

## Post-Conflict Security Sector and Public Finance Management: Lessons from Afghanistan

*In recent years, international organizations like OECD and the World Bank have concluded that standard principles of Public Finance Management (PFM) are equally applicable to all areas of the national budget, including the security sector. To date however, very few reviews of PFM systems have included the security sector, not least because many governments tend to be overly protective about scrutiny of public finances in this sector, and as a result most donors have been reluctant to engage. As a result, the bulk of public expenditure reviews have focused on non-security components of the national budget, which represent an important but incomplete slice of national spending. Despite growing awareness of the importance of extending PFM reviews to the security sector, so far the challenge of moving beyond basic principles toward the adoption of a more comprehensive approach to building an effective and fiscally sustainable post-conflict security sector remains elusive. In countries such as Afghanistan, Iraq and Sierra Leone, national authorities and donors are struggling to regain control of unaffordable levels of security sector spending, much of it financed directly by donors. In many cases long-term external assistance may be required for the security sector, generating severe trade-offs with other priority sectors which also require long-term external support. Overcoming the legacy of a fiscally unsustainable and poorly managed security sector calls for full application of PFM principles to support the establishment of checks and balances required to establish a wholly accountable security sector. The recent World Bank PFM review of Afghanistan, perhaps the first example of such a review, provides a number of lessons, summarized in this note.*

### SECURITY, PUBLIC FINANCE AND DEVELOPMENT

#### The importance of security for development

*Security in post-conflict situations is a key condition for a return to political normalcy and conversely, development is also needed for security.* Protracted conflict has a devastating impact on the delivery of basic services, encourages illegal and illicit activities, undermines the evolution of an accountable and transparent government, and discourages private investment inhibiting growth and further limiting revenue generation opportunities. Ongoing conflict undermines the state and diminishes public confidence in its institutions. Both human and social capital are—for generations—irreversibly damaged.

*Donors and the security sector.* Traditionally, donors have ignored the security sector, in favor of sectors such as education, health, and infrastructure. However, in most post-conflict countries security sector spending (armed forces, police and judicial services) often dominates both the operational and capital budget of government. Governments generally steer donors away from comprehensive scrutiny of the security sector, on the grounds that it is a national security matter, although the provision of bilateral military training and equipment is deemed acceptable.

#### Public finance principles

*Sound public financial management (PFM) promotes accountability and efficiency in management*

*of public resources—both critical to the achievement of public policy objectives and the establishment of a legitimate state. Critical dimensions of a PFM effort include: policy-based budgeting; predictability and control in budget execution; accounting, recording and reporting; and external scrutiny and audit. These are all important parts of the budget cycle. Key cross-cutting features include comprehensiveness, transparency and ‘out-turns’ of the PFM system, namely the credibility of the budget itself.*

*Comprehensiveness and discipline are key to PFM.* The annual budget process is the main mechanism available to discipline government decision-making. The budget should encompass all government fiscal operations—as all policy decisions which have financial implications have to be considered against hard budget constraints and prioritized against competing demands. Comprehensiveness requires a holistic approach to the national budget, understanding all policy and institutional impediments to improved performance. It requires the entire state and its institutions, to undergo a process of strategic policy making, planning, prioritization of resource allocation, and the correction of any gross imbalances in spending. It also requires knowledge and monitoring of all expenditures financed by external assistance.

#### Security as a public good

*The standard service delivery framework, as applied to traditional sectors, remains relevant to the security*

sector. Security, like education and health, is an essential public good. The same basic principles of public finance management and the basic tenets of public administration and civil service reform are therefore equally applicable. While there are certain unique aspects of the security sector (e.g., the costs of such services may change within a budget year depending on the nature of the threat, measuring and monitoring performance is complex, and the intelligence aspect of security often limits disclosure) the fundamental principles of good governance—in particular those focused on institutions, incentives, and accountability—are wholly pertinent to this sector.

*Cordonning off the security sector in terms of PFM often results in a national budget that is neither comprehensive nor realistic*, particularly where the security sector budget dominates public spending. Consequently, it undermines: (i) the credibility of the entire budget; (ii) the forecasting of budgetary aggregates and overall fiscal discipline; (iii) the strategic allocation of resources across the whole of the fiscal envelope; (iv) the efficient utilization of resources; and (v) the overall control framework and the application of fiduciary standards. The absence of these conditions undermines the development process and limits progress toward good governance.

## **AFGHANISTAN: SECURITY SECTOR REFORM—A NATIONAL PRIORITY**

### **Security and the rule of law—priorities for the Government**

*Security—a Millennium Development Goal for Afghanistan.* Twenty three years of conflict, including occupation and other external interventions as well as internecine fighting, led to the political fragmentation of the state and almost total collapse of public security and law-and-order institutions. Following the removal of the Taliban from power in November 2001, (re)establishing effective, efficient and accountable security sector institutions was perceived as both a national and international imperative.

#### **Afghanistan's main security institutions include:**

- Security management and oversight bodies such as the National Security Council, the Ministries of Defense, Interior, Counter-narcotics, Border and Tribal Affairs, Justice, Finance and the Auditor General's Office.
- Security services such as the Afghan National Army (ANA), the Police, Border Guards, Counter-Narcotic Forces, Security apparatus and Customs.
- Justice and legal institutions such as the Judiciary, Attorney General's Office, prosecutorial offices and non-statutory bodies (e.g., private bodyguards, militia and armed factional groups).

As a result, the Government decided to make security its 9th Millennium Development Goal, and

has integrated security and rule-of-law issues in its development strategy.

### **International support to Afghanistan's security sector—long-term implications**

*Resource allocation to the security sector has been conducted in isolation from the overall national budget.* In meeting short-term security and stability objectives, the international community, not government, determined the staffing establishments, pay and grading structure of the security sector. This was done in isolation from overall fiscal constraints and other sectoral needs, and has heavily undermined the government's ability to finance such costs through state revenues over the longer term. Consequently, the recurrent costs alone of the security sector will dominate government spending for many years to come, impacting negatively on other critical services.

*High-level external support to the security sector has been 'fragmented' and 'projectized.'* In the absence of a multi-annual agreement with the international community, external support for national security and law and order continues to be based on an annual project commitment basis.

*Security sector budget allocations despite weak fiduciary capacity.* Given the weak fiduciary capacities in all security sector ministries, reconstituting an accountable PFM system, in line with international best practice, is considered an important aspect in the establishment of a sustainable security structure by key national actors and the international community.

## **THE WORLD BANK AND SECURITY SECTOR REFORM IN AFGHANISTAN**

### **How the World Bank engaged in Afghanistan**

*Specific request from the Ministry of Finance.* Given the significance of security sector spending, the Afghan Ministry of Finance requested the Bank to include the security sector in the Public Finance Management Review. The review was undertaken jointly with DFID. While most skills required for the review of PFM in the security sector were available in the Bank, some aspects (e.g., planning or monitoring in the security sector) required skills unavailable in the Bank and were provided by a specialized consultant.

*Comparative advantage of the World Bank.* The Bank has substantial technical expertise in both PFM and public-sector reform. Support in these areas is both within the Bank's mandate and its core functions—poverty reduction through strengthening governance and reforming public institutions.

*Gradually built credibility and relationships.* The Bank had already established credibility working with Afghan counterparts on counter-narcotics issues. The Bank team was as concerned as government about the long-term fiscal sustainability of the security sector. Through the review, it engaged with Afghan security

agencies by providing information on the affordability of security sector policies and expenditures, both in the short run (annual budget) and the longer term. It demonstrated the process used to develop realistic budgets and the benefit of strengthening PFM capacity in security agencies. The Bank coordinated donor and government briefings, facilitated dialogue, and gradually built trust with key security agencies. It provided support in incorporating the security sector in the overall annual budget formulation process; subjecting it to aggregate fiscal constraints and sector ceilings like any other sector; and fully incorporating medium-term fiscal projections and planning.

#### **The Afghanistan PFM review objectives**

*Gain as complete an understanding as possible of security sector expenditures.* In its strategy documents the Government divided budgetary expenditures along four pillars: human capital development, physical infrastructure, general administration, and security. Security is considerably smaller than human development in the Core Budget, but twice as large in the External Budget. The ANA itself was the largest single sector in terms of expenditures in 2004/05.

*Assess strategic coherence, consistency, and fiscal sustainability of security sector expenditures.* The initial security sector reform plans were problematic. Overall public expenditures have been extraordinarily high (equivalent to 57% of 2004/05 GDP) as a result of extremely high development spending. The security sector accounted for 39% of total spending in 2004/05.

*Review PFM processes in the security sector and assess extent to which sound PFM principles are followed.* With the recognition that security and fiscal issues are closely linked, the team provided advice on developing an overall ‘resource envelope’ for the national budget based on strategic priorities identified by the Afghan counterparts. Key PFM principles like comprehensiveness and transparency were applied.

#### **Accomplishments so far:**

- Injected fiscal and PFM aspects which were missing in the security sector debate.
- Brought much needed attention to fiscal sustainability issue.
- The Bank increasingly was perceived to be providing intellectual leadership on the nexus of security, development and public finance.

*Analyze the institutional framework for the security sector and assess its capacity to apply sound PFM principles.* Resources appropriated for the security sector need to be used efficiently and effectively, which implies full application of PFM instruments and processes in budget execution—thus the team assessed the control framework, information flows, procurement, and monitoring and evaluation systems

in the security sector, and provided PFM capacity-building assistance to the security agencies.

#### **Key challenges and recommendations**

*The need for a holistic and integrated security sector strategy and policy framework.* In the absence of such a framework, sound programmatic public expenditure decisions (e.g., on force sizes, equipment) cannot be made.

*Unsustainably high donor-executed spending through the external budget.* High levels of spending outside the appropriated budget undermines coherence of spending across and within security sub-sectors, and has implications for fiscal sustainability over the medium term when donor funding declines.

*Difficulties in coordinating and prioritizing security expenditures and actions.* Fragmented decision-making across donors undermined coherence, making it more difficult for the National Security Council to fully implement its mandate in terms of strategy development, leadership and coordination functions.

*Concerns about the fiscal sustainability of security sector staffing levels.* Early in the process, the salary structure of the national army was determined without reference to fiscal constraints or pay elsewhere in the civil service. This has set a precedent which the police and other sectors aspire to—an expectation that will be fiscally costly. In 2005/06 security spending was roughly five times domestic revenues.

*Imbalance in development of the ANA and other security institutions.* Slow implementation of priority public administration reforms and capacity building in security management and oversight institutions, and lack of progress in some security sub-sectors (e.g., justice and police), carry risks for the future.

*The need to develop good governance and sound and sustainable financial management practices in the security sector.* Substantial capacity-building to implement sound PFM principles in the security sector is still needed.

#### **LESSONS FROM THE POST-CONFLICT SETTING: GETTING THE FUTURE RIGHT**

*PFM practices can take into consideration the most complex and confidential issues without undermining the application of the fundamental principles of accountability to elected civil authorities.* Encouraging public finance, public administration and civil service reform experts to support the security sector more explicitly is vital if both post-conflict governments and the international community are to work toward developing reform programs that support development in a sustainable way.

*Security remains a critical concern in many country contexts.* In many post-conflict situations external actors risk leaving an unbearable fiscal burden on the government, while crowding out spending on other

essential public goods. The weak application of PFM principles undermines national security directly and harms development.

*There is no justification for treating the security sector as separate or sacrosanct, and not subjecting it to budgetary and fiduciary processes.* The Afghanistan PFM Review suggests that donors can contribute to improving public finance management in the security sector by: (i) supporting development of an agreed national security strategy and corresponding strategies and policies for the individual sub-sectors (defense, police, justice, etc.); (ii) costing requirements in light of fiscal constraints; (iii) helping enhance the capacity of oversight actors (e.g., Auditor General, legislature) and economic managers (e.g., Ministry of Finance Budget Office) to address issues relating to financial management in the security sector; (iv) channeling more of their assistance to the security sector through the Core Budget; (v) for resources not channeled through the Core Budget, ensuring that timely and accurate information is made available to the budget authorities, and maximizing use of internationally acceptable procedures (e.g., procurement); (vi) helping key security ministries strengthen their budget formulation and budget execution processes; and (vii) discussing medium- and longer-term availability of external resources for the security sector. Donors need to advocate the adoption of standard PFM principles, and reaffirm the budget as the core tool of government policy.

*There is strong justification for analytical work in the security sector from development and PFM perspectives.* The experience in Afghanistan highlights that a security sector PFM Review can be effectively conducted, using existing PFM methodologies and without interfering with issues of national security.

*Reviewing security reform through a PFM lens reduces risks and costs to both the country concerned and donors.* In the mutual interests of all parties (government and donors), the application of sound PFM principles in a post conflict setting at the earliest stage of reconstruction is essential to lessen the long-term burden of ill-informed fiscal decisions both on government, and on citizens. In addition, poor fiscal decisions on the part of donors and weak PFM planning will inevitably increase the burden on donors by raising costs and lengthening the period during which the security sector will require external support.

*Effective donor coordination and partnerships are essential.* While donor coordination and the development of effective partnerships are important in any sector, the Afghanistan PFM Review makes the case that this is even more important in the security sector. As the Afghanistan case shows, the Bank has

the mandate to approach the security sector through PFM, but donor coordination and partnerships are important to complement traditional fiscal approaches with broader security perspectives and, where appropriate provide additional skills that may not be readily available within Bank teams.

#### **Guidelines for future PFM reviews of the security sector**

Possible objectives for future reviews of security sector expenditures, from both a PFM and development perspective, could include the following key issues:

- Gain as complete an understanding as possible of the current level and structure of security expenditures, recent trends, and likely future expenditure requirements based on current plans;
- Assess the extent to which coherent strategies, for the security sector and the major parts of the security sector, guide public expenditure allocations;
- Review processes for determining funding levels, expenditure allocations, budget execution, and post-execution functions, and assess the extent to which they follow sound PFM principles;
- Describe the institutional framework for the security sector and ascertain the extent to which it embeds or is conducive to sound public financial management; and,
- Assess the fiscal sustainability of security sector expenditures.

Entry points for dialogue:

- The traditional fiscal perspective that applies to non-conflict countries also applies to countries emerging from conflict. While national stakeholders must guide any reform of the security sector, donors can provide technical, financial and material support;
- Donors need to encourage governments to adopt a broader perspective when conducting a PFM review, to include budget planning, execution process, transparency, and procurement issues for all key security agencies;
- The Ministry of Finance is usually a key entry point, but an explicit request to review the sector is a pre-requisite;
- Informing donors of the approach adopted in Afghanistan may be useful, especially for cases where substantial external funding of the security sector is part of post-conflict reconstruction. Conversely, large external funding also means that donors have some interest in understanding the sustainability of their funding.
- The benefits of working in partnership ensure that the country can make full use of specialized skills brought in by the international community to work toward sound fiscal health, stability and economic development.

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