



SIGAR

Office of the Special Inspector General
for Afghanistan Reconstruction

April 15, 2015

The Honorable Daniel F. Feldman
Special Representative for Afghanistan and Pakistan

The Honorable P. Michael McKinley
U.S. Ambassador to Afghanistan

Dear Ambassadors:

I am writing to request information concerning the \$100 million bailout provided by U.S. taxpayers in response to the Afghan government's request for assistance in addressing its budget shortfall for fiscal year (FY) 1393 (December 21, 2013, to December 20, 2014). The information requested by this letter will assist my office in fulfilling its duty to account for U.S. reconstruction funds spent in Afghanistan.

In September 2014, several media outlets reported that Afghanistan's Ministry of Finance (MOF) had asked international donors for an emergency infusion of \$537 million to cover the Afghan government's budget shortfall. The Afghan government indicated that without these funds it would have to defer bill payments, including civil servants' salaries.¹ In a letter dated September 26, 2014, I asked your offices to provide information on when the State Department became aware of the Afghan government's budget shortfall and what action would be taken.² The department's response, dated October 10, 2014, stated that it had been aware of the shortfall for several months and implied that a formal request had not been received, but gave few details.³

On February 25, 2015, SIGAR was informed by Embassy Kabul that only a week after the State Department's reply to SIGAR, the U.S. and other donors had received a formal request from the MOF for a \$537 million budget bailout and that the State Department had responded by providing \$100 million through the Afghanistan Reconstruction Trust Fund (ARTF).

The MOF was notified in a letter from then-Ambassador Cunningham that the U.S. was providing \$75 million based on actions the newly-elected Afghan government had already taken, mainly the signing of the bilateral security and status of forces agreements, and President Ghani's decision to revisit the Kabul Bank case.⁴

Ambassador Cunningham's letter also indicated that, in order to expedite the "decision process" for disbursement of another \$25 million in bailout funds, he was requesting "appropriate documentation showing how the aforementioned \$75 million in assistance is spent."⁵ In response to this request, the MOF explained that the funds were spent "addressing urgent needs including payment of civil servant salaries and ensure [sic] the continued delivery of key public services like

¹ "Afghan Official Says the Government Has Nearly Run Out of Money, Needs U.S. Bailout," The Washington Post, September 16, 2014; "Cash-Poor Afghanistan Will Delay Paying Civil Servants: Finance Ministry Official," Reuters, September 27, 2014.

² SIGAR, Inquiry Letter: Afghan Budget Bailout, SIGAR-14-101-SP, September 26, 2014.

³ State Department, response to SIGAR inquiry letter SIGAR-14-101-SP, October 10, 2014.

⁴ See Letter from Ambassador James Cunningham to His Excellency Acting Minister of Finance Omar Zakhilwal, October 30, 2014; Letter from Ambassador P. Michael McKinley to His Excellency Acting Minister of Finance Mustafa Mastoor, December 14, 2014.

⁵ Letter from Ambassador James Cunningham to His Excellency Acting Minister of Finance Omar Zakhilwal, October 30, 2014.

education and health.”⁶ Despite this limited explanation, the State Department decided to disburse the \$25 million on the condition that the Afghan government grant U.S. Embassy personnel access to the Afghanistan Financial Management Information System (AFMIS), and upon written confirmation that the Afghan government was taking steps to award a new contract for satellite bandwidth for civil aviation.⁷

We are encouraged by Embassy Kabul’s insistence on gaining access to AFMIS and the willingness of Afghan authorities to grant it.⁸ SIGAR believes AFMIS may give U.S. agencies a more useful view of Afghan government expenditures and help provide advance warning of future budget shortfalls.⁹ However, the U.S. should be prepared to help the Afghan government ensure that the data entered into AFMIS is accurate and verifiable.

Nevertheless, despite this additional funding, Afghanistan’s fiscal problems are unlikely to be resolved in the near future. For example, in Afghan FY 1393, total domestic revenues missed government targets by \$602 million (-35 percent), and decreased by approximately \$187 million from the same period in FY 1392 (-9.9 percent).¹⁰ Unless these trends change, it seems likely that the Afghan government will require continued financial assistance from the United States and other donors for years. In fact, in February 2015, officials from the U.S. Embassy warned me that the shortfall could be as much as \$400 million this year unless the Afghan government’s revenue generation increases significantly.

In light of these concerns, please provide responses to the following questions:

- How did the State Department determine that \$100 million was an appropriate amount to provide in response to the Afghan government’s request for \$537 million?
- What other countries provided FY 1393 budget bailout funds to the Afghan government and in what amounts, as of April 15, 2015?
- If the United States and other donors did not provide the full \$537 million requested by Afghanistan, what were the consequences of the remaining budget gap for the Afghan government?
- Did the United States verify how the \$100 million in U.S. bailout funds was spent? In particular, did the United States verify with the World Bank that the initial disbursement of \$75 million was used to pay civil-servant salaries, and that the subsequent disbursement of \$25 million was spent to meet immediate obligations in Afghanistan’s “ordinary” budget?¹¹
- What does the State Department estimate Afghanistan’s FY 1394 (December 21, 2014, to December 20, 2015) budget shortfall will be and what is the basis for that estimate?

⁶ Letter from His Excellency Acting Minister of Finance Omar Zakhilwal to Ambassador James Cunningham, November 13, 2014.

⁷ Letter from Ambassador P. Michael McKinley to His Excellency Acting Minister of Finance Mustafa Mastoor, December 14, 2014. This letter also requested that the Afghan government provide an accounting of “all U.S. government offices and personnel with AFMIS access.”

⁸ Letter from Ambassador P. Michael McKinley to His Excellency Acting Minister of Finance Mustafa Mastoor, December 14, 2014; Letter from His Excellency Acting Minister of Finance Mustafa Mastoor to Ambassador P. Michael McKinley, December 15, 2014.

⁹ SIGAR, *Quarterly Report to the United States Congress*, October 30, 2014, p. 165 and January 30, 2015, p. 150; SIGAR, Inquiry Letter; Afghan Budget Bailout, SIGAR-14-101-SP, September 26, 2014.

¹⁰ Ministry of Finance, Monthly Fiscal Bulletin, Month 12, 1393, January 26, 2015.

¹¹ Letter from His Excellency Acting Minister of Finance Mustafa Mastoor to Ambassador P. Michael McKinley, December 20, 2014.

Please provide the information requested no later than May 4, 2015. Should you have any questions about this request, please contact me directly, or have your staff contact Jack Mitchell, Director of Special Projects, at [REDACTED] or [REDACTED].

Sincerely,

A handwritten signature in black ink, appearing to read 'John F. Sopko', with a long horizontal flourish extending to the right.

John F. Sopko
Special Inspector General
for Afghanistan Reconstruction

cc: Mr. William Hammink, USAID Mission Director for Afghanistan



United States Department of State

Washington, D.C. 20520

May 4, 2015

John F. Sopko
Special Inspector General for
Afghanistan Reconstruction (SIGAR)
2530 Crystal Drive
Arlington, VA 22202

SUBJECT: SIGAR Letter 14-4-SP to the Department of State (DOS), United States Agency for International Development (USAID) and Department of Defense dated October 10, 2013

Dear Mr. Sopko:

I am writing in response to your April 15 letter requesting information about U.S. funding provided to the World Bank's Afghanistan Reconstruction Trust Fund in late 2014 following Afghan Government requests to address a revenue shortfall at the end of their fiscal year. Please find the information below, including a summary of our strategy to improve Afghanistan's fiscal sustainability, a description of the resources we use to support the Government of Afghanistan's civilian service delivery, and responses to your other specific questions. The Department of State is committed to strong oversight and the effective use of U.S. government funding, and we stand prepared to help SIGAR fulfill its duty to account for U.S. reconstruction funds spent in Afghanistan.

As your office is aware, the Afghan Government relies on foreign financial support to supplement its annual operating budget. The United States, working closely with the Government of Afghanistan and our international partners, has been prioritizing efforts to increase Afghan fiscal sustainability, support increased revenue collection, address corruption, and improve service delivery. The United States has long recognized the link between Afghan stability and the ability of the Afghan Government to sustain its public finances and deliver services. At the same time, we have moved to increase the percentage of our civilian assistance provided to the Afghan government that is linked to specific reforms. This effort was spearheaded by the United States at the 2012 Tokyo Conference, at which we successfully encouraged other donors to join us in implementing similar "incentivized" mechanisms.

As you are further aware, the United States has been providing support to the Afghan Government through the World Bank's Afghanistan Reconstruction Trust Fund (ARTF) since 2002. Funds provided through the ARTF reimburse the Afghan Government for certain, approved non-security expenditures, including the provision of critical health and education services to the Afghan people. Further detail on the extensive oversight and auditing of the ARTF is included below. It is worth noting that a portion of ARTF funding stream is linked to specific reforms and/or revenue targets agreed between the World Bank and the Government of

Afghanistan. The United States has further decided to put funds allocated to the Afghan Government from our own reforms-based “incentive program” through the ARTF.

The prolonged electoral process through the summer and fall of 2014 and a general economic downturn, in part associated with the withdrawal of international troops, led to depressed revenues. At the same time, the previous government chose not to conduct a mid-year budget review that would have identified actual or impending budgetary shortfalls. As a result, the outgoing government continued to spend money at an unsustainable rate, and the Government of National Unity, once inaugurated, inherited an immediate financial crisis with no immediate means to remedy the situation. These unexpected contingencies generated a short-term fiscal challenge that placed the government in a very precarious position of not being able to pay salaries and provide critical government services.

The United States noted depressed Afghan revenues just prior to the first round of Presidential elections on April 5, 2014. We continued to monitor the situation over the summer and into the fall, while insisting that any discussion about remedies be conducted with a government formed as a result of the elections. Following the inauguration of President Ghani, his government requested financial assistance from the United States and other major donors to address the revenue shortfall. As part of that request, the government presented information to clarify the impact of the shortfall on expenditures and the austerity measures the new government is undertaking to mitigate the gap, including freezes on discretionary spending and salary increases among others. I would note that the new government also promised to engage the IMF on macroeconomic reform—a commitment that has resulted in the successful conclusion of a new IMF-Afghan agreement.

The \$100 million disbursement that you refer to in your letter of April 15 was drawn from Fiscal Year 2012 and 2013 funds previously appropriated and notified to Congress as intended for the World Bank’s ARTF. Based on a request from the then-recently inaugurated Government of National Unity, the United States disbursed a total of \$100 million, in two tranches, into the ARTF to help address short-term cash shortages that were disrupting the Government’s ability to pay civilian salary payments and provide certain services.

To reiterate, we did not increase the overall amount of our anticipated contribution to the ARTF, nor did we seek additional appropriated funds from Congress. We did, however, make the decision to disburse these funds, in response to the Government’s request, some months sooner than anticipated, and only after receiving specific assurances regarding expenditure control and other reform efforts. As you will recall, the new Government had also moved quickly to sign the Bilateral Security Agreement (BSA), the NATO Status of Forces Agreement (SOFA), and address issues remaining from the Kabul Bank crisis. At the same time, we encouraged other major donors, in both capitals and in Kabul, to take similar steps to support the Afghan budget in the near term.

I appreciate the opportunity to respond to SIGAR’s questions and continue the many conversations that our offices have had with regard to our contributions to support the Afghan Government through the ARTF. I would note that at the time of these disbursements in late 2014

we also briefed key congressional staff to explain the situation and the actions the Department took to avert a crisis.

Please find detailed answers to the inquiry letter's specific questions below.

1 – How did the State Department determine that \$100 million was an appropriate amount to provide in response to the Afghan government's request for \$537 million?

The Department of State evaluated available evidence about the extent and potential ramifications of the short-term financial gap and decided that it was necessary to support the new Government of National Unity's request for immediate financial assistance. However, we determined that diverting additional resources for this purpose would send an incorrect signal to the new government and might dissuade responsible fiscal policies in the future. Therefore, we chose to accelerate planned contributions to the ARTF. The Department had already notified \$300 million of its FY 2012 funding and \$250 million of its FY 2013 funding for contributions to the ARTF, and we would have disbursed those funds periodically over the course of the 2015 calendar year under normal circumstances. We believed that \$100 million would provide immediate resources for the government to mitigate the worst aspects of the shortfall until a new budget could be passed and revenues could recover. We further decided that limiting such assistance to what we had previously agreed with the government would allow us to intervene without undermining our development priorities or exceeding our congressionally-notified commitments.

It is important to note that the Department made the decision to accelerate funding with a clear understanding of the potential consequences; more ARTF funding via the ad hoc component of the Recurrent Cost Window up-front would mean less ARTF funding at the end of the year as our general contribution. Ad hoc contributions reimburse the Afghan Government's salaries and certain prescribed operational expenses, while general contributions to ARTF are used to support development projects and other Afghan government priorities under the ARTF financing strategy that is approved by the ARTF's donor board and implemented by the World Bank. The Department made clear to the new Afghan Government that accelerated disbursements would preclude significant support at the end of Afghanistan's coming fiscal year. Both President Ghani and CEO Abdullah assured the Department that they would manage the budget and implement reforms in a way that would minimize chances for a repeat of the shortfall experienced last year. These measures include plans to take to improve revenue mobilization—such as implementing new taxes and fees and replacing corrupt or unqualified officials—passing a budget based on realistic revenue targets, and curtailing discretionary development projects in the FY 1394 budget.

2 – What other countries provide FY 1393 budget bailout funds to the Afghan government and in what amounts, as of April 15, 2015?

The United States could not reasonably consider or be expected to cover the entirety of the new government's short-term fiscal gap. We encouraged other donors to join the United States in trying to minimize the negative effects of the Afghan government's fiscal situation.

Donors that chose to specifically target assistance in response to the government's request for help include:

Japan	\$70 million
Australia	\$17.2 million
UK	\$26 million
Canada	\$8.2 million
Total	\$121.4 million

3 – If the United States and other donors did not provide the full \$537 million requested by Afghanistan, what were the consequences of the remaining budget gap for the Afghan government?

Based on accelerated financial support from donors and higher than expected budget revenues in the last month of 2014, the Government of National Unity was able to continue paying salaries and operating costs. The international community, however, was unable to fill in the entire \$537 gap. As a result, the government had to incorporate approximately \$200 million in arrears into its FY 1394 budget. These arrears include payments for certain operating costs in budget codes 21, 22, 24, and 25 (\$50-\$80 million) and payments for discretionary development projects (\$125 million).

4 – Did the United States verify how the \$100 million in U.S. bailout funds was spent? In particular, did the United States verify with the World Bank the initial disbursement of \$75 million was used to pay civil-servant salaries, and that the subsequent disbursement of \$25 million was spent to meet immediate obligations in Afghanistan's "ordinary budget?"

As underscored in the inquiry letter, the United States accelerated disbursement of \$100 million in planned contributions to the ARTF. The ARTF provides a useful tool for providing on-budget funding to the government of Afghanistan, because ARTF funds are ring-fenced in Afghanistan's accounting system (AFMIS) and traceable to specific uses—the ARTF Recurrent Cost Window can only be used for government salaries and wages of non-uniformed civil servants and the Government's operating and maintenance (O&M) expenditures outside of the security sector. Moreover, the Afghan government has to submit expenditure records for those salary and O&M costs before the ARTF disburses funds. We can see, therefore, that ARTF disbursements were used for the government's intended purpose of paying salaries and other immediate operating expenses.

5 – What does the State Department estimate Afghanistan's FY 1394 (December 21, 2014, to December 20, 2015) budget shortfall will be and what is the basis for that estimate?

The Afghan Government could face a negative cash balance before the end of the fiscal year, if it accrues cumulative monthly deficits. While the Department recognizes this potential, we cannot accurately predict the extent of any potential shortfall, let alone a balanced budget or potential surplus cash position. The government's financial health over the coming eight months will be contingent upon the efficacy of revenue generating reforms, overall revenue generation from the enforcement of existing revenue measures, budget execution, the results of a mid-year

budget review, the government's success qualifying for additional donor funds, and even weather patterns, which influence the agricultural harvest. Amidst so many different variables, any estimate of the government's final cash position is largely speculative. The new government has, however, committed to economic self-reliance, and we remain hopeful that it will uphold that commitment in the form of sound budget execution and additional reforms to mobilize revenue.

Sincerely,

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Jonathan Carpenter
Deputy Special Representative
for Afghanistan and Pakistan



United States Department of State

Washington, D.C. 20520

May 4, 2015

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Jonathan Carpenter
Deputy Special Representative
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