*"Funding requirements for security – to build and sustain the Afghan National Army and Afghan National Police – far surpass today's indigenous public revenues. And if government officials cannot be adequately and reliably paid, then corruption follows as night does day."*

— JOHN DOWDY & ANDREW ERDMANN

# Private Sector Development in Afghanistan:
## The Doubly Missing Middle

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The challenge posed by Afghanistan is how to build, strengthen, and sustain a state that can provide security, stability, and support to its people in the face of resilient insurgencies. This chapter will argue that the international community's approach to addressing this state-building challenge needs to recognize more fully the strategic importance of private sector economic development in three areas:

- The creation of a sustainable **public finance model** for the Afghan state so that the government can perform its essential functions without being a permanent ward of the international community. Where is the money to come from except through private sector development of trade, industry, and, most important, natural resources?
- The **integration of Afghanistan** both internally and with its neighbors. Business ties can help create, nurture, and solidify interests and networks across fault lines within a fragmented Afghanistan, and between it and its neighbors, as well as the international community beyond.
- The **provision of livelihoods** for the populace – including former insurgents attempting to reintegrate into society – and tangible signs of a rising standard of living.

Unfortunately, since 2001, despite numerous policy pronouncements that only an integrated political-military-economic strategy – a "whole of government" solution – can succeed in Afghanistan, the so-called "economic line of operations" has taken a back seat to the security and governance challenges that dominate the agenda of interagency and international meetings.[1]

Further, even within the "economic line of operations," other economic activities have eclipsed private sector development. In the offices of the U.S. government, international financial institutions, international organizations, ministries around the world, and in Kabul, the lion's share of attention among those working on Afghan economic policy is devoted to what might be called "macro-policy" issues. These include maintaining the overall architecture of assistance under the International Compact with Afghanistan; reviews of Afghan macro-economic health, including inflation, currency stability, and debt relief; and policy reform and capacity building in ministries in Kabul.

In the field, our remaining development investments have focused upon large scale infrastructure projects and grassroots development work aimed at tackling basic human needs encapsulated in the UN Millennium Development Goals. Although intended to be focused on tactical counterinsurgency (COIN) objectives, the military's Commanders' Emergency Response Program (CERP) funds have likewise emphasized basic infrastructure, with over 60 percent committed to transportation-related projects between 2005 and 2009.[2]

These development investments have merit and are worth evaluating on their own terms.[3] And many have indirectly promoted private sector development, such as when a new road reduces the time to market for perishable crops. However, direct support for private sector development – including, until recently, agricultural sector assistance – has represented only a sliver of U.S. assistance to Afghanistan. As such, it does not seem overly provocative to suggest that private sector development has been "doubly missing" from U.S. Afghanistan strategy to date.

You can see firsthand today the peculiar implications of this neglect of the Afghan private sector on many bases around Afghanistan. In late 2009, the United States and the United Nations together launched the "Afghan First" procurement policy to channel contracting spending to competitive local businesses.[4] Yet, a small fraction of up to $14 billion the Department of Defense annually procures goes to Afghan firms. In September 2010, General David Petraeus issued guidance to all NATO and U.S. military personnel serving in Afghanistan that emphasizes the strategic importance of directing international contracting spend to both promote economic development and to avoid strengthening actors that undermine Afghan security.[5] Over nine years after the U.S. intervention in Afghanistan began, you can still find palettes of bottled water imported from the U.A.E. on a U.S. base that is within a few miles of at least three separate Afghan water bottling plants, plants whose owners would welcome contracts with international forces.

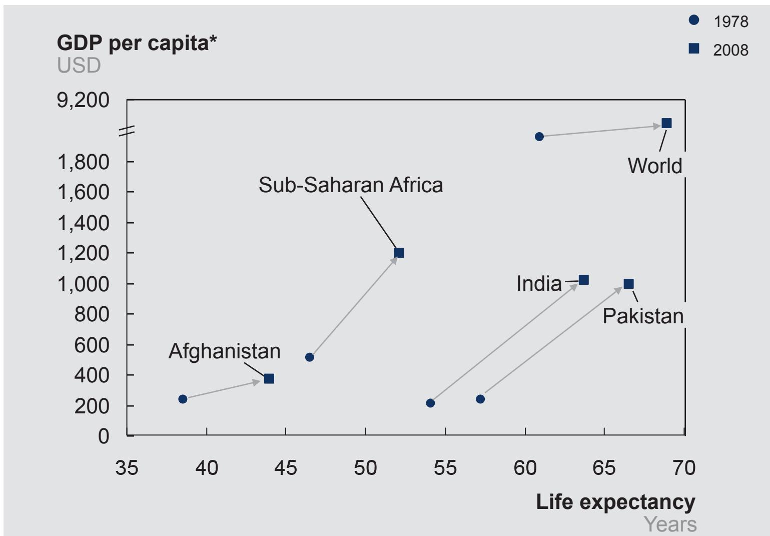
Why should this be so? It may simply be that people and organizations naturally gravitate to issues and solutions with which they are familiar, and where they feel they have answers. By and large, U.S. policymakers, by training and experience, are more comfortable with providing security, political, and diplomatic solutions rather than facing the challenges of Small and Medium Enterprise (SME) development, business plans, and attracting Foreign Direct Investment (FDI). Likewise, our development agencies, contractors, and NGOs are more comfortable with technical assistance, infrastructure projects (with more easily quantifiable outputs to measure progress), and grassroots development initiatives. Contracting organizations and officers traditionally focus upon reliability in cost and delivery of goods and services in making their decisions, not on potential implications for local economic development. And most Afghans still have difficulty navigating through our procurement processes that are of byzantine – or, more appropriately, Afghan – complexity.

In what follows, this chapter sets the context with a brief discussion of Afghanistan's economic inheritance, provides at a high level what is involved in meeting the challenge, argues for the necessity of an approach that explicitly prioritizes investments in certain sectors and industries, and closes with the implications for U.S. Afghanistan strategy, policy, and execution.[6]

## Afghanistan's economic inheritance

At first blush, Afghanistan appears to present a hopeless development challenge. Afghanistan is a desperately poor place, ranking at or near the bottom on every global measure of economic and human development.[7] If Afghanistan has been distinctive at one thing since the late 1970s, it has been in exemplifying the "traps" – to adopt Paul Collier's terminology – that retard development in "bottom billion" countries *(Exhibit 1)*.[8]

**EXHIBIT 1: Afghanistan has lagged its neighbors and the rest of the world in economic and human development during the past 30 years**




*Nominal GDP
SOURCE: World Bank World Development Indicators Database

First and most importantly, Afghanistan has been caught in a "conflict trap": The war waged by the Soviets and their Afghan allies against the Mujahedeen; the Afghan civil war following the Soviet withdrawal in 1989 that propelled the Taliban's rise to power; the Taliban-Northern Alliance war; the American-catalyzed overthrow of the Taliban regime; and the current NATO-led war against the Taliban insurgencies.

Second, Afghanistan is landlocked and surrounded by "bad" neighbors.

Third, it suffers from "shaky" governance, to be charitable.

Fourth, even its recently trumpeted wealth in natural resources poses a potential "resource trap" to Afghanistan's development and governance, as a look at Nigeria or the Congo would suggest.[9]

All this has resulted in profound structural challenges to Afghanistan's development. The overall effect of these challenges, especially the "conflict trap," has been to shrink the economy from $3.8 billion annual GDP in 1979 to less than

$1 billion in 2000, destroy infrastructure, livestock and crops, scatter a diaspora of educated Afghans around the world, stymie the once profitable natural gas industry, deter most outside investors, and foster the explosion of an illicit poppy economy.[10]

The Afghan experience before the political instability of the late 1970s, however, shows that development has been possible. During the reign of King Zahir Shah (1933-1973), trade expanded around 8 percent per year.[11] Formal education grew from a mere 1,350 students in 1932 to over 830,000 in 1974.[12] The economy grew modestly but steadily at about 3 percent per year between 1960 and 1973.[13] Afghanistan also originally benefitted from Cold War competition as both the United States and the Soviet Union poured development assistance into the country in the late 1950s and 1960s. Helmand Province – where U.S. forces fight the Taliban today – was known then as "little America" because of the extensive U.S. development presence. Above all, basic infrastructure – especially the national road network – expanded, thereby linking Afghanistan's regions together as never before.[14] In many respects, therefore, the 1979-2001 period represents not the norm, but a disastrous detour on Afghanistan's road to development.

There are also signs since 2001 that Afghanistan has been getting back on track. Similar to many post-conflict economies, Afghanistan has experienced steady growth of around 20 percent per year (albeit off a very low base).[15] The economy rebounded well from the global downturn, with GDP growing at an estimated 22.5 percent in 2009/10.[16] Afghanistan has a good record on currency stability and inflation. Exports increased more than five-fold between 2003 and 2009. Vehicles on the road grew from just over 175,000 to nearly 1 million between 2003 and 2009, helping to accelerate the movement of people and goods despite the woeful state of basic infrastructure in most areas. SME production has expanded to supply the growing local market and has started to displace the imports that dominate nearly every category of good. Between 2002 and 2009, for example, annual production of shoes and plastic sandals increased 75 percent per year, from 1 million to over 28 million pairs, and plastic dishes increased at 45 percent per year, from 11 thousand tons to 98 thousand tons.[17] A new industrial park outside Herat, for example, boasts over 160 companies and 10,000 employees working in food and beverage processing, marble cutting, plastics, iron, and other unglamorous but profitable industrial businesses. The explosion in the use of cell phones – from essentially none in 2001 to now over 12 million cell phone accounts in a country of 29 million people – is perhaps the most visible example of how the opening of the Afghan economy is changing lives in new ways.[18]

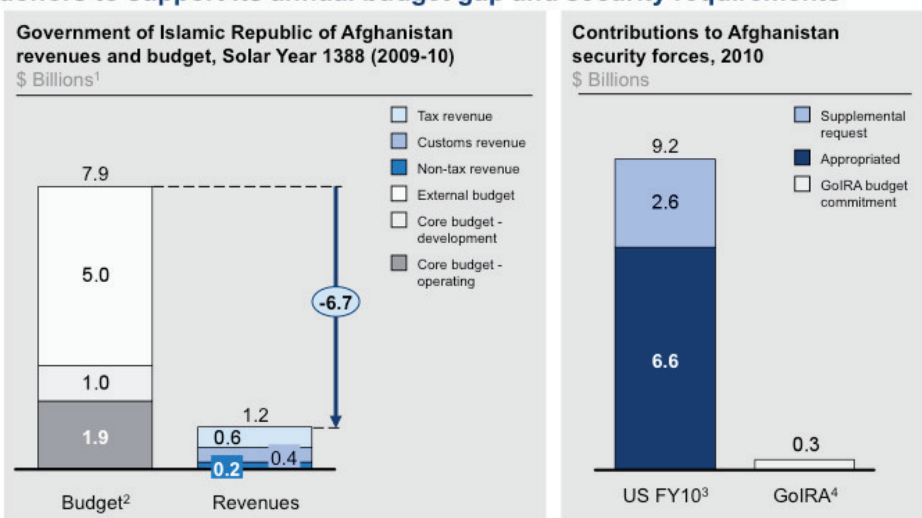
Beyond a recitation of statistics, it is important to note Afghanistan's long history and deep culture as a trading nation, a fact vital to explaining this recent success, and which offers some hope for the future. This represents the living legacy of the Silk Road. Equally important – and in contrast to other countries such as Iraq – the Afghan state never asserted control over the entire economic sphere. Major industries were state-owned according to the 1977 Constitution, but even the move to extend state control under the Afghan Communists was halting and incomplete. Overall, state-owned enterprises represent a small and shrinking portion of the Afghan economy. If you speak to Afghan SME owners and entrepreneurs you would be impressed by their dynamism, determination, and business acumen. They can cite cost differentials in supply chain options down to the Afghani, how Turkish, Iranian, Indian, and Chinese equipment compares, what they need, and how they will train their staff. Although they typically lack formal business training and refined technical and communication skills, Afghan businessmen know how to think through business problems by a combination of experience, intuition, and tradition.

## Meeting the challenge

It is in this context that the challenge of building a sustainable public finance model for the Afghan state, integrating Afghanistan internally and with its neighbors, and providing livelihoods for the populace must be understood.

**Public finance:** Afghanistan is now a ward of the international donor community. The government has two budgets – core (comprised of "operating" and "development" components) and external. The latter, however, is outside of its control. Funding requirements for security – to build and sustain the Afghan National Army and Afghan National Police – far surpass today's indigenous public revenues *(Exhibit 2)*. And if government officials cannot be adequately and reliably paid, then corruption follows as night does day. This profound imbalance and dependency upon international donor assistance poses a challenge to Afghanistan's "economic sovereignty" and thereby the viability of the overall Afghanistan mission, as Paul Brinkley of the Task Force for Business and Stability Operations has emphasized.[19]

**EXHIBIT 2: Afghanistan remains dependent upon international donors to support its annual budget gap and security requirements**




1 Exchange rate: 52 Afghanis to 1 USD (benchmarked to 1388 Afghanistan National Budget)
2 Core budget – Operating: composed primarily of recurrent costs, such as government salaries Core budget – Development: development budget in the areas of governance, infrastructure, agriculture, economic reform, and private sector development; External budget: composed primarily of security expenses, though some development funding is included (estimate based on projected budget of Afghanistan vs. core budget
3 USG FY10 contributions to Afghanistan Security Forces Fund (ASFF)
4 GoIRA funding contributions to budget for Solar Year 1388 (2009-10)

SOURCE: SIGAR, April 30, 2010, pp. 48-49, 159; GoIRA 1388 National Budget, p. 15; GoIRA,Ministry of Finance, Pre-Budget for 1390, p. 6; Department of Defense Budget Overview, FY2011, pp. 6-5; Department of Defense, "US Plan for Sustaining Afghan Security Forces" (April 2010), pp. 93-95.

Duties on trade and other tax revenues alone will likely never close the public finance gap. The answer, therefore, lies in the responsible development of Afghanistan's vast natural resources, especially minerals and energy. Afghan officials have recently stated that they believe the country's natural-resources reserves might well be worth over $3 trillion dollars in the coming decades – or over $100,000 per Afghan citizen, in a country with an annual per capita GDP today of around $500.[20] Taxes, duties, and royalties from these resources' development could eventually provide billions of dollars every year to the Afghan treasury.

Natural resources are thus the only "game changer" available. Local Afghan firms are already mining industrial materials such as marble, gravel, and sand. Yet only globally traded minerals, such as copper, iron, gold, and rare earth elements, and energy supplies have the potential to generate significant public revenues. This will necessarily involve major international mining and energy companies, since the Afghans do not possess the indigenous capabilities themselves. The development of the Aynak copper reserves demonstrates that the Chinese are willing to enter the Afghan market. Facilitating additional international private sector engagement in this area – while also helping the Afghans put in place safeguards against a "resource curse" – is thus critical.[21]

**Integrating Afghanistan:** Business and trade relations can help build networks of shared interests that transcend traditional territorial and ethnic boundaries. Today, Afghanistan is fragmented economically, as well as politically. Afghan businessmen often look outward to their more developed and easily accessible international neighbors as much as, if not more often than, within their own country. Speak with businessmen in the different regions of Afghanistan and this reality is thrown into stark relief. In Jalalabad, business ties and supply chains flow into Pakistan. In Mazar-e-Sharif, you see imported goods from Turkmenistan and Uzbekistan and hear talk of how the country's first railway line will link Mazar-e-Sharif to the Uzbek rail network, and then to the European network, thus further accelerating trade relations. In Herat, electricity flows from Iran, along with hundreds of trucks carrying goods overland every day via the Iranian port of Bandar Abbas. Soon Herat will be linked to the Iranian rail network. Such business ties across international borders are inevitable and largely beneficial. Afghanistan's development should be accelerated by connections to international markets. However, they can be unhealthy if they reinforce centrifugal forces within Afghanistan. Afghanistan's internal market still has limited interconnectedness – as highlighted by the Department of Defense's Task Force for Business and Stability Operations – and this poses potential long-term negative implications for the viability of the Afghan state.[22]

*"Continued infrastructure investment, alongside improved security, should help Afghanistan restore the internal market links that have been torn asunder in the past three decades."*

It is crucial to encourage and support wherever possible the development of deeper private sector relationships across regions inside Afghanistan. SMEs involved in light manufacturing, trade, construction, and logistics are potential leaders for such integration. Doing so will reinforce the broader strategic goal of integrating Afghanistan. This would also work in tandem with the natural tendency for Afghan businessmen to seek to integrate their own "value chains" by expanding into transportation and distribution to reduce the risks and transaction costs in a society with inconsistent rule of law. Continued infrastructure investment, alongside improved security, should help Afghanistan restore the internal market links that have been torn asunder in the past three decades, as well as develop strategic trade corridors linking north with south, and east with west, to rejuvenate regional trade across a new Silk Road.[23] In sum, it will likely not be possible to achieve a sustainable political settlement without some kind of mutually reinforcing internal and regional synchronization of economic interests as well.

**Providing livelihoods:** Ultimately, what the average Afghan citizen cares about is "How will I and my family survive?" The first concern is security – but that security is economic as well as physical.[24] A basic standard of living is essential. Outside of direct government employment – especially in the security forces – these livelihoods will come from the private sector. Moreover, roughly two-thirds of Afghan workers in the agricultural sector are in some way connected to the private sector, and their fates are thus intertwined. Positive, visible private sector growth will be seen as an indicator of state effectiveness.

But there is also a more immediate need for private sector job creation; namely, helping counter the appeal of the Taliban. Baldly put, when the Taliban's representative arrives and says he can give you a job, and if the government has been saying for months that it can too, but hasn't done so, then the Taliban representative will win. Moreover, jobs are an important element in the disarmament-demobilization-reintegration (DDR) program that could bring many Taliban "in from the cold."[25] Providing jobs and demonstrating that the Afghan state can deliver on its commitments to its people is where economics connects most directly with the strategic goals of reconciliation and stabilization. If you consider Iraq, a large part of the success of the "surge" was the fact that, when dealing with the Sunni insurgency, the United States put a lot of people on the payroll – it was, effectively, a huge temporary public works program. But such programs need to transition to a sustainable private sector basis to endure. The adage remains true: idle hands do the devil's work.

## A priority sector and industry approach

How can private sector development accelerate to secure these strategic goals? Philosophically, it is important to accept that there are different models for private sector development, with different balances among the state, firms, and individuals that depend upon unique history, culture, natural endowments, and structure of economies. There is no one-size-fits-all solution.[26] Especially in countries such as Afghanistan, a reflexive "pure free market" approach is not viable.

What is necessary in any model, however, is a sector competitiveness analysis that guides the use of limited resources to their highest strategic impact. This should not be framed as a question of "picking winners," but rather of identifying the industries with the highest potential, and then tailoring policies and other support to promote these industries.[27]

To date, most approaches to private sector development have emphasized those goods where Afghanistan has potential long-term competitiveness in the international marketplace. These include marble, fruits, nuts and other agricultural products (including niche ones, such as saffron), handicrafts (especially carpets), and minerals and energy. Prioritizing these industries makes sense. Exports bring in much needed foreign currency, and Afghan development should focus upon industries that promise to have sustainable competitive advantage. But export-oriented opportunities represent, at most, half the story.

Agriculture deserves a chapter of its own. It represents approximately two-thirds of employment and a quarter or more of GDP.[28] These numbers will decrease in time as the economy matures. For now, however, agriculture must be done right, or an economic development strategy would be ignoring the vast majority of the population. Moreover, the agricultural sector is typically a leading driver of long-term growth in developing economies.[29] U.S. policy belatedly, but correctly, has begun to recognize the strategic importance of the agricultural sector.

Another part of the story is the non-tradable industries, especially in the services and infrastructure sectors. Non-tradable industries in these sectors (trade, retail, construction, transportation, etc.) typically account for half of GDP and approximately two-thirds of employment growth in developing economies.[30] Construction services and materials have great potential in Afghanistan, driven by significant local and donor demand and because they support the development of all other industries.

Rounding out the story is the whole panoply of light industry – unglamorous stuff ranging from food processing to paints and plastics. Although technically tradable, these are not an "export play," but viable businesses that can substitute for the imports that currently feed local Afghan demand. Despite higher costs on some inputs, such as electricity, local Afghan firms can often be cost-competitive because they have much lower transport costs as well as lower labor costs.

These sectors and industries can be mapped back to our three strategic priorities. Tapping Afghanistan's natural resource wealth will provide the largest part of public finance. Transit, trade, and SMEs will help integrate the Afghan market locally, regionally and internationally, and provide new jobs. And improving agricultural productivity and yields will help the majority of the population move up from borderline subsistence.

Sustained execution of such a strategy is more challenging than devising it. Security remains an obvious concern. Enormous infrastructure challenges remain. Electricity supply, for instance, is often unreliable and/or expensive, thereby negatively impacting Afghan goods' competitiveness. The "ease of doing business" in Afghanistan is one of the worst in the world, with its stultifying corruption and sometimes capricious bureaucratic processes.[31] And perhaps the biggest constraint on SME growth, as reported in interviews with SME owners around the country, remains the lack of access to credit.[32] The crisis in Kabul Bank that unraveled in September 2010 exemplifies the general weakness of the Afghan financial system.[33]

Despite these challenges, the potential upside is significant and realistic. While not minimizing the security challenges, you can see "business as usual" moving forward wherever the environment reaches a baseline of stability. Modest improvements in performance can deliver step-changes in value-added, precisely because of the primitive condition of much of the Afghan economy. The marble industry illustrates this pattern along its entire value chain, from extraction to polishing. The use of primitive extraction and cutting techniques (including blasting with unexploded ordnance) can destroy up to 80 percent of the value of Afghanistan's world-class marble. Widespread introduction of improved techniques, which have been successfully piloted, would eliminate this wastage. Furthermore, much of the final value-added processing – refined cutting and polishing, worth perhaps 10 percent of the marble's final value – is often completed in Iran or Pakistan. As one marble factory owner lamented: "we do the hard job and they get all the benefit." Similar patterns can be seen in agriculture, the carpet industry, and other industries as well.

Put another way, there is real value in Afghan work, but much of it is lost and then, of what remains, others capture much of the remaining value. This reality captures both the tragedy and potential of the Afghan private sector.

## Implications for U.S. Afghanistan strategy, policy, and execution

What is to be done?

First, private sector development must be given the priority it merits. It holds the key to a sustainable model of public finance and encourages networks, interests, and shared identities that bind rather than fragment Afghanistan. It gives those outside Afghanistan a stake in its success and provides Afghans confidence that their country is again on a path of development that will improve their lives and provide basic security for their families.

Second, our efforts must focus where the probability of success is highest. The United States, its coalition partners, and the Afghans do not have unlimited money, people, skills, or time. Given the scale and scope of the challenge, the industry priorities are clear: natural resources, agriculture, construction, trade and related services, and light industry. Some geographies have more potential because of favorable location, security, natural resources, or other factors. Many of these opportunities have been analyzed and highlighted before; but the basic improvements recommended have not been implemented on a consistent, sustained basis.[34]

This leads to a third implication, namely, that these national and local industry priorities must be integrated into a coherent plan of specific initiatives that are then driven down to the local level and sustained.[35] Infrastructure is rightly recognized as important. The infrastructure level in Afghanistan was so poor after decades of destruction and neglect, that virtually any investment would produce some positive return. But, all else being equal, future infrastructure projects – such as investments in electricity – should be more closely integrated with priority industry development to maximize impact. Likewise, technical assistance and policy reform initiatives should prioritize certain industries. For instance, mining laws, regulations, and procedures will likely have to be changed to provide the right incentives and security to outside investors to accelerate development of revenue-producing fields.[36] In some cases, direct grants will be appropriate – as USAID's Afghanistan Small and Medium Sized Enterprise Development (ASMED) program has done – to help Afghan companies capture value through more efficient practices and by moving into higher-value-added processes. Other businesses will be able to expand to meet increased international demand for certain local goods and services as part of the "Afghan First" contracting initiative. Still others will benefit most from business-to-business linkages to build skills, find new markets, and attract international investors. Together, though, a consistent pursuit of strategic priorities is needed –

rather than a "let a thousand flowers bloom" approach – to achieve results in such a challenging operating environment.

Fourth, there is a need for a new operating model. Today, execution is incredibly fragmented. Programs and responsibilities often overlap. It is not clear who is in charge. In agriculture alone, there are U.S. Department of Agriculture advisors, the military's Agricultural Development Teams (ADTs) and CERP-funded projects, Provincial Reconstruction Teams and District Support Teams staffed with State Department and USAID personnel who may be involved in agricultural programs, trade experts at Embassy Kabul, and so on. This is just in one sector, and does not take into account the slew of NGOs and development organizations of other countries (Canadian, British, German, Italian, Scandinavian, etc.). The regular rotation of civilian and military staffs further exacerbates this problem, as institutional memory and working relationships have to be constantly recreated. Without some greater continuity, coordination, and communication of efforts, confusion and duplication will continue.

*"There is a need for a new operating model. Today, execution is incredibly fragmented. Programs and responsibilities often overlap. It is not clear who is in charge."*

Fifth, program design and implementation must provide the right incentives to escape the short-term mindset that too often dominates our actions in Afghanistan. The cliché is sadly true: we have been fighting nine "one-year" wars in large part because that is what those in the field are encouraged to do. Especially in USAID, a concern with program monitoring and audits has led some USAID contractors to avoid some important long-term projects because their impact would only be felt – and be measurable – after their period of contract performance had ended.[37] Military commands are sometimes judged by how rapidly they spend their CERP funding, not how wisely. The endless pursuit of "quick wins" is ultimately a losing proposition.

Lastly, the U.S. government needs to rethink its existing models of public-private partnerships in Afghanistan. The Aynak copper mine is an instructive case in point. Putting aside allegations of corruption, the Chinese developed a better offer than other international bidders because they successfully integrated business investment alongside more traditional economic development assistance. From the vantage point of Afghan economic development, it may not matter whether the investment comes from China or India or Europe or the United States, unless a particular investment has negative internal or regional political ramifications. But from the U.S. perspective, our statecraft would be strengthened if the government could more closely coordinate and even collaborate across the public-private sector line in such complex contingencies.[38] In the U.S. government today, there is no clear owner for the promotion of private sector development in Afghanistan – nor, more generally, to support our stabilization missions around the world. To consider three efforts from across the government, USAID's ASMED program is a relatively small part of the overall USAID effort, the Department of Commerce's Iraq and Afghanistan Task Force lacks resources and bureaucratic clout, and the Department of Defense's Task Force for Business and Stability Operations is an *ad hoc*, temporary body. Significantly, the Task Force had proven to be ecumenical in its approach, facilitating U.S. and non-U.S. companies' relations with the local business. Non-U.S. companies will often have greater knowledge of the market, tolerance for risk, and therefore, willingness to operate in countries such as Afghanistan. Thus, cooperating with U.S. and non-U.S. companies is a necessary innovation that puts the mission ahead of narrow American economic interests. The time has come to consider establishing an enduring, expeditionary capability within the U.S. government whose mission would be to facilitate private sector engagement and development in fragile and conflict-affected states. Afghanistan could be its first stop.

Getting the economic dimension right is not alone sufficient for success, but it is necessary. The international community cannot afford to have private sector development missing from this struggle for the future of Afghanistan.

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[1] Off-the-record conversations with U.S. Government officials, 2009-2011.

[2] Special Inspector General for Afghanistan Reconstruction, "Increased Visibility, Monitoring, and Planning Needed for Commander's Emergency Response Program in Afghanistan" (September 2009). The use of CERP funds to support private businesses is explicitly prohibited, with a few exceptions (e.g., battle damage payments). DOD Financial Management Regulation, "Summary of Major Changes to DOD 7000.14-r, Volume 12, Chapter 27, Commander's Emergency Response Program (CERP)" (January 2009), p. 27-8, available at comptroller.defense.gov/fmr/12/12_27.pdf.

[3] For skeptical appraisals of how well CERP development investments contribute to COIN objectives, see Andrew Wilder and Stuart Gordon, "Money Can't Buy America Love" (December 1, 2009), at ForeignPolicy.com; Edwina Thompson, "Winning 'Hearts and Minds' in Afghanistan: Assessing the Effectiveness of Development Aid in COIN Operations," *Report on Wilton House Conference No. 1022* (Whilton Park, April 2010). For evaluations of USAID programs, see USAID Inspector General's audits of Afghanistan programs available at www.usaid.gov/oig/public/reports/afghanistan_information_audit_and_specialrptsmemos.html.

[4] Department of Defense, "Report on Progress Toward Security and Stability in Afghanistan" (April 2010), p. 69.

[5] Alissa J. Rubin, "Afghan Commander Issues Rules on Contractors," *New York Times* (September 13, 2010); COMISAF memorandum, "COMISAF's Counterinsurgency (COIN) Contracting Guidance," 8 September 2010, available at http://www.isaf.nato.int/images/stories/File/100908-NUI-COMISAF%20COIN%20GUIDANCE.pdf.

[6] In developing this argument, we have learned much from reading analyses by and speaking with experts in the U.S. government, major international development agencies, think tanks and academia, and in Afghanistan. Above all, however, our experiences meeting Afghan businessmen – whether walking a shop floor in Herat or discussing electricity prices in Jalalabad – informs our perspective.

Helpful published works for understanding Afghanistan, its complex history, and its recent economic development include: Thomas Barfield, *Afghanistan: A Cultural and Political History* (Princeton: Princeton University Press, 2010); Steve Coll, *Ghost Wars: The Secret History of the CIA, Afghanistan, and Bin Laden from the Soviet Invasion to September 10, 2001* (New York: Penguin, 2004); Colin Cookman and Caroline Wedhams, *Governance in Afghanistan: Looking Ahead to What We Leave Behind* (Washington: Center for American Progress, 2010); Jake Cusack and Erik Malmstrom, "Afghanistan's Willing Entrepreneurs: Supporting Private-Sector Growth in the Afghan Economy," Center for a New American Security Policy Brief (November 2010); Jake Cusack and Erik Malmstrom, "Bactrian Gold: Challenges and Hope for Private-Sector Development in Afghanistan" (Kauffman Foundation, February 2011). Martin Ewans, *Afghanistan: A Short History of its Peoples and Politics* (New York: HarperCollins, 2002); Nathaniel Fick and Clare Lockhart, "The Economic Imperative: Stabilizing Afghanistan Through Economic Growth," Center for a New American Security Policy Brief (April 2010); Ashraf Ghani, "Afghanistan: Opportunities and Risks," *PRISM* (September 2010), pp. 15-24; Ashraf Ghani and Clare Lockhart, *Fixing Failed States: A Framework for Rebuilding a Fractured World* (New York: Oxford University Press, 2008); Antonio Giustozzi, ed., *Decoding the New Taliban: Insights from the Afghan Field* (New York: Columbia University Press, 2009); David Kilcullen, *The Accidental Guerrilla: Fighting Small Wars in the Midst of a Big One* (New York: Oxford University Press, 2009); Ahmed Rashid, *Taliban: Militant Islam, Oil and Fundamentalism in Central Asia* (New Haven: Yale University Press, 2001); Barnett R. Rubin, *The Fragmentation of Afghanistan: State Formation and Collapse in the International System,* second edition (New Haven: Yale University Press, 2002). The indispensible source Afghanistan's economic history through King Zahir Shah's reign remains Maxwell Fry, *The Afghan Economy: Money, Finance, and the Critical Constraints on Economic Development* (Leiden, Netherlands: E. J. Brill, 1974). Additional insights on Afghan economic development through the mid-1980s are available in Richard Nyrop and Donald M. Seekins, *Afghanistan: A Country Study* (Washington: American University, 1986), pp. 141-207. The publications of the World Bank and IMF provide the most up-to-date data and analyses of recent Afghan economic developments, and are readily available on their websites. See, for instance, The World Bank, *Afghanistan Economic Update* (Washington: World Bank, October 2010). The Special Inspector General for Afghanistan Reconstruction (SIGAR) provides the most thorough, easily accessible accounting of U.S. reconstruction spending and programs in Afghanistan in its quarterly reports to Congress, available at www.sigar.mil. Although sometimes inconsistent in availability and quality, the publications of the Government of the Islamic Republic of Afghanistan, especially those related to the Ministry of Finance, Afghan National Development Strategy, and the Afghan Investment Support Agency (AISA), are helpful. Of special note among "think tanks" is the Afghan Research and Evaluation Unit, based in Kabul, which has produced a series of insightful publications, which are available at www.areu.org.af. For more general discussions of private sector contributions to post-conflict stabilization, see Mats Berdal and Nader Mousavizadeh, "Investing in Peace: The Private Sector and the Challenges of Peacebuilding," *Survival* (April-May 2010), pp. 37-58; Carl Schramm, "Expeditionary Economics: Spurring Growth after Conflict and Disasters," *Foreign Affairs* (May/June 2010), pp. 89-99.

[7] Afghanistan ranks 162 of 180 countries in GDP (nominal) per capita income at $486/year (International Monetary Fund, World Economic Outlook Database, accessed on July 20, 2010). Its rank on most other indicators is shockingly poor. For instance, Afghanistan ranks the worst in Asia in infant and child mortality, maternal mortality, gender equity in education, primary education completion, population using improved water sources, life expectancy at birth, death rate, and slum population as a percent of urban population. See Asian Development Bank, *Key Indicators for Asia and the Pacific, 2009* (Manila, Philippines: Asian Development Bank, 2009).

[8] For his discussion of the four principal "traps" to development, see Paul Collier, *The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It* (New York: Oxford University Press, 2007).

[9] Paul Collier, "In Afghanistan, the Threat of Plunder," *New York Times* (July 20, 2010).

[10] GDP (nominal) data from WMM (Global Insight).

[11] Estimate based upon data contained in Fry, *The Afghan Economy.*

[12] Rubin, *The Fragmentation of Afghanistan*, p. 71.

[13] GDP (nominal) data from World Bank, World Development Indicators Database.

[14] By the mid-1970s, regional price differences decreased significantly as the new road networks facilitated for the first time the establishment of a true national market. Nyrop and Seekins, *Afghanistan*, p. 167.

[15] GDP (nominal) data for 2002-2009 from WMM Global Insight. On overall post-conflict trends, see UNDP, *Post-Conflict Economic Recovery: Enabling Local Ingenuity* (New York: UNDP, 2008).

[16] World Bank, *Afghanistan Economic Update*, p. 3.

[17] See trade, vehicles, and industrial production data in IMF, "Islamic Republic of Afghanistan: Statistical Appendix," February 2008, and Central Statistics Office available at www.cso.gov.af.

[18] Department of Defense, "Report on Progress Toward Security and Stability in Afghanistan" (April 2010), p. 68.

[19] See "Special Defense Department Briefing by Paul Brinkley, Director, DOD Task Force for Business and Stability Operations in Afghanistan; Jack Medlin, Regional Specialist, U.S. Geological Survey International Programs; Kathleen Johnson, Mineral Program Coordinator, USGS" (June 14, 2010) available at www.defense.gov/transcripts/transcript.aspx?transcriptid=4643. See also Task Force for Business and Stability Operations, "Afghan Economic Sovereignty: Establishing a Viable Nation" (Briefing released June 2010) available at www.defense.gov/news/d2010614slides.pdf.

[20] Alisa Rubin and Mujib Mashal, "Afghanistan Moves Quickly to Tap Newfound Mineral Reserves," *New York Times* (June 17, 2010).

[21] On addressing the "resource curse" challenge, see Collier, The *"Bottom Billion,"* pp. 38-53; Collier, "In Afghanistan, the Threat of Plunder"; Amela Karabegovic, "Institutions, Economic Growth, and the "Curse" of Natural Resources" *Fraser Institute Studies in Mining* (July 2009); the Center for Global Development, "Fighting the Resource Curse Through Cash Transfers" at www.cgdev.org/section/initiatives/_active/revenues_distribution; and the Extractive Industries Transparency Initiative, which Afghanistan has recently joined, at www.eiti.org.

[22] See Task Force for Business and Stability Operations, "Afghan Economic Sovereignty: Establishing a Viable Nation."

[23] S. Frederick Starr and Andrew C. Kuchins, "The Key to Success in Afghanistan: A Modern Silk Road," Central Asia-Caucasus Institute Silk Road Studies Program (May 2010). See also the information on the Central Asia Regional Economic Cooperation (CAREC) Program, which is a multilateral partnership to promote regional economic development in Central Asia, at www.adb.org/CAREC.

[24] When asked "what is the biggest problem facing Afghanistan as a whole?", 36 percent chose insecurity/violence, 35 percent unemployment, 20 percent poor economy, and 17 percent corruption, followed by Taliban, education, and poverty. When asked "what is the biggest problem in your local area?", economic and infrastructure concerns dominated with 26 percent selecting unemployment, 26 percent electricity, 22 percent water, 24 percent roads, and only 13 percent insecurity/violence. These ratings are consistent with the similar surveys conducted in 2006, 2007, and 2008. Furthermore, when asked to rate the performance of the Afghan government, the majority felt it was doing a bad job with creating jobs (71 percent), fighting corruption (68 percent), and economic development (62 percent), whereas a majority thought it was doing a good job with security (61 percent favorable). Asia Foundation, *Afghanistan in 2009: A Survey of the Afghan People* (Washington: Asia Foundation, 2009), Figures 2.7, 2.9, 5.1.

[25] See, for example, Carlotta Gall, "Karzai Pressed to Move on Taliban Reintegration," New York Times (June 25, 2010).

[26] Thomas K. McCraw, *Creating Modern Capitalism: How Entrepreneurs, Companies, and Countries Triumphed in Three Industrial Revolutions* (Cambridge: Harvard Business School Press, 1998).

[27] Our approach here has been critically informed by the work of the McKinsey Global Institute. See, for instance, McKinsey Global Institute, *How to Compete and Grow after the Recovery: A Sector Approach* (September 2009); *How to Compete and Grow: A Sector Guide to Policy* (March 2010).

[28] SIGAR, "Quarterly Report to Congress" (October 31, 2009), p. 95, reports agriculture's share of GDP in 2008-09 at 31 percent. IMF, Islamic Republic of Afghanistan: Sixth Review Under the Arrangement Under the Poverty Reduction and Growth Facility, Request for Waiver of Nonobservance of a Performance Criterion, Modification and Performance Criteria, and Rephasing and Extension of the Arrangement" (January 2010), p. 5, indicates formal agriculture is approximately 24 percent of GDP.

[29] An analysis of 25 developing economies (<$5000 per capita GDP) for which there is comparable GDP data between 1985 and 2005 (from Global Insight) revealed that agriculture was, overall, the most important sector contributor to GDP growth, and a top-3 driver of growth in 17 of the 25 economies.

[30] McKinsey Global Institute, *How to Compete and Grow after the Recovery: A Sector Approach* (September 2009), p. 10.

[31] Afghanistan ranks 160 of 183 economies surveyed, and dead last in three categories: protecting investors, trade across borders, and closing a business. World Bank, *Ease of Doing Business: Afghanistan 2010* (Washington: World Bank, 2009).

[32] Center for International Private Enterprise and Chaney Research, "Afghan Business Attitudes on the Economy, Government, and Business Organizations – 2009-2010 Afghan Business Survey, Final Report" (May 2010), available at www.cipe.org/regional/southasia/pdf/Afghan%20Business%20Survey%20Report_5-04-10_FINAL.pdf.

[33] Alissa J. Rubin and Adam B. Ellick, "More Trouble Ahead for Kabul Bank," *New York Times* (September 14, 2010); Dexter Filkins, "Letter from Kabul: The Great Afghan Bank Heist," *The New Yorker* (February 14, 2011).

[34] See, for example, OTF Group, "Three Cluster Discussion Document" for Commercial Competition Commission of Afghanistan (September 14, 2005).

[35] McKinsey Global Institute, *How to Compete and Grow: A Sector Guide to Policy* (March 2010).

[36] See James R. Yeager, "The Aynak Copper Tender: Implications for Afghanistan and the West" (2009).

[37] On this broader theme, see Andrew Natsios, "The Clash of the Counter-Bureaucracy and Development," Center for Global Development Essay (July 2010).

[38] On this general point, see Berdal and Mousavizadeh, "Investing in Peace: The Private Sector and the Challenges of Peacebuilding."