delivery of a contract.

“Donors will promote the use of local and regional procurement by ensuring that their procurement procedures are transparent and allow local and regional firms to compete. We will build on examples of good practice to help improve local firms’ capacity to compete successfully for aid-funded procurement.”

*Source: Accra Agenda for action, Statement of Ministers, September 2008*

## 5.2 Data Collection and Analysis

As a first step in moving forward to monitor the commitments made under the Afghanistan Compact, the previous study provided a preliminary baseline of the local economic impact of donor spending in Afghanistan. This follow-up research was intended to strengthen that baseline and to provide a time series for analysis of donor impact. While this has been successfully achieved, data constraints, as well as other evidence, suggest that further research on the local economic impact of procurement is required. For example, there is anecdotal proof that donors have initiated action to increase local procurement and that there has been an increase in the capacity of the Afghan private sector to produce and supply goods and services domestically.

**Recommendation 4:** Conduct further analysis with a focus on FY 1387 (2007) and upcoming FY 1388 (2008) data, building on the Paris Declaration Survey and providing further time series information from the two PDT studies.

To effectively measure and monitor local economic impact of donor spending, donors need to report regularly and accurately on their disbursements in the field – this includes actual figures on how much money is spent,

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33 Carnahan, Michael, Bill Durch, and Scott Gilmore. “The Economic Impact of Peacekeeping.” March 2006.

by whom, and on what. Improved data on the local economic impact of spending will also better inform policy, programming and other strategic decisions associated with how support is provided to Afghanistan. A template was attached to the previous report and is again attached in Annex 3 of this report.

Recommendation 5: Donors establish and implement standard reporting procedures to their home country and to the Afghanistan Government, using the suggested template in Annex 3.

Recommendation 6: Donors establish systems to monitor the procurement practices of implementing partners and vendors. This includes requiring that all implementing partners, and where possible, vendors, report back on their disbursements – again, by using some form of the template provided in Annex 3.

This report highlights the need for coordinated and tangible action by the donor community. As demonstrated by the results over the past two-and-a-half years, this will not happen without strong leadership and engagement. While the Ministry of Finance’s ACU has a lead role in this process, it also has limited capacity to focus on the technical side of aid effectiveness (i.e. the local economic impact of spending) given its other aid coordination priorities. It is therefore recommended that in the short-term the ACU be given the appropriate support to help build internal capacity to monitor local procurement and its effects in the coming years.

Recommendation 7: Supported by the newly established aid coordination mandate of UNAMA, the Ministry of Finance’s ACU create systems for monitoring, collecting, and reporting on the local economic impact ODA.

- Rather than a ‘point in time’ engagement with donors to collect data, that this be an ongoing engagement with donors so that information can be actively used to assess the performance of their expenditures and progress to meet related commitments in the Afghanistan Compact.
- Appoint an advisor to the Ministry of Finance’s ACU who would who would oversee reporting, data collection and advise on economic impact and local procurement activities prior to the commencement of the next review.

### 5.3 Concluding Remarks

Enhancing the effectiveness of international aid through an increased use of local goods and services can have numerous beneficial results for host and donor countries alike. Using local goods and services to carry out project work, for instance, allows a development dollar to be spent twice – providing much needed services to Afghan citizens and communities while simultaneously creating jobs, generating revenue, and promoting a more sustainable marketplace – all of which can ultimately reduce the likelihood of a relapse into conflict. Given the recent deterioration in the security situation in Afghanistan and what experts view as an increasingly limited window of opportunity, making aid more effective – not only anecdotally, but also in tangible, measurable ways – is essential.



Over the period studied, the local economic impact of development assistance has improved significantly – from around 31.2% to 37.6%. The local economic impact nearly doubled from 1384 (2005) to 1385 (2006), from \$414m to \$788m. This increase can be explained by several factors including the inclusion of additional donors in this research and the higher level of assistance disbursed over 1385 (2006). While there was an improvement in local economic impact, this report also identifies a number of challenges that need to be addressed, including the generally poor systems that are currently in place to track and monitor disbursements, and as a result, do not allow for a more full understanding of how monies provided to Afghanistan are ultimately being spent. In addition, interviews with private sector participants indicate that there are a number of additional steps that could be considered to further enhance the local impact development assistance.

As was cited in the report, it is critical to recognise that in some cases project outputs and outcomes may not be as effectively or efficiently delivered if international contractors are not used. The primary purpose of international development assistance is to deliver goods and services to support sustainable growth, economic development, and poverty reduction in recipient countries. However, it may be the case that funding projects through government channels actually provides services to Afghan citizens and communities more effectively as well as efficiently – meaning that in this way the development dollar is genuinely spent twice. The lack of real comparative studies that assess the effectiveness of aid delivered through these different funding channels is a gap that needs to be filled.

## Annex 1: Total Disbursement & Expenditure Data Provided by Donors (USD)

Development Partner	1385 (2006) ODA Total Disbursements	1385 (2006) Expenditure Data Provided
ADB	92,120,000	92,116,736
Canada	131,000,000	131,066,619
EC	184,000,000	184,049,257
Germany	102,800,000	83,232,389
Italy	36,320,000	35,783,363
Netherlands	87,915,602	87,915,602
Norway	69,700,000	69,678,118
Sweden	45,325,000	45,549,070
UK	195,941,240	195,878,838
US	1,403,596,000	997,722,135
World Bank	172,773,362	172,773,363
<b>Totals</b>	<b>\$2,521,491,204</b>	<b>\$2,095,765,490</b>

Source: Data for 1385 from donor responses to Ministry of Finance/PDT requests.

## Annex 2: Estimated Local Economic Impact of ARTF Activities

Spending Category	Spending (USD)	Local Economic Impact (%)	Local Economic Impact (USD)
Wages and Salaries	216,199,000	100%	216,199,000
Operations and Maintenance	84,015,000	39%	32,765,850
Projects	164,357,915	67%	109,673,714
Monitoring Agent	2,534,000	0%	-
<b>Totals</b>	<b>\$467,105,915</b>	<b>77%</b>	<b>\$ 358,638,564</b>

Source: ARTF quarterly reports, World Bank data and PDT staff estimates

### Annex 3: Proposed Template for Data Collection

Fiscal Year \_\_\_\_\_

Donor or Implementing Partner \_\_\_\_\_

Contact (Kabul) \_\_\_\_\_

Contact (Capital) \_\_\_\_\_

#### Summary

<b>Disbursements to:</b>	
Trust Funds	
UN agencies	
Contracts issued from head office	
Contracts issued from the field office	
Local contractors	
Local NGOs	
<b>Sub-Total ODA-eligible Disbursements</b>	
<b>Disbursements to non-ODA eligible activities</b>	
Defence Pacts or similar	
Other	
<b>Sub-Total of non-eligible Disbursements</b>	
<b>Total Assistance Disbursed</b>	

#### Detailed Information

Programme	Implementing Agency	Project Description	Contact Details	Actual Disbursement	International Staff	National Staff

## Annex 4: Estimating the Keynesian Multiplier

There is considerable anecdotal reporting on the multiplier impact of expenditure by UN missions. Reports such as 'each job associated with the mission generates five other jobs' are common. In reality, this is unlikely to be true. While it is not possible to be precise around the magnitude of the multiplier associated with this spending, it is unlikely to be greater than two. The Keynesian multiplier measures the overall impact of a fiscal stimulus – that is how many times an additional dollar cycles around the economy. However, each time the original dollar cycles, a portion of it is taken out. These leakages are associated with the amount of the dollar that is saved, the amount that is paid in taxes, and the amount that is spent on imported goods.

The primary economic beneficiaries from a mission's presence were those that gained employment either directly with the mission or indirectly through expansion in the provision of services for international staff; and those that either had land to lease or capital to expand their businesses. As a share of the total population, mission employment of national staff is generally quite low and so the number of primary beneficiaries will actually be low as a share of the population. Moreover, it is likely that the primary beneficiaries would have occupied the upper portion of the wealth distribution and been well placed to save a portion of this income. Additionally, these people would also have been aware of the transitory nature of the economic windfall they were receiving from the international presence, so would be unlikely to have spent it all. In the absence of concrete data, it is postulated that the savings rate out of this income may have been in the range of 15-30%.

Again, in determining the likely leakage into imports it is important to remember that the group receiving this economic windfall are likely to be at the upper end of the socio-economic distribution. Hence, their consumption spending would have a higher import content than that of the average consumer in the society. There are two features of the Timor-Leste economy that are particularly relevant. First, in most countries where missions are operating there are very few consumption goods or services produced domestically outside of food, basic household furniture, or construction and rehabilitation of property. Increasingly services provided for internationals enjoy a crossover of clientele from the wealthier members of the local population. During the process of post-conflict recovery an increasing amount is produced domestically. During the first couple of years of most missions people who wished to purchase consumption goods had to purchase imports. Second, in many of the countries where missions have been established, the economy has been characterized by very few intermediate 'value-adding' industries. Most production involves taking either raw materials or imports and then transforming these directly into a finished product. This means that the import content of consumption is always going to be higher than in a country where there are several intermediate production steps. The only non-imported value-added is either the natural raw material or the labour of the business doing the production. These two features together suggest that the leakage into imports could be quite high.

In terms of quantifying this effect, assuming a savings rate of 15-20%, assuming a tax take of around 5-10% and a marginal propensity to import of 25-30% generates a Keynesian multiplier with an upper bound of two. Discussions with UN mission staff and IMF and World Bank field staff suggest that, if anything, both of these figures are at the low end of likely estimates. On the balance of probabilities, the multiplier is more likely to be below two, probably closer to 1.5 than above two.<sup>34</sup>

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34 Carnahan, Michael. 'Estimating the Fiscal Impact of UN Peacekeeping Missions,' working paper, 2005.