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The Economic Imperative: Stabilizing Afghanistan Through Economic Growth

POLICY BRIEF



By Nathaniel Fick and Clare Lockhart

America's strategy in Afghanistan is predicated on a belief that sustainable security there and in the broader region requires a sovereign Afghan state that meets its internal responsibilities to protect and serve its citizens and meets its obligations to the international community.¹ Smart execution of this strategy must proceed simultaneously across several lines of operation. These include not only the provision of basic security for the Afghan people but also support for a political process characterized by consensus building, the development of participatory politics, good governance, and attention to political and economic concerns in the broader region.

The strategy also depends on successful efforts to foster economic development in an impoverished and war-weary country with poor infrastructure, low literacy rates, and little recent economic integration with the rest of the world. This

economic component is the least fully developed aspect of the American and NATO campaign to deny Afghan territory to non-state actors and to prevent the wider destabilization of Central and South Asia. Development and security, however, can be mutually supportive, and training people to create economic opportunities is a useful tool in countering insurgencies.

The Economic Gap

The reasons for inattention to the economic dimensions of the Afghan campaign are many. They include: a justifiable preoccupation with security when allied troops and Afghan civilians are dying every day; norms that place much of the responsibility for economic development on international organizations rather than sovereign governments; the belief that security is a precondition for economic activities; and the fact that development theory itself is increasingly being called into question, particularly after nearly a decade of failure by the international community, and in particular, by the development agencies active in Afghanistan, to create or enable sustainable economic enterprises.² Linking all of these is the simple reality that most policymakers are not business people, do not speak

the language of business, and tend – like many of us – to revert to the tools they know even when these are insufficient to deal with the problem. The international community, therefore, tends to dwell on capacity-building and the rule of law to generate security rather than focusing on creating jobs quickly to provide legitimate economic opportunities for the population.

In the years after 2001, significant progress was made under the Bonn Agreement and the related reconstruction effort. However, after 2005 the hard-earned gains proved fragile and Afghanistan reverted to instability.

The newly revamped U.S. strategy seeks to address some of the underlying causes of this reversion to war, and hopes to correct them through:

- A focus on protecting the population, rather than on holding terrain or targeting the enemy.
- A recognition that long-term stability in Afghanistan must account for both sides of the border with neighbor Pakistan.
- An understanding that capable Afghan National Security Forces representing a credible and non-predatory government will be the necessary enabler of any responsible withdrawal of U.S. and NATO forces.
- A belief that true stability will rest on a sovereign Afghan government that accepts the responsibility and acquires the capabilities to serve its population and govern with accountability.
- A belief that economic development is key not only to combating the Taliban by reducing the economic incentives to join their ranks, but also to making Afghanistan something more than a permanent ward of the international community in the wake of the inevitable withdrawal of Western forces. The country is capable of generating revenue and providing jobs and



Source: CIA, www.cia.gov.

livelihoods for its own population, thus giving Afghan citizens a stake in the future of Afghanistan.

Each of these objectives aims to convince the average Afghan to take the dangerous step of choosing sides in this conflict at personal risk. In order to be successful, the Afghan government and its global partners must provide a vision for the future that is powerful enough to change peoples' behavior. Basic security and good governance can enable that, but the possibility of economic success makes it real. Providing economic opportunity for Afghanistan's youth is the most effective way to persuade them to opt for a future within a system governed by the rule of law.

One of the paradoxes bedeviling Western governments in Afghanistan has been that every line of operation in a counterinsurgency campaign seeks to bolster the legitimacy of the host-nation government, yet the incompetence of parts of the Afghan government has prevented it from winning the

people's trust. Significant portions of the Afghan government have retained and improved capabilities for governance, not least through the National Solidarity Program, the National Health Program, a telecommunications licensing regime that has enabled the use of millions of cell phones, and the exchange and regulation of currency and budget functions. However, at district levels and across some ministries, governance has been plagued by mismanagement and abuse of power. The United States and its partners are well-advised to focus the next phase of this campaign as much on developing the economy and civil society as promoting good governance, thereby avoiding the pitfall of Afghanistan being worse off for connecting people with corrupt and predatory authorities.

Unfortunately, the predominant approaches to international aid and economic development in conflict and post-conflict societies revolve around a misunderstanding of the tools for job creation and the fundamentals of free market economies. The United States has championed a development theory abroad (focused largely on central planning) that puts little emphasis on the key driver of economic growth: firm creation and growth. Economies do not grow or shrink – firms do.³ When firms develop, this entrepreneurial activity creates jobs, goods, services, and tax revenue, in addition to growing a class of people with a vested interest in stability and order rather than chaos.

The Economic Imperative

The benefits of entrepreneurial activity in Afghanistan can enable the successful implementation of a counterinsurgency and stabilization strategy. First, there is a significant youth bulge, with 44 percent of the country below the age of 15. These young people have few memories of the 1980s struggle against the Soviets, and many have either lived abroad in exile or lacked access to basic education and training through years on the

move or under the shadow of war. This generation could easily be lost to recruitment by the Taliban, criminal groups, radical madrassas and the poppy industry if no alternative future is made available to them. Skills training and jobs are the most viable ways to secure their participation within a system based on the rule of law. Focus groups and polls show that Afghan young people are desperate for the opportunity to participate in the upsides of globalization, not to subvert it. But with places at universities more than three times oversubscribed and minimal vocational training available, many of these opportunities are lost.⁴

Second, a growing economy not only creates jobs, but also raises the revenue needed within the licit economy to meet the costs of Afghan security and governance. To realize this revenue potential, however, Afghanistan will require an immediate investment in the fundamental security and civil society that will enable a legitimate economy to emerge. Growing Afghan government revenue will shift the burden of the bill for governance – law enforcement, justice, agriculture, education and health – to the Afghan people, while helping to cement the relationship of accountability between Afghan citizens, as taxpayers, and their government. This psychological shift is often overlooked: Afghan-led growth increases the sense that the country is moving in the right direction, that life is improving, and that these conditions can be attributed to the Afghan government and people rather than to an external force.

Afghanistan's Economic Potential

Afghanistan is among the world's poorest countries. Years of war have devastated the economy and its people, and the country is near the bottom of every welfare index. However, this poverty should not obscure the economic potential of the country. As recently as the 1970s, Afghanistan produced and exported agricultural goods ranging from dried

fruits and nuts to leather and wool; it had a range of light industry including the production of cement and energy (gas and hydropower); and it produced textiles such as cotton, carpets and embroidery.⁵

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Today, there is potential for growth in a range of sectors that could provide jobs in the short term and provide revenue and incentives for regional economic cooperation in the medium to long term. U.S., European, and other companies are investing in Afghanistan and will continue to do so as security improves. More than 700 foreign companies from 25 countries, including Coca-Cola and Standard Chartered Bank, invested 1.66 billion dollars in Afghanistan between 2003 and 2009, in addition to 3.2 billion dollars formally registered in domestic investment from Afghans.⁶ The key opportunity now is to enable the creation of businesses with the potential to become large-scale enterprises owned and operated by Afghans or joint ventures that can attract Afghan as well as foreign direct investment.

Key business sectors include:

Agriculture and livestock: Afghanistan has enormous potential in agriculture, from wheat to higher-value crops including fruit and vegetables. It is world-famous for melons, grapes, apricots, pomegranates, oranges, almonds, pistachios, and herbs and spices such as saffron and cumin. Nomadic Afghan communities thrive on livestock and goods such as meat, dairy products, wool and leather. Unfortunately, Afghanistan also has a booming illicit agricultural economy based on harvesting poppies for the drug

trade, with the profits financing the insurgency and violent extremism. Promoting the growth of legitimate agriculture would have positive effects including providing jobs, encouraging economic growth, and slowing the drug trade as a major source of funding for the Taliban. Success in this sector may be achieved best through a National Agriculture Program that would focus on creating the value chain to form the right market linkages, appropriate marketing tools, access to credit, processing facilities, cold storage, irrigation and transportation. Such a program could be supported by a consortium of international investors and a network of Afghan land-grant colleges with specialized agricultural knowledge.

Construction and infrastructure, including distributed renewable energy: International partners spend billions on construction contracts in Afghanistan. However, little of this money gets to Afghan construction firms, with the majority siphoned off through contracts with foreign companies. Afghan firms are usually contracted at the end of a chain of contracts, with the highest returns reserved for the foreign companies who hire them. Firms often import laborers from other countries, even for jobs requiring only basic skills such as demolition and bricklaying. Simple changes to the procurement process for construction contracts could set the conditions to nurture the Afghan construction industry, providing capacity for infrastructure construction, more jobs, and the opportunity for Afghans to become owners of their own businesses, thereby giving them a stake in the system. Expanding opportunities in real-estate development would provide decent housing, increase production of construction materials such as cement and bricks, and enhance economic opportunities. A program to provide incentives and support for entrepreneurs who seek to provide distributed renewable energy would also provide job opportunities while providing power to rural areas that lack access, thus further spurring small enterprises throughout the countryside. The United States, as the major funder

of infrastructure construction, would have to change its policies so that contracts are awarded with the primary objective of catalyzing the domestic construction industry in Afghanistan.

Mining: The recent U.S. Geological Survey in Afghanistan demonstrated that the country has significant mineral resources including copper, iron ore, marble, lapis lazuli, emeralds, rubies, oil, natural gas and a number of rare earth minerals.⁷ Some of these mineral rights have been leased to private operators. Establishing the right licensing frameworks and enforcing these rules will be essential to ensuring that the exploitation of minerals appropriately balances the needs of revenue collection, job creation, and environmental protection, and prevents foreign companies from depleting these reserves without duly compensating the government and people of Afghanistan. Finding opportunities to add value in marble and jewelry design and production could also add a significant number of jobs.

Urban Services: Afghanistan's cities are expanding rapidly, and beyond construction and food products there is a burgeoning demand for goods and services including waste and sanitation, electricity, household goods, telecommunications and information technology, construction and consulting, and logistics. Afghan production and service delivery is increasing but could expand further, especially if enabled by increased access to credit, the resolution of land-ownership disputes and increased vocational training in fields deemed critical. The telecommunications sector provides a useful example, having created more than 60,000 jobs and more than a billion dollars in investment during the last five years.⁸ The expansion of the mobile phone market can also have secondary benefits, such as increased access to banking by cell phone.⁹

Textiles: Afghanistan has a rich heritage of excellent carpet weaving and embroidery, as well as the capacity for production of wool, silk and cotton. Trade

access through legislation in developed markets would significantly increase the potential demand for Afghan textiles. Improving the quality and market linkages for carpet production in Afghanistan could also generate large numbers of jobs in rural areas with minimal additional infrastructure requirements.¹⁰

Financial services: Access to credit is essential for economic activity to thrive, but Afghanistan's financial sector is anemic. There are some services in place – a central bank, several state-owned banks, a few privately licensed banks and a large national micro-finance program – but the broader range of products including loans to small businesses, mortgages, risk guarantees (with the exception of some Overseas Private Investment Corporation [OPIC] facilities), and insurance are not widely available and could be better leveraged.

Grounds for Optimism

Basic security is required for investor confidence. Development and security, however, can be mutually supportive, and waiting for security before investing makes security harder to achieve. The provision of jobs and the prospect of long-term sustainable employment give the population hope for a different future and encourage them to support that outcome. Further grounds for optimism can be derived from three factors:

- First, Afghanistan had a relatively functional economy as late as the 1970s.
- Second, Afghanistan has abundant financial resources, albeit much derived from illegal activities, as well as assets that provide for the factors of production, such as fertile land, water, minerals, and a young population.¹¹
- And third, there are a range of examples of countries that have transformed from conditions of poverty, instability, conflict or corruption into thriving economic hubs.

Singapore, Vietnam, Rwanda, Spain and Chile are examples of rapid economic transformations. Singapore provides an instructive example of how a group of enlightened leaders created boot-strapping entrepreneurs and international partners, leading to the creation of capabilities to design economic development programs, the development of sound procurement practices, and a new construction industry that generated houses for citizens, provided jobs and ensured an ownership stake in Singapore's economy. We do not wish to over-draw the comparison but point out that several stable and prosperous societies have made the journey from poverty with remarkable rapidity.

The Regional Dimension

Afghanistan's location at the crossroads of South Asian, Central Asian and Persian Gulf states creates an opportunity for it to resume its age-old status as the land bridge between these areas, with immense opportunity for trade, transit and regional economic cooperation in energy, railways, trucking and water management. Just as European integration grew from an initial collaboration involving coal and steel, this region can identify opportunities for economic gains to underpin security and political cooperation. With the right approach, Afghanistan can become the breadbasket for the region, producing food for Pakistan, India, and the Middle East, all of which face shortfalls in food production. Afghanistan could also provide building materials and rare minerals for Central and South Asia, as well as oil and gas on a global level. If Afghanistan became the transit route from India and the Far East to Europe, then the stakeholders in Afghanistan's stability would radically increase.¹² Too few opportunities exist for Afghanistan and its neighbors to discuss and take advantage of synergies, and this area has yet to receive sustained attention or diplomatic facilitation at the highest levels. The World Bank and Asian Development Bank play a significant role in

ENABLING DEVELOPMENT

Provide access to credit, especially for small business owners and agricultural producers.

Guarantee a price floor for the advance purchase of crops through a facility (such as an Agricultural Board).

Attract businesses through an economic development board or reconstruction agency and nurture value chains and market linkages.

Support vocational training, including the identification of apprenticeship opportunities in certain industries including oil, gas, marble and other minerals production.

Provide insurance, including crop insurance for farmers.

Support branding. A "Made in Afghanistan" brand, for instance, has sales potential.

facilitating dialogue on planning, financing and managing regional infrastructure, and could be brought back to play a leading role in this domain.

The Way Ahead

Promising development initiatives already exist in Afghanistan but they are hindered by a lack of security, the persistence of centralized development planning rather than a more distributed, bottom-up approach, and a lack of will to grow successful programs to scale quickly.

Four of the best programs deal with each of these limitations by producing tangible benefits quickly for Afghans:

1. Microfinance programs: A national program, Microfinance Investment Support Facility for Afghanistan (MISFA), began operating in Afghanistan in 2003 to provide a common framework, oversight and core financing to microfinance providers across the country. It provides credit through small loans ranging

from 100 to 3,000 dollars. MISFA has invested more than 100 million dollars in more than 400,000 clients through a network of 307 branches in 26 provinces.¹³

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2. National Solidarity Program: NSP provides a block grant to every village in the country. It is operating in more than 22,000 villages and has disbursed 700 million dollars. It encourages growth by working closely with development councils elected by each village to initiate projects that use local labor to meet local needs. NSP has built roads, water pumps, irrigation, and other infrastructure projects that have affected 19 million people¹⁴ in every province, approximately half the population of Afghanistan. This program should be scaled up to increase the size of the block grants to the villages and to encourage more private-sector providers to collaborate with the villages.¹⁵

3. Public works programs: A range of public works programs uses public money to contract out urgent rebuilding or repair works, including irrigation, roads and buildings. In addition to providing needed services to Afghans, these funds stimulate the long-term growth of Afghan firms by providing capital and the opportunity to develop skills, both of which will be necessary to build and maintain the country's infrastructure.

4. Risk guarantees: OPIC has encouraged U.S. businesses to invest in Afghanistan by offering credit and political-risk insurance to minimize the exposure associated with direct investment. Projects have included support to the telecommunications licensing process in 2002, a total of 13

million dollars in loans to help enable the shipment and sale of Afghan cashmere wool,¹⁶ 35 million dollars in financing and risk insurance for building an international hotel in Kabul in 2003,¹⁷ and 60 million dollars in loans for the construction of a Marriott hotel in Kabul in 2007.¹⁸ These guarantees should be expanded through OPIC and other entities to a wider range of sectors.

Pursuing these opportunities will require significant and lasting partnerships with the private sector before Afghans can develop the capacity to execute them on their own. Therefore it is critical that international assistance catalyze these programs and move beyond the ineffective contracting and technical assistance modalities outlined above.

To take this agenda forward, next steps include:

1. Revitalizing the role of the World Bank and Asian Development Bank – in partnership with the Afghan people, government and business, and reaffirming the centrality of the Afghanistan Reconstruction Trust Fund (ARTF) and National Programs as coordinating mechanisms.
2. Support the creation of a National Task Force for skills, jobs, and training with the goal to create 1 million jobs for Afghans, through public works programs and the generation of sustainable economic opportunities.
3. Reaffirming the significance of the “economic ministries” such as the Afghan Ministries of Commerce and Finance, Rural Development, Agriculture, the Central Bank, the Afghan Investment Support Agency and the Chambers of Commerce – in leading this agenda and ensuring their ideas are represented alongside the Security and Governance ministries in policy dialogue.
4. Create an incubator and task team of global thinkers to identify gaps in strategy, financing and mechanisms, to explore and set up new and expanded financial instruments (including risk

guarantees and investment vehicles to make access to credit for Afghan entrepreneurs more easily available), expanded facilities to assist with business planning, and facilitate district and provincial-level chambers of commerce based on the main sectors of the economy.

The United States' new strategy needs quick, self-sustaining wins in order to demonstrate progress to U.S. voters, U.S. allies, the enemy, and – most importantly – the Afghan people.

Guiding principles for this work should include attention to even-handedness of investment and job creation across the country so that all regions and groups are treated fairly and have the same access to opportunity, and with careful attention to opening space for fair competition, guarding against the capture of resources and opportunities by a narrow elite.

Conclusion

The United States' new strategy needs quick, self-sustaining wins in order to demonstrate progress to U.S. voters, U.S. allies, the enemy, and – most importantly – the Afghan people. Harnessing the potential of the Afghan people to succeed on Afghan terms through Afghan institutions will reinforce stability as it spreads from areas cleared of insurgents, will give more Afghans a stake in the future of their country, and provides the only path to national self-sufficiency. This, in turn, will hasten the time when U.S. troops can be replaced by diplomats and business people and a society whose citizens have a stake in its stability and rule of law.

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Endnotes

1. This paper draws heavily on the work of Carl Schramm and his colleagues at the Ewing Marion Kauffman Foundation, and on the work of Dr. Ashraf Ghani, former finance minister of Afghanistan and Chairman of the Institute of State Effectiveness; and the Market Building Initiative at Aspen Institute. The authors are grateful for their support and encouragement.

2. See Carl Schramm, "Expeditionary Economics: How To Spur Post Conflict Growth," forthcoming in *Foreign Affairs* (May/June 2010).

3. See Carl Schramm and Robert E. Litan, "A Policy Agenda for Scale Entrepreneurship and Growth," *Wilson Quarterly*, forthcoming. In the context of Afghanistan, a "firm" can be almost any autonomous or semi-autonomous economic unit, including cooperatives or village clusters. Other contextual factors must be considered, including the notion that there are several distinct economies in Afghanistan: An urban economy in Kabul and a few other population centers, an economy in the rural Pashtun belt of the east and south with close ties to Pakistan, and a northern economy with links to Central Asia.

4. "Skills Development in Afghanistan," World Bank, October 2008, http://www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2009/01/09/000333038_20090109004209/Rendered/PDF/470780NWP0Box31ed10915080by0Spector.pdf.

5. <http://coin.fao.org/cms/world/afghanistan/en/CountryInformation/Horticulture.html>

6. <http://www.aisa.org.af/bulletin/Investment%20Bulletin%20for%20June09.pdf>

7. "Preliminary Non-Fuel Mineral Resource Assessment of Afghanistan, 2007," United States Geological Survey, <http://pubs.usgs.gov/of/2007/1214/PDF/0.1-summary-FINAL.pdf>. Please see USGS in Afghanistan for more information: <http://afghanistan.cr.usgs.gov/index.php>.

8. Summary of Achievements in the Year 1386 (21 March 2007-20 March 2008). Islamic Republic of Afghanistan, Ministry of Communications and Information Technology, <http://www.mcit.gov.af/Documents/publication/MCIT%20Brochure%20-%20english%202008.pdf>.

9. It is worth noting here that the West's conception of telecommunications potential in developing countries such as Afghanistan is constrained by the West's experience: Mobile phones spread through most of the West only after a well-developed landline system and, while cell phones are rightly

lauded as innovative in places like the United States they can be transformative in developing countries. They are not simply new technologies, but platform innovations that open up a vast and unknown horizon for new innovations and business models (consider that the spread of telecommunications networks in Afghanistan also enables the electronic payment of the police, eliminating a major source of graft and corruption). This concept of platform innovation suggests that the West should not seek to lay out a detailed development path in Afghanistan, but rather should strive to give people the tools to create that path.

10. For example, an offer was made to Afghanistan by a global furniture chain to provide advance purchase guarantees for significant numbers of Afghan carpets.

11. Recent documentation showed that at least 10 million dollars in cash daily was being smuggled out from Kabul airport alone. <http://www.latimes.com/news/nation-and-world/la-fg-afghanistan-cash7-2009dec07,0,6226073.story>

12. Currently, Pakistan bars the use of Pakistani territory for Indian exports to Afghanistan. This issue has been a major point of contention in recent trade negotiations on the Afghanistan-Pakistan Transit Trade Agreement. For more information see: <http://www.dawn.com/wps/wcm/connect/dawn-content-library/dawn/news/business/09-india-afghan-transit-trade-issue-for-composite-dialogue--szh-07>.

13. <http://www.misfa.org.af/> for more information

14. <http://www.worldbank.org.af/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/AFGHANISTANEXTN/0,,contentMDK:22195728~pagePK:1497618~piPK:217854~theSitePK:305985,00.html?cid=3001>.

15. www.nspafghanistan.org for more information

16. Three million dollars in 2003, and an additional 10 million dollars to expand operations in 2008.

<http://www.opic.gov/sites/default/files/docs/newsletter/OPICNews0508.pdf>.

http://www.opic.gov/sites/default/files/docs/annualreport_2008.pdf

17. <http://www.opic.gov/sites/default/files/docs/newsletter/OPICNews0503.pdf>

18. <http://www.opic.gov/news/press-releases/2007/pr011907>
http://www.opic.gov/sites/default/files/docs/annualreport_2007.pdf

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Photo Credit:

Women spin cashmere thread at the Mazar-e-Sharif AgFair and Cashmere Exhibition in March 2009. Afghanistan is the world's third largest producer of cashmere.

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