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A Blessing or a Curse? Aid Rentierism and State-building in Afghanistan

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In the aftermath of the 9/11 attacks on the World Trade Center and the Pentagon, the United States, on October 1st 2001, announced its support for "a political transition and a UN-coordinated reconstruction programme in Afghanistan". This marked the beginning of international counter-terrorism and state-building efforts, which brought together both the UN and broader international agendas through political and economic support from the US and its coalition partners.[1] International intervention through funding has been the main engine to drive the fiscal administration, which has opened up a new era of unprecedented aid rentierism in the country. Economic resources, required for all operations of public services, have almost entirely been financed by international assistance, rather than being generated domestically.[2]

Evidence suggests that around 97% of Afghanistan's GDP is derived from spending related to the presence of the international military and donor community. For instance, between 2001 and 2010, only US$57 billion of the US$90 billion pledged by donors was spent, and more than half of total international assistance was invested in the security sector. The government generates an annual revenue of approximately US$2.5 billion, while the cost to fund its security forces alone is roughly between six and eight billion US dollars per annum. The Afghan government and economy will be totally unsustainable without long-term foreign aid.[3]

The new era of aid rentierism in Afghanistan has been subject to controversy with conflicting outcomes from a political economy perspective. It has been a blessing as well as a curse, which this paper aims to examine. Section two provides some highlights on the term rentierism, and briefly discusses its history, types, and effects. The third section will explore the literature of aid rentierism, focusing on its effects on state-building from a political economy perspective. Section four empirically evaluates aid rentierism in post-Bonn state-building in Afghanistan in order to highlight the positive and negative effects. Finally, the last section deals with some concluding remarks and findings.

Rentierism, What Does it Mean?

In the early twentieth century, economists used the term "rentier state" to refer to the loans extended by the European states to non-European governments.[4] Hussein Mahdavy was the first scholar to lay out the fundamentals of rentierism as a term and concept. According to him, a rentier state receives significant rents from "foreign individuals, concerns, or governments".[5] Beblawi refined this definition and argued that a rentier state is one where the rents are paid by external actors, accrued directly to the state. Only a few are engaged in the generation of rent, while the majority are engaged in its distribution or utilisation.[6] It is important to note that rentier states derive most of their required revenues from the outside world and the functionality of their political system is highly dependent on unearned income called "rent".[7]

Rentier states live mainly off unearned revenue; to resource the state, there is little organizational or political effort by the state apparatus.[8] Rentier income is mainly derived from two streams: first, the natural resource rents or the 'income derived from the gift of nature', which are usually accrued from the exports of natural resources, mainly oil, gas, minerals, diamonds, and tropical timbers.[9][10][11][12] The second category is made up of strategic rents or aid in the form of bilateral or multi-lateral payments for development or military spending.[13][14] While both natural resources and aid can impact upon state-building and domestic resource mobilization,[15] the latter, which Verkoren and Kamphuis call "aid rentierism", seems more problematic than the former.[16] The states do not own aid. It is basically the donors who call the shots.[17] Further, the flow of aid can abruptly stop, unlike income from oil, 'rendering aid rentierism a particularly problematic strategy in sustainable state formation.[18]

Aid Rentierism and State-building: a Theoretical Framework

Aid plays a significant role in the process of state-building, particularly in the post-conflict era. In poor countries, aid normally contributes a lion's share of government expenditure, thus allowing aid providers to contribute to the development of an inclusive society through the reduction of horizontal inequalities.[19][20] It can be useful, and can certainly contribute to economic development and an improvement in quality of life, which has been the case in many countries. Aid has been successful in cases where strong programs were pursued and objectives were defined.[21]

"External assistance during the war-to-peace transition can help finance economic recovery, social expenditure and peace implementation programs including the establishment of new democratic institutions." During the post-war transition, it is crucial to build state capacity in order to mobilize resources domestically, and to allocate and manage expenditures.[22] It has been argued that many democratising states are subject to civil wars, and that receiving aid for democracy is one of the main factors that "shelters" such states from the political violence that could exist domestically. Democratising states that are in receipt of more aid for democracy are less likely to experience civil conflicts than those that receive less, or no, democratic aid assistance.

In the course of democratic transition, the central authority grows weaker and there is more uncertainty among domestic groups regarding the state's political commitments in the future. Democracy aid in this respect reduces the conflict risk by decreasing the problems of commitment and uncertainty.[23]

Despite its importance, aid still can have adverse effects. Aid can cause states to fail to sustain their expenditure commitments, and sovereignty and legitimacy can be subsequently affected. Countries, whose budgets are highly contributed to by aid, rather than by their own domestic resources, will lose significant political autonomy with respect to their capacity to manage and make decisions on budget priorities. Massively depending on aid also undermines democracy, diminishes political accountability to the local people, and makes the state more accountable to donors than their own citizens.[24] This is because the state elites do not require public support nor legislative compliance when they do not raise revenues from domestic economy.

Instead, they maintain their donor relations and are eager to provide donors with alternative sources of funding. Despite the frequent complaints of states about donors' tight conditions, it is still much easier to meet the demands of donors than the slow and politically challenging responsibility of building, and progressing, domestic revenue collection.[25]

Furthermore, a high dependence upon aid undermines the state's ability to bargain with powerful non-state actors. It is very likely that the state would accommodate illegitimate power holders, further weakening the state's legitimacy due to uncertainty about the future of aid.[26] Although aid funds long-term development, it operates like natural revenues, as a 'resource curse'. When states cannot persuade their citizens to pay taxes in order to finance their expenditures, but are financed by natural resources, aid, or other types of income, the development of effective and democratic institutions can be negatively affected.[27] Reliance on unearned income leads state actors to be more autonomous from citizens, which can increase their ability to act in predatory ways, or 'at the very least reduces the need for state leaders to develop long-term political bargains with interest groups'.[28] Aid inflow not only leads to a limited focus on the collection of domestic taxes, but also impedes the development of domestic institutions, such as the tax administration.[29] Governments that enjoy access to large amount of aid actually reduce their revenue generation efforts.[30]

Aid Rentierism in Afghanistan: a Historical Overview

Aid rentierism in Afghanistan has been controversial and is subject to debate. Aid rentierism is firmly rooted in

Afghanistan's history.[31] Afghanistan has been an aid-dependent country for at least two centuries, which coincides with the reigns of Durrani rulers, such as Shah Shuja (1809–1818) and Dost Mohammad Khan (1819–1839), who enjoyed British stipends.[32] External funding was mainly used to maintain internal political stability and was initially funded by British stipend; however, as the twentieth century advanced, competitive support between Soviet and US interests provided the key feature of state finances.[33] External subsidy allowed the Afghan rulers to consolidate their internal control. For instance, in 1882, Abdul Rahman (1880–1901), was in receipt of annual subsidy of 1.2 million Indian rupees, which he used to employ conscripts. This in turn enabled him to increase direct tax revenue from landowners.[34] Musahiban regimes (1929–1978) also enjoyed the British subsidy in 1930s to reestablish the army.[35]

Afghanistan has been a rentier state since at least 1957 and derived over 40% of its annual revenue from external aid.[36] Total foreign grants and loans contributed to 80% of the country's investment and development expenditure between 1956 and 1973.[37] This led the state to fail to confront tax resistance from rural landowners and merchants, and thus did not build a domestic taxation base. As a result, the state did not attempt to build up the structures it needed to manipulate the country.[38][39] In the 1980s, over 90% of Afghanistan's development budget was financed by the socialist economies, of which 70% was from the Soviet Union.[40] There is no sufficient evidence of how much aid the Mujahideen government received during their rule in the 1990s; however, during their fight against the communist regime in 1980s, they enjoyed a total of six billion US dollars of aid,[41] provided by both the US and Saudi Arabia.[42] The total amount the Saudis provided during the war era was likely as much as the US$3.3 billion spent by the US.[43]

For the Taliban, too, external assistance by Pakistan and Saudi Arabia was the main source of rent. The official budget of the Taliban (excluding military expenses) was totally financed by direct aid from Pakistan, which amounted to Rs.500 million, or US$10 million, in 1998.[44] Post-Taliban Afghanistan has also largely retained its character as an aid rentier state.[45] Foreign aid financed around 90% of all official expenditure during most of the post-invasion years, declining only slightly towards the end of the decade.[46] Aid in 2010–2011 was around 15.7 billion, which is almost equal to nominal GDP. More than 30% of government revenue comes from customs and import duties that are intimately linked to external assistance.[47] Domestic revenue in 2013 covered only 30% of the budget, while the shortfall of 70% was covered by aid.[48]

This massive aid dependency in the last ten years is unprecedented in Afghan history. This includes both the Communist and Daoud's residential terms in office, which are considered as periods of extreme dependence on foreign aid. As can be seen in the table below,[49] domestic revenue, which accounted for just over 60% of Daoud's (1973–1977) state budget and about half during the first year of Soviet's rule, increased to 70% three years following the emergence of Soviets in power. By comparison, three years after the US invaded Afghanistan, domestic revenue only contributed 31% of the budget. This does not include the fully financed and controlled 'external budget' of donors after 2004.[50]

The Effects of Aid Rentierism on Post-Bonn State-building in Afghanistan

Aid has a significant impact on Afghanistan.[51] Although it cannot lead to reducing the conflict risk directly, it can achieve gains from the impact it makes upon growth and higher employment.[52] Since 2002, external funding has been the main driver of economic growth in Afghanistan. Following the ousting of the Taliban, the economy has briskly grown (which can be expected from a country with such a low starting point). Per capita income has increased from US$147 to US$289 from 2002–2007. Aid and reconstruction made a sizeable contribution to this – equivalent to 40% of GDP.[53] Since 2007, per capita income has almost tripled, standing at US$799 in fiscal year 2012–2013.[54] Massive inflows of large security spending in turn fuelled demand for goods and services, including that of construction.[55] Between 2002 and 2013, annual economic growth averaged 12.4%, but demonstrated considerable volatility, lurching from 28.6 in the fiscal year 2002–03 to 2.3% and 3.2% in 2008–09 and 2010–11, respectively (Table 2).[56]

It is assumed that developing countries lack higher rates of savings and investments, and that foreign aid will help fill these gaps.[57] This can be achieved via flow of increased aid to fill the gaps of savings or by providing necessary foreign exchange, which is required to remove the deficits of current accounts.[58] This has been true in Afghanistan, which has continuously suffered a chronic trade deficit. Current account deficit was Afs2.3 billion in 2002–03 and Afs8.5 billion in 2012–13 (Table 3). Evidence suggests that these deficits were largely funded by foreign aid. For instance, in 2011 and 2012, the huge trade deficit of 40 and 43 percent of GDP was respectively offset by large transfers – mainly foreign aid inflows – to the current account.[59]

Upon availability of aid for public expenditure, it can lower the pressure to mobilise domestic revenue, thus making it easier to avoid revenue-generating measures, which may hamper or distort a broad-based recovery. Aid also allows the domestic political actors to buy time and reach the working agreements necessary to build revenue institutions. As the economy recovers, a growing tax base will in turn provide some revenue buoyancy, and as new tax arrangements come on stream, revenue growth will increase.[60] In the last ten years, the growing and massive inflows of aid favoured the Afghan political actors, buying them some time to build domestic extractive capacity of commodities, which has been weak throughout their history.[61] Based on available evidence, in the last ten years, Afghanistan has seen a steady growth rate in domestic resource mobilisation. The share of domestic revenue to GNP increased from 4.6% in 2003 to 11.5% in 2012 (Table 4).[62]

Despite aid rentierism having favoured Afghanistan, it seems to have also been a curse as far as state-building is concerned. There is little doubt that, historically, foreign aid has provided Afghan rulers with the ability to mobilise capital, coercion, and legitimacy.[63] Whilst aid, the "unearned revenue", has given the Afghan state-builders the capital and coercive power, legitimacy has been weakened and, consequently, the broad-based scope of the coalition has been undermined.[64] Also, the inflow of aid, particularly when focused on stabilising the more insecure and war-affected provinces, has been a "source of rents, patronage and political powers" which has sometimes inadvertently worsened tensions and grievances among different groups.[65] Giustozzi and Ibrahimi argue that aid projects fuel anti-government mobilisation via rebels taxing the aid projects in Afghanistan.[66] Reports suggest that aid projects and the delivery of supplies in areas accessible by insurgents are subject to 20–40% tax. According to a report by USAID, in 2009, contractors paid protection money to insurgents, including an estimated US$5.2 million of USAID funding suspected of being paid to the Taliban.[67]

Aid is also a barrier to democratisation. Suhrke argues that aid reliance in Afghanistan has hindered democratisation.[68] A parliament with no fiscal power is destined to remain more of a forum for debate than an instrument which could channel popular demands into national level decisions and hold the executive branch accountable. Furthermore, over-dependence on external funding hindered the state's hope of becoming a fiscally independent administration. Depending on external funding for the next twenty to thirty years would re-establish one of the main impediments to domestic state-building.[69]

Accountability goes where aid direction flows. When the national budget of Afghanistan is fuelled by aid from foreign governments and institutions, the Afghan state tends to be more accountable to donors rather than its own people. This was also the case in earlier Afghan regimes that depended on foreign assistance.[70] For example, the revenue Daoud received, from both foreign aid and the sales of natural gas to the USSR, enabled the state leadership to expand the apparatus under its control with no bargaining or being accountable to its own citizens. The very citizens who could be called upon to fund the state's expansion by taxes derived from their own productive activity. In addition, while rentier states that sell oil on a market do not depend on particular customers, Afghanistan had to bear the pressure from both aid suppliers and the only consumer for its gas: the USSR.[71]

Although donor funding is vital to the current Afghan government, it has provided the donors with a great deal of power in bargaining for formal policy and establishing demands on the central government.[72] Given the weak administrative capacity of the Afghan state, which was absent in the early age of post-Taliban Afghanistan, international agencies and consultants were employed to administer the flow of aid. They soon created a parallel administration or a dual public sector,[73] which in turn did not favour the process of state-building. For instance, instead of the state controlling the disbursement of aid under the budget, which could make it accountable to its people, many donors, particularly the US, created their own expenditure mechanisms and procedures accountable to their own political authority.[74]

In addition, international organisations, contractors, and implementing partners also have their own financial systems, accounts, and reporting mechanisms.[75] Statistics reveal that, between 2002 and 2010, 77% of aid disbursed was managed by donors outside the Afghan government treasury and policy framework. The remaining has also been earmarked in line with donor preference.[76] Although the dual public sector can be considered as a short term solution to the problem of a lack of state public capacity, it brings vested interests with it. These pose threats to the development of the Afghan public sector capacity that is necessary for both stability and political accountability.[77]

Conclusion

Having discussed the role of aid rentierism on state-building in post-Bonn Afghanistan, the paper concludes that, apart from certain areas in the economy, aid rentierism did not favour state-building efforts in Afghanistan and has been a curse rather than a blessing. Aid rentierism in Afghanistan has been a good contributor to economic growth and GDP per capita. Afghanistan managed to maintain an average of 12.4% growth rate between 2002 and 2013, while per capita income has increased over five-fold between 2002 and 2013. Aid rentierism has, in particular, been favourable with respect to current account deficits, which the country has been suffering for many years. Further, aid rentierism also led the state to improve its extractive capacity. As a result, domestic revenue and GDP ratio increased substantially.

Despite its positive effects on the Afghan economy, aid rentierism has had adverse consequences, which have hampered state-building. State legitimacy has been weakened and, as a result, the broad-based scope of the coalition has been undermined. It has also been a source of rents, patronage, and political power, which have exacerbated tensions and grievances. Aid rentierism has hindered democracy and the hope for a fiscally independent administration. It also fuelled anti-government mobilisation via rebels taxing the aid projects in Afghanistan. Reports suggest that aid projects in areas controlled by insurgents were taxed between 20 and 40 percent. More important to note is the fact that aid rentierism overshadowed accountability. When the national budget of the Afghan state is massively fuelled by aid from foreign governments and institutions, the Afghan state has tended to be more accountable to donors rather than its own people. Further, aid rentierism enabled donors to influence formal policy, which resulted in a parallel or dual public sector. The parallel international public sector is not taxed, which has led to unwelcome competition with the national public sector. Further, it posed serious threats to developing the Afghan public sector capacity, which is necessary for both stability and political accountability.

Aid rentierism has not only hampered state-building during the last decade; it also poses serious threats to the future of state-building in Afghanistan. According to the World Bank, Afghanistan is likely to remain an aid-dependent country, if not for the long term, for the medium term, at least.[78] It is arguable that the country will be forced into a deep economic depression following the departure of foreign troops in 2014, as the donor funding and civilian personnel presence rapidly declines.[79] Military spending and foreign aid fuel the Afghan economy and, as such, Afghanistan's economy is at a negative multiplier risk and support will shrink following the departure of troops.[80] Afghan and American civilian and military planners fear that the country's fall into an economic abyss will encourage some Afghans back into the insurgency, and further deepen the poverty of Afghans across the country.[81]

Notes

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[9] Richter and Steiner (2008, 943-4) have recently identified six types of rents: First, the natural resource rents which stem from the export of natural resources, like oil or natural gas and other minerals. Second, location rents, which are generated by major transportation facilities, like the Suez Canal or the SUMED pipeline. Third, strategic rents, which include foreign grants and soft loans given directly to the government as military and economic aid and assistance. Fourth, political rents, such as donations to government institutions for human dignity or development reasons. Fifth, worker remittances, which are generated by the higher average wages paid in other countries, and which flow into domestic financial systems and are partially absorbed by the state through taxes and transaction fees. And sixth, international tourism revenues, which are based on the use of unique natural endowments (e.g. the pyramids) and on the development subsidies and special fees that support operations. Richter, Thomas and Steiner, Christian, Politics, Economics and Tourism Development in Egypt: Insights into the Sectoral Transformations of a Neo-Patrimonial Rentier State, *Third World Quarterly*, 2008, 29, 939–959

[10] Oil, however, has been the dominant source throughout the period of around a century when the rentier states as a phenomenon had emerged. (Moore 2003, 14)

[11] Beblawi, Hazem, The Rentier State in the Arab World, In *The Arab State,* edited by Giacomo Luciani, 85–98, London, Routledge, 1990, (Moore 2003, 14).

[12] Illegal narcotics are also conventionally included in this category, but this is not principally because the 'peripheral' countries have any strong economic advantage in the production process (Moore 2003, 14).

[13] Moore 2004, 305, Schwarz 2008, 604

[14] Moore 2001, 14

[15] According to Ross (2001, 332-38) rent has three effects in sustaining and prolonging the authoritarian and non-democratic governments in oil states: First, the rentier effects, where low or no taxation bought-off the population and gained the public's political acquiescence to toleration. Second, the repression effects, where the wealth from rents helped the state to purchase repressive state apparatus and institutions and to keep democratisation pressures at

bay. And third, the modernisation effects, where rents caused or enhanced socio-political stagnation or underdevelopment and, again, prevented democratic impulses from taking roots.

[16] Verkoren, Willemijn and Kamphuis, Bertine (2013), State Building in a Rentier State: How Development Policies Fail to Promote Democracy in Afghanistan, *Development and Change,* (2013, 509), 44/3, 501-526

[17] Typically the oil exporting governments manipulate the oil income while aid funds are never controlled by recipient governments, not even the general budget support or the less conditional kinds of aid. Taxation practices in recipient governments are influenced in a number of ways, which have no similarity in oil economies. Donors influence these countries through technical advice and funds, with few strings associated with conditional demands for specific policies on tax or other issues, and sometimes tied to signals about withdrawal of funding in cases of non-compliance. See Therkildsen, Ole, *Keeping the State Accountable: Is Aid No Better Than Oil?* (2002, 2-3), 33/3, 1-17

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[20] Horizontal inequalities fuel violent conflicts, which in turn exacerbate inequalities. For more, see: Brinkman, Henk-Jan, Attree, Larry and Hezir, Saša, *Addressing Horizontal Inequalities as Drivers of Conflict in the Post 2015 Development Agendas,* United Nations Peacebuilding Support Office (2013, 1)

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[30] Brautigam and Knack 2004, 13

[31] Verkoren and Kamphuis 2013, 511

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[35] Ibid, 894

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[37] From 1976–1978, the Soviets provided Afghanistan with US$ 1.65 billion in economic aid and roughly US$1.25 billion in military aid. See Rubin, Barnett R., *The Search for Peace in Afghanistan: From Buffer State to a Failed State,* Yale University Press, New Haven and London, (1995b, 22), Johnson, Chris and Leslie, Jolyon, *Afghanistan: The Mirage of Peace,* Zed Books, London and New York (2004, 139), Rubin, Barnett R., *From Buffer State to Failed State: The Fragmentation of Afghanistan,* Yale University Press, New Haven, (Rubin 1995a)

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