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Tokyo Summit and Afghanistan's Business Potential

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Delegations from over 60 countries and 20 international organisations gathered in Tokyo on 8 July 2012 and discussed plans for economic development in Afghanistan. The delegates pledged a total of US\$ 16 billion in multi-donor aid to fill the Afghan government's fiscal gap and to develop the Afghan economy over the next four years. The event attracted widespread media coverage – inside and outside Afghanistan – and raised hopes that the international community will stand by Afghanistan in the coming years. While this seemingly generous pledge by the international community does signal hopes ahead, if the Afghan government fails to correct the current state of affairs, this US\$ 16 billion will be as much a waste as the tens of billions of international aid has been so far. To go ahead and create real hope for the future of Afghanistan, the Karzai Administration needs to come out of its 11-year old cocoon and bring about some bold changes in its economic development strategy.

At present, the bulk of the Afghan economy, about 95 per cent according to the World Bank, is donor-driven, whether financed through aid money or contracts for international military spending in the country. This clearly cannot be counted as the 'real' economy, simply because these activities will decrease proportionately with the draw-down of the international military forces and with the eventual reductions in international civilian aid. Therefore, if Afghanistan is ever going to become financially self-sufficient, it needs to work on building its 'real' economy, one that stands and operates independently of foreign aid. As such, it is high time the Afghan government puts its affairs in order and creates an enabling

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environment for private sector development. To do so, a multi-pronged approach is needed to connect practical support with political and institutional change. In our view, the following aspects are the most important areas that need to be reformed:

Legal Framework

A pro-business legal framework is nearly non-existent, and the existing laws are out of touch with ground realities. There is simply too much uncertainty about what rules and regulations apply. Some laws remain from many years ago, while others have been introduced recently. The new Investment Law was enacted in 2003, which needs a lot of improvement, but it is yet to be revised. In the past several years, the tendency has been to draft and enact as many laws as possible without much regard to regulatory impact assessments. Therefore, an overall review and amendment of existing laws is critical to make sure they are applicable and promote an environment conducive to business.

Institutional Framework

Over the past decade, several executive and semi-autonomous governmental agencies have been reformed or established to streamline procedures, reduce red-tape, provide effective and efficient services and information and also advocate a pro-business environment. While some of these institutions have brought about some positive change, the mere existence of multiple organisations, doing more or less the same thing, has become part of the problem. There is much infighting over executive powers and responsibilities. In most cases, the amount of red-tape has even increased, as the establishment of multiple organisations, working on the same issues, has led to duplication of roles and parallel structures. Therefore, a thorough mapping of roles, authorities and responsibilities of the relevant governmental and semi-governmental bodies must be conducted in order to reduce duplication, overlap, infighting and unnecessary bureaucracy.

Economic Growth as Primary Objective

At present, the government's main objective in its dealings with the private sector is to raise its own revenues through taxes. This has led to a situation where the Ministry of Finance relentlessly pursues businesses for tax collection without regard to the potential survivability of the businesses. While generating internal revenues is critical for the government, the growth of the private sector must be the primary objective. Afghanistan's private sector is mainly composed of micro, small and medium enterprises, most of which are in their infancy

phase when the chances of failure are high. The government should provide the environment for these firms to grow and expand, and if that would entail short- to medium-term tax breaks, the government should consider them. There is no doubt that mobilising more revenue remains a crucial objective, but that should not be sought at the cost of unreasonable financial burden on businesses that are struggling for survival. A balanced and sound tariff and taxation system could create the platform for real and sustainable growth besides serving as a healthy source of revenue.

Role of the Private Sector in Reforms

Private sector is the primary engine of economic growth in any market economy. As such, the Afghan private sector has a critical role to play when it comes to government's policy formulations. A constructive and progressive two-way communication line between the government and the private sector will substantially facilitate relevant policy and regulatory reforms. To date, the dialogue has been limited, and even that limited interface has to do with the few larger businesses which do not share the same challenges and interests as those of the micro, small and medium enterprises that compose the bulk of the private sector in the country. This large divide between the government and the business community is a major factor contributing to the mixed results of economic governance and reforms in the business environment.

Curbing Corruption

Widespread corruption has been one of the biggest obstacles to economic development in Afghanistan. Corruption is so prevalent that literally nothing can be done in government agencies without making some sort of payment. This has resulted in both a reduction in government revenue collection – as businesses pay bribes to have their taxes and customs duties reduced – as well as in many businesses failing. And this problem will continue, even get worse, if the Karzai Administration does not come up with a radical approach, firmly committed to curbing corruption.

To conclude, while the recent pledge of US\$16 billion of international civilian aid to Afghanistan is an important contribution which can help push the Afghan economy forward, Afghanistan will not get anywhere unless its government takes up responsibility of creating an enabling environment for private sector development. Pumping money into the Afghan economy is important for its survival, but there are many challenges facing the Afghan private sector that cannot simply be remedied by more money. Addressing those challenges requires bold, committed action on the part of the Afghan government.