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SPECIAL REPORT

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## About the Report

The record of countries coming out of war or chaos is dismal: roughly half of them fall back into crises, and, among the other half, most end up highly aid dependent. As a participant in discussions organized by the United States Institute of Peace's Center for Sustainable Economies, the author was invited to develop her proposal for reconstruction zones as a way to jump-start the economies of conflict- and disaster-affected countries in a dynamic and inclusive way, by improving aid effectiveness and accountability. She is grateful for many comments and suggestions on a previous draft.

## About the Author

Graciana del Castillo is an economic expert on countries in crises, including those affected by conflict, natural disasters, or financial collapse. She is a founding partner of the Macroeconomic Advisory Group and a member of several advisory boards. She received her PhD in economics from Columbia University in 1986 and was an adjunct/visiting professor there (1990–2007) and senior research scholar (2008–10).

Dr. del Castillo has advised international organizations and governments on how to create a country vision and improve comparative advantages to attract desirable foreign investors into different sectors of the economy, including free-trade zones and infrastructure development. She is widely published and the author of *Rebuilding War-Torn States* (Oxford University Press).



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*Graciana del Castillo*

# Reconstruction Zones in Afghanistan and Haiti

## A Way to Enhance Aid Effectiveness and Accountability

## Summary

- The longest war and one of the largest relief efforts in U.S. history—in Afghanistan and Haiti, respectively—are testing the cost-effectiveness of U.S. foreign assistance in conflict-ravaged or disaster-torn countries. U.S.-led economic reconstruction in both countries is clearly off track and becoming increasingly costly and unpopular—both at home and in the respective countries.
- Reconstruction zones (RZs), consisting of two distinct but linked areas to ensure synergies between them—a local-production reconstruction zone (LRZ) producing for local consumption and an export-oriented reconstruction zone (ERZ) producing exclusively for export—could be used to replace the fragmented way aid is provided to these countries with an integrated strategy for economic reconstruction.
- With an appropriate legal and regulatory framework, ERZs—operating as free-trade zones—could create appropriate links to the national economy as well as positive externalities or spillovers. Such a framework would avoid the problems created by these zones operating as enclaves in Haiti in the past.
- By targeting aid to provide adequate infrastructure and services within the RZs at a manageable scale, countries could jump-start their productive sectors and create jobs and entrepreneurship in agriculture, light manufacturing, and services, both for domestic consumption and for exports.
- By creating dynamic and inclusive growth, RZs could help countries stand on their own feet, consolidate peace, and overcome the unsustainable aid dependency to which they have grown accustomed.

# Introduction

The United States' longest war and one of the largest relief efforts in U.S. history are testing the cost-effectiveness of U.S. foreign assistance in war-ravaged or disaster-torn countries. U.S.-led economic reconstruction in Afghanistan and Haiti is off track and becoming increasingly costly and unpopular—both at home and in the respective countries.[1] Efforts at economic reconstruction will not succeed unless there is a coherent and integrated strategy, which implies that many of the policies will have to change in fundamental ways.[2]

The provision of aid to conflict-affected or disaster-ravaged countries is clearly in disarray in these and in many other countries in similar situations.[3] In fact, aid itself has often proved to be more of a problem than a solution, in part by contributing to the creation of economies that would soon collapse if the international community and aid flows withdraw. Only a few countries have managed to avoid high aid dependencies created by the large spikes of aid that these countries receive as they try to come out of the crises.[4] Such dependencies are not sustainable in the aftermath of the 2008 global financial crisis and increased taxpayers' scrutiny in advanced donor countries.

The challenge for many war-ravaged or disaster-torn countries and for the international donors that support them is to redesign aid packages to focus primarily on the provision of reconstruction aid that promotes investment, local employment, and entrepreneurship. While humanitarian aid to save lives in the short run should not be neglected, such aid would promote consumption rather than investment, create price distortions and work disincentives, and fail to build local capacity. It should therefore be discontinued as soon as possible.

A dynamic and inclusive reactivation of the economy is critical to provide citizens—particularly those most affected by the crisis—with self-employment opportunities, jobs, and basic infrastructure and services, which would allow them to have an honest and fair income on a sustainable basis. Work opportunities and job creation may sound like a normal development challenge, but in the context of war- or disaster-affected countries, the challenge is fundamentally different. The main objective of reconstruction in the short run is to address the grievances of crises-affected groups, which have been either the root causes of the conflict or have been the most vulnerable to the natural disaster.

Using war-ravaged Afghanistan and disaster-torn Haiti, this study will make proposals to create reconstruction zones (RZs) linking free-trade zones to the domestic economy as a way to move out of the current fragmented, inefficient, and costly approach to reconstruction in these two countries.

After a cursory discussion of existing conditions in Haiti and Afghanistan following years of military intervention, peacekeeping operations, and large volumes of aid, the author will make a specific proposal for each country. Keeping in mind the importance of national ownership, the proposals build on Haiti's existing framework for using free-trade zones as a way out of the current crisis and on the framework that is under consideration, at least in some quarters, in Afghanistan.

This report will provide all stakeholders with an analysis of the pros and cons of reconstruction zones as agents of change and outline legal and regulatory frameworks for these zones, based on the international experience of other countries with such zones. The better informed governments are before making key decisions, the more effective their economic reconstruction policies will be. Thus, the purpose is to stimulate debate and contribute constructively to the identification of policies and strategies that would make achieving this goal possible.

## What Are Reconstruction Zones and How Can They Make a Difference?

The experiences of Ireland in the late 1980s, Costa Rica in the 1990s, and Uruguay in the 2000s offer some lessons about the need to link free-trade zones to the rest of the economy rather than to let them become enclaves within the country. Free-trade zones that exist as enclaves in Haiti, Dominican Republic, Mexico, El Salvador, Guatemala, China, and other countries are popularly referred to as sweatshops (*maquila* in Spanish). Sweatshops are used to assemble low-quality, low-value-added goods, using mostly imported inputs and local unskilled labor. Foreign and domestic investors have operated these sweatshops in Haiti and elsewhere without creating basic links to the domestic economy beyond the creation of low-wage employment.[5] On the contrary, the proposal for RZs links the free-trade zones to the domestic economy.

RZs in conflict-ravaged or disaster-torn countries would consist of two distinct but linked areas to ensure synergies between them—a local-production reconstruction zone (LRZ) producing for local consumption and an export-oriented reconstruction zone (ERZ) producing exclusively for exports.[6] The ERZ could be used for light manufacturing, commercial agriculture, or services for export under the stable legal policy framework and the tax and tariff preferences normally granted by such zones.[7] By creating RZs and building infrastructure in these designated areas first, countries could overcome the overwhelming challenge of having to provide infrastructure, security, and services throughout the country. This is an important consideration in crises-affected countries like Haiti and Afghanistan, which have large deficiencies. Providing infrastructure across the country would necessarily diffuse the impact it can have on reactivating production.

***By creating RZs and building infrastructure in these designated areas first, countries could overcome the overwhelming challenge of having to provide infrastructure, security, and services throughout the country.***

In the ERZs, local and foreign investors could produce a variety of low-skilled manufacturing products (garments, textiles, carpets, beauty products, agro-industries, or other low-skilled manufacturing products), goods that are often produced worldwide in free-trade zones. Although agricultural products are not normally produced in free-trade zones, ERZs could provide fiscal preferences and the international community could provide preferential access to its markets for goods such as vegetables, fruits, flowers, and spices, with different degrees of processing, from these zones. This preferential access could induce investors to produce gourmet and exotic products in these higher-risk locations. Haiti and Afghanistan could target markets that are close to them so as to compete also on the basis of transportation costs and logistics.

The second area—the LRZs—would produce agricultural products, process foods, and have light manufacturing for the less demanding local market, as well as services and input goods for the ERZ. Governments could also establish a single and low tax rate (say a 10 percent flat rate) for microenterprises, small business, and small local agricultural producers (MSEs) to encourage them to operate in the formal sector. Because LRZs are not closed areas as the ERZs, the MSE framework would apply to them wherever they are located. The LRZs, however, would create a level playing field for MSEs by offering them adequate security and infrastructure.

Having both ERZ and LRZ activities in the same RZ would create appropriate links to the national economy as well as positive externalities or spillovers from operating the two zones together. This linkage would avoid the problems created by free-trade zones in Haiti in the past.

Although Haiti and Afghanistan have very different histories with free-trade zones,[8] they both seem to have hopes to increase exports in the future through this type of framework. Their histories with foreign aid, however, are much more similar and relatively negative, as mentioned earlier. The unquestionable challenge going forward is to avoid the mistakes of the past in the provision and management of aid. To make aid more effective, it should be targeted toward creating viable RZs as soon as possible.[9]

Necessary infrastructure and services in each country will depend on the particular RZ and its location but will include energy, electricity, water and sanitation, telecommunications, roads and airports, and other services.[10] Infrastructure should not only be restricted to the needs of production but it should also ensure that workers have an adequate place to live, children have adequate educational facilities and clinics, and there is adequate transport for workers and their families to come back and forth if they live far from the zones or if they carry out activities away from them.[11]

At the present time, donors in Haiti and Afghanistan seem to be focusing on developing different types of infrastructure in different parts of the country. This piecemeal approach in which a donor builds a dam here, another a road there, and a third a school or clinic elsewhere has been ineffective and costly. The approach of spending as much as possible on many projects, hoping that some will stick, has also proved ineffective and costly. To be cost-effective, reconstruction aid needs to be provided in an integrated manner and considerate of local conditions and needs.

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## The Creation of Reconstruction Zones in Haiti and Afghanistan

After a brief discussion of existing conditions in each country, the analysis will focus on how the framework for RZs could be designed or modified to reactivate the productive sectors and bring Haiti and Afghanistan out of the dismal socioeconomic conditions they face, making aid more effective and accountable in the process. The case of Haiti will be used to illustrate in greater detail the challenges of designing and implementing an appropriate framework for ERZs so that they can be effective in reactivating the rest of the economy. The case of Afghanistan, on the other hand, will be used to illustrate how to start an RZ by creating the LRZ first, using as much as possible existing infrastructure and services, and ensuring that production and employment can start in a reasonable period.

### *Haiti: The Current Situation*

Haiti faces formidable challenges (including conflict-related challenges), many of them dating from long before the January 2010 earthquake. As Janet Reitman has recently put it, "Haiti's dysfunction, while undeniably exacerbated by the quake, goes back generations."[12] At the same time, the quake has been the worst of the many disasters that have hit the country, with damage and losses estimated at $8 billion, or about 120 percent of 2009 GDP. In comparison, the 2008 hurricanes caused damage of about one-third of GDP. The $5.3 billion pledged in March 2010 for the next eighteen months represented more than 50 percent of the projected GDP over that period.[13]

Given the appalling situation in which Haiti still finds itself a year and a half after the quake, it is time to rethink the strategy going forward by revising the misguided policies and misplaced priorities of the past. In the short run, a most important and neglected challenge is to provide basic health, security, and shelter needs of the millions affected by the quake, particularly the seven hundred thousand people still living in camps under vulnerable conditions, and the several thousand that have died or are exposed to cholera. Another short-term challenge is to generate employment-creating growth in a country where 70 percent of the population lives on less than $2 a day, and 40 percent is younger than fourteen years old.[14] Short-term intervention is key if the country is ever to move into a long-term development path where the country can start worrying about improving higher education, upgrading infrastructure, and other normal development challenges.

As Nicholas D. Kristoff argued in January 2011, what Haiti needs is assistance that leads to savings and investments on the part of the beneficiaries and in their sending their children to school so that their livelihoods can improve, “not just shipments of food and clothing.” He concludes, “It’s hard to think of a charitable project that will be as beneficial as the Coca-Cola Company’s decision to build up the mango juice industry in Haiti, supporting 25,000 farmers.[15] The same is true of the move by South Korean garment companies to open factories in Haiti.”[16] As discussed earlier, this will be true only if such projects do not become an enclave without any links to the national economy, or a source of exploitation of local labor and farmers that will lead to further conflict and insecurity. Previous such endeavors in the country have also been rejected by the population at large because of displacement of agriculture production and environmental, human rights, and other concerns.[17]

As Janet Reitman noted in August 2011, the March 2010 Action Plan for National Recovery and Development, prepared by Haitian prime minister Jean-Max Bellerive with the support of the World Bank and the United Nations, envisaged “a radically overhauled Haiti: a country bursting with mango-processing plants, fish farms, solar-powered irrigation facilities, industrial parks and duty-free zones, financed, to a large extent, by the private sector.” She attributes this vision to recent work by “Paul Collier, who maintained that with its low-paid workforce and loose labor regulations, Haiti could become a major supplier for the apparel industry.” As she also notes, “The ideas weren’t dissimilar from the policies that had been foisted on Haiti as far back as the Duvalier era.” Sadly, she vividly reports how different the reality on the ground has been from what was envisaged in the action plan.[18]

### *Reactivation of the Haitian Economy through Reconstruction Zones*

To reactivate the Haitian economy and promote stability, the government of Michel Martelly needs to develop its strategic vision on how to do it and establish a coherent and integrated reconstruction strategy that can be supported by a divided Haitian society and by the international community.

Although such a vision and strategy does not yet exist, there are some elements of it that have made headlines, particularly with regard to the key role to be played by the garment industry. Given the serious deficiencies in infrastructure and the poor business climate that exists in the country and that these conditions will take time to improve, it makes sense for the government of Haiti and the international community to focus on free-trade zones as a way of reactivating employment in the short run. Nevertheless, the export-oriented policy needs to be well imbedded in the overall economic strategy of the country for the policy to succeed in reactivating the economy in a fair and balanced way.

In this regard, the Haiti Economic Lift Program Act (HELP), signed into law by President Barack Obama on May 24, 2010, is an effort to make investment in the Haitian free-trade zones more attractive,[19] not only for U.S. firms but also for other investors as well. The HELP Act expands duty-free access to the U.S. market for certain Haitian textile and apparel exports and extends until 2020 existing trade preference programs for certain imported knit apparel articles made in Haiti from yarns wholly formed in the United States.[20] The law also provides duty-free treatment for additional textile and apparel products that are wholly assembled or knit-to-shape in Haiti, regardless of the origin of the fabric or yarns from which the articles are made. Duty-free quotas for Haiti exports are also almost tripled to 200 million square-meter equivalents.

Although these changes to trade preferences have become of interest to Korean and other investors from Asia that want to penetrate the U.S. market, in addition to U.S. companies that want to produce at competitive costs, it is important that the new investment does not become a new source of polarization within Haitian society. In the past, the so-called sweatshops have been a source of labor and social conflict in Haiti as a result of unnecessarily harsh conditions, including serious violations of human rights. At the same time, their impact on poverty alleviation has been questioned since wages have remained extremely low.[21] It is thus important to avoid potential conflict in the future and to ensure that these zones do not become a way to perpetuate poverty and insecurity in the country. Most importantly, the only way in which this type of investment can have a significant impact on the Haitian economy is if it creates important links to it and does not remain an enclave.

### *Proposal for Reconstruction Zones in Haiti*

With the right legal and regulatory framework and the synergies that would be created by integrating production for export to the local economy, RZs in Haiti would overcome the poor performance and strong opposition to free-trade zones in the past. In this regard, the government of Haiti should create an appropriate legal framework for ERZs. The ERZs would operate exactly as free-trade zones with an improved legal framework so as to eliminate some of the abuses of the past and to ensure appropriate links to the rest of the economy. Such links would be facilitated by the creation of an LRZ close to each ERZ, as part of the same RZ. The LRZs would produce goods and services both for the local economy and for supplying inputs and services to the ERZs, thus ensuring synergies between the two zones. Different RZs could be strategically located throughout the country, thus contributing to decentralization and to the development of infrastructure away from Port-au-Prince. The location of these areas is important, and they should not replace agricultural production or threaten the environment.

***A serious effort at reactivating food production and achieving food security should start as soon as possible, including in the RZs.***

Given the importance of agriculture to the Haitian economy, a serious effort at reactivating food production and achieving food security should start as soon as possible, including in the RZs.[22] Tourism, another sector with great potential in Haiti, however, should be left out of the RZs, since ERZs are closed zones where people should not be allowed to live within the zones, which make them unsuitable for tourism. The government could, nevertheless, promote the expansion of this sector through special tax, tariff, and other incentives to make it more competitive, as governments often do in some Latin American countries.

In the ERZs, local and foreign investors operating in the zones could produce garments and other low-skilled goods exclusively for exports under tax and tariff preferences.[23] Since this is the type of production that operates normally from free-trade zones, investors will not locate in Haiti unless ERZs have these preferences. Trade preferences under HELP give Haiti a comparative advantage vis-à-vis other such areas in the Caribbean and Central America. ERZs could also include processing of local agricultural products such as juice production and other agribusinesses. Administrators of the ERZs, however, would not normally be entitled to fiscal preferences.[24]

In a divided society such as that of Haiti, the establishment of LRZs to complement the ERZs would create a level playing field for micro and small enterprises (MSEs). Having activities for export and local consumption in the same RZs would also create other externalities and synergies. The LRZ could produce light manufactures, agricultural products, and services for the less demanding local market. It would also have clinics, schools, and professional schools for workers in the ERZs and their families. Other infrastructure and services required in the LRZs will depend on their location and on what can be found in the vicinity.

In the case of Haitian firms producing for export in the ERZs, the authorities need to ensure that operations from these zones do not become a way of avoiding local taxes and tariffs on other activities that these firms carry out for the domestic economy. It should be enforced that the tax exemptions for ERZs are granted exclusively for exports. Otherwise, such avoidance would discourage other local producers from paying their taxes.

### *Necessary Improvements to Haiti's Legal and Regulatory Framework*

To maximize the benefits and ensure links from the RZs to the national economy, the government would have to modify the legal and regulatory framework for free-trade zones, taking into account lessons and best international practices. The proposed changes would increase the multiplier effect that the zones could have. In exchange for the trade and fiscal preferences given to users of the ERZs, the law and related regulations should include specific requirements for foreign and domestic firms operating from these zones so that they

- attract foreign investors who can be expected to contribute to transfers of technology and training of local workers;
- encourage investors to pay local workers fair wages, with wage increases as their productivity increases;
- establish basic security, human rights, and other adequate working conditions in the zones;
- establish minimum levels of investment and/or local employment in the ERZs;
- establish links between the activities of foreign investors and the local economy by encouraging use of competitive local inputs and services so that there can be a multiplier impact by facilitating procurement within the local economy;
- require agreements between the foreign and domestic companies operating in ERZs and local technical schools and universities to create specialized courses, internship programs, and other arrangements to promote transfers of technology and capacity building of the local labor force;
- encourage corporate responsibility in social and environmental areas of foreign and domestic companies operating in ERZs. For example, these companies could be required to create local parks, schools, clinics, environmental projects, and other such projects in the LRZs in exchange for their benefits;[25]
- promote options for expanding ERZs' operations beyond the apparel and textile sector to higher value-added products; and
- promote different options to use local agriculture to develop agribusiness industries in the ERZs, attract foreign investors in these sectors, and negotiate preferential treatment in foreign markets for these goods.

It is not enough, however, to design the adequate legal and regulatory framework for ERZs. For the framework to have its intended impact it needs to be enforced. To be able to do such enforcing, the government of Haiti will need to develop the capacity to do so on its own. Leaving it in the hands of nongovernmental organizations (NGOs), as it has often been the case in the past, will not suffice.[26]

### *Expected Results from Reconstruction Zones in Haiti*

The establishment of RZs could help Haiti come out of the vicious circle of poverty, insecurity, political instability, and aid dependency in which it finds itself. By starting at a feasible scale, RZ could help reactivate the economy so people can start having decent shelter, adequate food and health services, and a productive occupation, thus moving beyond the emergency phase. The effective design and management of aid to facilitate the establishment of the RZs could help turn this vicious circle into a virtuous one characterized by investment, dynamic growth, economic inclusion, and political stability by

- generating direct employment with improved wages and better working conditions in the ERZs;
- generating indirect employment by promoting and facilitating the use of local inputs and services, that is, by creating links to the LRZs and helping to reactivate the domestic economy;[27]

- improving the skills of local workers by attracting foreign firms that are competitive in their respective industries;
- improving corporate practices and security measures of local suppliers working for foreign firms with higher standards;
- contributing to the transfer of technology by creating links between the foreign and domestic companies operating in ERZs and local technical schools and universities;
- attracting new foreign companies once the skill level of workers improve to raise the value added of production and exports;
- increasing exports and foreign exchange earnings that would make the economy less reliant on aid; and
- improving social cohesion at the community level by improving working and living conditions in the RZs.

Despite the tax and tariff preferences given to the users of the ERZs, the government will nevertheless raise revenue from these zones in the form of social security contributions of workers and by taxing the administrators and the indirect activities created by the ERZs. Activities in the LRZs will be taxed in the same way as other activities produced for the domestic market. A preferential and simple regime for MSEs should be established across the country to encourage them to join the formal sector.

### *Afghanistan: The Current Situation*

After three decades of conflict due to the Soviet occupation, Taliban rule, and the post-9/11 military intervention, Afghanistan embarked on a multidisciplinary transition to peace that started with the UN-mediated Bonn Agreement of 2001, supported by large volumes of aid and debt relief. As disarming, demobilizing, and reintegration (DDR) programs failed and the security conditions deteriorated in 2006, an intensive and increasingly costly involvement of NATO and U.S. troops took place, including a civilian surge to accompany the military surge in 2010.[28]

How costly the U.S. involvement has been in Afghanistan and how much of it is allocated to humanitarian and reconstruction aid is a source of great confusion. One thing is clear: the military cost of the war has been huge in relation to the assistance for relief and reconstruction to the country. Of $443 billion budgeted for the Afghan War for fiscal years 2002–11, $52 billion were allocated to major programs in the country. More than half of that was allocated to security-related programs in Afghanistan. Putting aside the financing to cover embassy operations, construction of the new embassy in Kabul, and aid oversight, about $20 billion (48 percent) of U.S. assistance was left for relief and reconstruction. Since GDP in Afghanistan during this period was about $100 billion, U.S. aid for relief and reconstruction represented 20 percent of GDP on average per year.[29]

Furthermore, a large part of nonsecurity aid to Afghanistan is spent on U.S. contractors and U.S. supplies. The same is true of security aid, where a large proportion is spent in the United States for the purchase of arms and equipment. Thus, the spectacular growth that the Afghan economy has experienced since 2001—fueled by large volumes of aid and the large foreign presence in the country—has little benefited the average Afghan citizen.

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Indeed, with annual average growth rates of 12 percent a year during the 2002–10 period—higher than China's 11 percent—the Afghan economy has failed to reactivate in a dynamic, inclusive, and licit way. Afghanistan continues to be stunningly poor and faces major challenges to achieve the Millennium Development Goals (MDGs) by 2020, the target year that the government has negotiated with the United Nations. Life expectancy at birth is slightly above forty years, adult literacy is below 30 percent, and the combined gross enrollment in education is roughly 50 percent. Not surprisingly, large parts of the country remain insecure, creating the right environment for the drug industry and the insurgency to thrive.[30]

More than seven million Afghans (about a quarter of its population) have been affected by the impact of disasters and extreme weather events such as drought, earthquakes, disease epidemics, sandstorms, and harsh winters. Many others have been affected as a result of different explosive devices that have not been removed by demining. Counternarcotics policies have had mixed results. Despite increases in the number of poppy-free provinces and decreases in the area under cultivation, productivity has increased, and the country still produced about 7,000 tons of opium in 2009. Afghanistan is also one of the biggest producers of hashish. The strong association between insecurity, lack of agricultural assistance, and opium cultivation is just as valid today as it was before the surges.[31]

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Insecurity, corruption, high levels of poverty and environmental degradation, extraordinary levels of unemployment, lack of basic services and dilapidated infrastructure, dissatisfaction about the presence of foreign troops, and the fragmentation and ineffectiveness of aid interventions constitute critical impediments to establishing peace and security in the country.

### *Reactivation of the Afghan Economy through Reconstruction Zones*

After a trip to Afghanistan in May 2011, the author returned more convinced than ever that the Afghan economy will soon collapse as the U.S. military retreats (many companies, including foreign investors, are likely to close as demand falls to a trickle).[32] To avoid such collapse, the government of Afghanistan needs to jump-start the productive sectors. A decade after U.S. military intervention and the Bonn Agreement, Afghanistan is still going through amazingly challenging times and has been unable to reactivate productive activities and exports, thus remaining highly dependent on aid. Most activity takes place in the construction and retail sectors, with agriculture still unable to recover its historical dynamism before the war. Investment and trade are pivotal to Afghanistan's transition from aid dependency to dynamic, sustainable, and inclusive economic growth.

With better prospects for licit jobs in a country where employment and underemployment is as high as 60 percent, and with improved access to basic services and infrastructure, it would be possible to turn the entrepreneurial spirit of the Afghan people away from producing drugs. This may be the only recipe to control further gains by the Taliban. The military strategy—with a few development projects on the side—has indeed proved expensive and relatively ineffective.

To do so, Afghanistan could create RZs. For this, the government needs to finalize first the appropriate legal and regulatory framework for the ERZs, taking into consideration the issues discussed in relation to Haiti so as to make the ERZs more effective and linked to the domestic economy.[33] Likewise, the United States should grant preferences—as it grants to Haiti—for goods produced in the ERZs in Afghanistan. Other donors should, of course, follow. This is particularly important of neighboring countries in the Gulf, and other countries such as India and China, which would be natural markets if ERZs for agricultural goods were created.

While ERZs in Haiti already exist and the legal framework is broadly in place, it will take time in Afghanistan to develop such a framework. Thus, while it was recommended that in Haiti RZs start in places where the ERZs are already operating by complementing them with LRZs nearby, in the case of Afghanistan, it could take the opposite path. It would be best to start with the establishment of LRZs in areas where ERZs could be eventually set up nearby. Given security conditions, RZs could be established in places like Kabul, Herat, Mazar-i-Sharif, and Jalalabad where the environment is relatively more conducive.

Afghanistan's Investment Support Agency is considering creating ERZs and so are some provinces. The World Bank, for example, is financing a multipurpose industrial park in Jalalabad where the infrastructure for two hundred companies is almost ready. Also, the provincial governor of Kunduz has asked the German Agency for International Cooperation to do a feasibility study for an export-oriented industrial area, which would be located at a key location, bordering Central Asia. These projects add urgency to the need to have an appropriate legal framework for ERZs in place as soon as possible.

The first RZ in Afghanistan could be located in the Dehsabz-Barikab area north of Kabul, taking advantage of security conditions, existing infrastructure, and government plans for development of this area. This RZ could become a major pillar in reactivating production in the country in an integrated and viable way. It could also provide an inspirational and practical demonstration of how aid can be used more effectively and transparently to help the country stand on its own feet.

The LRZ could be immediately established in the villages surrounding the Dehsabz district. The government is interested not only in preserving village life in this area and improving services and infrastructure,[34] but also in enlarging the green belt around this area by having rural development in land in between the villages. The village councils (or *shuras*) would promote a consensus-building process to determine priorities so that the villages can take full ownership of the activities that take place in the LRZ. Shuras would actively and effectively involve all members of the community in different projects, according to their possibilities. In fact, for administrative and financing purposes the LRZ could be established as part of the National Solidarity Program (NSP), since this program has received good reviews from donors as a result of its transparent and participatory practices in community development. Doing so would be a way to strengthen the NSP since its impact on reactivating production and creating employment has been one of its weak points.

People living in the villages in the LRZ could be involved in two types of activities. Some villagers would be involved in an integrated rural development project producing for the local community, and eventually processing their surpluses to create agribusinesses to supply the domestic economy. The model for an integrated rural development project could be based on the experience and positive results of the Millennium Villages Project of the Earth Institute in many countries in sub-Saharan Africa. This model is based on local ownership supported by specific interventions in five broad areas—agriculture and food security, health, education, infrastructure, and business development.[35] Farmers will need access to credit, improved irrigation, tree woodlots, extension services and training, improved seeds and fertilizers, and other such inputs. The government could establish across the country a single and low tax rate (say a 10 percent flat rate) for the micro and small enterprises (MSEs.) This could encourage them to operate in the formal sector, both inside and outside of the LRZs.

In setting up the LRZs, existing infrastructure should be utilized as much as possible. In the case of Dehsabz, the LRZ should include the housing project at Alice-Ghan, bordering the Barikab area where the ERZ would eventually be established. Having job opportunities and services would be a strong incentive for settlers to return to Alice-Ghan, which now looks like a ghost town after people deserted.[36]

The ERZ could be established in the one-third of the Barikab area (thirty-three square kilometers) that the government wants to develop as commercial agriculture.[37] This area requires large investments in infrastructure (water, electricity, roads, other services, storage) that the government would have difficulty in financing. However, with an appropriate and stable legal framework and tax and tariff preferences of ERZs, investors would have an incentive to locate in this secluded area in which the provision of infrastructure, services, and security would be more manageable. With appropriate infrastructure a number of legumes, grains, cereals, spices such as saffron, fruits (including vineyards, apples, peaches), and flowers could be produced for export to countries in the region.[38]

With regard to flower production, for example, the Japanese, Dutch, Americans, or Colombians could be invited to sponsor, invest, or provide technology for this type of activity. Japan, which has provided strong financial support and technical assistance to the Dehsabz-Barikab project through the Japan International Cooperation Agency (JICA), or the Netherlands, which has invested heavily in Afghan security and development since 2001, would be top choices to lead in this area.[39] Once a few investors decide to establish operations in the ERZ, others will likely follow.

Eventually, the ERZ could be expanded into the production of agro-industries and other low-skilled manufacturing also for export, such as textiles, carpets, and other products using local inputs. Given the demand for carpets, jewelry, and other Afghan products, production of them in the ERZs could improve employment opportunities for women and returnees.

Companies operating in the ERZ would be encouraged to support health, education, and training in the LRZ as part of their corporate responsibilities (and as a quid pro quo for the preferences they get in the ERZs). This would create better conditions for their workers and make them more productive.

Some policymakers oppose the creation of ERZs under the fiscal myth that foreign investors are going to invest in the national economy anyway (which is not at all the case), and hence they will be forgoing tax revenue. Those policymakers ignore the fact that no tax revenue would be forgone if production does not take place and that production in crisis-affected countries where the risk is high may not take place without the right infrastructure, services, and strong incentives that could attract foreign investors.[40]

### *Why Would Afghanistan's ERZs Be Attractive to Foreign Investors?*

If appropriately designed as discussed earlier, the ERZ law would provide a stable legal and regulatory framework (rather than the very inefficient one existing in Afghanistan now).[41] The law would also provide significant tax and tariff preferences that would make production cheaper and more competitive. The government will also need to negotiate preferential access to world markets for production from the ERZs.

At the same time, the ERZs would provide domestic and foreign investors with

- abundant labor supply at competitive cost;
- close markets for perishable vegetables, fruits, flowers, etc.;
- preferential treatment in donors/neighbors' markets;
- adequate security, infrastructure, and services (in comparison to the rest of the country);
- adequate logistics and lower transportation costs to regional markets; and
- adequate housing for workers just outside the ERZ.[42]

Desirable foreign investors (Dutch, Japanese, or any other flower producers, for example, that can bring technology and know-how and can open international markets for Afghan products) are unlikely to invest in Afghanistan outside an ERZ for the following reasons:

- lack of public security and infrastructure;
- unstable and uncertain investment framework (permits) and generally unclear and changing rules of the game;
- unfriendly and nontransparent business climate (highly discretionary public policies, corruption, red tape);

- uncompetitive public services in terms of quality, price, availability, and reliance;
- weak justice system to enforce contracts.

### *Expected Results from the Reconstruction Zones in Afghanistan*

RZs could have widespread effects in Afghanistan by demonstrating how an integrated and well-coordinated strategy for reconstruction, linking export-oriented production to the local economy, could have spectacular results—in comparison with the fragmented approach that has, so far, been donors' prevalent practice in the country.

Once the two areas—the LRZ and the ERZ—are in operation, people from other regions, together with donors, could be brought in to appreciate what can be achieved by an efficient use of aid and technical assistance to support community priorities and livelihoods, attracting the right type of foreign investors. This process could be expected to deter the spread of the insurgency.

If the government could find support from donors and RZs were established, financed, and implemented in a reasonable period, the vicious circle of poverty, insecurity, political instability, and aid dependency could turn into a virtuous one of investment, dynamic growth, economic inclusion, and political stability by

- improving the utilization of aid and project management based on the priorities of local communities and the government. On the political side, this could contribute to an effective process of decentralization and, on the economic side, it would generate foreign-exchange earnings, train local people to utilize better technologies, utilize local contractors in a supervised way, bring Afghan expertise from the diasporas, and decrease the aid dependency in which the country is trapped;
- improving governance, local public capacity, and coordination. By involving community leaders, the different ministries at the local level, the UN Group, bilateral aid agencies, NGOs, and other stakeholders that want to participate in supporting the reconstruction strategy, the RZs will be contributing to improvements in governance and in capacity building within the government, and also in the creation of effective channels of coordination and cooperation at the local level;
- working together with effective NGOs that share the philosophy and the model of the RZs. The LRZ would also involve NGOs that operate with a compatible model of training and employing local men and women, attracting Afghan expatriates, and minimizing the foreign presence in the country. It would collaborate with NGOs with an established record, such as the Global Partnership for Afghanistan (GPFA),[43] and would draw on the expertise and resources of other NGOs, such as the Organization for the Advancement of Afghan Women, that address the educational and medical needs of women. At the same time, the ERZ could benefit from expertise and marketing of NGOs such as Arzu Studio Hope, which support carpet weavers in Afghanistan and facilitate export to the United States;
- "Afghanizing" the development process. RZs will be better educated, healthier, and more skilled communities that will be able to have an impact on production and trade. RZs can be expected to have a positive demonstration effect on other communities and to attract the right foreign investors. RZs may offer the best alternative for developing adequate skills, creating jobs, and increasing government's access to foreign exchange while jump-starting sustainable growth in Afghanistan, so that the country can finally stand on its own feet.

## Conclusion

RZs—consisting of both an export-oriented and a local-production zone—could be used by both Afghanistan and Haiti to transition from the fragmented aid policies of the past to a coherent and integrated strategy for economic reconstruction. RZs would facilitate jump-starting these economies by both improving aid effectiveness and accountability and by creating positive externalities between the zones. To create RZs, aid should be targeted to providing adequate security, infrastructure, and services within the zones, which is key in creating jobs and entrepreneurship in agriculture, light manufacturing, and services, both for domestic consumption and for exports. By creating dynamic and inclusive growth, RZs could help consolidate peace and avoid aid dependency.

***By creating dynamic and inclusive growth, RZs could help consolidate peace and avoid aid dependency.***

With an adequate and stable policy framework and the tax and tariff preferences normally granted by free-trade zones, ERZs could be used for attracting foreign direct investment and producing a variety of goods for export. The purpose of LRZs would be to alleviate poverty, build sustainable livelihoods, and restore environmental sustainability in the communities by producing agricultural products, processing foods, and light manufacturing for the less demanding local market, as well as services and input goods for the ERZs. Having both ERZ and LRZ activities in the same RZ would create appropriate links to the national economy as well as synergies from operating the two zones together.

Changing the status quo has never proved easy, but peace will not take root unless the reconstruction process in Afghanistan and Haiti is properly planned and implemented. Both countries are at a juncture in which broad-based debate of the type that took place in connection to the Marshall Plan—including national leaders, U.S. government officials, military leaders, members of Congress, academics, think tanks, and practitioners from other stakeholders in these countries—is urgently needed and should take place without delay. The international community cannot continue to ignore the serious consequences that business-as-usual policies are having in the respective countries, and their spillover effects in the regional and global economies in terms of refugees, drug trafficking, terrorism, political instability in the regions, and other such ill effects. Neither can we ignore the tremendous financial cost of failure, particularly when donor countries are dealing with major unemployment, large fiscal imbalances, and increased scrutiny from taxpayers at home.

## Notes

1. The terms *economic reconstruction* and *reconstruction* are used interchangeably throughout this paper, as are the terms *long-term development, normal development,* and *development as usual.* The terms *free-trade zones* and *export-oriented reconstruction zones (ERZs)* are also used interchangeably throughout this paper.
2. For the author's views on the problems with aid and reconstruction in Afghanistan and Haiti, and the rules or guidelines that could help develop a more appropriate and effective strategy for these and other countries, see Graciana del Castillo, *The Economics of Peace: Five Rules for Effective Reconstruction,* Special Report No. 286 (Washington, DC: United States Institute of Peace Press, 2011) and "The Economics of Peace: Military vs. Civilian Reconstruction—Could Similar Rules Apply?" in *Expeditionary Economics: Toward a Doctrine for Enabling Stabilization and Growth* (New York: West Point United States Military Academy, 2011). For a sobering review of aid and U.S. policies toward Haiti since the quake, see Janet Reitman, "How the World Failed Haiti," *Rolling Stone Magazine*, August 4, 2011. For a review of an excellent example of the problems created by lack of integration in aid provision in Afghanistan, see Jack Healy, "Alice-Ghan Journal: A Model Afghan Village for Dashed Hopes," *New York Times,* August 9, 2011.
3. Aid refers to official assistance that provides some relief to the receiving country, and includes both grants (assistance without a quid pro quo) and concessional loans (loans at interest rates below commercial or market terms). The World Bank reports official development assistance (ODA) data as a percentage of gross national income (GNI), http://data.worldbank.org/indicator/DT.ODA.ODAT.GN.ZS.
4. For examples, see Graciana del Castillo, *Rebuilding War-Torn States: The Challenge of Post-Conflict Economic Reconstruction* (Oxford: Oxford University Press, 2008).
5. Ireland, Costa Rica, and Uruguay developed niches in pharmaceuticals and health products, microchips and software, financial services, and other higher-tech goods and services, which will not be the case of Afghanistan and Haiti. The benefits they got from links from the free-trade zones to the rest of the economy, however, are equally valid for zones producing low-skilled products in Haiti, Afghanistan, and elsewhere. For the experience of Ireland, Costa Rica, and Uruguay, see Graciana del Castillo, "Promotion of Export-Oriented Foreign Direct Investment" (study prepared for the Inter-American Development Bank, Washington, DC, 2003), www.macroadvisory.com/gdc_publications.html.
6. ERZs in crisis-affected countries would operate exactly as free-trade zones do in other countries. The ERZ law normally would offer tax and tariff preferences to companies operating within closed ERZ areas, including domestic investors, foreign direct investors (foreign majority-owned), or joint ventures between domestic and foreign investors. For tax and tariff purposes, ERZs are considered outside the country's territory (although all other national laws apply and the government would have ultimate responsibility for the ERZ). If desired, the

legal framework of the ERZ could specify that part of the production of the ERZ can be exported to the local economy paying the appropriate tariffs.

7. An administrator operates the ERZ. The ERZ has space (land, buildings, silos, greenhouses) within the zone that the administrator leases to tenants or users for a specific rent. The administrator also provides services to users for specific fees. The administrator of an ERZ could be the government or a private entity. A private administrator normally does not have tax exemption (and therefore it is subject to local taxation), although it normally has tariff exemption to import equipment and other imports required for the ERZ.

8. In Haiti, for example, the free-trade zones law entered into force on July 2002. Afghanistan still lacks the legal framework for free-trade zones.

9. In this regard, it is encouraging that the International Monetary Fund (IMF) considers the June 2009 procurement law passed by the Haitian Parliament to be in line with international best practices and that "this law constitutes a solid legal basis for the establishment of a modern and transparent procurement system." See IMF, "Haiti: Enhanced Initiative for Heavily Indebted Poor Countries—Completion Point Document," Country Report No. 09/288, September 2009, 9. In Afghanistan, aid should be channeled through the Afghanistan Reconstruction Trust Fund (ARTF), making sure that the World Bank accelerates its disbursement procedures, which in the past has been very slow.

10. RZs may eventually need to have a wide variety of services, including services related to recruitment and training of personnel, medical and educational facilities, and on-site day care; legal and administrative services; round-the-clock security; general maintenance and environmentally responsible landscaping; on-site customs; courier services; satellite and communications; post office and banking facilities; and energy and transportation. The more attractive the zones are and the better workers are treated, the higher the productivity and the lower the probability of labor conflicts and violence. The larger the number of services provided, the stronger the links that these will provide to the rest of the economy.

11. In building the necessary infrastructure, it is very important that governments learn from the bad experiences in Afghanistan, Iraq, and elsewhere, where such infrastructure was often not appropriate for local conditions or the skills of local workers, or the government could not afford to maintain it, which often caused it to be underutilized or abandoned once it was built.

12. Janet Reitman, "How the World Failed Haiti."

13. See various IMF country reports on Haiti, www.imf.org/external/country/hti/index.htm. See also Tatiana Wah's presentation in panel 3 at the Columbia University Conference on Peace Through Reconstruction, http://capitalism.columbia.edu/view/events/conference. Haiti's problems have led to a long political and security UN involvement in the country dating since 1991, after the coup that took Jean-Bertrand Aristide out of power. In fact, the UN Stabilization Mission in Haiti (MINUSTAH) currently in the country was established in 2004 after President Aristide departed for exile in the aftermath of an armed conflict, which spread to several cities across the country. Conflict and natural disasters have been recurrent challenges in Haiti. Since 1993, the United Nations has established five peacekeeping missions in the country. For data on the economic and social situation of Haiti, see Post Disaster Needs Assessment at www.refondation.ht/resources/PDNA_Working_Document.pdf.

14. See the United Nations Children's Fund (UNICEF) for other data, www.unicef.org/infobycountry/files/UNICEF_Haiti_Humanitarian_and_Recovery_-_Mid-Year-Review_of_the_2010_HAR.pdf.

15. See "The Coca-Cola Company Announces $7.5 Million Haiti Hope Project Project to Boost Incomes of 25,000 Mango Farmers In Haiti," press release, Coca-Cola Company, March 31, 2010, www.thecoca-colacompany.com/dynamic/press_center/2010/03/the-coca-cola-company-announces-75-million-haiti-hope-project-to-boost-incomes-of-25000-mango-farmer-1.html.

16. See Nicholas D. Kristoff, "Ladders for the Poor," *New York Times,* January 5, 2011.

17. See, for example, World History Archives, "The History of Free Trade Zones the Republic of Haiti," www.hartford-hwp.com/archives/43a/index-cfa.html.

18. Paul Collier's views are detailed in "Haiti: From Natural Catastrophe to Economic Security" (report for the UN secretary-general, January 2009). See also his "Beyond the Begging Bowl," *Guardian*, April 3, 2009, and his article with Jean-Louis Warnholz, "Building Haiti's Economy, one Mango at a Time," *New York Times,* January 29, 2010. In Janet Reitman, "How the World Failed Haiti, " she reports, for example, how people in a camp in Port-au-Prince were encouraged to relocate to Corail on the promise that they would get jobs in garments factories that Korean firms would build there. A year later, none were built because there was not enough water to supply the manufacturers.

19. The free-trade zones law, which entered into force on July 2002, specifies the conditions for operating and managing these zones. The law defines free-trade zones as geographical areas with a special regime on customs duties and controls, taxation, immigration, capital investment, and foreign trade. In these zones, both domestic and foreign investors can provide services, import, store, produce, export, and re-export goods. These zones may be private or joint ventures. The law provides the following incentives and benefits for enterprises located in them: (a) full exemption from income tax for a maximum period of fifteen years, followed by a period during which there is partial exemption that gradually decreases; (b) customs and fiscal exemptions for the import of capital goods and equipment needed to develop the area, with the exception of tourism vehicles; (c) exemption from all communal taxes (with the exception of fixed occupancy tax) for a period not exceeding fifteen years; and (d) registration and transfer of the balance due for all deeds relating to purchase, mortgages, and collateral. It should be noted that users of some free-trade zones—for example, those in Uruguay—are exempted from all taxes currently in effect, or that may be created in the future, for the full term of their contract, which can be granted until 2040 at the time the permit for the administrators of the zones runs out.

20. These include the Caribbean Basin Economic Recovery Act (CBERA), amended by the United States–Caribbean Basin Trade Partnership Act, the Haitian Hemispheric Opportunity through Partnership Encouragement Act of 2006 (HOPE Act), and the Haitian Hemispheric Opportunity through Partnership Encouragement Act of 2008 (HOPE II).

21. For a detailed analysis of Haiti's free-trade zones, the problems that they have created, and the changes that need to be made so as to become effective and respect international labor laws, see Yasmine Shamsie, "Time for a 'High-Road' Approach to EPZ Development in Haiti" (paper prepared for the Conflict Prevention and Peace Forum [CPPF], Social Science Research Council [SSRC], January 24, 2010). Conditions in Haiti's free-trade zones are no different from those of other countries, but these are increasingly under attack and will necessarily have to change. See, for example, Kathrin Hille, "Showing the Strain," *Financial Times,* May 29/30, 2010, which discusses the problems in the Chinese city of Shenzhen, where a series of suicides in the staff of a Taiwanese company, Foxconn, producing 4 percent of Chinese exports, have called attention to appalling working conditions. In

March 2011, Shenzhen had to increase minimum salaries by 20 percent (about $200), the largest increase ever (*El Observador,* March 3, 2011).

22. See, for example, Jeffrey Sachs, "After the Earthquake, How to Rebuild Haiti From Scratch," *Washington Post,* January 17, 2010, and "Reconstructing Haiti," *Project Syndicate,* January 20, 2010. According to the Inter-American Development Bank (IADB), agriculture is the largest sector within the Haitian economy, employing roughly two-thirds of the labor force. Many farmers concentrate on subsistence crops, including cassava (manioc), plantains and bananas, corn (maize), yams and sweet potatoes, and rice. The IADB notes that Haiti's unique microclimate produces high-value crops of superior quality and that its proximity to the U.S. market and significant untapped potential make the country an attractive destination for investors and buyers alike. Haiti offers premium products, such as mangoes and coffee, which are capable of meeting both organic and fair-trade standards. See IADB, Fact Sheet, Haiti's Agribusiness Sector, International Business Meeting, Port-au-Prince, October 1–2, 2009.

23. According to the IADB, the light manufacturing sector was at its most dynamic in the 1980s, employing around 100,000 workers to make apparel, electronics, baseballs, toys, and Rubik's Cubes. By 2009, the garments sector employed about 25,000 workers in twenty-three factories. The industry supplies mostly mass-produced commodity knitwear, such as T-shirts and sweatshirts, to the U.S. market. More complex garments, such as pants, shirts, lingerie, and suits, account for about 20 percent of production. In 2008, goods worth $428 million (with significant upward potential) were exported to the United States. See IADB, Fact Sheet, Haiti's Garments Sector, International Business Meeting, Port-au-Prince, October 1–2, 2009.

24. Private administrators of the zones would charge fees to the users of the zones and pay taxes to the government. The government, however, could consider granting special preferences to administrators who are willing to set up RZs in desirable areas that the government wants to develop. The government could also establish and administer these zones by using aid resources. In countries such as Uruguay, for example, there are both private and government-administered free-trade zones. Private administrators are not tax exempt.

25. A few companies are already exercising corporate responsibility in Haiti. Reitman, "How the World Failed Haiti," notes that Digicel, the telecommunications giant and the largest taxpayer in Haiti, together with other private-sector partners, has committed millions of dollars to reconstruction through the Clinton Global Initiative's Haiti Action Network. With $12 million donated by Denis O'Brien, head of Digicel, the Iron Market, a 120-year old marketplace, became one of the quickest and most successful projects rebuilt since the earthquake.

26. The way to regulate and supervise free-trade zones varies across countries. In Uruguay, for example, the Ministry of Economy and Finance is in charge of the supervision and control of the FTZs, through its Free-Trade Zone Unit. The minister himself is directly in charge of the FTZs' policies.

27. There are different levels of indirect employment. For example, the goods produced in the ERZs need to be taken to the airport, which creates jobs in transportation. Eventually, the trucks will need to be replaced and that can create another level of indirect employment in the automobile sector, if trucks are produced or assembled locally.

28. See del Castillo, *Rebuilding War-Torn States* and "Peace through Reconstruction: An Effective Strategy for Afghanistan," *Brown Journal of World Affairs* 16, no. 2 (Spring/Summer 2010), 195–211. For an inside story, see M. Ishaq Nadiri, "Economics as a Pre-Requisite for the Stability of Afghanistan and the Region," (working paper no. 45, Center on Capitalism and Society, Columbia University, October 2009), http://capitalism.columbia.edu/files/ccs/Nadiri%20Working%20Paper%2045.pdf.

29. The United States has spent about $325 billion in Afghanistan in fiscal years FY2001–10 and has budgeted $118 billion for FY2011, which would bring the total budgetary cost of the war to $443 billion. An additional $114 billion has been requested for FY2012. Of the $120 budgeted for FY2011, about 94 percent of the funds are for the Department of Defense, 5 percent for foreign aid programs and embassy operations, and 1 percent for medical care for veterans. See Amy Belasco, "The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations since 9/11," Congressional Research Services (CRS) Report for Congress, RL33110, March 29, 2011. Since some of the Department of Defense funding has been used for nonmilitary purposes, U.S. assistance for relief and reconstruction since the beginning of the war has been about $52 billion. For a breakdown on how these funds were allocated, see Kenneth Katzman, "Afghanistan: Post-Taliban Governance, Security, and U.S. Policy," CRS Report for Congress, RL30588, June 3, 2011 (also 2010 and 2009 versions). Including other donors, official aid peaked at 46 percent of GNI in 2008 (the last year for which World Bank reports ODA data for the country) or about $5 billion (of which the U.S. contributed about $3 billion). In per capita terms, ODA in 2008 represented about $190 per person. UN peacekeeping and NATO operations add to the cost of U.S. security and military operations in Afghanistan.

30. Despite U.S. involvement and large cost to the international community, the 2009 United Nations Development Programme (UNDP) Human Development Index ranks Afghanistan worst of all countries with respect to poverty and second worst with respect to human development. In the 2010 index, however, Afghanistan is ranked above some of the sub-Saharan African countries, which reflects some gains in 2008 (the year used in the 2010 index).

31. See United Nations Environment Programme (UNEP), *UNEP in Afghanistan: Laying the Foundations for Sustainable Development* (Kabul: UNEP, January 2009) for environmental problems in the country. See also United Nations Office on Drugs and Crime (UNODC), *Afghanistan Opium Survey* (Kabul: UNODC, several years) and *Afghanistan Cannabis Survey* (Kabul: UNODC, 2010) for drug-related information. As UNODC recognizes, drugs have "catastrophic consequences" by funding criminals, insurgents, and terrorists in Afghanistan and abroad and by undermining public trust in government officials, security, and the rule of law because of corruption. Katzman ("Afghanistan: Post-Taliban Governance," 2009, 20) reports that narcotics traffic provides $70 million to $100 million per year to the Taliban. Drugs are also posing a larger public health problem in Afghanistan since drug addiction and HIV are spreading death and misery throughout the country, particularly among the most vulnerable groups, which include refugees and internally displaced people. UNODC reported that roughly 800,000 Afghans (about 7 percent of the adult population) now use opium, heroin, and other illicit drugs, a jump from five years ago. Furthermore, tens of thousands will die again this year around the world from heroin overdoses, with about 90 percent of heroin coming from Afghanistan. UNODC reports that villages with a low level of security and that had not received agricultural assistance in the previous year were significantly more likely to grow poppy than villages with good security and those that had received assistance.

32. The *New York Times* has recently reported that "an estimated 95 percent of the country's economic activity is derived from foreign aid and Western military expenditures" and that the departing U.S. ambassador has "warned of an economic collapse in Afghanistan as donors begin to reduce their spending there." See Alissa J. Rubin and Rod Nordland, "Departing U.S. Envoy Sees Progress in Afghanistan, and Pitfalls Ahead," *New York Times,* July 5, 2011.

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33. The governments will need specific expertise to create such a framework to ensure that it will be effective and can be enforced. The Ireland Development Agency could perhaps provide technical assistance to the government as it has done to other countries in the world.

34. The Ministry of Reconstruction and Rural Development (MRRD) has already agreed to supply infrastructure for about forty villages that the MRRD and JICA have identified for a pilot project.

35. Interventions in these areas will be decided after a thorough consultation process with local communities and with the national and local governments on a number of issues to understand how the Earth Institute and its partners can help the community achieve its goals in the respective areas. For details, see the report Harvests of *Development in Rural Africa: The Millennium Villages after Three Year* (Earth Institute, the Millennium Promise, and the UNDP, 2010). http://millenniumvillages.org/files/2011/02/MVP_Report_2010FINAL.pdf. The proposal for the Millennium Villages Project in Afghanistan was prepared with inputs from Jeffrey Sachs, M. Ishaq Nadiri, and the author, and is available by request at gd14@columbia.edu.

36. Alice-Ghan is a $10 million resettlement project created by UNDP for returnees, and financed by the Australian government. As Jack Healy, "Alice-Ghan Journal," makes clear, this project reflects everything that is wrong with aid. Housing was built in the middle of nowhere, miles away from any possible jobs, without water or electricity, and with only a mobile health clinic that visits on Tuesdays. Things could change should the ERZ be built a few blocks away. Building the LRZ and ERZ in an integrated way would not only create synergies between them, but it would also address some of the concerns that critics of the Millennium Villages Project in Africa have expressed, that is, that strong support is given to a few villages to the exclusion of others.

37. In addition to carrying out the preservation of the villages and developing commercial agriculture, the government started building 12,000 housing units in Dehsabz (out of 80,000 planned for the next five years) and has plans to develop necessary infrastructure. These plans include water, electricity, roads, and the commercial infrastructure necessary to market the products in this area. Developing Barikab as an ERZ would probably facilitate the development of infrastructure in this area.

38. A detailed soil study will need to take place after soil leveling is done. A study will also need to take place on the provision of water for the zone through karez systems, flood irrigation, or reservoirs, or from the Panjshir Valley. This is a very windy area and windbreaks would have to be planted around the thirty-three square kilometers. In a second phase, pastures would be planted in the mountains to create pasturelands for animal husbandry.

39. Rather than financing through NGOs and UN agencies, the Dutch are now focusing on financing the private sector directly. There are two specific ways in which the Dutch could support the Barikab ERZ or any other such zone in the country. First, the Dutch Agency for International Business and Cooperation (EVD) could finance investors that decide to locate in an ERZ. Since EVD's objective is to support sustainable economic growth, and the agency does this by selecting innovative pilot projects in commercial sectors, any ERZ would fit perfectly well within that framework. EVD finances Dutch companies as well as joint ventures with local companies. In this regard, EVD could promote joint ventures between Dutch investors that bring know-how, capital, and best management practices, and Afghan investors that know the local environment and bring local expertise, language, culture, and other important factors to make the project successful. If EVD decided to fund pilot projects in the Barikab ERZ, the EVD could support up to 60 percent of the private investment up to a maximum of €1.5 million per project. The rest of the financing would need to come from domestic investors.

40. Empirical evidence from many countries shows that ERZs could contribute to the government fiscal accounts in many ways: ERZs generate "indirect employment" (in companies that provide inputs and services to the zones) and these would be subject to national taxes; private administrators of ERZs would pay a fee to the government or be subject to national taxation; local workers would pay social security taxes; and, by generating direct and indirect employment, ERZs would contribute to improve security and lower security expenditure.

41. Establishing a company in Afghanistan requires several permits and these permits need to be renewed on an annual basis. This is not only a perfect recipe for corruption but also denies the legal framework that investors require to make economic decisions. For details, see Ernst & Young Presentation of Tax Issues in Afghanistan, Serena Hotel, Kabul, May 2011.

42. Housing already exists in the Dehsabz villages and in the Alice-Ghan project, which, together with other existing infrastructure in the surroundings, justifies the proposal to create the first RZ in this area.

43. GPFA is a U.S.-based NGO that helps rural Afghans alleviate poverty, build sustainable livelihoods, and restore their environment. It has been operating in Dehsabz and neighboring areas for a number of years without any security problem. With a $3.5 million annual budget, GPFA employs 180 Afghan men and women as staff members. It is working to boost the income of 15,000 male and female farmers in twelve provinces working in horticulture, agro-forestry, reforestation, vegetable production, and water management. Its track record in reviving and expanding nurseries, orchards, vineyards, and woodlots has been recognized by the Clinton Initiative and received a number of awards. See the GPFA website, http://www.gpfa.org/ProjectSummary.pdf. As a member of GPFA's advisory board, the author had the privilege of visiting some of its projects with its Afghan staff.

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