

## **“Building on Local Skills and Experience”**

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The focus of my remarks today is on building up the private sector – more precisely, the *market* economy without which, history shows, there can be no stability and no democracy. The *market* economy is sustainable and can expand. It is the basis for a pluralistic society that can feed, clothe and house itself. Indeed, it is a genuine precursor to the democratic form of government.

No market economy, no democracy, nowhere.

There are three major revenue streams in Afghanistan today: the drug trade, contracts and grants, and the local economy. The drug trade is a major source of funding for the insurgency and probably not much else for the development of Afghanistan. The contracting world has been rebuilding Afghanistan and has contributed to the Afghan economy via money spent in the country at all levels, but it lacks the sustainability that the Afghan economy needs. The only sustainable way to get Afghanistan back on its feet is by building the local economy through the private sector and investing, both domestic and foreign, in those Afghan companies engaged in the real market economy.

Ladies and gentlemen, it is the “local skills and experience” of those in companies in the private sector and in the *market* economy, myself included, that I shall be talking about. And in the same breath, those government entities which can either promote, or depress, the private sector deserve our attention.

Our AACC experience over the years since 9-11 is that the best way to boost local skills and experience is to markedly increase investment directly in Afghan companies, those in the market economy in particular, as they are where the “skills” and the “experience” of the Afghan people are presently abuilding. I will elaborate on mechanisms to do this, some of which you may have already heard about in John Aldonas’ remarks yesterday.

Building on the skills and experience of those in key government positions who have regulatory authority over the private sector so far has proven quite difficult, in spite of major investments in capacity-building in various economy-relevant Ministries. Capacity-building is a long hard slog and difficult to do but will, with patience, eventually bear fruit.

The limited capacity in government bureaucracies is ample reason why, to the largest extent possible, a business-to-business, direct investment modus operandi is preferable to getting involved with bureaucracy, particularly a still-maturing Afghan bureaucracy.

Before I further address the subject at hand, as we say in politics, “Where you stand depends on where you sit”, so let me introduce you to AACC. AACC was formed after 9-11 by Afghan-Americans and others to promote investment, business, employment, and what one terms today, an “enabling environment” for doing business in Afghanistan. We were pioneers in promoting attention and resources to the Afghan private sector and market economy, done always in cooperation with our Afghan business colleagues.

Some history: Our organization, it might be said, gave birth to the Afghan national discussion over the very idea of a market economy. We did this by virtue of an early, post 9-11 presence in the country, working on the economic aspects of the Constitution, and, creating first-ever public

forums on key issues in collaboration with our partners in the Afghan business community and with relevant Afghan Ministers.

AACC gave birth, again with our Afghan business colleagues, to the first ever independent business association in the country, the Afghan International Chamber of Commerce (AICC). AICC combined just last year with the previously government-controlled Chamber to form the present national organization, the Afghan Chamber of Commerce and Industries (ACCI). We are proud of our close working relationship with ACCI, having collaborated with them most recently on our AACC 5<sup>th</sup> Annual U.S. – Afghanistan Business Matchmaking Conference, held last October in Washington, DC.

Now for Investment, in Afghan SMEs: Such investment is the main fuel for economic growth and the related job creation that underlies stability. We believe it's imperative for the Donor nations to strongly boost the direct availability and access to capital for Afghan businesses.... by increased Donor participation in financing private sector development and by providing critical related technical assistance (TA). This needs to be done as much as possible *without middlemen or government bureaucracy.*

The bottom line is this: In Afghanistan, given the level of real and perceived risk to investment, public money and/ or assistance must be made available to ramp up and incentivize private capital currently sitting on the sidelines.

In this vein, the USG has taken the lead. As you heard yesterday, OPIC has provided funding to the *Afghan Growth Finance* "on-lending" operation and their support base is growing. ACDI/VOCA has an Afghan Rural Development Fund that focuses on agricultural business. These funds together, now have on the order of several tens of millions of dollars which is a whole lot more now than just a year ago but still limited.

Their portfolios could grow measurably with increased resources, both personnel and financial, provided by Donors. They and other like them can leverage much dormant Afghan capital.

Some have argued for a much larger investment fund, say \$100 million to \$200 million, akin to the so-called Enterprise Funds which helped jump-start economies in Eastern Europe after the fall of the Soviet Union. A number of these loans have returned greatly on their initial investment by the United States and some of the Funds, now turned into private investment funds, have actually paid back the original funding from the U.S. Government.

A large-scale Investment or Enterprise Fund for Afghanistan was considered by the U.S. much earlier in the post 9-11 era, but the then-uncertainty in the Afghan business environment and the absence of creative input of investment professionals to tailor the concept to Afghan realities kept the idea from coming to fruition. Circumstances are far different today.

Also, now there are some 18 operating banks with multiple branches all over the country. A mechanism to incentivize longer-term commercial lending via an Investment or Enterprise-type Fund, making *equity* capital available to Afghan businesses and to supplement the lending of Afghan banks meeting international standards, has received Donor attention as well.

The critical element in any fund of this sort is the professional deployment of capital by private fund managers operating independently of bureaucratic interference. This was the hallmark of the successful enterprise funds. With the right approach, it could happen in Afghanistan as well.

We at AACC believe it is an idea whose time has come.

There is a large amount of Afghan citizens' private capital, much in Dubai but elsewhere as well, that is not being invested in the country and could be with the right deal. We hear all the time that with Donor nation engagement of one sort or another, investors are much more likely to take the

plunge. When the USG gets involved, businesspeople seem to feel more secure. Thus, an enterprise fund for Afghanistan could lay the foundation for the many other potential private investors .

At this time, USAID, often through their presence in the PRTs and via their USAID implementers in general, and the USAID ASMED program in particular, are making many more of certain kinds of private sector investments, usually investments that boost not just one firm but provide for multiple-user services and facilities that benefit a contingent of companies in the private sector. Cold storage and carpet finishing come to mind.

Contracts, Grants and the Market Economy: It is also important for Donors to recognize the difference between funds flowing into the contract and grant economy and into the market economy. The former is *not* sustainable while the latter *is*. The former grows only with greater infusion of external wealth coming in, while the latter generates and grows wealth, internally.

A related issue is that the average Afghan business has to fight to keep its most qualified employees to keep from losing them to the far more lucrative contracting world, foreign governments or NGOs. Donor-agency or UN drivers made two and three times more than my plant manager responsible for some 80 people! If the Afghan economy is to show signs of sustainability, the employment base needs to be more balanced so that Afghan businesses can play on a level field and maintain a qualified, quality work force.

The contract and grant system is how most Donor expenditure gets into the Afghan economy. The awarding of contracts, is not subject to the market discipline of competition between sellers and buyers, and so contains the seeds of corruption. All too often we see the buying and selling of contracts. *Corruption appears to be embedded in the contracting system* and it is very difficult to design programs around it, or enforce against it. These are very good reasons to shift a reasonable amount of resources away *from* it and directly *into* financing the private sector, wherever feasible. Either that, or boost the amount of investment resources going directly into the private sector.

On the other hand, the market economy desperately needs public infrastructure such as roads, bridges, power generation and transmission, transportation facilities, etc. which, most often, are beyond the market economy's ability to provide. Society needs schools, hospitals, government buildings and military facilities. Contracts and grants also provide the vast bulk of foreign currency which upholds the value of the Afghani, the Afghan currency. Contracts and grants put purchasing power into the local economy provided the moneys stay in the country.

**This is dilemma for Afghanistan and other developing nations receiving foreign aid as the same resources that help build up the country also provide fertile ground for debilitating corruption.**

Let's talk about Security..... for Business: Recent events in Kabul notwithstanding, security that businesspeople talk about is quite different from national security, the kind in the war against the Taliban. This particular kind of security is more personal and company related; it's protection from crime: The theft, kidnapping and corruption that plague Afghan businesspeople and their companies over the length and breadth of the country is far more critical to Afghan businesspeople than the much the more localized and removed protection against Taliban attack.

Ministry of Interior improvements and Donor assistance in building a better police force and justice system are crucial to the conduct of everyday business every where. The good news is that Donors have an excellent Interior Minister to work with these days. Donors are expending the resources to train and reform the police. Of course, all that will take years to bear fruit.

Taxes: Tax policy should incentivize investors. Let's not forget the amount of Afghan business wealth in Dubai that is not taxed at all. The government needs to establish low and

straightforward tax policies that encourage business and investment, rather than depress them. Progress has been made in tax collection but it is still quite variable across the country. Really, for Afghanistan to prosper, it needs to be a tax haven for investors and today, it is not.

Tax rates need to be lowered and the tax base broadened. Revenue to the government can increase. Donors can help do that. Afghanistan is ready for it. Investors will be encouraged by it.

A 20% tax, however flat and across the board, is way too high given the perceived risk and the less than adequate collection process, and myriad other taxes, fees and costs faced by Afghan businesses.

Also, it makes no sense to tax capital equipment coming into the country prior to profits being realized from it. Yet another problem -- levying taxes on gross income, which some tax collectors demand in violation of the Tax Law, rather than on net income, earned after business costs and investments are deducted. This is sooo.. very basic.

The good news is that current policies under the present Finance Minister seem to be moving in the direction of progress on these fronts.

Finally, there is the issue of governance and government policies towards business. A sustainable free market economy requires stable, predictable, fair and honest governance and administration at all levels of government. Now that's a real tall order for a country in a situation like Afghanistan but we must all work towards the goal.

Businessmen and women are the ultimate providers of sustainable jobs and economic activity -- which we agree constitutes the very basis for stability in Afghanistan. They need to know what to expect from their government and to be able to work with what is reasonable and honest.

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So.....If we can build on the local skills and experience of the Afghans by investing in them, and in their business entities; if we can ensure that the best educated Afghans are also employed in companies in the local market economy; if we can help to reduce the criminal activity that depresses Afghan investment; if we can factor in attractive tax policy and administration into the investment equation, and finally if economic governance is improved along the way, there is no stopping Afghanistan from markedly improving the lot of its people and thus going a long way to achieve stability and sustainability.

In closing, ladies and gentlemen, if entrepreneurs and businessmen and women are the ones providing jobs, food, shelter and all those things essential to a better life for the Afghan people, then they are the real heroes, and we all need to acknowledge them in their achievements and support them in their endeavors.

Thank you all for listening and may God bless Afghanistan.

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