



# **Afghanistan Compact Procurement Monitoring Project**

**Final Report**

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**April 1, 2007**

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## **Preface and Acknowledgements**

This report was researched and written by Michael Carnahan, a Visiting Fellow at Asia-Pacific School of Economics and Government, Australian National University and Economic Advisor at Peace Dividend Trust; and Jennifer P. Holt, a Senior Project Officer with Peace Dividend Trust.

It responds to a request made by the Ministry of Finance of the Government of Afghanistan to conduct an assessment of the local impact of international aid being delivered to the country as part of the monitoring of the Afghanistan Compact.

While this was a collaborative endeavour, this study reflects the views of the Peace Dividend Trust as a representation of the data collected, received and analyzed from the Ministry of Finance, the development donor participants, and from surveys carried out with local businesses in Kabul and does not necessarily represent the policies or views of the Government of Afghanistan.

The findings presented in this report offer the first assessment of commitments made in the Compact by the international community and the Afghan Government related to increasing local procurement as a means to enhance the effectiveness of aid. In addition to preliminary estimates of the local impact of official development assistance spending during the Afghan fiscal year 1384, recommendations are also offered that target the current capacity to monitor and meet these commitments and ways in which stakeholders can work to increase local procurement in Afghanistan. It is important to note that the quality of the estimates made in the report are intimately linked to the quality of the data that was provided by donor agencies to the Ministry of Finance and the project team from Peace Dividend Trust.

Field research for this project began on November 1, 2006 and concluded on February 6, 2007. However, given the significant challenges posed by assembling the necessary information required to carry out the economic analysis, the project team extended the data collection period until March 26, 2007.

Peace Dividend Trust wishes to thank the United Kingdom's Department for International Development (DfID) for making this project possible through their generous financial support.

This project could not have been accomplished without the contributions and participation of many individuals, businesses and institutions. First and foremost, Mustafa Aria and the members of the Aid Coordination Unit of the Ministry of Finance, who played an essential role both in the development of the project and the data collection process. Enormous gratitude to Ainsley Butler Ostojic and the Peace Dividend Trust staff in the Kabul Marketplace office who offered indispensable insight and support from the projects' inception to its completion. Finally and perhaps most important, the international actors and business owners, who are working to meet difficult deadlines and

objectives, but took time out of their overextended schedules to participate in this study. While many donors were not able to contribute the requested data for our research purposes, they each offered critical and thoughtful feedback that helped inform the outcomes and recommendations of this report.

## Executive Summary

Approximately \$1.5b in official development assistance was disbursed in Afghanistan during the Afghan fiscal year 1384 (21 March 2005 to 20 March 2006). In keeping with the commitments made in the Afghanistan Compact the aim of this study was to measure the impact of this assistance and put forth recommendations on how the local economic impact of this spending could be enhanced.

Three major conclusions were drawn from this research:

- The high level commitment made to increase the local impact of development spending has yet to translate into a focus on the ground in either assessing this impact, or instituting practical ways to enhance its impact on the Afghan economy.
  - A greater focus on collecting and analyzing data on actual *disbursements* (that is funds that have been paid out) rather than on commitments (that is funds that have been promised) would both provide a baseline for better analysis and raise awareness of the importance of the issue.
- Within the different ways that donors spend their funds, by far the greatest local economic impact is obtained when resources are provided directly to the government (local impact around 85%) compared to funds provided to international companies or NGOs (less than 20%) to carry out projects.
  - Thus increasing the level of monies provided through trust funds represents the simplest way to increase local economic impact.
  - In addition, while local economic impact is only one of the criteria that donors use to assess the effectiveness of their aid, there are no studies that demonstrate funding outside of trust fund channels delivers more effective outcomes or better value for money.
- Finally, when funds are provided outside trust fund channels for the purchase of goods and services there are still a number of approaches that can be explored to ensure that the local economic impact is heightened.
  - In many cases this means applying the lessons learned by businesses and NGOs that are having a greater local impact. In other cases it involves changes in donor procurement practices that will increase the local impact without reducing value for money.

The objective of this study was to collect information from donors on their disbursement of funds in 1384. Donors were asked how much money they disbursed through different channels, including trust funds, UN agencies, international contracts and local contracts. This data was then analyzed, along with interviews with local and international contractors to estimate the impact of donor spending on the Afghan economy. Results

were also refined and calibrated based on empirical research carried out in other post-conflict societies.

Chief among concerns was the difficulty that this straightforward request caused for the majority of donors. While many donors were able to provide some information on their disbursements in response to requests made by the Ministry of Finance for this project none had well prepared material readily available specifying information on their actual disbursements. What most donors did possess were detailed publications outlining their commitments.

Despite the commitments in the Afghanistan Compact, and its importance in assessing the effectiveness of development expenditure, including local impact, for several reasons, reporting and analyzing disbursement data remains a low priority for staff of donor agencies. First there are some technical challenges such as the difficulty in aligning donor government and recipient government fiscal years. However, these technical challenges are outweighed by the lack of focus on this issue from head office and political resistance from many donor agencies in making their data public.

The overall results of the study showed that of the \$1.36b spent in 1384 by the major donors from whom data was obtained, the local impact was around 31.2% or \$424m.

As a final point it is important to remember that this study provides preliminary estimates of the local economic impact of international donor spending. The quality of these estimates is intimately linked to the quality of the data that was provided by donor agencies to the Ministry of Finance and the project team from Peace Dividend Trust. To the extent that there is dispute over the accuracy of the results, the next step is for the interested donors or other parties to do a more comprehensive analysis with better quality data to improve upon these estimates. This additional research, like this study, will support the Afghan Government and the international community in obtaining a better understanding of the local impact of development spending, and therefore be better placed to meet their shared obligations under the Afghanistan Compact.

# **1. Introduction**

## **1.1 Overview**

In order to ensure the most effective and efficient use of funds being delivered to Afghanistan, the international community and the Afghan Government committed themselves to the Afghanistan Compact. Under the 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 is not possible, the Compact recognizes the importance of three things: using national partners rather than international partners to implement projects; increasing procurement within Afghanistan; and using Afghan goods and services wherever possible, rather than imported goods and services. This approach is founded in the understanding that by using development assistance in this way, the local economy can be kick-started. Thus, development assistance projects deliver a dual benefit: they provide a service to the community while providing local incomes and employment.

Following the signing of the Compact, the Afghan Ministry of Finance became aware that there was little empirical evidence on the economic impact of donor spending on Afghanistan. Because they did not possess the technical expertise or capacity to execute such an assessment, the Government sought partnership with Peace Dividend Trust (PDT), an organization with technical expertise in the area, to carry out a study that would attempt to measure these important commitments and to formulate a plan for the Ministry of Finance to monitor progress through its own analysis in the coming fiscal years.

With support from the United Kingdom's Department for International Development (DfID), the project set out to produce the following: 1) An estimate of the total spending that enters the Afghan economy through local procurement by participating donors and agencies; 2) An analysis of spending patterns and trends of participating donors that identify demand for goods and services and the most likely areas for growth 3) A comprehensive list of goods and services used most frequently; 3) Practical recommendations, taking into account all stakeholders involved, on how local procurement can be increased in the country; and finally, 4) A methodology for estimating the local economic impact of donor and Government spending in Afghanistan.

## **1.2 Background**

By signing the Afghanistan Compact at the London Conference in February of 2006, nearly 60 nations and international organizations pledged their support to the ongoing effort to rebuild Afghanistan. The Compact, which succeeds the implementation of the Bonn Agreement<sup>1</sup>, was developed to support the Afghanistan National Development

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<sup>1</sup> See "Agreement on provisional arrangements in Afghanistan pending the re-establishment of permanent Government institutions", online at <http://www.afghangovernment.com/AfghanAgreementBonn.htm>



Strategy<sup>2</sup> and sets out a five year plan for achieving goals in the areas of security, governance, and development.

Given the significant financial resources invested in the country for the reconstruction and development effort, the Government and donor community further committed themselves to strategies that would ensure that aid delivered to Afghanistan yielded the highest possible impact. Two key principles were agreed to that guide the aid effectiveness agenda and set the stage for the underlying commitments to be met. These are: increasing the leadership of the Afghan Government in setting its development priorities and strategies and the support needs of the country and the coordination of donor assistance; and transparency and accountability on the part of both the Government and the donors of the international assistance being provided in Afghanistan.

Shortly after the promulgation of the Afghanistan Compact, the Afghan Government carried out a survey to monitor the Paris Declaration on Aid Effectiveness. In addition to the twelve original indicators from the Declaration, six commitments were prioritized from the Compact and included in the survey, three of which (Indicators 16, 17 and 18 – please see Annex III) were related to local procurement.

Responses to the survey showed that none of the donors were able to provide qualitative details on their purchase of goods and services in Afghanistan. Only six donors were able to respond to requests for quantitative data. This limited information not only demonstrated the need for further investigation, but the difficulties in obtaining data also illustrated that a mechanism would need to be put in place in order to monitor and measure progress made on commitments in the Compact.

### ***1.3 Structure of the report***

This report, which is the outcome of the collaboration between the Ministry of Finance and PDT, presents the results of the research undertaken. It provides the first assessment of the Government and international community's capacity to measure and fulfil commitments made in the Afghanistan Compact related to increasing local procurement as a means to enhance the effectiveness of aid. The next section of the report provides the background to and methodology for estimating the local impact of international development expenditure. The third section of the report discusses the data collection process and the particular challenges around collecting quality data for the project. The fourth section presents the analysis of the data and the estimation of the local impact of international spending. The fifth section then offers a qualitative discussion around the issues covered in the report, based on interviews with businesses conducted as part of the project. The last section presents the conclusions of the study and the recommendations, which are designed to strengthen existing frameworks and offer practical and feasible opportunities for increasing local procurement in the country.

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<sup>2</sup> Afghanistan National Development Strategy (ANDS) is a dynamic framework that prioritizes and strategizes the Afghan Government's reconstruction and development efforts.

## **2. Estimating the Economic Impact**

Estimating the overall economic impact of international assistance provides the baseline from which progress against the commitments agreed to under the Afghanistan Compact can be measured. This section outlines the background to calculating this impact and the methodology used in this project.

### **2.1 Context and Summary of PDT Expertise in the Area**

The local economic impact of peace and development operations is emerging as an important component of post-conflict recovery. During reconstruction, the presence of development and humanitarian organizations, NGOs, civil society, donor agencies, international military forces and international corporations often constitutes the largest domestic market and thus provides an opportunity to significantly impact and support both local economic recovery and the overall nation building effort.

In 2004, the United Nations Secretary General’s Commission on Private Sector and Development brought together existing ideas and lessons learned from business, civil society, labour organizations and other development actors to create a framework for allowing the full potential of the private sector to be utilized in developing post-conflict countries. The final report concluded:

The private sector can alleviate poverty by contributing to economic growth, job creation and poor people’s incomes. It can also empower poor people by providing a broad range of products and services at lower prices. Small and medium enterprises can be engines of job creation—seedbeds for innovation and entrepreneurship. But in many poor countries, small and medium enterprises are marginal in the domestic ecosystem (United Nations, 2004).<sup>3</sup>

The Commission’s report recommended increased public-private partnership to facilitate greater access to financing options and assist in skill and knowledge development for entrepreneurs and the workforce. It also encouraged increased cooperation among private actors, including business and non-governmental organizations (NGOs) as a way to build linkages and create opportunities in “bottom-of-the-pyramid” markets (footnote) where the worlds poorest are the main players. Cooperation and partnerships can help offset the high risks that can discourage Private Sector Development (PSD) in post-conflict environments, and consequently prevent the private sector from serving the poor.

PDT has pioneered the measurement and analysis of the local economic impact of operational spending of international agencies. In 2005, PDT was commissioned by the United Nations Department of Peacekeeping Operations (DPKO) to lead an initiative directly related to the proposed objectives of this research entitled the Economic Impact

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<sup>3</sup> United Nations Commission on Private Sector and Development “Unleashing Entrepreneurship”, p. i (2004)

of Peacekeeping (EIP) project<sup>4</sup>. This study looked at the economic impact of ten current and former United Nations peacekeeping missions and carefully estimated how much of each mission's budget was actually spent on locally-produced goods and services. With the exception of Kosovo, research showed that less than 10 percent of mission spending went directly into the local economy, although in four mission areas with very low economic activity, even such a low fraction of spending boosted local gross domestic product by 4 to 8 percent.

The overall conclusions of the study is that United Nations missions do more good and less damage, in economic terms, than is commonly believed; that there is an immediate upsurge in economic activity associated with the restoration of basic security; spending from international staff allowances, local procurement and on national staff wages provides a stimulus to the local economy; and lastly, the perception of widespread inflation is not borne out —some price rises occur in parts of the economy servicing internationals, and wages for scarce skilled labour increase. Despite these conclusions, the study also noted that there was considerable room to enhance the local economic impact, particularly in local procurement practice and in how missions go about hiring and paying local personnel.

As a direct result of the EIP recommendations, in 2006, PDT launched the “Peace Dividend Marketplace”, a procurement brokerage pilot project based in Kabul, Afghanistan. This project links the operational needs of the international community with local providers of goods and services to generate new business opportunities in the country. The venture provides the means for the international community to navigate the local marketplace, while assisting local entrepreneurs in understanding procurement processes such as contract bidding as a way to increase and facilitate the number of contracts awarded to Afghan businesses. Work thus far has resulted in \$52 million in local economic impact, clearly demonstrating that more of the existing humanitarian, development and security-related funds can be channelled directly into the local economy by matching international buyers with local suppliers that comply with the ‘value for money’ principle of procurement.

The EIP research was the first and to date only quantitative analysis of the economic footprint of peace and humanitarian missions. However, the project only considered the impact of United Nations DPKO peacekeeping operations and the overall economic footprint is appreciably larger than just the peacekeeping operation. This awareness coupled with PDT's newly gained knowledge and expertise of the Afghanistan marketplace made supporting the Government of Afghanistan in monitoring the local impact of international donor spending a logical extension of the methodology and the project.

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<sup>4</sup> Please see the PDT website: <http://www.peacedividendtrust.org/en/?sv=&category=EIP> for the full report.

## **2.2 Methodology**

The specific commitments being measured from the Afghanistan Compact are:

- Increasingly use Afghan national implementation partners and equally qualified local and expatriate Afghans;
- Increase procurement within Afghanistan of supplies for civilian and military activities; and
- Use Afghan materials in the implementation of projects, in particular for infrastructure.

The methodology utilized in this research is drawn directly from the aforementioned EIP project. In summary, the methodology looks at the total Official Development Assistance (ODA) allocated by a donor country to Afghanistan and then subtracts the amounts that are not spent locally (e.g. head office costs of international companies or wages paid to international consultants). Of the money that is actually spent in the local economy, the methodology then considers how much of this is spent on locally produced goods and services and how much is spent on imported goods and services. Under this approach, the local economic impact is defined as the value of production undertaken by local workers and businesses.<sup>5</sup>

The methodology takes as its starting point the total amount of ODA that is allocated by a donor to Afghanistan. This money is then categorized according 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, LOTFA etc);
- Funds provided to UN agencies;
- Funds provided to international companies or international NGOs;
- Funds provided to local businesses or local NGOs; and
- Other funds.

The local impact of spending under each of these categories was then estimated based on the make-up of the spending, information gained from field interviews with businesses that were awarded contracts, and information obtained during previous field research for the original EIP project. In terms of funds provided to both international companies and NGOs, the contracts were further broken down into five categories:

- Contracts for the supply of international technical assistance;
- Contracts for the provision of construction or similar services;

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<sup>5</sup> For a more detailed discussion of the estimation methodology see Michael Carnahan, 'Estimating the fiscal impact of UN peacekeeping missions,' working paper, 2005 ([www.peacedividendtrust.org/en](http://www.peacedividendtrust.org/en)).

- Contracts for the provision of actual service delivery (e.g. health care);
- Contracts for the supply of specific goods; and
- Other contracts.

The overall economic impact of the international community is, of course, larger than the impact of spending covered 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 cooperation or to intelligence agencies). However, for the purposes of this project, the focus was only on ODA-eligible expenditure. The challenges in obtaining reliable data even in this narrow category (outlined below) supported the decision to limit the study in this way.

Finally, the information presented in this study focuses on ODA-eligible assistance provided by donors, either directly, or through conduit funding channels such as trust funds or UN agencies. In addition it only includes the largest donors to Afghanistan. Within that group, the donors that did not provide information to the study were excluded. A more complete examination would also have accounted for assistance provided by the international development banks in terms of grants and credits and a more detailed study of the spending by UN agencies. Given the level of reliability of the responses from bilateral donors, the weak responses from UN agencies when asked for information, and the possibility of double counting, the report focuses only on the information provided by bilateral donors.

### **3. Data Collection**

The terms of reference for this project identified the ability of donors to provide accurate and timely information on disbursements from their ODA programs as a critical factor in monitoring progress to achieve commitments made under the Afghanistan Compact. A major conclusion of this project is that in many cases the capacity to provide this data is very limited or is not seen as a priority. Accordingly, a principal finding of this study is the strong need for improvement in this area, including providing recommendations to support and facilitate this improvement.

#### **3.1 Data Requested**

In an effort to capture a snapshot in time, the following data was requested from the 14 largest donors for the most recent completed Afghan fiscal year, 1384:<sup>6</sup>

- the total amount of ODA spent on Afghanistan in 1384/2005;

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<sup>6</sup> Afghan FY1384 began 21 March 2005 and ended 20 March 2006.

- the amounts disbursed from contracts issued at head office to international contracting companies, the name and contact details for the company and a brief description of the nature of the work;
- the amount disbursed from contracts issued in-country - showing local contracts for local supply and international contracts for local supply; the names and contact details of the company contracted; and 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 including the amounts and names of agencies to which disbursements have been made.

This data was requested because it would show the stream of funding from the donor, beginning with the total amount of ODA disbursed for Afghanistan, down to the recipient firm contracted for a particular project. If provided, this data would enable an accurate analysis of the real level of local procurement in the country.

Prior to conducting individual interviews, an effort was made to avoid duplicating previous data requests already made by the Government of the donor agencies. As such, research was first undertaken at the Ministry of Finance to compile any respective data already obtained for other reports.

Telephone and in-person meetings were then carried out with each of the 14 donor agencies to review data needs and answer relevant questions. Presentations on the project and its objectives were also made at both the Aid Effectiveness Working Group (AEWG) meetings held in November 2006 and January 2007 and the UN Heads of Agencies meeting in January of 2007.

Based on the data provided by each donor, interviews were then initiated with international and local Afghan businesses and organizations to determine local content of contracts awarded. A total of 20 businesses and organizations agreed to participate. These represented a broad range of business sectors.<sup>7</sup> In addition, several large development contractors and one international NGO agreed to be interviewed.

Each company or organization was surveyed about their operational spending on goods and services during 1384. Questions included:

- What goods or services did you purchase to operate your company?
- Where did you purchase or import these goods and services from?
- How much did you spend on each of these goods and services?
- How many international and national staff did you employ?

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<sup>7</sup> A list of businesses and organizations interviewed, including international and Afghan officials, is available by contacting the reports' authors. For security purposes, these names have not been appended to this publicly distributed report.

- What has been your experience with the procurement process in Afghanistan?

### **3.2 Data Collection Challenges**

There were major challenges in obtaining accurate and reliable information from most donor agencies. In most cases, data was not readily available, or was not compiled in a way that was accessible or amenable to analysis. It was often incomplete, inconsistent both with aggregate information that donors had published elsewhere or had previously provided to the Government, or provided at a level of aggregation which prevented meaningful analysis. Unfortunately this compromised the ability to accurately estimate the local economic impact of ODA expenditure. Without such a baseline it is not possible to track progress against the indicators in the Afghanistan Compact.

The challenges faced in collecting data for this project can be considered under four distinct categories: technical; priority/focus; capacity; and political.

There are a range of technical challenges associated with providing this data. Chief among these is the different fiscal reporting years that different agencies operate on. The project focused on the Afghan fiscal year 1384, which runs from 21 March 2005 to 20 March 2006. However the fiscal year for donors does not align with this. A second technical challenge is identifying when funds that have been disbursed by a donor have actually been spent in the local community and had an impact. In the case of contracts with local or international contractors, a large portion of funds are not paid until the good or service is delivered. Also, when funds are disbursed to trust funds or intermediate agencies who then subcontract other groups to actually deliver the goods or services (e.g. many UN agencies) there is a lag between the disbursement from the donor and the impact of the spending in the local community. Lastly, many donor agencies reported that they were not accountable for monitoring disbursements made by their implementing partners and therefore had no record of data beyond the initial disbursement when in fact a project could be sub-contracted multiple times before it reaches the stage of implementation. In each of these instances there are straightforward technical solutions, while not precise, that still allow for estimation of the economic impact with a degree of accuracy which would be sufficient to assess whether progress is being made against the indicators in the Afghanistan Compact.

The lack of priority accorded to measuring disbursements and assessing the impact of projects represents a far bigger challenge than any of the technical problems. Put simply, there is far greater tendency amongst the international donor community for announcing commitments than for reporting on disbursements. A cursory reading of documentation prepared by international bilateral and multilateral donor agencies illustrates that much more is written about what the agency is committed to doing and what funds the agency is committing, than is written about what the agency has actually done, or what funds have been disbursed. In the context of this project the example was even starker. All agencies that were approached had details on-hand about their program and spending on

a commitment basis – that is what they planned to do. However, very few had accurate and full information readily available on their actual disbursements.

Increased interest in aid effectiveness has yet to permeate into an increased interest in the detail of where and whether funds were actually spent. In almost all cases, donor agencies reported that the information that was being requested had never been previously asked for. Until the focus on disbursements becomes equal or greater to the interest in commitments, the capacity constraints and challenges discussed below will always mean that little if any quality data is available.

The donor agencies in Afghanistan are staffed by committed, professional officers working in very difficult conditions. They are faced with multiple competing challenges, including a complex security situation, difficult and often unreliable infrastructure, and in many cases weak local counterpart capacity. Further to this, they are under pressure from both their head offices and from key local stakeholders to design and implement programs rapidly to meet the considerable needs of the people and communities in Afghanistan. Their time and capacities are very stretched. Against this background, and given the lack of genuine priority accorded to monitoring disbursements and measuring effectiveness from their head office management, it is not surprising that providing data for this project was a low priority. For projects like this to be successful, following through on the commitments in documents like the Afghanistan Compact must be made a priority by senior officials and Ministers and this must then be communicated to field staff for implementation. Otherwise, the commitments become empty rhetoric.

The final issue that was encountered in meetings with donor officials was a certain degree of reluctance at a political level to making the requested information available. This was the case with several donors and was surprising as PDT staff were working in partnership with the Afghanistan Ministry of Finance. Part of the political resistance can be attributed to the fact that information of this nature has not been routinely provided or requested in the past. A second concern was that the data available may not have been accurate or disclosing this information could have been used to paint a negative picture of the operations of the donor. Finally, some donors expressed concern that providing the requested data would violate confidentiality agreements made with their implementing partners when projects were awarded. Therefore, they were either unwilling to provide data, or if provided, they did not want the information published, or identified as their own. These responses could be seen to run counter to the broader context of commitments made to transparency and accountability.

## **4. Results**

### **4.1 Overview**

The overall results of this research is that around 31% of the ODA provided to Afghanistan impacts the local economy – meaning that it is 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). Funding to Afghanistan provided through trust fund arrangements has a significantly higher impact on the local economy (around 85%) compared to funds provided to international companies or international NGOs (around 15%). Increasing the local impact involves both providing more funds through the channels that have the higher impact (trust funds) and putting in place mechanisms to increase the amount of funds that go to Afghan contractors, or that international contractors spend in Afghanistan.

#### **4.2 Overall ODA provided**

This section presents data based on material provided by donor agencies to the Afghanistan Ministry of Finance and to PDT staff. Table 1 presents the data provided by donors for inclusion in the report to the OECD for the monitoring of aid effectiveness under the Paris Declaration. The first column is the amount that donors reported as having disbursed on ODA eligible activities in Afghanistan in 2005. The second column is the amount of funding for which information was presented in response to the request issued as part of this project for information on disbursements during the Afghan fiscal year of 1384. While there is considerable overlap between the two time periods (1384 runs from 21 March 2005 to 20 March 2006), this cannot fully explain the differences. Rather in many cases these differences highlight shortcomings in data collection and reporting by the individual donor agencies.

**Table 1: Total ODA Disbursements Based on Data Provided by Donors (1384 and 2005)**

<b>Country</b>	<b>2005 spending (\$US)</b>	<b>1384 spending (\$US)</b>
Canada	\$88,460,000	\$100,259,187
Denmark	\$29,350,000	\$24,880,000
EC	\$229,000,000	\$125,090,000
Germany	\$84,760,000	\$84,230,000
India	\$198,000,000	*
Netherlands	*	\$46,520,000
Norway	\$59,413,231	\$50,216,540
Sweden	\$44,000,000	*
UK	\$113,310,787	\$117,453,492
USAID	\$721,100,000	\$812,026,749
<b>Total</b>	<b>\$1,613,914,018</b>	<b>\$1,611,872,659</b>

Source: Data for 2005 from country submissions in response to Paris Declaration survey. Data for 1384 from donor responses to Ministry of Finance/PDT requests. \* reflects data not received from donor, or data not received in a usable form. No data was received from Japan. In constructing meaningful and comparable totals, where data is not available for either 1384 or 2005, the available figure has been used as an estimate (e.g. the estimate for India for 1384 is assumed to be \$198m).

Table 2 breaks the spending down by country into the channels through which it was spent. In this case, the expenditure shares are based on the data reported to the project as this level of disaggregation was not included in the monitoring of the Paris Declaration. The first column shows the monies provided to fund the government either through trust funds (such as the ARTF and the LOTFA) which represent the vast majority of the funds, or in a handful of cases, direct budget support. The second column shows funds provided

by donors to United Nations agencies. The third column is funds contracted to either international companies or international NGOs. The fourth column is funds contracted to local NGOs and businesses. While there is a large difference in the local impact between local and international entities (with local entities contributing a much larger local impact) there is little difference between international NGOs and international companies in terms of their impact. And there is virtually no difference in either their impact or their operations between local NGOs and local businesses.

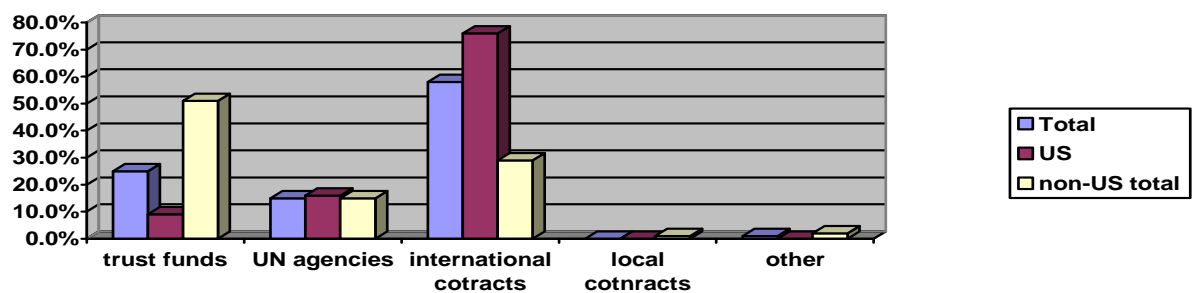
**Table 2: Major Channels of ODA Disbursements by Donor**

Country	Trust Funds	UN agencies	International contracts	Local contracts	Other
Canada	43%	35%	9%	0%	12%
Denmark	38%	26%	36%	0%	0%
EC	68%	16%	13%	2%	0%
Germany	1%	0%	99%	0%	0%
Netherlands	54%	21%	14%	0%	11%
Norway	44%	5%	47%	3%	0%
UK	69%	8%	20%	1%	1%
subtotal	49%	15%	31%	1%	4%
USAID	9%	16%	76%	0%	0%
<b>Total</b>	<b>25%</b>	<b>15%</b>	<b>58%</b>	<b>0%</b>	<b>1%</b>

Source: Donor responses to Ministry of Finance/PDT survey requests. Figures are rounded, so the 0% for local contracts is actually 0.4%.

Below, the results for different funding channels are represented graphically for the international community as a whole. Because of the size of its disbursements, and therefore the scope to skew the findings, the results for the US and also for the international community without the US are also presented.

**Figure 1: Aggregate Donor Spending Organized by Major Funding Channels**



In the case of non-US donors, around half the funds were allocated to multilateral trust funds, 15% to UN agencies and 30% to international contracts. In contrast, the US allocated almost three quarters of its funds to international contractors, 15% to the UN agencies (mainly to UNOPS for a secondary roads program) and just under 10% to trust funds. Of the funding to international companies by the US, around 60% of these funds, or around 45% of total ODA funds to Afghanistan were made in contract awards to five large US contractors.

### 4.3 The Local impact

The local impact of funding for different channels and different types of projects is presented in table 3 below. The major result from this is that funding through multilateral trust funds has a much higher local impact than funding to international contractors. The reason for this disparity is that trust funds are used to pay local wages and fund major programs such as block grants or microfinance, all of which put money in 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. It was not possible to estimate the local impact of funds to UN agencies because they did not provide any detailed information on their operations to project staff. More detail on the estimation process is provided in the following table.

**Table 3: Estimated Local Impact of Donor ODA Spending**

<b>Funding Arrangement</b>	<b>Estimated Local Impact</b>
Trust funds	80%
International contracts	10-15%
Local contracts	35-50%

*Source: PDT staff estimates based on field surveys*

#### *Trust funds*

Contributions provided to trust funds had the highest local impact, primarily because these funds were used to pay local wages, purchase goods from predominantly local businesses and fund programs such as the National Solidarity Program and the microfinance program, which involve cash payments to local communities and individuals. In addition, because they are required to 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 (the largest of the three trust funds) in 1384 is provided in table 4. These disbursements were the basis for the estimate of local impact from trust funds.<sup>89</sup>

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

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<sup>8</sup> The patterns of spending and therefore the local impact would be similar for the Law and Order Trust Fund, but possibly slightly lower for the Counter-Narcotics Trust Fund. However as the CNTF had much smaller disbursements in 1384, the figure for the ARTF outlined above is used in the report.

<sup>9</sup> A second technical issue to consider is that funds that donors report as disbursed to the ARTF in 1384 may be different to the funds disbursed by the ARTF in 1384, as there is a time lag between donor disbursement and disbursement of funds from the ARTF. However, if the spending patterns from the ARTF are broadly similar across years, then the assessment based on 1384 ARTF spending can be applied to donor disbursements in 1384.

being considerable local purchasing, in many cases imported goods were purchased locally, meaning that the local impact was a smaller fraction of the actual purchase price (possibly 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 the project funds, just over \$100m was spent on the National Solidarity Program and the Microfinance Program. The local content of these programs was estimated as being approximately 85% because of the large cash grant component, and because there was considerable local employment associated with the administrative overhead. The remaining projects had a much lower local impact because of the large amount spent on international staff.

**Table 4: Estimate of Local Impact from Afghanistan Reconstruction Trust Fund Activities**

<b>Activity</b>	<b>Amount (\$USm)</b>	<b>Local impact (%)</b>
Wages and salaries	201.5	100%
Operations and maintenance	86.5	35%
Projects	117.6	75%
Monitoring Agent	2.2	0%
<b>Total</b>	<b>407.8</b>	<b>80%</b>

*Source: ARTF quarterly reports and PDT staff estimates*

### *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 impact of these contracts was just below 15%: that is for every \$100 of the contract, just under \$15 is 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. 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 and calibrated against 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 estimated to have around 10-15% local impact. The vast majority of funds are used to pay for international staff and the procurement of international materials – both capital equipment and inputs. Considerable local labour is used by these companies, but with the local wages being much lower than wages paid to international staff, this does not represent a large portion of expenditure. Over time, some goods have become available in-country, but the vast majority of others 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 impact of around 10%. The major expense in these contracts is salaries and allowances paid to international consultants under these contracts – this constitutes around 80-85% of the expenditure under these contracts. The remaining funds are spent on translators and national staff, locally contracted labour, travel (including vehicles), accommodation and food, and general operating expenses. Of this expenditure, 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 impact of around 15%, higher than the technical assistance contracts, and slightly higher than construction contracts. Based on discussions with providers, there was slightly less use made of international staff and more use made of local staff, which increased the local impact. While some equipment was manufactured locally (such as some disposable medical supplies), much of the equipment, such as major medical supplies or vehicles and fuel, still needed to be imported or purchased locally from Afghan import businesses. The final category of international contracts considered was for the supply of specific goods (e.g. fuel or vehicles). In these cases the local impact was negligible as the products were all imported.

### *Local contracts*

Like international contracts, the data on local contracts was not of a high quality. However, building on discussions with local businesses, and again drawing on experiences in other post-conflict countries to calibrate and refine estimates, the local impact of locally procured goods and services contracts was around 35-50%. At the outset 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 were awarded to international firms. The majority of contracts won by Afghan contractors 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 – a large burden with minimal local impact. However, like international contractors, they still faced the local shortage of key construction inputs such as fuel, steel bars and iron sheets. In many cases construction equipment was also imported.

Combining the information on individual contracts with an estimate of the local impact of different types of contracts allows an estimate to be made of the overall local impact of spending by bilateral donors in Afghanistan.

Overall the local impact of the \$1.36b of funds spent by the international donors covered in this study was around 31% or \$424m. In the case of these international donors excluding the United States, the local impact was just under 50% or around \$250m.

## 5. Discussions with Businesses

A total of 20 businesses and organizations were interviewed, representing a broad range of sectors including construction, heavy machinery, printing, IT equipment, furniture, fuel, medical supply and equipment, and telecommunications. Businesses selected for the interviewing process were chosen from the data received from each of the thirteen donor participants<sup>10</sup> and were both Afghan owned and international companies with a local office in Afghanistan. In addition, several large development contractors and one international NGO participated in the interviewing process. The majority of the businesses and firms had been operating in Kabul for at least the last five years.

Most local businesses interviewed had immediate access to documentation representing their operational spending and costs, were extremely hospitable and eagerly participated in the study. These discussions provided the opportunity to access a wealth of knowledge about the inner workings of the marketplace in Afghanistan. In addition to data on the purchase of goods and services, some offered examples of business proposals, readily sharing insight and feedback about the obstacles and challenges faced by local business owners in the current business environment.

Data on the purchase of goods from businesses was completely consistent across firms varying in size and focus. While some goods, such as tiles, bricks, disposable medical supplies, and wiring systems have become available in-country with the increase in demand, the vast majority of other materials such as major medical supplies, paint, ink, paper, fuel, equipment, steel bars, iron sheets, and cement needed for service and project delivery continue to be imported and purchased on the local market or imported directly from countries including Turkmenistan, Russia, Pakistan, Tajikistan, and China.

In terms of the purchase of services needed for business operations, almost all Afghan owned businesses fulfilled all of the various business roles needed to operate their firms with existing full-time staff. There were exceptions such as transportation costs, specialized consultants, and advertising, but again, in most cases, Afghan owned businesses were utilized for these services.

One of the biggest concerns expressed by business owners was working alongside international companies who have significantly larger budgets and more open access to resources. Companies argued that not only did this make it difficult for them to be competitive, it also stunted their ability to grow and gain technical expertise that would improve their practices and ability to deliver services demanded by the international community.

Local businesses reported that the lack of electricity associated with poor infrastructure and a reliance on outdated equipment also greatly decreases productivity and capacity to carry out larger projects. For example, one construction company researched a mixer in Germany that cost \$65k and would greatly increase their efficiency and outputs. The

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<sup>10</sup> Of the 14 donors that were asked to participate in this study only 13 provided data.

machine only required one person to operate, but because the price was unaffordable, they were forced to purchase a mixer for \$3k that requires eight workers to operate.

Several firms, in particular furniture companies, reported struggles associated with the growth of their businesses and have actually seen a major downturn in requests by the international community over the last few years. They stated that there was a spike in orders in 2002/2003, but recently there has been a steady decline with many goods being purchased off-shore that are readily available in-country.

Company owners also shared challenges encountered in the procurement process. Some reported that after losing a contract to another firm during the bidding process that no feedback or explanation was offered despite repeated efforts to obtain this information. Other businesses explained that when they did win contracts, they were often not paid in a timely manner, making it difficult for them to maintain their operations.

Business owners openly identified the need for sharpening and honing their business skills and acumen as a way to increase their competitiveness, expressing a readiness to engage in training, discussions and activities that will facilitate this growth.

Three international organizations including two major development contractors and one large international NGO agreed to be interviewed, though not all of them were able to provide data on the procurement of their goods and services. Feedback from these interviews indicated that where possible, goods and services available on the local market were being procured for projects and operations while initiatives were simultaneously being undertaken to help develop the capacity and expertise of Afghan nationals. In particular, the international NGO reported being able to purchase 75% of its goods locally though much of these goods are not produced in Afghanistan. Items included but were not limited to office supplies, furniture, air conditioners, IT and telecommunications equipment, agricultural equipment, and laboratory supplies. Some shared that while certain goods are available on the local market that these goods often do not comply with international standards and therefore there is a continued reliance upon imports.

## **6. Conclusion and Recommendations**

With successful elections and a newly established government at work, the Afghanistan Compact holds the promise of strengthening and building upon existing infrastructure and capacity that will help move the country closer to independence. However, being able to measure commitments made in the Compact is a critical aspect of its success. Currently there is no mechanism in place for carrying out or monitoring progress on the commitments in the Compact targeted at increasing local procurement. Further, and perhaps more importantly, while donors are contributing significant funds to the recovery and reconstruction effort, little is known about how those monies are ultimately expended since donors are not accountable for funds beyond disbursement to their implementing partners.

The quality of the estimates in this study are intimately linked to the quality of the data that was provided by donor agencies to the Ministry of Finance and the project team. This was a concern that was identified early in the project and the poor quality of some of the data provided is a recurrent theme in this report. That said, where there is concern over the accuracy of the estimates, the next step should be the undertaking of a more comprehensive study by the interested parties. For example, international donors believing the results presented in this study do not reflect the actual local impact of their spending, they should commission research, and provide the data, that would allow a more comprehensive analysis to be undertaken. In this way, the preliminary results can be enhanced and refined.

The conclusions and recommendations in this report are presented in three themes: improved data collection; altering funding channels; and measures to directly enhance local impact.

### **6.1 Improving data collection**

The first step in moving forward to monitor the commitments under the Afghanistan Compact, and enhance the local impact of donor spending in Afghanistan, is to determine the current baseline impact. This was the overall aim of this study, but the conclusions presented in this report should only be seen as preliminary, as the data provided by donors – the critical input into the baseline was only of a sufficient quality to allow for an initial estimate.

To do this, donors need to report regularly and accurately on their actual disbursements in the field – that is, how much money is actually spent, by whom and on what. A template is annexed to this report. This is an urgent issue, as Afghanistan already finds itself in the second year of a five year compact with the international community, without adequate and sufficient information needed to monitor progress.

*Recommendation 1: International donors 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 accurate estimation of the local impact of donor spending to be prepared on an aggregate and donor-by-donor basis.*

*Recommendation 2: UN agencies and major multilateral development partners provide similar information as bilateral donors to the Ministry of Finance on their actual disbursements in a timely fashion.*

One additional benefit of this improved data collection is that it will also raise awareness around the issue of local economic impact, and in this way increase the likelihood that donors will make use of some of the suggestions presented in 6.3 below.



## **6.2 Altering funding channels to increase local impact**

A stark result from this analysis is that the local impact of donor spending is dramatically higher when funds are channelled through trust funds or directly to the government. Providing increased funding via government channels or to the government via trust fund arrangements is also a core benchmark in improving aid effectiveness as outlined in the OECD principles.

*Recommendation 3: International donors look at increasing funding to the government directly or through trust fund arrangements, in order to increase local impact.*

There may be concerns that the outputs and outcomes will not be as effectively or efficiently delivered if international contractors are not used. That is, while enhanced local 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. Hence, there is merit in further study to determine which funding channels deliver the best value for money.

*Recommendation 4: Studies be commissioned to assess the comparative effectiveness of different funding channels in delivery development outcomes.*

## **6.3 Opportunities to increase local procurement**

There is considerable room to increase the local economic impact of aid through increased procurement. During the data collection process, a number of suggestions were made as to how the international community and the Government of Afghanistan could do business differently so as to increase the local impact of ODA spending while still ensuring the best value for money.

- I Implementing procedures and systems through administrative and operational structures will standardize and simplify procurement practices. This could be accomplished through:
  - 1.1 Donors adopting language in their procurement policies (similar to that of the Government of Afghanistan) stating that the local market should be accessed first when acceptable standards and cost equal to or less than other alternatives exists.
  - 1.2 The Government of Afghanistan taking steps (including approving legislation) to strengthen and increase local procurement through its core budget.
  - 1.3 The Government of Afghanistan providing licenses and approval to local manufacturers and suppliers in a timely manner (i.e. Hospitals cannot procure drugs locally if the pharmaceutical factories do not have the

relevant licenses needed from Ministry of Public Health).

- 1.4 Upholding payment terms, which is critical given the widely acknowledged limited access to formal means of financing and the cash constrained operations of Afghan businesses. As such, payment for completion of services should be issued within 30 to 60 days.
- 2 Increasing access to and usage of existing mechanisms that support local procurement will prevent ad hoc projects and improve and streamline these resources. This can be accomplished by:
  - 2.1 Offering or funding third party seminars for the international community that educate them on available services.
- 3 Developing the capacity of the Afghan marketplace will allow more access to goods and services by the international community while saving costs, creating jobs for Afghan nationals, and sustaining local businesses. This can be accomplished by:
  - 3.1 Ensuring that training national staff and businesses is an explicit part of project awards. Training should address the varying stages and responsibilities of a project, beginning at the tendering phase, and could be aligned with sourcing requirements.
  - 3.2 Supporting information campaigns that specify current and upcoming projects and include project details and timelines.
  - 3.3 Always providing feedback to Afghan businesses when they do not win a project they have bid on.
  - 3.4 Without compromising value for money, splitting large scale projects into smaller contracts (i.e. road construction) that otherwise would not be accessible to an Afghan SME.
  - 3.5 The Government of Afghanistan or third parties surveying the international community bi-yearly concerning their experience with local suppliers and making this data available to Afghan businesses through the chambers of commerce and business associations

## ANNEX I: Proposed Template for Donor Procurement Data Submission to Government

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

**Donor** \_\_\_\_\_

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

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

### Summary

Disbursements to:	
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>	
Disbursements to non-ODA eligible activities	
Defence Pacts or similar	
Other	
<b>Sub-Total of non-eligible disbursements</b>	
<b>Total Assistance disbursed</b>	

### Detailed Information

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

## ANNEX II: Paris Declaration Indicators of Progress

### Indicators of Progress To be measured nationally and monitored internationally

OWNERSHIP		TARGET FOR 2010	
1	<i>Partners have operational development strategies</i> — Number of countries with national development strategies (including PRSs) that have clear strategic priorities linked to a medium-term expenditure framework and reflected in annual budgets.	<b>At least 75% of partner countries</b> have operational development strategies.	
ALIGNMENT		TARGETS FOR 2010	
2	<i>Reliable country systems</i> — Number of partner countries that have procurement and public financial management systems that either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.	(a) <b>Public financial management – Half of partner countries</b> move up at least one measure (i.e., 0.5 points) on the PFM/ CPIA (Country Policy and Institutional Assessment) scale of performance.  (b) <b>Procurement – One-third of partner countries</b> move up at least one measure (i.e., from D to C, C to B or B to A) on the four-point scale used to assess performance for this indicator.	
3	<i>Aid flows are aligned on national priorities</i> — Percent of aid flows to the government sector that is reported on partners' national budgets.	<b>Halve the gap</b> — halve the proportion of aid flows to government sector not reported on government's budget(s) (with at least 85% reported on budget).	
4	<i>Strengthen capacity by co-ordinated support</i> — Percent of donor capacity-development support provided through co-ordinated programmes consistent with partners' national development strategies.	<b>50% of technical co-operation flows</b> are implemented through co-ordinated programmes consistent with national development strategies.	
5a	<i>Use of country public financial management systems</i> — Percent of donors and of aid flows that use public financial management systems in partner countries, which either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.	<b>PERCENT OF DONORS</b>	
		Score*      Target	
		5+ <b>All donors</b> use partner countries' PFM systems.	
		3.5 to 4.5 <b>90% of donors</b> use partner countries' PFM systems.	
		<b>PERCENT OF AID FLOWS</b>	
		Score*      Target	
5+ <b>A two-thirds reduction</b> in the % of aid to the public sector not using partner countries' PFM systems.			
3.5 to 4.5 <b>A one-third reduction</b> in the % of aid to the public sector not using partner countries' PFM systems.			
5b	<i>Use of country procurement systems</i> — Percent of donors and of aid flows that use partner country procurement systems which either (a) adhere to broadly accepted good practices or (b) have a reform programme in place to achieve these.	<b>PERCENT OF DONORS</b>	
		Score*      Target	
		A <b>All donors</b> use partner countries' procurement systems.	
		B <b>90% of donors</b> use partner countries' procurement systems.	
		<b>PERCENT OF AID FLOWS</b>	
		Score*      Target	
A <b>A two-thirds reduction</b> in the % of aid to the public sector not using partner countries' procurement systems.			
B <b>A one-third reduction</b> in the % of aid to the public sector not using partner countries' procurement systems.			
6	<i>Strengthen capacity by avoiding parallel implementation structures</i> — Number of parallel project implementation units (PIUs) per country.	<b>Reduce by two-thirds</b> the stock of parallel project implementation units (PIUs).	
7	<i>Aid is more predictable</i> — Percent of aid disbursements released according to agreed schedules in annual or multi-year frameworks.	<b>Halve the gap</b> — halve the proportion of aid not disbursed within the fiscal year for which it was scheduled.	
8	<i>Aid is untied</i> — Percent of bilateral aid that is untied.	<b>Continued progress over time.</b>	

## ANNEX II (continued):

HARMONISATION		TARGETS FOR 2010
9	<i>Use of common arrangements or procedures</i> — Percent of aid provided as programme-based approaches.	<b>66% of aid flows</b> are provided in the context of programme-based approaches.
10	<i>Encourage shared analysis</i> — Percent of (a) field missions and/or (b) country analytic work, including diagnostic reviews that are joint.	<b>(a) 40% of donor missions</b> to the field are joint.
		<b>(b) 66% of country analytic work is joint.</b>
MANAGING FOR RESULTS		TARGET FOR 2010
11	<i>Results-oriented frameworks</i> — Number of countries with transparent and monitorable performance assessment frameworks to assess progress against (a) the national development strategies and (b) sector programmes.	<b>Reduce the gap by one-third</b> — Reduce the proportion of countries without transparent and monitorable performance assessment frameworks by one-third.
MUTUAL ACCOUNTABILITY		TARGET FOR 2010
12	<i>Mutual accountability</i> — Number of partner countries that undertake mutual assessments of progress in implementing agreed commitments on aid effectiveness including those in this Declaration.	<b>All partner countries</b> have mutual assessment reviews in place.

**Important Note:** In accordance with paragraph 9 of the Declaration, the partnership of donors and partner countries hosted by the DAC (Working Party on Aid Effectiveness) comprising OECD/DAC members, partner countries and multilateral institutions, met twice, on 30-31 May 2005 and on 7-8 July 2005 to adopt, and review where appropriate, the targets for the twelve Indicators of Progress. At these meetings an agreement was reached on the targets presented under Section III of the present Declaration. This agreement is subject to reservations by one donor on (a) the methodology for assessing the quality of locally-managed procurement systems (relating to targets 2b and 5b) and (b) the acceptable quality of public financial management reform programmes (relating to target 5a.ii). Further discussions are underway to address these issues. The targets, including the reservation, have been notified to the Chairs of the High-level Plenary Meeting of the 59th General Assembly of the United Nations in a letter of 9 September 2005 by Mr. Richard Manning, Chair of the OECD Development Assistance Committee (DAC).

\* **Note on Indicator 5:** Scores for Indicator 5 are determined by the methodology used to measure quality of procurement and public financial management systems under Indicator 2 above.

## **ANNEX III: Excerpt from the Paris Declaration Monitoring Survey:**

### **Indicator 16: Use of Afghan national implementation partners (Annex II of Compact)**

- What percentage of the subcontracted funds is further subcontracted to the Afghan private, public, and non-profit sectors?

Q<sup>d</sup>23. Total amount subcontracted in 1384 (USD):

Q<sup>d</sup>24. Percentage of total amount subcontracted to the Afghan private, public, and non-profit sectors in 1384:

### **Indicator 17: Use Afghan materials in implementation of projects (development and military operations) (Annex II of Compact)**

- What percentage of goods and supplies procured in Afghanistan?

Q<sup>d</sup>25. Total amount of goods and supplies procured in 1384 (USD):

Q<sup>d</sup>26. Total amount of goods and supplies procured in Afghanistan in 1384 (Afghan materials used in the

production of goods and supplies) (USD):

### **Indicator 18: Promote participation of the Afghan private sector (Annex II of Compact)**

- In your 1384 international bidding processes, what percentage of your bidders are Afghans?

Q<sup>d</sup>27. Total number of bidders:

Q<sup>d</sup>28. Total number of Afghan bidders:

## **ANNEX IV: Annex II from the Afghanistan Compact:**

### **IMPROVING THE EFFECTIVENESS OF AID TO AFGHANISTAN**

The international community has made a significant investment in the future of a democratic state of Afghanistan since December 2001. This Compact is an affirmation of that commitment. The Afghan Government and the international community are further committed to improving the effectiveness of the aid being provided to Afghanistan in accordance with the Paris Declaration on Aid Effectiveness (2005), recognising the special needs of Afghanistan and their implications for donor support.

Consistent with the Paris Declaration and the principles of cooperation of this Compact, the Government and the international community providing assistance to Afghanistan agree that the principles for improving the effectiveness of aid to Afghanistan under this Compact are:

1. Leadership of the Afghan Government in setting its development priorities and strategies and, within them, the support needs of the country and the coordination of donor assistance;
2. Transparency and accountability on the part of both the Government and the donors of the international assistance being provided to Afghanistan.

Under these principles and towards the goal of improving the effectiveness of aid to Afghanistan, the Government will:

- Provide a prioritised and detailed Afghanistan National Development Strategy (ANDS) with indicators for monitoring results, including those for Afghanistan's Millennium Development Goals (MDGs);
- Improve its abilities to generate domestic revenues through, *inter alia*, customs duties and taxes; and to achieve cost recovery from public utilities and transportation;
- Agree with donors, international financial institutions and United Nations agencies on the benchmarks for aid channelled through the Government's core budget and for the utilisation of such aid; and monitor performance against those benchmarks; and
- Provide regular reporting on the use of donor assistance and performance against the benchmarks of this compact to the National Assembly, the donor community through the Afghanistan Development Forum and the public at large.

The donors will:

- Provide assistance within the framework of the Afghanistan National Development Strategy; programmes and projects will be coordinated with Government in order to focus on priorities, eliminate duplication and rationalise donor activities to maximise cost-effectiveness;
- Increasingly provide more predictable and multiyear funding commitments or indications of multiyear support to Afghanistan to enable the Government to plan better the implementation of its National Development Strategy and provide untied aid whenever possible;

## **ANNEX IV (continued):**

- Increase the proportion of donor assistance channelled directly through the core budget, as agreed bilaterally between the Government and each donor, as well as through other more predictable core budget funding modalities in which the Afghan Government participates, such as the Afghanistan Reconstruction Trust Fund (ARTF), the Law and Order Trust Fund for Afghanistan (LOTFA) and the Counter-Narcotics Trust Fund (CNTF);
- Provide assistance for the development of public expenditure management systems that are essential for improving transparency and accountability in the utilisation of donor resources and countering corruption;
- Recognise that, because of the need to build Afghan capacity, donor assistance provided through the external budget will be designed in such a manner as to build this capacity in the Government as well as the private sector and non-profit sector;
- Ensure that development policies, including salary policies, strengthen national institutions that are sustainable in the medium to long term for delivery of programmes by the Government;
- For aid not channelled through the core budget, endeavour to:
  - Harmonise the delivery of technical assistance in line with Government needs to focus on priority areas and reduce duplication and transaction costs;
  - Reduce the external management and overhead costs of projects by promoting the Afghan private sector in their management and delivery;
  - Increasingly use Afghan national implementation partners and equally qualified local and expatriate Afghans;
  - Increase procurement within Afghanistan of supplies for civilian and military activities; and
  - Use Afghan materials in the implementation of projects, in particular for infrastructure;
- Within the principles of international competitive bidding, promote the participation in the bidding process of the Afghan private sector and South-South cooperation in order to overcome capacity constraints and to lower costs of delivery;
- Provide timely, transparent and comprehensive information on foreign aid flows, including levels of pledges, commitments and disbursements in a format that will enable the Afghan Government to plan its own activities and present comprehensive budget reports to the National Assembly; this covers the nature and amount of assistance being provided to Afghanistan through the core and external budgets; and
- For external budget assistance, also report to the Government on: the utilisation of funds; its efficiency, quality and effectiveness; and the results achieved.

These mutual commitments are intended to ensure that the donor assistance being provided to Afghanistan is used efficiently and effectively, that there is increased transparency and accountability, and that both Afghans and the taxpayers in donor countries are receiving value for money.