



# **National Business Agenda**

**2006**

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### Foreword

August 14, 2006

Dear Friends,

The Afghan International Chamber of Commerce AICC is proud to present to you our first National Business Agenda (NBA). The purpose of the NBA is to put forward a public statement of the most important policy issues affecting our country's business community. During the course of the next year, we will utilize this statement to both inform our members of our policy priorities and guide our interactions with elected and appointed officials.

It is important to note that creation of the NBA was a fully representative undertaking. Our Chairman Mr. Hafizi and myself, along with other Senior AICC representatives conducted a National Advocacy Tour and met with several-thousand business representatives in cities across Afghanistan to hear and record their views. To confirm our findings AICC also conducted a comprehensive opinion survey of hundreds of AICC members. In short, our wide-ranging inventory of the issues most important to the business community represents more than half-a-year of research, resource investment and the personal involvement.

Finally, we would like to acknowledge the generous technical and financial support of the United States Agency for International Development, which made this project possible.

At a convenient time, please review our policy recommendations and transmit any suggestions you might have about promoting the NBA or about improving development of future National Business Agendas.

Thank you sincerely for your continued support.

Respectfully,

Hamidullah Farooqi  
CEO; AICC

# The Background

## Afghanistan's Road Ahead

Despite our turbulent history, we have crossed a few remarkable milestones on the way to modern statehood. For all our troubles, the promise of a modern infrastructure, a free-market economy, and a participatory democracy are becoming more tangible. Among the most notable milestones were our successful creation of a representative government and our private sector growth.

The results of the Afghanistan International Chamber of Commerce's (AICC's) National Membership Survey (discussed in a following section) underscores the importance of these major milestones to the Afghan respondents. The level of enthusiasm and optimism shared by Afghan entrepreneurs across the country, despite the many challenges they have endured, is extraordinary.

Sadly, we have had predictable obstacles against a "backdrop of rising threats to security and an economy dominated largely by illicit production and export of opium."<sup>1</sup> Our recent parliamentary elections suffered from a low turnout even in Kabul, where security was not an issue. Turnout was a meager 36%. The country now enters a new phase of "state building in uncharted waters."<sup>2</sup> A considerable disillusionment and low motivation on the part of many voters is attributed to the perceived lack of improvement in their daily lives since they first voted in the 2004 presidential elections.

Transforming our economy requires ongoing strong dedication to the reform agenda, greater effort to promote the private sector and the continued commitment of the international community. Our government estimates that a sustained annual growth rate of 9% of the licit GDP is required to provide our citizens with a tangible sense of improvement in living conditions and to compensate for the contraction caused by the elimination of the narcotics sector. The good news is that the projected growth for FY2006 (at 11.7%) and FY2007 (at 10.6%) should exceed this minimum. However, this scenario assumes that agricultural production will not be affected by drought, development assistance programs will proceed as planned, and the private sector will continue its recent expansionary trend.

In recent years, our country has witnessed encouraging signs in terms of trade and industrial development. First, international investments have increased. Second, economic growth returned to double-digit levels in 2005. Third, our economy continues to expand. According to the International Monetary Fund's (IMF's) External Relations Department, despite the fact that the real GDP growth slowed in 2004/05 primarily because adverse weather conditions cut agricultural production, real GDP grew by an estimated 14% in 2005/06, as agricultural output recovered because of better precipitation, while continued momentum in the reconstruction effort sustained activity in manufacturing, construction, and services.

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According to the World Bank, our government continued its solid track record of macroeconomic policy and structural reforms in 2006. The total domestic revenue collection met the budgetary target for the year. In addition, Afghanistan was ranked 16 among 145 countries for ease of opening a business. Conversely, according to the 2005 Doing Business report of the World Bank, Afghanistan ranked only 122 out of 155 economies, largely due to high transaction costs. Effective enforcement mechanisms, particularly a commercial court system, are not yet in place or lack the resources to function properly, which presents one of the major challenges faced by the nation.

### The Challenges

For now, we are enormously dependent on international support. Approximately two-thirds of our country's budget comes from international donors. Our domestically generated revenue, although growing, is utterly insufficient to fund the government's expenditures. Our ratio of revenue to GDP is one of the lowest in the world and domestic revenues will not match the government's operating costs until at least 2011.

Additionally, our qualified pool of management candidates is small and requires significant capacity-building assistance. We have 325,000 civil servants, all of whom are poorly trained and underpaid.<sup>3</sup> Our shortage of skilled management and professional staff limits the confidence and growth of both the public and private sectors. Our available resources to battle the twin evils of a fanatical insurgency and a massive drug network are meager and compound a widespread perception that our government is weak and corrupt, which consequently impedes our country's ability to right itself without increased foreign investment.

Although recent surveys reflect that there is some optimism among Afghans (for example, Afghans say they are now less fearful of the Taliban, who failed to disrupt the elections), there are still great concerns about the rising power of the country's warlords, who won seats in the new Parliament. The proportionally greater dispersal of government spending in Kabul, the unfair resource allocation to the provinces, and concerns over transparency are also causing political discontent.

Moreover, despite the dramatic success of our recent elections, the most recent Transparency International rankings awarded our country with an unenviable score of 117 (lower scores are preferred).<sup>4</sup> Iceland, Finland and New Zealand have scores of 1, 2, and 3 respectively. The United States has a score of 17 and the United Kingdom a score of 12. Conversely, our score was better than our neighbors (with the exception of Iran that came in at 93). Respectively, Tajikistan tallied 137, Uzbekistan 143, Pakistan 146, Tajikistan 150 and Turkmenistan 157.

### The Role of the Business Community

AICC accepts as true that it is the responsibility of our country's business community to ensure that the government will follow through on its commitments.

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While government revenue is expected to increase to 6% of GDP in 2006/7 (from 5.5% in 2005/6), it clearly must accelerate the reform program to reach the “Afghanistan Compact” target of more than 8% by 2010/1.<sup>5</sup> One key priority of the government must consequently be to encourage formalization of the economy. This can most easily be done through improving the investment climate.

As the principal source of public and private wealth, our business community is ideally suited to assist with efforts that boost formal participation in the economy. As AICC’s National Membership Survey showed, there is a strong desire for increased formal participation so that communities and the country prosper. Furthermore, our business community can play an influential role in rectifying the lack of public sector transparency and widespread corruption by demanding a predictable business environment. As we know, there are many calls for more publication of tax and customs guidelines, and opportunities for appeals.

For most business investments, a stable environment is fundamental. In this respect, much of our business community’s advocacy efforts toward the government will require focus on creating an enabling-environment for the private sector. Currently, a large share of our private sector activity (according to some estimates, 80% to 90%) is concentrated in the informal sector. This has implications for longer-term investments, creates market distortions and reduces the potential for our domestic tax base.

It will be necessary for the government to work closely with business representatives to find more tax revenues and nurture a sustainable market economy. For example, in an investment climate survey conducted by the World Bank, 64% of respondents cited lack of electricity, 60% access to land, 53% corruption, and 51% access to finance as major or severe obstacles to doing business. Our lack of production has an objectionable impact on external competitiveness.

### **AICC’s Response**

AICC conducted a National Advocacy Tour to gain private sector input into issues that should be prioritized in the National Business Agenda. The tour included meetings in our country’s six largest cities, as well as comprehensive survey of business community attitudes. The results culminated in the following prioritized issues:

**Issue # 1: Security**

**Issue # 2: Corruption**

**Issue # 3: Taxation**

**Issue # 4: Customs Regime**

**Issue # 5: Infrastructure and its Impact on Agriculture**

**Issues 6: Education**

**Issue # 7: Development Policies and Access to Capital**

### The Recommendations

The following is an overview of AICC's recommendations in the seven priority areas identified by the private sector during its National Advocacy Tour. Additional information on these recommendations may be found in the issues section of this document.

**Issue # 1: Security:** AICC's research indicates that security is closely linked with economic development. Its recommendations in this area focus on the following:

- Continued commitment from the international community to stabilize the security throughout Afghanistan.
- Continued commitment from the international community to recruit, train and equip a professional and ethnically balanced police force, Afghan National Army, and other security forces.
- Public policy support for initiatives that create rule of law, which will favorably impact security.
- Support for a greater portion of public resources to be devoted to the support of private enterprise, which will create jobs and economic opportunity throughout Afghanistan thus having a favorable impact on security.
- Improvement of public infrastructure in order to increase access and information flow to all areas of Afghanistan, which will favorably impact security.

**Issue # 2: Corruption:** AICC's research indicates that corruption is prevalent at all levels of Afghan society and that it is a severe limiting factor in the promotion of democracy and free enterprise. Its recommendations in this area focus on the following:

- Implementation of public policy that will establish rule of law and therefore increase Afghanistan's transparency at all levels of society.
- Implementation of public policy that ensures access to information.
- Implementation of public policy that ensures accountability of public officials and the private sector.
- Institution of civil service reform to ensure that the most qualified individuals are employed at all levels of government and that they are paid a wage consistent with a reasonable standard of living.
- Implementation of public policy that requires clear and transparent national appointments and the end of nepotism at all levels of government.
- Promotion of codes of ethics and conduct for government employees, law enforcement agencies and the court system.

**Issue # 3: Taxation:** AICC's research indicates that the private sector is willing to pay its fair share to increase public services, improve infrastructure and enhance security. However, it is not willing to accept an arbitrary tax system that causes businesses to

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adopt informal processes and that limits the growth of the market economy. Its recommendations in this area focus on the following:

- Government's consideration the effect of specific taxes on the private sector by conducting economic impact studies on every proposed tax.
- Integration of the government's tax policy with its overall economic policy.
- Reforming of the government's tax collection system through the initiation of investment friendly taxes, tariffs and fees.
- Research as to the effect social security taxes will have on state revenues as well as social wellbeing.

**Issue # 4:** Customs: AICC's research indicates that the country's customs system continues to be a source of concern for the private sector. Its recommendations in this area focus on the following:

- Empowerment of one government entity to develop and release impact statements for any export or import regulation that affects the customs regime.
- Support for government policies that focus on improving compliance for taxes and locations with the highest revenue yields.
- Initiation of a 2% across-the-board duty on all goods coming through customs into Afghanistan and the elimination of duty on exports.
- Where possible, the consolidation of customs-related government offices under one roof, which will increase coordination among agencies as well as mainstreaming of procedures.
- Installation of a well-trained and professional tax and customs corps.
- Establishment of clear and concise customs regulations that can be challenged in an administrative court system.
- Establishment of a transparent appeals process.
- Establishment of uniform export procedures.
- Assessment of goods at only one entry point into Afghanistan.
- Installation of computerized customs procedures and valuations.
- Establishment of other procedures that simplify the customs regime and promote transparency in valuation of goods, enforcement of regulations, and assessment of duties.

**Issue # 5:** Infrastructure and its Impact on Agriculture: AICC's research indicates that more than 19 million Afghans would benefit from rural development measures. Its recommendations in this area focus on the following:

- Improvement of the road network by continuing rehabilitation, building the capacity of officials within the Ministry of Public Works, and developing strategies for maintenance of donor-funded infrastructure.
- Improvement of air transportation by ensuring compliance of Afghan metropolitan airports with International Civil Aviation Authority standards, as well as the active

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recruitment of new airlines through fair and competitive practices, to serve major Afghan markets.

- Improvement of energy resources by recovering at least 75% of energy costs from users connected to the national power grid, as well as the development of a strategy for use of renewable and environmentally friendly energy sources.
- Improvement of mining and natural resources through the creation of an enabling regulatory environment for profitable extraction of our natural resources.
- Improvement of water resource management by promoting investments in irrigation, large water projects and nationwide access to running water.
- Development of specific guidelines for urban development that focus on improving the capacity of municipalities to deliver municipal services and to address growth issues.
- Improvement of the agriculture sector by promoting increased public and private investment.
- Integration of information and communication technologies into the mainstream of Afghan society by ensuring access to technology throughout the country.

**Issue # 6:** Education: AICC's research indicates that while more than 5 million Afghan children are now in school, literacy rates are still low and curriculum is outdated. Its recommendations in this area focus on the following:

- Passage of policy initiatives that will dramatically increase the primary school enrollment for both boys and girls.
- Initiation of a national campaign to explain the economic and social benefits of education to communities, families and the country as a whole.
- Integration of democracy and free-market education into the public schools.
- Updating of curriculum for all primary, secondary and post-secondary schools in order to ensure the best international standards within classrooms.
- Initiation of a competency tests for Afghan teachers in primary, secondary and post-secondary (universities) institutions.

**Issue # 7:** Development Policies and Access to Capital: AICC's research indicates that development policies are not consistent with access to capital and other measures that will build our economy. Its recommendations in this area focus on the following:

- Integration of access to capital, reasonable interest rates and bank guarantees into Afghanistan's monetary policy.
- Creation of liberal investment policies that establish transparent land ownership in order to facilitate the usage of land as collateral.
- Proliferation and privatization of industrial parks under the guidance of an Industrial Parks Authority that has both public and private sector participation.

### The Issues

#### Issue #1: Security

##### *Background*

Afghanistan is presently embroiled in some major security problems. The recent upsurge in violent incidents involving antigovernment factions, including attacks directed at foreign forces and international aid personnel, leads the list of these security problems. During 2005 we witnessed more conflict-related deaths than any since 2001, and 2006 is proving to be similarly violent. The large security costs, estimated at 17% of GDP in FY2005, and currently covered primarily by international donors, will remain beyond the government's payment capacity for some time. We can all concur that this violence is directly detrimental to our social and economic progress.

Additionally, the renewed expansion of the opium trade into the country's economic and political system has contributed to increased violent confrontations between the police and the military on one side, and the criminal networks on the other. Further compounding this problem are some new alliances between criminal networks and fanatical antigovernment factions. The drug networks furnish weapons and financial resources, while the fanatics deliver manpower.

These security problems are placing increased restrictions on aid programs. The negative impact on private sector investment is unambiguous. Our country remains a high-threat post for many of our foreign guests, and security considerations often drastically constrain the capabilities of Afghan and international organizations to implement and monitor projects. While the security situation is precarious, the overwhelming majority of our people appreciate the work done by aid organizations and understand that a more stable environment is in their immediate and long-term interest.

##### *Overview of Survey and Tour Findings*

The following table summarizes the most critical issues identified during the National Advocacy Tour in six Afghan cities. As can be noted, security was a major concern for the almost 2,500 businessmen and women who participated.

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Priorities	Kandahar	Jalalabad	Bamyan	Kunduz	Mazar-e-Sharif	Herat
Security	√	√	√	√	√	√
Corruption	√	√	√	√	√	√
High taxation (including municipal taxes)	√	√	√	√	√	√
High customs duties (including lack of protection from dumping practices)	√		√	√	√	√
Inadequate business infrastructure (including roads, water supply, electricity and hydropower plants)	√	√	√	√	√	√
Inadequate access to financial or technical resources (including micro loans)		√	√	√	√	
Lack of proper development policies for private sector growth		√	√	√		√
Lack of irrigation or agro processing facilities	√	√	√	√		
Lack of industrial park, ports, or trade facilities		√	√		√	
Difficult access to domestic or foreign markets	√		√	√	√	
Slow process of privatization of state-owned enterprises		√		√		
Lack of access to information	√		√	√		
Lack of proper tourism initiatives			√			
Low literacy rate and education (including lack of schools )			√			

### ***Progress and Obstacles***

With the aid of the international community, our central government has begun to build a multiethnic army and police force that should be able to exert government control in regions outside the capital. According to the World Bank, our government is strongly entrenched in Kabul and has a high degree of legitimacy throughout the country.<sup>6</sup> However, there remain many areas where it is not very effective and provides few security services, especially where the insurgency is strong.

Despite all that, perhaps the biggest problem for rebuilding our country is the widespread misconception that security problems make it an entirely unsafe place for investment and conducting business. This exaggerated portrayal is often promoted by self-serving reports and sensationalizing journalists. There are in point few, if any, entirely safe environments in which to conduct business, even in developed countries.

As part of its role in promoting Afghanistan's goods and services, AICC representatives frequently find themselves in the critical role of presenting the country's investment climate to other nations. All too often these representatives discover that inaccurate and negative misconceptions about our country have been permitted to circulate unchallenged. AICC representatives are required to reinforce the reality that there are many reasonably safe investment opportunities in our country.

These inaccuracies clearly have a negative effect on foreign and domestic investments. This is not meant to infer that all or most of Afghanistan's problems are a matter of misperception. Rather, this statement means that many problems are surmountable and should not rule out most investments.

Furthermore, most astute observers understand that stability and development in Afghanistan cannot be achieved exclusively by armed forces. AICC supports the notion that national security also requires good governance, justice, the rule of law, and economic opportunity for all of our citizens. Afghanistan's business community can be most useful and constructive in helping to create a fair playing field for businesses at all levels and to provide economic opportunities for everyone. AICC strongly supports the idea that the private sector is best suited to supply the unique ingenuity and sophisticated knowledge that leads to wealth creation and job opportunities, which can substitute for participation in antigovernment factions, banditry, and the illicit drug trade.

We must alter negative perceptions of potential investors by demonstrating progress in dealing with basic human needs. Our country was ranked 173 out of the 178 countries included in the United Nations Development Program's (UNDP's) 2004 Human Development Report (HDR). That year's HDR noted that the country's poverty is compounded by a lack of social services; poor health, education, and nutrition; gender inequality; and human displacement. The HDR emphasized that, despite progress in many of Afghanistan's development sectors, basic human needs and the genuine grievances of the Afghan population—lack of jobs, health, education, income, dignity, and opportunities for participation—still must be addressed.

### ***Policy Recommendations***

AICC supports recent declarations by Afghanistan's government that our country will require the continued commitment of the international community to ensure security and stability for some time to come. This includes continued engagement of the U.S.-led antiterrorism coalition.

AICC also strongly recommends international support for policy efforts to recruit and equip a fully professional and ethnically balanced Afghan National Army, National Police, and Afghan Border Police that will meet the security needs of the country.

Afghanistan's business community can significantly contribute to relieving our country's security quandary by focusing on building a strong economy. AICC recommends the

promotion and implementation of public policies that advance this premise. These policies will reduce the size of recruitment pools for antigovernment factions, which use fanatical philosophies and drug profits, as well as the divisions between rural and urban areas, to exploit poor communities.

AICC recommends a comprehensive program of policies that publicize our improvements in infrastructure, security, legal reform, and liberal investment policies.

AICC suggests that a significant degree of public resources be earmarked for promoting investment opportunities and that a more realistic and accurate portrayal of the security situation be conveyed to potential investors.

In addition, AICC advocates that a greater portion of public resources and public policies to be devoted to energetically promoting Afghan private enterprise. While much of the donor nations' technical assistance to our country is unavoidably channeled to buildings, roads, water projects, clinics, and schools, AICC suggests that a greater degree of public policy attention should be channeled into developing private enterprise. Infrastructure investments do not always create sustainable markets, businesses, or jobs. Additionally, they are usually large targets that demand a great deal of security. The good news is that the security hazards for small- and medium-size private sector investments are far smaller and more widely distributed than infrastructure investments.

Finally, the weak status of our public infrastructure still remains one of our principal security-related problems, despite the recent improvements in logistics. Roads are of poor quality and invite more crime and violence. There are many companies offering logistics, security, air cargo, freight forwarding, and shipping services that would allow Afghan businesses to send information and materials quickly, domestically or internationally, with far less exposure to risk. It is in our national security interest to encourage these companies to invest in here through reasonable incentive packages.

## **Issue # 2: Corruption**

### ***Background***

Corruption is an issue that plainly strikes a nerve with most Afghan businesspeople. It was referenced even more than the topic of security in each of the National Advocacy Tour events. Some observers suggested that this was because businesspeople are more frequently exposed to coercion from corrupt officials than they are to violent fanatics.

It was also suggested that corruption evoked more comments during the National Advocacy Tour because there was the recognition that the business community could play a more influential role with combating corruption than it could with the security issue (i.e., security was regarded more as a military issue). As well, many participants

commented that businesspeople can have more impact on corruption if they work together to promote and enforce examples of fair and standardized practices.

Transparency International's Corruption Perceptions Index (CPI) has been widely credited for putting Transparency International and the issue of corruption on the international policy agenda. The CPI ranks more than 150 countries in terms of perceived levels of corruption, as determined by expert assessments and opinion surveys. Afghanistan scored 117 in 2005 and 103 in 2006. It is probably no small coincidence that freedom of the press ranks low (107), as well.

### ***Overview of Survey and Tour Findings***

Corruption largely appears to be one of the most critical issues in the eyes of the Afghan business community. From the opinions offered during the National Advocacy Tour and AICC National Membership Survey, it is evident that, by corruption, Afghan businesspeople usually mean administrative corruption in different government agencies and departments that commonly interact with the public.

Even so, respondents essentially consider that from the standpoint of societal growth and progress, this issue must be addressed without delay. Many stated a belief that ignoring public sector corruption may ultimately pave the way for economic stagnation in such a young and fragile economy. They believe it will discourage investment, generate a loss of entrepreneurial confidence, and foster a hostile business climate.

In the view of many AICC National Survey respondents, it is crucial that the private sector and the government come together and attempt to tackle this key issue. This is a difficult task because administrative corruption is perceived as being deeply entrenched and crosscutting business life from acquiring licenses to paying taxes.

### ***Progress and Obstacles***

As previously mentioned, corruption is endemic in our country—nearly 58% of firms surveyed by the World Bank cited corruption as a major or severe problem, just behind access to land and electricity. Firms reported paying an average 8% of sales as bribes, more than four times the average reported in neighboring Pakistan.

Afghanistan's business community can play a key role in tackling the challenges that line the road ahead. As the primary source of public and private wealth, the business community is ideally suited to assist with efforts that boost formal participation in the economy and consequently eliminate the roots of corruption.

The encouraging news is that Afghan businesspeople are predisposed to participate in this challenge. The results of AICC's National Membership Survey demonstrate that there is a strong propensity for increased formal participation so that our communities and our country prosper. There is also significant confidence within the business

community that increased government revenues will have a positive economic ripple effect through the reduction of individual tax burdens. Less bribery and corruption would result from a better-paid civil service. The severe price of maintaining security would also be reduced in an economy where unemployment was lower.

Finally, the corruption connected with opium cultivation has increased across the country. This, too, poses a threat to our long-term stability. A survey conducted in early 2006 showed that poppy cultivation is likely to rise in 2006, despite the fact that the government (with international support) has stepped up efforts to eradicate it and provide alternative livelihoods.

### ***Policy Recommendations***

As part of a comprehensive approach to rooting out public sector corruption, AICC will support policies that serve to expose illegal and coercive practices of public officials.

According to Transparency International, “access to information relates to the policies, practices, laws and procedures that help guarantee openness in the conduct of public affairs. In a broad sense, it is a question of how much access to internally held information outsiders are entitled to, and what outsiders can do if insiders are not sufficiently forthcoming in providing such access.”

AICC recommends implementing policies and initiatives that serve to reduce Afghanistan’s poor freedom of press ranking, which would probably result in systematic exposure of corrupt or improper official conduct.

AICC advocates government policies that ensure access to information. AICC supports the contention of Transparency International and other anti-corruption organizations that access to information plays a key role in efforts to curb corruption and control its impact. More particularly, this means having more information available in the public domain. It means that official information should more often than not be viewed by any interested party (including interested citizens, civil society organizations, and the media). Essentially, corruption becomes more difficult to conduct when it is harder to conceal. This reality helps establish a functioning system of national integrity.

AICC also recommends the implementation of government policies that ensure accountability. For example, each government ministry should conduct a thorough review and reform of oversight procedures relating to corruption, lack of due process, and miscarriages of justice. Reforming the justice system must be a priority for both our government and the international community. The aim will be to ensure equal, fair, and transparent access to justice for all, based on written codes, fair trials, and enforceable verdicts. This is particularly relevant for the development of a vibrant economy and investment environment.

In order to combat corruption, our government must:

- Recruit competent and credible professionals to public service on the basis of merit,
- Establish a more effective, accountable, and transparent administration at all levels,
- Implement measurable improvements in fighting corruption, upholding justice, and enforcing the rule of law.

In this respect, AICC recommends that a clear and transparent national appointments mechanism should be established without delay at every level of government, including provincial governors, chiefs of police, district administrators, provincial heads of security, and the judiciary. In addition, clear merit-based appointments, vetting procedures, and annual performance reviews should be initiated for all civil servants.

Finally, AICC recommends that our government security and law enforcement agencies adopt and promote codes of conduct and procedures aimed at preventing arbitrary behavior and execution of official duties, while promoting high professional standards.

### Issue # 3: Taxation

#### *Background*

As the sections on security and corruption have detailed, our country plagued by many troubles. Governmental inability to collect taxes should not be one of them.

The most severe fiscal challenge facing the current government is to design a broad-based income tax system in a country where, according to some estimates, 80% to 90% of private sector activity is concentrated in the informal sector and an estimated 33% of national income derives from illegal opium sales. According to the World Bank and the International Monetary Fund, Afghanistan lags behind most other countries in the world in collecting taxes. As can be seen from the table below, our current tax system collects less than 5% of GDP as budget revenue, which is less than the impoverished governments of sub-Saharan Africa.

<b>GOVERNMENT REVENUE AS A PERCENTAGE OF GDP<sup>7</sup></b> Fiscal Year Ended March 31, 2005	
<b>COUNTRY</b>	<b>REVENUE AS % OF GDP</b>
Afghanistan	<b>4.5</b>
Rwanda	10.4
Uganda	11.5
Pakistan	16.4
India	18.5
Iran	20.5
Kazakhstan	22.3

The medium-term goal is for our government to use its own money to meet recurring expenses such as salaries, infrastructure maintenance, and ensuring an appropriate supply of energy. Foreign donors would continue to pay for large investment projects, such as building schools and hospitals, which we will probably not be able to afford in the foreseeable future. The Afghan-American Chamber of Commerce (AACC) recommends following the tax reform model of countries such as Malaysia, Thailand, and the United Arab Emirate of Dubai in order to avoid pervasive poverty and dependency on foreign aid.<sup>8</sup> Or, as Afghan Finance Minister Anwar ul-Haq Ahady put it, “We should be able to stand on our two feet and be a normal country—a poor, underdeveloped, normal country.”<sup>9</sup>

Other underdeveloped or transitional economies have proved that fiscal self-sufficiency can be achieved. Even Rwanda and Uganda, both of which have also struggled with the legacy of anarchy and violence, have managed to double government revenue to more than 10% of GDP within the past 15 years, according to the World Bank.

In 2005, Afghanistan announced a new income tax to help wean the central government off foreign aid. At that time, our tax collections accounted for only 30% of government revenue, while foreign aid covered the reminding 70%. The new tax rate is 10% on income over 12,500 Afghanis a month (\$292) and 20% on income over 100,000 Afghanis a month (\$2,336). However, Finance Minister Ahady estimates that 95% of Afghans earn less than \$250 a month and therefore pay no income tax at all.<sup>10</sup>

Indeed, in 2005 Afghanistan registered an absolute decline in tax revenues over 2004, which occurred despite strong economic growth, the introduction of new measures, and administrative reforms. Several of these measures have yet to generate the expected benefits, with the exception of the rental tax, collection of which has increased markedly.<sup>11</sup> According to the IMF, revenue collection has also been negatively affected by delays in the approval of the new enforcement provisions, which means that compliance remains voluntary.

Critics of the existing tax system assert that it suppresses growth and employment by placing an undue burden on businesses and encouraging corruption. During the National Advocacy Tour, taxpaying business representatives complained that the tax base is far too narrow and that they are burdened by a list of too many taxes, including a 20% corporate tax and a 12.5% tax on gross receipts. Comparatively, the corporate tax rate is 30% in China, nearly 37% in India, and 35% to 50% of profits in Pakistan.

Additionally, our business community is plagued by a large number of *nuisance* taxes. These are taxes that provide very little revenue, but discourage business development, investments, and employment growth, due to their complicated procedures, lack of transparency, and often corrupt implementation. The World Bank estimated that Afghanistan has about 90 taxes, half of which raise less than \$21,000 a year. This clearly undermines the central government’s legitimate tax-collecting efforts.

According to AACC, there is a negative relationship between tax collections and income growth under the current tax structure: the greater the tax collections, the worse the impact on future consumption expenditures, employment, and income.<sup>12</sup> AACC's recommendation to change this inverse relationship is to alter the tax system so that producer incentives improve, thus allowing revenue to grow because of the enlarged tax base. Altering the tax system would essentially focus on investment and job-friendly taxes, while removing taxes on business and applying them to consumption or income.

Our government currently relies on taxes on total revenue—not net income—and on capital and imported inputs that seriously depress business investment.<sup>13</sup> The focus on larger businesses also discourages growth in size and efficiency. Finally, locally imposed and spotty price controls act as a tax on all businesses, lowering taxes collected directly by reducing revenue, and also lowering taxes collected indirectly by discouraging investment.

### ***Overview of Survey and Tour Findings***

The policy priorities identified in AACC's National Membership Survey included establishing a fair and transparent tax regime. Respondents stated that they are beset by extraordinary problems such as a shattered physical infrastructure, electricity shortages, and tough foreign competition for manufacturers. Many complained that they are not well positioned to pay the legal and nuisance taxes that are routinely required.

Respondents often connected the point of nuisance taxes with the first priority point of addressing corruption because many associated the prevalence of nuisance taxes with bribes in government offices and agencies. Respondents also perceived this to be a factor that discourages capital-rich businesses from entering important business sectors such as manufacturing, services, agriculture, and mining, and using their funds to fuel the construction and real estate boom.

Respondents often volunteered that a taxation system should provide reasonable revenues to the government, while not stifling important business activities, avenues of growth, and entrepreneurial initiatives in the country.

During the course of the survey, numerous business leaders repeatedly commented that a large number of taxes inhibit the ability of businesspeople to conduct their operations in a smooth and organized manner. These include taxes on imported machinery and raw materials. In the view of the respondents, all of these taxes contribute toward increasing production costs and the price of the final product, thereby making it difficult for local products to compete with the massive influx of foreign products into Afghanistan.

### ***Progress and Obstacles***

A short list of the obstacles that our country faces on the way to financial self-sufficiency would include the following:

- **Lack of experience** due to our century-long history of foreign intervention. The economy is dominated by goat herders, opium growers, shopkeepers, and day laborers, few of whom have much experience with the paperwork required by a modern tax system. Or, as Finance Minister Ahady put it, in this informal economy “You don't have cash registers. You don't pay by check ... We are bound to lose revenue.”<sup>14</sup>
- Prevalence of **outdated collection and enforcement equipment**, most of which dates back to the Soviet era. Moreover, some government leaders still hold an anti-business mentality, rooted in the decades of a Soviet-type, centrally planned, and controlled economy (where government was the employer of choice).
- **Pervasiveness of official corruption** comes from the natural conditions (rugged, mountainous terrains) that foster tax avoidance and fraud more than abiding by the laws. For example, the Taliban insurgency has made much of eastern and southern Afghanistan a “no-go zone” for any government official, let alone a tax collector.

The government has made some progress. The recent introduction of new tax measures, taxpayer education, and the approval of the new income tax law are all positive signs. Revenue should also be boosted after the introduction of a higher turnover tax rate for specific services (mainly luxuries), a wage-withholding tax, and an airport departure fee. However, given that the existing tax collection is partial and with limited administrative capacity, in a recent report the IMF supported the government's initial focus on large taxpayers. Publication of a revised income tax manual should also enhance public awareness and compliance in the near future.

Additionally, in November 2005, Afghanistan enacted legislation empowering government tax collectors to seize the assets of tax dodgers. That already has had an impact. In late December 2005, the Finance Ministry for the first time froze the bank accounts of a large company that had not paid its taxes. As a result, two large taxpayers, who had been negotiating their tax bills with the ministry, promptly capitulated and accepted the government proposals that had been on the table for weeks.<sup>15</sup>

The government, knowing that the ability to raise money is a stamp of legitimacy, has pledged to boost government revenue. Thus, according to the IMF, Afghanistan's medium-term fiscal framework includes an ambitious program to increase domestic revenue, from 4.5% of GDP in 2004/5 to 8.6% of GDP by 2009/10, through:

- The rationalization of the current tariff structure and the introduction of road tolls and excise taxes for 2006/7;
- Expanded coverage of the taxes introduced in 2005/6; and

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- Strengthened compliance arising from administrative reforms.<sup>16</sup>

These measures should reassure foreign donors, who finance 92% of the Afghan government's total expenditures. "Donors want to see a light at the end of the tunnel," says William Byrd, the World Bank's senior economic adviser in Afghanistan.<sup>17</sup>

But the measures don't address all of the major tax collection problems, many of which will require other forms of intervention. For example, four years ago regional warlords such as Ismail Khan in Herat and Abdul Rashid Dostum in Mazar-i-Sharif collected customs and refused to hand the money over to the central government. President Karzai has sidelined Khan and Dostum, and the customs revenue that once went to their fiefdoms now goes into the treasury in Kabul.

The Afghan American Chamber of Commerce has compiled a list of all the taxes, tariffs, fees, and commissions that the government is collecting from the businesses and citizens of Afghanistan: a border fee; a fee at the entrance to the cities; a tariff at customs; a 2.5% mandatory membership fee by the Afghanistan Chamber of Commerce and Industry on every transaction at customs; a 2% tax by the Ministry of Finance and 6% tax by the courts on the sales of real properties; a 5% tax for the registration of motor vehicles by the courts; a 2.5% tax by the Ministry of Finance on the value of all invoices, based on annual reports; a monopoly tax; a consumption tax; and a service tax. Then there is a 2% tax by the Ministry of Agriculture at customs for inspection services, which are not yet being provided.

There is also a 2.5% tax on net income by mosques and a 10% tax on all agricultural products; a 10% municipality tax on all goods transported through the city; an 11% tax on the value of the contracts (mistakenly called progressive taxation). In fact, this tax on contracts is levied prior to any profit being made! Out of 12 months, one month's rent is taken as tax on property by the Kabul municipality. A 60% tax is placed on annual income from real estate. In addition, there is a tax for the municipality on real estate for services such as cleaning and garbage removal. A \$137 fee is collected for every car registered that has its steering on the right side. There is even a tax for the department of traffic, a 2% transportation tax, and a 3% commission on transportation of goods and passengers. \$100 to \$200 in fees are collected by nongovernmental groups on each truck passing through the border into Afghanistan. Finally, \$150 is collected from each truck coming into Afghanistan at customs, and an additional \$100 is collected in the name of a "reconstruction tax" on those same trucks.<sup>18</sup>

With this many different taxes, there are too many tax collection points and too many officials empowered to collect them. All too frequently, a share of the taxes collected remains with the official rather than going to the government. Afghan businesses are currently subject to interventions by significant numbers of officials, each empowered by the present tax laws and precedents to collect modest fees. Ironically, despite the breadth of these interventions, the present tax system gathers only modest revenue for the government.

The Ministry of Finance wants to reduce our country's number of taxes down to five or six and "get rid of all the rubbish," says Graham Burnett, a New Zealander who is advising the Finance Ministry after helping set up tax systems in war-torn Kosovo and Timor-Leste.<sup>19</sup> The ministry is also working on a shopkeeper tax, a set fee that won't require financially unsophisticated merchants to calculate tax bills. In June 2006, the government was scheduled to start collecting tolls on some roads.

Thus far, the largest problems are related to the implementation of the tax package. For example, the government is currently trying to fix one experiment that went wrong—mobile customs teams that patrolled the roads, stopping trucks to check for illicit cargo. Unfortunately, the teams often abused their authority by demanding roadside bribes.

### ***Policy Recommendations***

Based on the analysis of corporate and overall tax rates for selected countries, AICC recommends that the Ministry of Finance take into account the following factors when solidifying its tax strategy:

1. Given the comparative underdevelopment of Afghan businesses, even a reasonably minimal tax burden (by international standards) might have a detrimental short-term effect.
2. The issues of eliminating informal taxes and implementing tax assessment and collection procedures that are consistent with international best practices must be addressed before establishing a new tax system.
3. Sound strategies that promote investment and boost long-term capabilities, not just the need to achieve a certain target revenue level, should form the basis for the Afghan tax system.
4. Taxation models such as the one used in Ireland could be used to develop a tax regime that will promote economic growth.<sup>20</sup> The alternative of comparing our tax regime with those of most developed countries is short sighted, and will likely not achieve the desired results. The Irish model, which offers competitive corporate tax rates in addition to tax incentives, generates revenue based on economic growth. In other words, it is a tax system that uses competitiveness, instead of arbitrary revenue targets, as an engine of growth.

AICC strongly recommends that when trying to raise expenditures, the government's fiscal policy must be part of its economic policy as a whole. The government must create a comprehensive economic policy that should consist of both fiscal and monetary components. AICC concurs with the IMF's caution against introducing piecemeal reforms, such as duty exemptions and some tariff proposals, and emphasizes the need for new measures within a comprehensive revenue policy and administrative reform framework.<sup>21</sup> This would include the proposed transition of the turnover tax into a more effective consumption-based tax, possible tariff reform, revenue and customs administration reform, and the abolition of nuisance taxes.

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AICC proposes the following recommendations to the government to reform its collection system and raise revenues for its expenditures through smart and investment friendly taxation, tariffs, and fees:

**Building permits.** Building permits issued by municipalities should be taxed in brackets, ranging from 8% on new construction or renovations worth less than \$200,000, to 1% for projects costing more than \$6 million. AICC estimates that \$1 billion is annually spent on construction in Afghanistan, 8% of which comes to \$80 million that could be collected as revenue for the government.

**ID cards (Tazkera).** AICC estimates that a \$10 charge per ID card will generate \$10 million in government revenue.

**Passports.** Under the assumption that 100,000 passports are issued annually and that each passport will cost \$200, revenue of \$20 million will result.

**Business licenses.** Every business must be issued a business license, which must be renewed annually for a flat fee of \$50 a year. This could generate revenues of \$100 million annually.

**Drivers' licenses.** The government should issue a driver license for a fee of \$200 per license, valid for a period of four years. This will raise annual revenues of \$50 million.

**Residential property tax.** There is a 1.5% tax per year on the value of residential properties throughout Afghanistan. Half a percent (0.5%) of the total property tax collected in a municipality should be budgeted to the municipality by the Ministry of Commerce (MOC). This will serve to eliminate corruption, which is currently occurring in the process of the collection of property tax based on rent.

**Commercial property tax.** 2% tax per year on the value of commercial properties in Afghanistan. The property owners or their agents must make the tax payment directly to the accounts designated by the Ministry of Finance. Half a percent (0.5%) of the total commercial property tax collected in a municipality should be budgeted to the municipality by the MOC. This will serve to eliminate corruption, which is currently pervasive in the collection of commercial property tax based on rent.

**Business tax on net profits.** AICC proposes that net profit be taxed at the annual rate of 10%. This will raise annual revenue of \$200 million for the government. The following expenses could be deducted from gross sales in order to show net profit: rent, payroll, cost of goods sold, taxes and fees paid to the government, interest payment, telephone and utility expenses, business vehicle expenses, advertising expenses, and travel expenses (the latter expense for managers only).

**Individual income tax.** Household income taxes should provide another significant portion of total government revenue. The main reason for income taxes is to provide tax

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revenue while significantly expanding tax coverage and redistributing income downward in incentive-neutral ways. The goal should be to get every household to file an annual consolidated tax return. To accomplish this, the filing process must convey potential benefits, i.e., netting out of income for the double taxation implied by the value-added tax (VAT) and the goods and services tax (GST).

Current international best practices indicate that there is one most favored (flat) tax rate of 10% to 13% on the incomes of households and businesses that are above a poverty threshold. From an estimated total taxable national income of \$10 billion, 10% would raise revenue of \$1 billion annually for the government. A personal deduction could be introduced to cover for some of the following expenses: rent, utilities, furniture, medical expenses, taxes, clothing, and food.

**General sales tax (or VAT).** IMF modeling exercises showed that a general sales tax rate of about 10% to 13%, broadly applied, would replace a considerable portion of the revenue collected from the myriad of existing (import and nuisance) taxes.<sup>22</sup> AICC proposes a sales tax of 4% on every sale conducted in Afghanistan. It is crucial that expenditure taxes be applied broadly, to all domestic consumption expenditures, regardless of the status of the household and enterprise spending units.

Adopting such a VAT eliminates the need for revenue-building tariffs on imports, since capital and intermediate imports will be tax exempt, and consumption imports will be taxed at their normal VAT rate, the tax to be levied when they are purchased by final users.<sup>23</sup>

**Custom duties.** AICC proposes a 2% across-the-board duty on all goods coming through customs into the country. There should be no duty on exports.

The total government revenue that would be generated through the collection of the aforementioned taxes, fees, and duties would amount to approximately \$4.2 billion annually.

As a prerequisite to the implementation of the proposed tax system and enforcement of fee collection, all other taxes, fees, and commissions must be abolished. The government should aim to become reliant on growth in the private sector tax base, rather than on international aid, for revenue.

Assuming that there is agreement on a well-funded, seven- to 10-year revenue-neutral tax reform program, the first step will involve undoing or getting rid of many of the nuisance taxes and price controls, and retraining (as part of the system reform process) those who have collected them to perform other tax collection or administration functions. Since the revenue actually transferred to the budget from these taxes is small, the revenue impact on the budget is of little concern.

Additionally, no government entity other than the Ministry of Finance should be allowed to levy or collect any taxes, commissions, or fees. Road inspections must be abolished because they are nothing more than a source of corruption.

AICC endorses AACC's recommendation of replacing the revenue now collected through (anti-business) taxes on total revenue, imported inputs, and capital (including foreign direct investment [FDI]) with much more employment-friendly, flat, modest, but widely applied taxes on consumption expenditures and income.<sup>24</sup> Collection coverage rates will rise faster when more resources are devoted to reforming tax administration and collection efforts.

Several AACC and AICC members have referred to Dubai's (UAE's) approach to taxation as being sensible for Afghanistan. Dubai's strategy stresses taxing wage earnings and net business income at the same rate. Taxes on employment-generating capital and investment are kept to a minimum. The result is greater employment and private investment, as well as greater consumption expenditures.

Arguably, a progressive tax system punishes those who work more and does not stimulate faster economic development. Therefore, a proportional tax system that would allocate the tax burden more evenly is recommended, taxing according to the taxpayers' ability to pay.

A final consideration concerns taxes for social security. AICC endorses AACC's opinion that the overriding issue here is the credibility of the government (citizens must believe that the government will deliver on its promises) and of the retirement program itself (if it looks too good to be true, it **is** too good to be true). The tendency of most governments in developing countries that have relatively large public sector work forces is to overpromise on retirement as a way to underpay public servants on a current basis. This is akin to excessive public sector borrowing and will likely have a seriously depressing effect on private investment. It also allows overcollections of social security taxes to finance excessive public sector expenditures in the initial years.<sup>25</sup>

## Issue # 4: Customs

### *Background*

AICC's December 5, 2005 review of custom reforms by the Ministry of Finance observed that Afghanistan must collect fair and appropriate taxes in order to provide services to its citizens. In that statement, AICC also expressed concern that:

- Tax rates were beyond the ability of some companies to pay, and were particularly high on some staple items (flour and sugar);
- The new reforms would create additional pressure on some sectors that were already ravaged by war and draught; and

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- Corruption would actually increase because of the nontransparent practices of customs officials and transport companies, which would tend to choose informality over the higher payments associated with paying customs duties.

Even so, the government continues to assert that an open and transparent trade regime has been its consistent priority. The government states that it has reformed the customs regime to the extent that our country has become one of the most open economies in the region. In support of this assertion, the government states that Afghanistan maintains import bans on very few products and imposes no seasonal restrictions, quotas, or other non-tariff barriers. Afghanistan's average customs duty is only 4%.

Customs duties constitute the largest source of revenue in our country, mainly because it has little production capacity, and—as in many developing countries—because customs fees are relatively simple to administer. In the interim, most observers recommend that the average import tariff should be kept relatively low, with a limited dispersion of rates to reduce arbitrary and excessive effective rates of protection as well as to minimize opportunities and incentives for corruption.<sup>26</sup>

### ***Overview of Survey and Tour Findings***

Many of AICC's National Membership Survey respondents were exporters. A number of these individuals shared a belief that excessive duties are being imposed on exports and need to be reduced. According to these same respondents, infrastructure, communication, and transportation problems faced by exporters are also immense business barriers. They stated that high customs duties now discourage growth in many of the export-oriented business sectors. This is particularly true regarding entrepreneurs who recently returned to Afghanistan to reestablish their businesses.

Additionally, according to many respondents, large quantities of imports from neighboring countries and beyond are flowing into the country, apparently fueled by the absence of Afghan manufacturing processes. Some respondents have commented that this point alone might justify generally higher taxes on imports. However, there is also some sentiment for more narrowly identifying some industries that can be afforded protection through higher duties on imports.

### ***Progress and Obstacles***

According to a recent World Bank report, Afghanistan's customs administration "faces many challenges, including the poor security environment, poorly trained staff, inadequate facilities and equipment, and outdated and cumbersome operating policies and procedures. Customs regulations reportedly are not applied consistently throughout the country, and the lack of an automated system undoubtedly impacts negatively on revenue performance." These flaws were consistently echoed during AICC's National Advocacy Tour and AICC's National Membership Survey.

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According to some sources however, customs collection is improving. Customs offices are gradually becoming computerized. In addition, although corruption is still believed to be pervasive, customs officials seem to be more honest and professional these days, according to some of the truckers who routinely deal with them.

Additionally, there is progress reported in reduction of the red tape associated with import license applications. According to a recent World Bank report, the process previously involved 42 steps, 58 signatures, and several weeks of processing. It now involves only three steps, six signatures, and two days to process. Afghanistan's trade regime consequently now ranks as a "4" in terms of the IMF's Trade Restrictiveness Index, the same as the European Union's and the United States' rankings.

These positive progress reports are clearly encouraging and should ordinarily be received as good news. Unfortunately, they do not entirely square with much of the first-person end-user testimony presented during AICC's National Advocacy Tour, during which witnesses claimed the customs processes were all too often mismanaged and time consuming. Some of the reports of improvement were challenged by participants, many of whom echoed the doubtful sentiments of AICC's initial review of custom reforms that have been implemented by the Ministry of Finance.

### ***Policy Recommendations***

The IMF considers that a move toward a more uniform customs tariff would be preferable to increasing the top rate or the dispersion, while excises may be more appropriate for raising revenue from specific goods.

AICC recommends that one government entity should develop and release economic impact statements for any export or import regulation that is promulgated, and that a set period of days for open communication and discussion should be initiated before regulations are enacted. Furthermore, it recommends that scheduled meetings open for public discussion should be made on the proposed regulations and responses to all comments should be required within a reasonable time period.

AICC will support government policies that focus on improving compliance for taxes and locations with the highest revenue yields. This will necessitate the elimination of numerous low-yield nuisance taxes and the curbing of unlawful levies, as well as avoiding double taxation and confusion.

AICC proposes a 2% across-the-board duty on all goods coming through customs into the country, and no duty on exports.

AICC recommends that, where appropriate, government customs offices be consolidated under a single roof for more organizational efficiency and consumer ease (i.e., consolidated one-stop clearance documentation and simplified procedures). The government should eliminate overlapping ministry and agency roles and adopt a coherent operating plan. Bureaucracy must be reduced as much as possible and

transparent customs inspections, clearance documents, and procedures should be initiated.

AICC enthusiastically renews its support for comprehensive customs reform policies, which include the development of a well-trained professional tax and customs corps. Specialized training programs and institutions, a career development structure, and a performance-based remuneration system should be key components of such customs reorganization reform.

AICC recommends that a clear appeals process be established, so that regulations and their implementation can be challenged in an administrative court system on the basis of need and fairness.

AICC also strongly recommends that uniform export procedures be used by all customs authorities and offices and that these procedures be well publicized and distributed.

Goods should be assessed customs duties at the point of entry into Afghanistan. Once goods have cleared customs, they should be exempt from other duties in any other city.

Furthermore, AICC strongly recommends the computer automation of all customs procedures and the establishment of a network to link the all-customs authority headquarters and branch offices in all ports of entry.

Finally, AICC makes the following recommendations:

- Any goods, machinery, and vehicles that have not cleared customs in seven days should be allowed to come out of customs duty free on the eighth day.
- It should be at the sole discretion of businesspeople whether or not they clear their goods through customs by themselves or hire an agent to clear the customs procedures on their behalf.
- The government should not prohibit the importation of any goods, machinery, or vehicles that are coming to the country for re-exportation.
- Free zones should be established to promote re-export trade in the regions.
- The customs system, with the help of the international community, should go through a total overhaul to ensure fair and transparent collection of tariffs in accordance with widely accepted international practices.

## **Issue # 5: Infrastructure and its Impact on Agriculture**

### ***Background***

Infrastructure includes the physical facilities (roads, airports, utility supply systems, communication systems, water, and waste disposal systems, etc.) and the services (water, sanitation, transport, energy) flowing from those facilities. The provision of productive public infrastructure is one of the highest priorities of the Afghan government.

Infrastructure—whether linking major regional trade corridors through a national road network or increasing productivity through small-scale irrigation schemes—is a key factor to enhancing the long-term growth potential of the Afghan economy.

Infrastructure directly contributes to economic growth because it comprises a significant proportion of GDP and because infrastructure services are essential inputs for other services, agriculture, and industry. Infrastructure is crucial for improving market integration, lowering prices for basic commodities, lowering the costs of production, attracting private investment, increasing Afghanistan's competitiveness, and stimulating the transit of goods within the region and across the rest of the world.

The current poor state of our country's infrastructure is evidence of the reduced levels of investments (outside the road sector) made in several key areas, including trade and transit infrastructure, transmission lines, energy, agricultural infrastructure such as dams and river diversions, storage facilities, water supplies, sanitation, and others.

Among our population, there is increased frustration that, even in urban areas, roads and buildings remain in ruins, power supplies are still irregular, medical facilities are disheveled, school construction is delayed, and supplies of potable water and sanitation facilities are insufficient. For example, the population of Kabul has increased from fewer than 1 million during the Taliban period to an estimated 3 to 4 million by mid-2005, placing extreme pressure on housing and urban services.<sup>27</sup>

Additionally, several years of drought reduced food security in as many as 12 provinces and contributed to a further deterioration in living standards among affected populations, according to a report by the Asian Development Bank.<sup>28</sup> While heavy winter snow and rain in early 2005 promised an end to drought conditions, some provinces experienced consequent flood damage.

### ***Overview of Survey and Tour Findings***

From the standpoint of the Afghan economy, agriculture cannot be considered a minor issue, as it represents about 36% of GDP (excluding opium), and provides almost 66% of employment. Particular agricultural output growth potential lies in high-value lines such as fruit, livestock development, agro processing, and rural industries. Investments in the rural economy are also key to our success of the counter-narcotics and poverty-reduction strategies. This is why both the AICC National Membership Survey and the National Advocacy Tour emphasized the importance of establishing an agricultural policy that promotes investments in rural areas.

The National Advocacy Tour highlighted the importance of solving the following issues:

- Inadequate business infrastructure (including roads, water supply, electricity, and hydropower plants)
- Lack of irrigation and agro processing facilities

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- Difficult access to domestic and foreign markets
- Lack of access to information

A large majority of our country's population is rural and is dependent on some form of agricultural activity for their livelihoods. Some respondents pointed out that large tracts of land can be brought under irrigation in different parts of the country if small- and medium-sized dams can be constructed in the provinces. They also stated that Afghanistan, due to its weather and topography, is suitably situated for diverse agricultural activities and can increase production of several vital agricultural products if enough investment, research, and efforts are directed at this sector. Several respondents drew attention to the point that increased agricultural production will create, in turn, a foundation for agro-based food processing industries.

### ***Progress and Obstacles***

In a World Bank survey of businesses on the investment climate in our country, the most serious constraints to investments reported were **electricity** and access to land. Over 64% of the surveyed enterprises cited electricity, and 60% cited access to land, as either a severe or major obstacle to doing business here.<sup>29</sup>

Indeed, the power supply in Afghanistan is of poor quality, characterized by low voltage, intermittent supply, and blackouts. Only about 76% of the World Bank sample was connected to the power grid, but even they received power on average about six and a half hours a day. Not surprisingly, 74% of businesses reported owning at least one generator; in Jalalabad, that figure was 97%. Of the country's installed power generation capacity of 420 megawatts, only 270 megawatts is operational; moreover, transmission and distribution capacities are inadequate.

Despite these issues, some infrastructure developments have been made. Rehabilitating the **road network** has been a top priority for the government. According to the World Bank, road investments—both rehabilitation of our country's main highways and building smaller and rural roads—have moved ahead. Thousands of kilometers of roads have been built, including the ring road from Kabul to Kandahar. Some improvements in travel times have already begun to materialize. Through the National Emergency Employment Program (NEEP) for example, around 6,000 kilometers of rural roads have been rehabilitated or constructed, and several small-scale, community-based irrigation schemes have been completed. In addition, numerous schools, nine clinics, 105 shelters, 26 government buildings, 29 nurseries, and many water schemes have been constructed. In total 11.2 million labor days were generated, with the program benefiting 375,000 households. NEEP activities have taken place in districts from all 34 provinces.

Through the National Area Based Development Program, 320 immediate recovery subprojects comprising the construction or rehabilitation of productive rural infrastructure have been completed.

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The Rural Water and Sanitation program has led to the construction of nearly 18,000 water points, 17 pipe schemes, and more than 8,000 latrines serving almost 3 million people (including 525,000 schoolchildren) countrywide.

But there is still a long way to go. Implementation has been in some cases slower than desired for various reasons, including security. Additionally, the costs of highway rehabilitation have tended to be high.<sup>30</sup>

**Logistics** have also greatly improved. Transport services were an important activity during the conflict, and private transport companies have expanded rapidly since the end of the war, offering logistics, security, air cargo, freight forwarding, and shipping services. Federal Express and DHL now operate in our country, allowing businesses to send information and materials quickly in and out of the country.<sup>31</sup> However, the government remains heavily involved in the transportation sector.

The **telecommunications** sector in our country is developing very rapidly. Driven by a competitive market and \$200 million in private investment, the mobile telecommunications footprint covers as much as 50% to 60% of the country's population, providing services in 23 provinces (as of March 2005).<sup>32</sup> There are two private mobile operators, and two additional licenses for mobile telecommunications have recently been awarded. In addition, several Internet Service Provider (ISP) companies are now functioning throughout the country, raising the modes of communication.<sup>33</sup> An access agenda for rural areas remains, as does a need to considerably improve the quality and range of services and to further reduce prices.

Progress has been much slower in other sectors such as power and irrigation. Financing of infrastructure is still not on a self-sustainable basis. Many state-owned enterprises (SOEs) are defunct, and there are still major regional differences and gaps.

Afghanistan is also rich in natural resources, including energy and minerals. The government promulgated a Minerals Law, which established the framework to invest in this sector. **Mining** and extractive industries are expected to attract significant FDI over the next few years. Afghanistan has largely untapped reserves of iron, copper, coal, hydrocarbons, quarry materials, and gemstones.

The state-owned natural resource assets could be used more productively, for example through the sale of public land for housing and privatization of state enterprises. Yet to fully benefit from these resources, regulatory and institutional deficiencies will have to be resolved and major infrastructure investments made. Passing the Hydrocarbons Law could create an open and transparent framework for potential investors to consider investment in the natural resources sector.<sup>34</sup>

The government has a great **need to communicate effectively** with district and provincial offices and to promptly deliver services. The success of mobile phones demonstrates the ability of modern technology to be quickly implemented and that

demand for it is large. According to the World Bank, the mobile footprint now covers 50-60% of Afghanistan's population, and mobile prices have declined by 70% during the last year and a half. In addition, a Government Communication Network has been set up in nine provinces and is expected to be expanded.

According to the UNDP, Afghanistan already has in place two key building blocks for a national **Information and Communication Technology** (ICT) policy in the form of the National Telecommunications Policy (issued in July 2002) and the Telecommunications Development Strategy (issued in October 2002). These two documents tackle critical aspects of building a communications infrastructure. However, several complementary public policy issues related to content and capacity building must be addressed before further progress can be made toward the development of a national ICT policy.

According to the UNDP, the role of government as a model user of ICT is significant to the successful introduction of ICT to Afghanistan. ICT can be used to improve public access to information collected by the government in areas of government responsibility such as health, education, and agriculture, and to provide other electronic government services. The government should make effective use of ICT to streamline its internal operations, as well as use public procurement of ICT as a tool to stimulate business development and foster innovation.

ICT underpins the evolution toward a knowledge-based society and will thus have a profound impact on how our businesses organize and operate. For example, the government must provide legislative provisions that ensure that commercial arrangements transacted electronically are valid and enforceable.

However, the cost of upgrading and ensuring full interconnection of our existing and new networks will be high. Afghanistan's immediate reconstruction needs cannot be met solely through private sources. In the near term, our country urgently requires assistance from the international donor community to support priority projects that will help ensure the success of the overall development program.

The interconnection of networks increases the flow of personal and business information. Existing data such as financial accounts, educational records, and medical records can be sent across national borders and sold or integrated with other databases. Because of the potential for abuse, there is a need for privacy protection.

Additionally, the potential for piracy of protected works and the consequent economic losses is a concern to creators and producers. The new digital environment raises a host of intellectual property questions. Afghanistan must take appropriate measures to protect the rights of creators. Additionally, offensive content on the network presents complex issues for Afghans and our government. A balance must be struck between freedom of expression and imposing controls to deter harm, particularly to our children.

### ***Policy Recommendations***

In most sectors (whether social services or public infrastructure), Afghanistan has much more flexibility in choosing the best options than do other countries that have well-established service delivery institutions and networks. Depending on the sector, this may involve deconcentration and moving toward more commercialized modes of service provision—by a utility company, through private sector participation, etc.

**Roads.** In order for Afghanistan to have a fully upgraded and maintained ring road, as well as roads connecting the ring road to neighboring countries and a fiscally sustainable system for road maintenance (commitments made by the Afghan government at the London Conference), AICC recommends the following:

- Continue the rehabilitation of the road network and key ports (land and air).
- Build capacity in the Ministry of Public Works to oversee the investment program.
- Develop mechanisms for efficient cost recovery.

Afghanistan already has a large highway rehabilitation program underway, with a total cost exceeding \$1 billion. AICC recommends that any major new highway project proposal must be treated with great caution and carefully prioritized. Benefits depend greatly on traffic forecasts (both freight and passengers), and on available alternative routes. Costs per kilometer may be fairly standard (depending on the type of road construction involved and the condition of the existing road), although according to the World Bank, there has been a great deal of cost variation in Afghanistan—depending in part on mountains, the number of bridges, tunnels, and so on. High altitude and steep grades also affect the costs of users and reduce the net benefits to them. Another factor is extra security costs, estimated at 3%–15% for highway rehabilitation projects.

**Air Transportation.** AICC supports the government's commitments to ensure that the Kabul International and Herat Airports achieve full International Civil Aviation Organization compliance, while the Mazar-i-Sharif, Jalalabad, and Kandahar airports are upgraded with runway repairs, air navigation, fire and rescue, and communications equipment. Several other domestic airports should be upgraded to facilitate domestic air transportation, while air transportation services and costs should be increasingly competitive with international market standards and rates.

**Energy.** AICC further recommends that the Afghan government follow through on its London Conference commitments of supplying electricity to at least 65% of households and 90% of nonresidential establishments in major urban areas, and to at least 25% of households in rural areas by the end of 2010. A recommended benchmark is that at least 75% of the costs should be recovered from users connected to the national power grid. Additionally, a strategy for the development and use of renewable energy is necessary to ensure our independence.

**Mining and Natural Resources.** AICC recommends the creation of an enabling regulatory environment for profitable extraction of our mineral and natural resources. Moreover, the investment environment and infrastructure need to be enhanced in order to attract domestic investment and FDI in this area.

**Water Resource Management.** Sustainable water resource management strategies and plans covering irrigation and drinking water supply need to be developed. AICC recommends irrigation investments, such as large waterworks, that should result in improved access to running water for the urban and rural populations.

Additionally, AICC believes that environmental regulatory frameworks and management services should be established for the protection of our air and water quality, waste management, and pollution control. Moreover, natural resource policies should be developed and implemented at all levels of government and within local communities.

**Urban Development.** Municipal governments should focus on improving their capacity to manage urban development and ensuring that municipal services are delivered effectively, efficiently, and transparently to all citizens. Investments in water supplies and sanitation should be continued to ensure that households in major urban areas have access to running water.

**Agriculture and Rural Development.** In order to create an enabling environment for legal agriculture and agriculture-based rural industries, AICC recommends that the government build the necessary institutional, regulatory, and incentive frameworks to increase production and productivity.

AICC recommends that public investment in agriculture increase, while particular consideration should be given to perennial horticulture, animal health, and food security by instituting specialized support agencies and financial service delivery mechanisms, supporting farmers' associations, branding national products, disseminating timely price- and weather-related information and statistics, providing strategic research and technical assistance, and securing access to irrigation and water management systems.

According to the Afghan government, rural development would benefit 19 million people in more than 38,000 villages. AICC believes it can be achieved through the election of voluntary community development councils in all remaining villages, promoting local governance and empowering communities. Road connectivity should reach a majority of all villages, increasing access to markets, employment, and social services. Small-scale irrigation and improved access to financial services will directly result in economic growth and the establishment of larger, more efficiently run agricultural businesses.

**Information and Communication Technologies.** AICC urges the government to ensure universal access to essential public communication services at reasonable cost. All Afghans, including those in remote areas, those who are functionally illiterate, and

other groups with special needs such as girls and women, should have access to an adequate range of services.

Additionally, consumer awareness and learning opportunities should be provided to enable Afghans to become effective users of ICT. In the information society, success in school, the workplace, and everyday life will depend on learning new and more efficient ways to rapidly access a variety of information- and knowledge-based resources. Users will need to understand how to access and use ICT effectively if they are to derive the full benefits of these services. Afghan consumers and small businesses should be encouraged to explore the opportunities that ICT will present through public awareness and training programs.

### **Issue # 6: Education**

#### ***Background***

Afghanistan has seen an extraordinary advance in elementary education since the end of the conflict in 2001. Even more impressive is the fact that male and female enrollments have reached levels far higher than at any time in our history. In 1992, there were virtually no Afghan girls being educated. According to *Newsweek*, girls now comprise more than 33% of the 5 million students enrolled in elementary education.<sup>35</sup>

Despite Afghanistan's remarkable progress, a great deal of work remains to be done in order to provide Afghans with a more stable and productive life and an antidote for violence. In short, the literacy rates are still paltry for a nation aspiring to modernization.

For example, the literacy rate of females in rural regions aged 7 to 13 is a meager 30% nationally. The literacy rate for urban males in the same age, by contrast, reaches 81%. Conversely, the literacy rate of rural males aged 15 years and older dips to 40%.

Afghanistan is caught in an educational and economic dilemma. On the one hand, the lack of opportunities discourages our workforce from developing their skills and education. On the other hand, our businesses will not invest or expand because of the lack of skilled labor. Additionally, only a small fraction of Afghan firms offer training.

A very low literacy rate helps explain some of the competitive disadvantages dragging on our private sector. Merely 33% of the workforce in Afghan businesses have a secondary education or higher. Additionally, while 96% of Pakistani managers and 98% of Indian managers have secondary or higher educations, only 62% of our managerial workforce has secondary or higher levels of education.

The situation in Afghanistan's public sector is comparable. Though some returning Afghans have brought important technical skills, the majority of civil servants lack the basic education requirements that would enable them to effectively deliver services.

### ***Overview of Survey and Tour Findings***

Years of conflict and neglect have had an adverse impact on our standards of education in the country. A number of AICC's National Membership Survey respondents noted that facilities and teachers in their communities are of low caliber and finances are woefully insufficient. Many respondents indicated support for hiring private contractors who would improve training programs and public standards.

Elementary and secondary education placed prominently among the main issues confronting our country, according to the findings of AICC's National Membership Survey. However, as a topic, university-level education was largely ignored. Perhaps this was an acknowledgment that the magnitude of elementary and secondary education problems required more immediate attention. Respondents by and large echoed recognition that there is an immense gap to fill in our educational sector, especially in the smaller towns and the rural areas where the majority of our populace lives. This, of course, needs to be coupled with improving standards of education.

### ***Progress and Obstacles***

High illiteracy, poor education, war, and political upheaval have resulted in a critical shortage of skilled labor in our country. During the conflict, many of our best-qualified workers, those with the best opportunities abroad, fled. Consequently, qualified management, skilled technicians, and educated professionals are scarcely available to today's enterprises.

Administration of our educational system comes with extremely meager levels of resources. There is almost no spending at the school level other than teacher salaries. Acquisition of textbooks and furniture is largely through international donor organizations and outside government control. In fact, approximately 75% of Afghanistan's education-related expenditures in 2004 and 2005 was donor provided.

### ***Policy Recommendations***

AICC strongly recommends supporting policy initiatives that will significantly increase primary school enrollment for our girls and boys.

AICC recommends a robust nationwide information and advocacy campaign to explain the economic and societal benefits of education to communities, families, and the country. Particular emphasis should be placed on providing educational support for girls. A special syllabus should be created to support this concept.

AICC recommends that our government incorporate a full-bodied component of instruction regarding participatory democracy and the benefits of free-market economies in the curriculum of all elementary and secondary educational programs. Furthermore,

AICC supports policy initiatives that serve to educate our adult population as to the benefits of democratic government and the opportunities of a free-market economy.<sup>36</sup>

AICC strongly recommends that an updated curriculum be systematically shaped for all secondary and postsecondary schools, and it should emphasize acquisition of marketable skills designed to meet the developmental and human resource requirements of our country and private sector growth. For example, these skills might include concentrations in vocational fields such as agriculture, health care, and critical technologies related to building Afghanistan's infrastructure (e.g., road and bridge construction, electricity, and irrigation).

Finally, AICC recommends that Afghanistan's teachers be obligated to pass a competency test and subsequent annual performance reviews. Furthermore, AICC recommends that opportunities be made available to teachers for in-service training to provide skills relevant to helping students obtain gainful employment.

## **Issue # 7: Development Policies and Access to Capital**

### ***Background***

Afghanistan is in a transition from a post-conflict society to a market-oriented democratic society. Governmental focus has necessarily shifted toward building sustainable governmental institutions, societal mechanisms, and organizing an investment-friendly business environment.

To date however, the donor community has more often supplied huge amounts of technical assistance and financial resources for large projects, such as buildings, roads, water projects, clinics, and schools. These critical projects are largely oriented toward infrastructure improvement, not strengthening the private sector. As stated previously under the section on security, they are also targets that require expensive security.

Many free-enterprise proponents, including AICC, point out that infrastructure alone does not define an economy. The infrastructure is in fact used by millions of people, who will by their socioeconomic and market-oriented choices define an economy. It is private enterprise that provides the creativity and broad-based work efforts that lead to new wealth and job opportunities that can substitute for participation in corruption, banditry, and the drug trade. Only private enterprise can ensure that use of infrastructure is maximized.

As opposed to the more often highly centralized infrastructure investments, small- and mid-size private sector investments are generally widely distributed.

### ***Overview of Survey and Tour Findings***

The National Advocacy Tour revealed several common concerns pressing our Afghan business community, including the lack of proper promotional and development policies on the part of the national government for private sector growth; the restricted access to capital and finance, especially small- and medium-size loans; and the lingering privatization of state owned enterprises.

During the course of the survey, respondents itemized a large number of problems confronting business representatives. One important item was the absence of credit and other banking facilities. Long-term investment financing, working capital loans, and letters of credit were considered to be key banking services that were unavailable in different parts of the country. Moreover, it has also been observed that some of the new commercial banks that have started credit operations charge high interest rates, which exceed the local businesspeople's capacity.

Land also surfaced as a problem for manufacturing enterprises. Many expect to obtain relatively inexpensive land in one of the newly established industrial estates where provision of necessary facilities and services is more efficient than in other areas. If such land is not available, a large number of manufacturers may be unable to function.

Some respondents invoked free-market economic principles to persuade the state to abandon involvement in business activities. According to these respondents, the relatively few businesses that are still owned by the government need to be privatized. Standing in the way of the respondents' demands, however, is the fact that there are certain large-scale projects that appear to be locked into government involvement for some time, including: some mines, hydroelectric projects, and large industrial plants.

Finally, many business representatives wanted AICC support (and seek public sector support) for the formation of joint ventures with foreign organizations—for example, for technology transfer, international investment funding, and foreign management and technical expertise exchanges.

Tourism is one subject that has been touted as a significant business potential for Afghanistan. Some survey respondents noted that initiatives in this business sector would have the dual benefits of bringing cash directly into the economy while exposing Afghan goods to the world. Tourism was the leading subject brought up by most of the several hundred business participants attending the National Advocacy Tour event in the remote Afghan city of Bamyan, the infamous site where the Taliban destroyed two of the largest statues of Buddha in the world.

### ***Progress and Obstacles***

Despite remarkable progress in such a short time, much crucial work remains in order to provide Afghans with a business environment conducive to productivity and profitability.

Many obstacles to economic investment and growth remain, and some international observers state that unless friendlier private sector rules and regulations are adopted, the country will not be able to keep up its current rate of GDP growth.<sup>37</sup>

The government has taken a number of steps to foster private sector investment. For example the Afghan government passed the Law on Domestic and Private Investment in 2002, which is intended to encourage and protect private investment. Under this law, 100% foreign ownership is permitted, unlike other countries where there are stricter joint-venture laws that restrict the amount of ownership a foreign entity may have. The law also protects investors against expropriation and provides internationally recognized dispute resolution provisions. In addition, Afghanistan ratified the New York Convention on the Enforcement of Arbitral Awards in 2004, providing additional assurance to investors that their agreements can be enforced.<sup>38</sup>

Also, the Afghan Investment Support Agency (AISA) was set up by the Afghan government with German support in October 2003 as an independent institution to serve as a “one-stop shop” for investors. Since then, the AISA has registered thousands of domestic businesses and 300 international businesses. The registration process typically takes less than two weeks to complete, with most registered within four days.<sup>39</sup>

An ambitious industrial park program (<http://www.aisa.org.af/ipda/index.html>) has also been developed with the assistance of the U.S. Agency for International Development (USAID) in order to promote private sector activities. There are several benefits that the industrial parks offer. For example, they offer a clear land title, reliable power and water supply, and 24-hour security. The slots for business development are available for companies of various sizes, and the registration process is simple and clear.<sup>40</sup>

Given the strong interest in the first sites, the government of Afghanistan is working on plans to develop additional sites for industrial park development to further promote investment and industrial development across the country.

The government of Afghanistan also established a procurement agency to facilitate the purchase of goods and services for the government. This agency, the Afghanistan Reconstruction and Development Service (ARDS), uses internationally recognized procurement procedures. Companies that wish to receive procurement notices can do so very easily by registering through e-mail. All notices are sent electronically to companies registered with ARDS. Information on ARDS and its program are provided on the Global Business Gateway.<sup>41</sup>

There has been significant progress in developing the financial sector. The Afghanistan Bank and banking laws have been formally enacted, many private commercial banks have been licensed, and three state-owned banks have been relicensed.<sup>42</sup>

Progress has also been made in developing the microfinance sector. The government has established the Afghanistan Investment Support Agency (AISA) with the mandate of

promoting and facilitating investment. The AISA has helped streamline the business registration process to the extent that Afghanistan now ranks among the best countries in the World Bank's 2005 Doing Business indicators of firm registration, as mentioned above (under Afghanistan's Road Ahead). However, a host of clearances and procedures are still required before a business can actually begin operating.<sup>43</sup>

Outside of agriculture, the private sector is overwhelmingly composed of informal family-owned micro-enterprises, most of which are engaged in trading or basic services. According to the World Bank, 80% to 90% of all economic activity is informal. There are few small- and medium-sized enterprises and only a handful of large ones. The manufacturing sector is tiny, export orientation is minimal, and most producers, with the exception of a few agro-processors, source their raw materials from abroad.<sup>44</sup>

The end of major conflict and the fall of the Taliban regime led to an increase in private investment, but investment has been limited relative to Afghanistan's potential. New entry and expansion have been far less than policymakers had hoped for. Only two enterprises have been privatized. AISA has registered nearly \$1.3 billion in new investment (not including the telecom firms) in the past two years, but most of this is merely approved investment, and just a fraction has actually occurred. Nearly 50% of the new investment approved by AISA has been in construction and construction material. The remainder is split almost equally between industry and services.

The concentration on construction, which is not unusual in post-conflict countries, reflects the massive flows of external aid and the need to rebuild Afghanistan's devastated infrastructure. The largest sectors in industry include plastics, bottlers, and processors of simple packaged foods—all aimed at the local market. Most are technologically simple and need only small investments. Examples are small producers of biscuits and other inexpensive packaged foods that aim to replace more expensive imports. For the most part, Afghan industrial enterprises are nascent and are unable to either effectively compete against imports, or enter the export market.<sup>45</sup>

The World Bank's Investment Climate in Afghanistan survey report highlights some noteworthy developments. For example, despite the difficult business environment, Afghan industry is steadily recovering and existing firms are coping well, performing on par with firms in neighboring Central Asian countries. Firms surveyed report a 67% average increase in employment over the past five years, with 22% increase in the past year alone. Average capacity utilization of manufacturing firms rose by 10% in 2005.

The rapid increase in employment was matched by a similar increase in sales and reflects the low base from which Afghan firms are starting. The median value of sales per worker in Afghan manufacturing firms is around \$3,333—greater than that reported in Tajikistan or Uzbekistan, but only around 33% of that of small manufacturing firms in India or Pakistan, and much less than that reported by Chinese firms.

Afghan industry's low capital intensity explains much of this shortfall in labor productivity. At 60%, average capacity utilization in Afghanistan manufacturing is only slightly below its neighbors and high for a country just emerging from sustained conflict. For example, in 1997 Mozambique was also three or four years out of major conflict, and average capacity utilization in manufacturing was only 48%.<sup>46</sup>

However, this optimistic view is tempered by the fact that industry is starting from a low base and most of the investment is in the most basic production processes. Afghan firms offer less training than do their neighbors and their managers, and workers are less skilled than are those in competitor countries. Many businesses in Afghanistan do not feel the threat of strong competition. These facts suggest that substantial barriers protect incumbent firms and relieve them of pressure to constantly upgrade their capabilities.

**Access to capital.** Afghanistan's financial system is just beginning to recover and businesses have almost no access to bank credit and only limited access to banking services generally. Most of the 12 commercial banks licensed to operate in Afghanistan are concentrated in Kabul and provide services primarily to international donors and businesses, foreign nongovernmental organizations, and foreign government agencies.

Commercial banks in Afghanistan offer financing with a maximum tenure of financing of up to three years. There are a small number of non-bank financial institutions (11 microfinance institutions, one credit union, and one leasing company), but although growing, they are still nascent and can meet only a very small fraction of credit needs. There are no credit bureaus or credit rating agencies.

**Privatization of Public Enterprises.** The legacy of numerous public enterprises responsible for various infrastructure operations, created during the period of the Soviet occupation or in some cases earlier, needs to be addressed through privatization. For example, many of the SOEs focused on infrastructure development and are defunct or provide only very low levels of service. Restructuring them should be a policy priority.

### ***Policy Recommendations***

Despite remarkable progress in a short time, much work remains to be done to rebuild the country's social fabric and infrastructure and chart a successful transition to democratic self-determination. The Afghan government should support economic growth by expanding rural incomes, improving access to economic and social infrastructure, and assisting with economic policy and regulation reforms. Additionally, it should provide alternative livelihood options to poppy cultivation through small business development, public works and infrastructure support, production of competitive agricultural products, and greater public access to credit and financing institutions.

AICC recommends that the Afghan government, with the support of the international community, continue to pursue high rates of sustainable economic growth with the aim

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of reducing hunger, poverty, and unemployment. Promoting the role and potential of the private sector, alongside the roles and potentials of the public and nonprofit sectors; curbing the narcotics industry; ensuring macroeconomic stability; and restoring and promoting the development of the country's human, social, and physical capital will help establish a sound basis for a new generation of business activity.<sup>47</sup>

AICC strongly recommends that Afghanistan's monetary policy include private sector's accesses to capital, reasonable interest rates, and bank guarantees in order to bring investments into the country, which most certainly is the safest way for the government to meet its fiscal budgetary requirements. Hence, the Afghan government should follow these recommendations:<sup>48</sup>

- Encourage greater participation of women in business.
- Ensure improved transparent financial management at the central and provincial levels by establishing and meeting benchmarks for financial management agreed on and monitored by the international community.
- Achieve lower transit times through Afghanistan by means of cooperative border management and other multilateral or bilateral trade and transit agreements.
- Increase the amount of electricity available through bilateral power purchase.
- Reach agreements with other countries in the region to enable the import of skilled labor and to enable Afghans to seek work in the region and send remittances home.
- Continue the reform of the Da Afghanistan Bank by focusing its activities on its regulatory functions (continuing to phase out its commercial activities) and strengthening its capacity. Encourage the expansion of existing private commercial banking activities and scaling up non-bank financial services.
- Prepare a specific action plan for the resolution of state-owned commercial banks that includes dates for the appointment of a comprehensive management team, a capitalization plan, and short- and long-term plans for the rehabilitation and incorporation of their urban and rural banking.
- Encourage strategic public-private financial partnerships.
- Establish loan guarantee facilities.
- Prepare a privatization policy to articulate the principles of privatization and lay out a transparent process for carrying out privatization and liquidation.
- Strengthen the legal and institutional framework for privatization; amend the SOE law to allow for private investment participation in SOEs and develop a legal framework to facilitate allocation of surplus SOE land.
- Establish commercial bank lending, venture capital, revolving loans, or trust funds. Seeding private enterprises will lead to creditworthy businesses later.
- Expand the promotion of small business development beyond Kabul, into the provinces and major cities.
- Expand policies regarding product quality control so as to improve the value of local products for competition in the local and international market. Moreover, quality controls also need to be applied to foreign products, especially food products, to weed out defective and counterfeit goods.

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- Provide business development services through specialized agencies and public-private partnerships in various functional areas of business such as marketing, finance and accounts, management, vital business and marketing information, regulatory information, business plans, credit and investment proposal writing, and leadership skills development.

Land and property rights remain a serious concern for investors throughout the world. AICC supports liberal investment policies that establish predictable land ownership principles.<sup>49</sup>

AICC recommends advancing public policies that will encourage industrial parks to advance private sector growth. Industrial parks can be advantageous to businesses of all sizes because they will offer a clear land titles, reliable power and water supply, and—most important—robust 24-hour security.

AICC recommends establishment of online portals such as Global Business Gateways that are hubs for business information that provide concise summaries of the trade, investment and travel, business highlights, and quick access to a categorized database of potential business partners, service providers, and investment opportunities.

Afghanistan's location in the heart of the expanding Central Asian market makes it a gateway to doing business and investing in the region. The country is a land bridge connecting the markets of Central and South Asia. Thus, investors can reach not only the estimated 25 million people in Afghanistan, but potentially also the 150 million people in close proximity to Afghanistan.

AICC also recognizes that tourism is the business sector that promises huge growth potential and recommends support for policies that foster its expansion. Afghanistan is steadily regaining its past reputation as a beautiful country with hospitable people. Until the 1970s, Afghanistan was a popular destination for its unique culture and diverse terrain. According to the Afghanistan Travel and Tourism Network, attractions in Afghanistan center on its diverse history, culture, and beautifully rugged terrain. Eco-travel agencies are already operating in Afghanistan. In 2002, Global Exchange—a nonprofit, international human rights organization—was one of the first organizations to provide a packaged tour for those interested in surveying and developing a sense for understanding Afghanistan's culture and environment.

Afghanistan's location at the crossroads of great civilizations in history has created a stunning diversity in food, arts, languages, and traditions, which should be promoted by the government as a unique resource.

### The Next Steps

The future of the AICC advocacy efforts, meaning those efforts involved in shaping the laws and regulations related to the business community, are closely linked to the process that created the National Business Agenda for 2006.

As important as the creation of the NBA is to Afghanistan's private sector, its creation alone is not enough. Now that the first phase of the NBA project has been completed, it is sensible to reflect on what is next.

AICC will use the NBA's creation to launch an overall advocacy process that promotes unity and professionalism. This will include the creation of committees to address key NBA issues as well as the engagement of government officials in the process. By and large, the NBA will call attention to those business community problems that should be addressed by public policy initiatives (lawmaking) or government regulation, or both. The NBA will be used by AICC to more effectively communicate policy concerns to elected and appointed officials and rally business community grassroots support. Ultimately, the NBA is designed to spur an ongoing process of listening to AICC members and business community representatives.

More specifically, in the upcoming months the NBA will be used to accomplish the objective of uniting Afghanistan's business community in several ways. First, it will serve to publicly deliver a statement that comprehensively identifies the problems of Afghanistan's business community. This will be accomplished by ensuring that every Afghan media outlet receives a printed copy and routine in-depth briefings regarding the agenda. Second, the NBA will be used as a credible leverage for prioritizing specific policy issues and concerns with decision makers. This credibility, acquired by systematic inclusion of the widest possible range of opinions from Afghanistan's business community, and will help coordinate the allocation of resources. Finally, the NBA will be used to coordinate the richly diverse efforts of the business sectors to solve problems collaboratively.

The National Advocacy Tour will be continued to collect updates on the main policy issues from different parts of the country. For example, the very important cities of Khost, Tarin Kowt, and Ghardiz will be included.

Over the next year the promotion of the NBA will take several forms:

- AICC will recruit business representatives from across the country to form advocacy committees. These committee members will be appointed from a cross-section of industries and regions. They will be brought to Kabul periodically to work together on drafting solutions to problems.
- AICC will also have scheduled days when business delegates from around the country gather in Kabul to promote and lobby for the solutions they have developed.

The first of these will likely occur during the fall of this year when the Parliament convenes.

AICC will use the NBA process as a model for years to come. Each year, the programmatic approach will be refined, and each year's approach will provide lessons and a foundation for improvement during those years that follow. When one policy issue has been solved, AICC will move to the next policy priority.

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<sup>1</sup> Ibid.

<sup>2</sup> Ibid.

<sup>3</sup> Afghan News Net.

<sup>4</sup> Transparency International, "Corruption Perception Index" 2005.

<sup>5</sup> Ibid.

<sup>6</sup> World Bank, "The Investment Climate in Afghanistan—Exploiting Opportunities in an Uncertain Environment," Finance and Private Sector Development Unit, South Asia Region, World Bank, December 2005.

<sup>7</sup> World Bank, International Monetary Fund.

<sup>8</sup> Myers, Dr. Robert, "Afghan American Chamber of Commerce, Reforming Afghanistan's Fiscal Systems/Procedures," August 14, 2005.

<sup>9</sup> Wiseman, Paul, "Afghanistan's Goal: Supporting Itself," *USA Today*, May 25, 2006.

<sup>10</sup> Chamberlain, Andrew, "The Tax Foundation, Afghanistan's New Income Tax," May 31, 2005.

<sup>11</sup> International Monetary Fund, "IMF External Relations Department, Islamic Republic of Afghanistan—Sixth Review Under the Staff-Monitored Program and 2005 Article IV Consultation, Concluding Statement of the IMF Mission," Kabul, Afghanistan, November 22, 2005.

<sup>12</sup> Myers 2005.

<sup>13</sup> Myers 2005.

<sup>14</sup> Wiseman 2006.

<sup>15</sup> Wiseman 2006.

<sup>16</sup> IMF 2005.

<sup>17</sup> Wiseman 2006.

<sup>18</sup> Myers 2005.

<sup>19</sup> Wiseman 2006.

<sup>20</sup> The Heritage Foundation, "Economic Freedom Report," 2004.

<sup>21</sup> IMF 2005.

<sup>22</sup> Myers 2005.

<sup>23</sup> Ibid.

<sup>24</sup> Ibid.

<sup>25</sup> Ibid.

<sup>26</sup> World Bank, "Afghanistan Managing Public Finances for Development Report."

<sup>27</sup> Asian Development Bank, Current Development Trends and Issues.

<sup>28</sup> Ibid.

<sup>29</sup> World Bank 2005.

<sup>30</sup> World Bank, "Managing Public Finances for Development," Poverty Reduction and Economic Management Sector Unit, South Asia Region.

<sup>31</sup> ICT Policy Development and Implementation Seminar for Afghanistan, Afghanistan: Open for Business, October 14–18, 2002,

<sup>32</sup> World Bank 2005.

<sup>33</sup> ICT 2002.

<sup>34</sup> Ibid.

<sup>35</sup> *Newsweek*, June 26, 2006.

<sup>36</sup> Building on Success 2006.

<sup>37</sup> USAID Budget Website.

<sup>38</sup> ICT 2002.

<sup>39</sup> Ibid.

<sup>40</sup> Ibid.

<sup>41</sup> Ibid.

<sup>42</sup> World Bank 2005.

<sup>43</sup> Ibid.

<sup>44</sup> World Bank 2005.

<sup>45</sup> Ibid.

<sup>46</sup> World Bank 2005.

<sup>47</sup> Building on Success 2006.

<sup>48</sup> Ibid.

<sup>49</sup> ICT 2002.