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PUBLIC FINANCIAL MANAGEMENT REFORM FOR PEACEBUILDING AND SUSTAINABLE DEVELOPMENT

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INTRODUCTION

Public Financial Management (PFM) reform enables better service delivery and macroeconomic stability. It has emerged in the development practices of key areas, including, but not limited to, policies and laws governing public resource management. PFM reform promotes decision-making practices and solvency in the public sector. Sustainable peace requires an effective state, robust economy, and professional public financial management systems. Ultimately, the implementation of a peace agreement, reintegration, and demobilization rest on proper public financial management. Post-war countries stand on critical lines. Some of the stakeholders involved in the deals are enthusiastic about the peace and reintegration process, while others are lukewarm and are still prepared to resume violent conflicts. This situation requires attention and commitment to enhance public well-being, living standards and provide better services. As a legitimacy tool, public finance can encourage concessions for peace and discourage intentions to return to the battleground.

Afghanistan has achieved considerable advancement in PFM reform. The practices and procedural improvements of the reform are eye-catching. However, those improvements have not contributed to the public's well-being and the delivery of quality service. Continuing violence, political instability, and high levels of corruption are often listed as the main obstacles. On-going peace efforts are expected to put an end to the long-lasting war. Subsequently, improvement in public financial management is required to fight against corruption and increase the delivery of quality service. At the same time, the peace agreement may result in changes or restructuring of the current government. Whatever the changes might be, reform requires sound and proper public financial management to sustain peace and development.

This paper aims to provide policy recommendations for enhancements of the Afghanistan PFM system. The new system should contribute to the sustainable peacebuilding process and economic growth. This paper is structured into two main sections. Following this introduction, the upcoming section draws on the importance of PFM reform in peacebuilding. It shows how reform can enable the government to have a monopoly over the means of violence to establish law and order. It elaborates on PFM reform's role on state legitimacy and the assurance of sustainable funding for service delivery. This section shows how PFM reform can play a significant role in creating jobs for ex-combatants and civilians in Afghanistan. Finally, the paper ends with a series of recommendations on how the PFM should be reformed to manage the financial resources to contribute to the peacebuilding process.

THE IMPORTANCE OF PUBLIC FINANCIAL MANAGEMENT IN PEACEBUILDING

Control and monopoly over the means of violence are essential for the emergence of the rule of law in the modern state.¹ Maintaining such a position requires fiscal sustainability.

1 North DC, Wallis JJ, Weingast BR. Violence and the rise of open-access orders. *J Democracy*. 2009;20(1):55-68.

Proper financial management is needed to mobilize enough resources for the security sector to establish law and order. In the post-war era, citizens expect security services to prevent renewed clashes. Historically, ethnic conflict and tension between the center and periphery have caused conflict consistently in Afghanistan.² The Soviet occupation, civil war, and war with the Taliban and Al-Qaeda have considerably impacted civilians and destroyed the nation's infrastructure. After a peace agreement, it would be crucial to prevent occurrences of such violence. Failure to do so would negatively impact the peace process and raise the question and danger of another failed state and failed peace agreement.

Regrettably, Afghanistan suffers from multidimensional security threats. These include, but not limited to, border protection and protecting natural resources. Further, control over border and customs outposts in Afghanistan is more of a security issue than a fiscal problem. Neighboring countries support extremists at the border and use them to implement their political agenda. For instance, insurgents on both sides of the Afghanistan-Pakistan border reap profits from cross-border trafficking and illegal excavations.³ Similarly, Taliban and insurgents earn between \$18.5 - \$21.9 million annually from the mining and transporting of marble.⁴ As in other cases, such as logging in Cambodia and diamond-mining in West Africa, Afghanistan's minerals are among extremists' leading income sources.

Fiscal capacity is required for building legitimate states. Democratic elections give the public a choice about how they want to be governed. States that emerge from public choice are legitimate in terms of democratic principles. The electoral process and transferring power from the post-war government require financial resources. In addition to the political spectrum, legitimacy rests on the government's service delivery ability. Enhancing living standards and improving social conditions make the state legitimate; however, the public will appreciate it only if they benefit from those improvements.⁵ Responding to public needs requires the capacity to manage financial resources efficiently and making public spending a tool of legitimacy for service delivery. These are essential steps for sustaining peace, economic growth, and state legitimacy.

PFM reform is required to assure sustainable funding for service delivery and reintegration programs. More importantly, to satisfy the condition for being called a state, a country must collect at least that much revenue to be sufficient for its recurrent expenditure.⁶ Transparency and accountability in revenue collection is the main challenge of financial sustainability. The willingness to pay taxes will increase after the establishment of transparent revenue collection systems. In the early stages of the peace process, Afghanistan may receive a

2 Wafayezada MQ. Ethnic Politics and Peacebuilding in Afghanistan The Root Causes of Political Conflicts and the Problems of Democratic Transition. Scholar's Press; 2013.

3 Dupee M. Afghanistan's conflict minerals: The crime-state-insurgent nexus. *Combating Terrorism Center West Point*. 2012;5(2):11-14.

4 Hughes S, Meleagrou-Hitchens A. The Virtual Entrepreneurs of the Islamic State. *Combating Terrorism Center West Point, CTC Sentinel*. 2017;10(3):1-7.

5 Gilley B. The determinants of state legitimacy: Results for 72 countries. *Int Polit Sci Rev*. 2006;27(1):47-71.

6 Ghani A, Lockhart C, Nehan N, Massoud B. The budget as the linchpin of the State: Lessons from Afghanistan. *Peace and the Public Purse*. Published online 2007:153-183.

large influx of external funds that can finance some of its immediate needs. However, in the long-run, the fund inflow will diminish. Afghans need to be prepared and plan for their revenue stream's sustainability to keep the government and its development program running. Without a proper public financial management system, it would be challenging to assure this sustainability. Worst of all, if the government cannot sustain funding and keep its institutions running, the fear of collapse will rise, and the peace process will no longer be sustainable.

Similarly, PFM reform can enhance the peace process by creating jobs. As part of financial management, spending should be followed by transparent and accountable procurement services to create jobs and support local businesses. In postwar countries, where local governments do not have enough financial capability, donor projects fund some of the government's activities. However, in most cases, donors bypass the government and channel their funds through NGOs and private partners. The private implementing partners buy products from international markets, which does not support job creation in the local market. Donors and their private contractors may argue that this approach is taken because of the local market's low quality and delivery speed. However, this is not always the case. An example against this biased perception is the purchase of school supplies in East Timor; during the transitional administration, World Bank hired a private company to buy a quarter of a million desks and chairs. The local official suggested that those supplies be from the local market because the purchase would create jobs and support local businesses. However, transitional officials led by the UN and funded by the World Bank rejected the idea based on the argument that local suppliers may not be able to deliver the product as quickly as the external supplier.⁷ School supply is vital, but it is not time-sensitive. It is not a case of life or death to rush the product delivery. This sort of biased argument could emerge in the absence of a sound public financial management system. Understanding the sensitivity and balancing between the time-sensitivity of services and local needs could create jobs and contribute to the peace process.

Another vital aspect of PFM reform in the peace process is coordination between the stockholders. Development initiatives are efficient when donors work with the government. An example of this could be the Afghanistan Reconstruction Trust Fund (ARTF).⁸ The World Bank set-up a joint account through which donors contributed to the government budget. The government spent the funds, and the spending is being verified by a third-party controller appointed by the World Bank. Though there are questions about the control mechanism and spending method, it could have been done more efficiently to achieve better results. However, it is much better than the other donor funding projects' mechanisms. Channeling aid through governments is efficient when there are control mechanisms, and the system can be established by reforming the financial sector.

7 Pires E, Francino M. National ownership and international trusteeship: The case of Timor-Leste. *Peace and the Public Purse*. Published online 2007:119-152.

8 Afghanistan Reconstruction Trust Funds (ARTF) is an account administrated by the World Bank. Through this account, donor funds the government's recurrent budget. Government spending are verified by an external monitoring agent appointed by the world bank.

PFM reform contributes to the peace process by reducing the cost-of-service delivery. Experience shows that relying on donors and their private contractors, even for the short term, creates long-term dependency.⁹ For example, in Cambodia, when after two decades, the United Nation's transitional government transformed power to the new government, the spending on technical assistance remained up to three times more than government civil servants' total wages.¹⁰ This could have been more efficient if donors had channeled their funds through the government and had built a capable public financial system.

PFM reform can contribute to the peace process by managing realistic expectations. At the beginning of the peace process, the donor might provide incentives and motivational packages to promote service delivery. However, those packages can create unrealistic expectations if not channeled through public financial systems. For instance, donors provided supplemental salaries to civil servants in Cambodia to participate in workshops. The daily rates of this incentive exceeded the regular monthly salary.¹¹ Though it seems motivational initially, it created the wrong implications in the long run; civil servants were willing to work in the government in search of external incentives. The primary goal of being a public servant was the prospect of having access to an external salary supplement.¹² Those unrealistic expectations can harm the civil servant's productivity and increase public resource misuse.

PFM reform will sustain peace only if the development initiatives are designed with consideration of the local context. Donor projects and technical assistance without consideration of local implications will not produce the expected results. For instance, digitalization has increased efficiency in the government,¹³ but not always in aid projects. For example, after the fall of the Taliban, donors provided technical assistance to computerize the finance ministry's information system. However, it did not produce the expected results as it was unsuitable in terms of complexity and language.¹⁴ It would have been much more efficient if the technical support was provided with the consideration of the local context.

STEPS FORWARD

This section lays out the main policy recommendations. The recommendations are framed in three main subsections: the policy level, resource mobilization, and efficient use of public financial resources.

9 Khieng S, Dahles H. Resource dependence and effects of funding diversification strategies among NGOs in Cambodia. *International Journal of Voluntary and Nonprofit Organizations*. 2015;26(4):14-12-14-37.

10 Smoke P, Taliencio R. Aid, Public Finance and Accountability: Cambodian Dilemmas. *Peace and the Public Purse: Economic Policies for Postwar State building*. Lynne Rienner Publishers; 2007.

11 Moss TJ, Petterson G, Glander G, Van de Walle N. An aid-institutions paradox? A review essay on aid dependency and state building in sub-Saharan Africa. *Cent Glob Dev Work Pap*. 2006;(74):5-11.

12 Becksford M, Sokha L, Roy R, Sisovanna S, Namazie C. The Macroeconomics of Poverty Reduction: The Case Study of Cambodia. New York UNDP. Published online 2003.

13 Corydon B, Ganesan V, Lundqvist M. Digital by default: A guide to transforming government. New York McKinsey Co. Published online 2016.

14 Ghani A, Lockhart C, Nehan N, Massoud B. The budget as the linchpin of the State: Lessons from Afghanistan. *Peace and the Public Purse*. Published online 2007:153-183.

Inclusive Policy

PFM is an intrinsically political and social process and is part of the overall governance policies. In light of comprehensive governance policies, Afghanistan needs to adjust public financial management to decrease violence and social resistance. The country needs to have an inclusive conflict impact assessment. The main focus should be reducing social tension and negative externalities in the short term and sustainability of peace and economic growth in the long term. In broad terms, the policy should encompass the baseline for economic development and sustainable peace.

- Balance economic and peacebuilding objectives. The overall monetary policy for the postwar period should be more cautious and realistic. Policy developers need to understand the importance of sequential macroeconomic goals such as price stability and the peacebuilding goal of political stability. Though controlling the gap between expenditures and revenue is necessary, the urgent needs for peacebuilding are crucial for its overall strength. In the short run, the price stability target could increase political stability. Spending more on reintegration projects and infrastructure could ease social tensions, while the inability to respond to the public demand for service delivery will fuel social anxiety. However, in the long-run, the policy should shift because neglecting economic stability may lead to high inflation, which could harm the economy and exacerbate social tensions.
- Involve communities in public financial management. In post-war countries, the government and the public are divided. It takes time to restore trust. The public should be involved in the decision-making process. Long-lasting war has splintered the peaceful relationships between the citizen and the government, and in some cases, between villages, clans, and members of ethnic groups.¹⁵ Local disputes have the potential to turn violent and expand the scope of conflicts. These all need constructive mechanisms and a local healing methodology to resolve the tension and open a window for brotherhood and social acceptance to flourish. On the other hand, experiences show that development initiatives through community-based approaches are more successful in Afghanistan. The National Solidarity Program (NSP) is a good example. The NSP program aligned development projects with the community's needs and achieved much better results than the other donor-funded project.¹⁶ Financial planning and development initiatives should be initiated from the village to the district, the province, and ultimately land to the line ministries. From one side, this model will increase public participation in the national process; and from the other side, it will ease tensions and contribute to peacebuilding. More importantly, this approach better aligns development initiatives with the public's needs. Similarly, the community

15 Waldman M. Community Peacebuilding in Afghanistan. Oxfam Int. 2008;29.

16 Beath A, Christia F, Enikolopov R. The National Solidarity Programme: Assessing the Effects of Community-Driven Development in Afghanistan. *Int Peacekeeping*. 2015;22(4):302-320. doi:10.1080/13533312.2015.1059287

should be the main oversight body for the governance practices and implementation of development projects. Involving communities in the national process creates a sense of ownership among the public and further builds the relationship between the public and the government.

- Establish oversight control and audit authority. In the post-war era, the need for robust oversight and control is more evident than at any other time. It is needed mainly for three reasons. First, it is required because of the lack of trust and negativity between the public and the government. Those who were involved in the war are pessimistic about the government's performance. To respond to that negativity, the government should involve the public, civil society, and academic entities in overseeing their activity. Second, it is needed to fight against corruption. Afghanistan is one of the most corrupt countries. It requires strict measures and strong political will to eradicate corruption. Most donor agencies and the international community are reluctant to fund development activities in the presence of corruption. Experiences show that in Afghanistan, donor-funded projects outside the government are also prone to corruption.¹⁷ Due to the high levels of corruption, donors do not implement their development projects through government systems. Corruption deters private investment, disrupts public service delivery, and fuels discontent.¹⁸ Third, it is needed to increase productivity. The Afghan government has not performed well in the past, and fear will continue in the future unless constraints and challenges are addressed. Most government agencies have not been able to spend their allocated development budgets efficiently. To gain public trust and ensure donors, Afghanistan needs to adopt multi-control systems in public financial management. The government should establish an authoritative oversight and control committee with distinct authority for restoring transparency and fighting against corruption. The committee members should incorporate a delegation from the donors, civil society, government agencies, and academia.

Resource Mobilization

In post-war countries, securing enough financial resources to fund the enormous need for reintegration, peace, and infrastructure building is one of the main challenges. For peace sustainability, the financial system must utilize resources for the short term and generate sustainable revenue for the long run. Afghanistan lacks the financial capacity to fund its need by utilizing its internal resources. It needs donors to pay for their development programs. However, donor funds will not last long enough and will diminish gradually. After the peace deal, Afghanistan needs a functional and transparent public financial management system to mobilize funds for its development and peacebuilding initiatives. The following are the main mechanisms through which the Afghan public financial management system can fund

17 Rubin BR. Constructing sovereignty for security. *Survival* (Lond). 2005;47(4):93-106. doi:10.1080/00396330500433357

18 Rose-Ackerman S, Palifka BJ. Corruption and Government: Causes, Consequences, and Reform. Cambridge university press; 2016.

its activities, keep the government running, and sustain peace.

- Prepare a peace financing package. It is required to make a peace package by estimating the amount needed to build the necessary infrastructure and fund the reintegration programs. The package should include building infrastructural projects that can create jobs in the short term and assure sustainability in the long run. The Afghan government should initiate this package with development partners such as the World Bank and the United Nations. The package should be used as the basis for peace financing. All donors and international agencies should adjust their activities within the frame of this package. Experience shows that fragmented donor projects will not produce efficient and sustainable results. It would be useful to prepare a development frame and ask donors to play their roles in funding it. More importantly, the package should develop a precise estimation mechanism, a timeline, and the total amount needed to complete each activity.
- Coordinate and channel aids through the government. Donors and international communities provide funds to post-war countries. However, their financial support is not channeled through the government. Instead, NGOs and multinational companies implement projects with a considerable margin. In addition to inefficiency, it creates dual public sector phenomena; government and donors work separately and create an internal system managed by the government and an external system funded by the donors and implemented by the NGOs and private companies. To avoid such a problem, first of all, the Afghan government should reform its financial management systems in such a transparent way to encourage donors to channel their funds through the government. Secondly, the government should establish a body to coordinate between government and donor and also between different donor agencies who fund development initiatives and reintegration programs in Afghanistan.
- Establish mechanisms for sustainable revenue streams. Donor funds and external sources are not sustainable. The public financial management should plan revenue generation to fund its development initiatives for the long run. With the start of the peace process's reintegration, pressing attention is diverted to short-term needs, which are valid because citizens need to feel the differences in their well-being. However, it should be remembered that the long-run begins in the short-term; peace will not be sustainable if the government cannot sustain the service delivery. It would not be realistic to expect donors to do the job and pay for whatever is needed. Hence, budget constraints are a must, and it is a mistake to rely on a flush of donor funding. To deal with such a situation, the government should focus on the projects that generate revenue in the long run. Simultaneously, the government should balance the available amounts of financial resources and its priorities. Long-term spending should be planned based on internal financial capacity. Consider the case of revenues and expenditures of Afghanistan after the fall of the Taliban. The Afghan National Army was built with a large funding

source from donors, particularly the United States. Security spending in three years (2003-2004) was 494% of the national revenue and roughly one-third of its GDP.¹⁹ Hence, to sustain peace, Afghanistan needs sustainable revenue streams.

- Maintain religious adherence perspectives of financial management. One of the main controversies among the peace negotiators results from different views about adherence to Islamic rules. The government of Afghanistan and the Taliban hold different conceptions of an Islamic state. Religion can play an essential role in sustaining peace. First, both the Holy Quran and Hadith warn Muslims to keep faithful to their promises. Secondly, Islam advises its follower to obey the rule of the land.²⁰ Cooperating with the government, such as paying taxes and preventing the destruction of infrastructure, and averting smuggling the natural resources, are part of the land's rules. To make people pay tax, religious leaders should interpret tax payment as a religious obligation. The public will participate willingly in activities that align with spiritual principles. Encouraging people to pay taxes and cooperate with the government will increase revenue and contribute to sustainable peace and economic development.

Efficient Use of Public Financial Resources

Considering the scarcity of financial resources, the government should reform its financial system to use its resources efficiently. The expenditure policy should consider both economic growth and the peacebuilding process. The following are the primary recommendations:

- Prioritize and sequence the strategic needs. In the post-war era, Afghanistan needs to implement substantial development projects, deliver services, and develop further peacebuilding initiatives. With a wide range of expectations and limited resources, the public financial management system should consider the overall aspects and then prioritize and sequence the strategic needs. The system should be vibrant enough to allocate resources efficiently to respond to public needs and assure productivity. The aim should not be only to follow the conventional theories by focusing on return maximization; instead, it should concentrate on durable peacebuilding. A trade-off between return maximization and peacebuilding is needed. Policy developers should create the potential for trade-offs between policies that promote growth and promote peace.²¹ Focusing only on economic returns may divert spending on the cities, leaving out the districts and villages that are less developed and can trigger the peace process. Therefore, public spending should be calculated cautiously, considering a trade-off between the economic and peacebuilding goals.
- Invest in revenue-driven projects. The government should plan its projects with

19 Bank W. Afghanistan: Managing Public Finances for Development. Published online 2005.

20 Crone P. *God's Rule: Government and Islam*. Columbia University Press; 2004.

21 Collier P. *Breaking the Conflict Trap: Civil War and Development Policy*. World Bank Publications; 2003.



caution and a deep understanding of future returns. Resources should be diverted to the government's priorities, not because they are unlikely to attract donor funds. Spending on such a project will not increase revenue for the government. Still, it will cause high operation and maintenance costs, which would be a financial burden for the government. An example of this sort of costly donor-funded project is the Gaza hospital funded by the European Union. The project had high operation costs and diverted resources from being used more efficiently to deliver essential health services packages.¹⁷ Such a donor-driven investment project is referred to as "Trojan horses."²²

- Build hard and soft infrastructure. Sustainable development and peace initiatives require both hard and soft infrastructure. Hard infrastructures such as roads, bridges, and power dams are critical for economic growth. Similarly, soft infrastructure or institutions such as efficient government organization, transparent bureaucratic procedures, functional and just court systems is vital for sustaining peace, reducing conflicts, and long-run economic growth. Institutional buildings are crucial to economic growth, peaceful resolution of conflict, and efficient public resource management. Donor-driven projects have focused on formal procedures and paper-based procedures but have not paid attention to outcomes and practices. Evidence shows that focusing on institutional functions and forms by considering the local context and reforming procedural rules provides a better result.²³ Hence, Afghans need to develop their own institutions and extend their practices to the regional levels to achieve economic growth and sustainable peace. Copying the practices of developed countries may not produce the expected results. Institutions are context-specific and need to be developed over time.²⁴ It is impossible to change the public's habits and daily practices overnight; instead, it would be suitable to regulate them first and change them over time.

22 Brynen R. *A Very Political Economy: Peacebuilding and Foreign Aid in the West Bank and Gaza*. US Institute of Peace Press; 2000.

23 Buntaine MT, Parks BC, Buch BP. Aiming at the wrong targets: the domestic consequences of international efforts to build institutions. *International Study Q.* 2017;61(2):471-488; and Andrews M. *The Limits of Institutional Reform in Development: Changing Rules for Realistic Solutions*. Cambridge University Press; 2013.

24 North DC. *Institutions, Institutional Change, and Economic Performance*. Cambridge University Press; 1990.

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