

“Building the Afghan *Market* Economy”

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The focus of my remarks today is on building up the private sector – more precisely, the private sector engaged in the *market* economy without which, history shows, there can be no stability and no democracy. The *market* economy provides sustainable employment and is programmed to expand expand. It is the basis for a pluralistic society that can feed, clothe and house itself. Indeed, the widespread dispersion of commerce is THE main precursor to any democratic form of government.

While much resources are being expended by donors to improve Afghanistan’s economic governance and the so-called “enabling environment”, the history of successful pluralistic and democratic societies from England and the European countries to the United States to the Pacific Rim nations once known as the Asian “tigers” to Chile. China, most recently shows that wide distribution of wealth-creating entities and commerce preceded good government and not vice versa as is commonly believed.

The Four Parts of Afghan Economy: Only the Market Economy is Sustainable

There are four major revenue streams which support the economy in Afghanistan today: the drug trade, contracts and grants, terrorism and the local market economy. The drug trade is also a major source of funding for the insurgency. The contracting sector has been rebuilding infrastructure and purchasing power in Afghanistan, but it lacks sustainability and seems to have corruption in its DNA. It also competes for the best personnel with the market economy as it pays far higher salaries.

Finally, there is the legitimate market economy. Our Afghan American Chamber of Commerce member and business-colleague experience over the years since 9-11 is that the only *sustainable* way to put Afghanistan back on its feet is through investment, both domestic and foreign, in growing those Afghan companies engaged in the legitimate market economy.

The Human Element -- Capacity

What is also important is to build up the skills and experience of those individuals in key Afghan government positions who have regulatory authority over the private sector. Without mentioning any names, there is an increasing number of Afghan Ministers who know their respective roles and responsibilities well, are corruption free and are building staff capacity capable of allocating donor funds more effectively. To the extent that the Afghan government can recruit and retain personnel in competition with the much higher-paying donor nation government agencies and contractors, it will build critical indigenous capacity. Now and over time, it is essential that our assistance be channeled in the direction of those capable Afghans and certain U.S. donor agencies are already working and planning for that to happen.

If the Afghan economy, encompassing both public as well as private sectors, is to show greater signs of capacity and sustainability, their work forces cannot be continuously raided by donor and foreign entities whose source of income is their respective governments’ taxpayer revenues.

Also, the limited capacity in government bureaucracies, certainly ours as well as theirs, is ample reason why a business-to-business, direct investment modus operandi is preferable to getting involved with respective bureaucracies if at all possible.

Financing Afghan Business in the Legitimate Market Economy

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 capital needs and by providing critical technical assistance (TA) to help do the related documentation for people who basically cannot write in English and are unfamiliar with sophisticated business planning.

In Afghanistan, given the level of real and perceived risk to investment, some public money must be made available to ramp up and incentivize the significant private capital currently sitting on the sidelines. Foreign company partnerships are also a way to mobilize and grow Afghan business but are no substitute for broad-based availability and access to capital.

While OPIC has provided increased funding to their *Afghan Growth Finance* "on-lending" operation in Afghanistan and their support base for AGF is growing to some \$80 million, this is still a very small fraction of overall non-military donor assistance. However OPIC is to be commended for leading the way towards expanding the availability of, and access to, capital for those doing business inside Afghanistan. The Afghan business community is suggesting that donors shift gears and begin capitalizing business efforts throughout the Afghan market economy. Even considering USAID funding of collective efforts to boost a particular economic sector, or advance the cause of SMEs via the Afghanistan Small and Medium Enterprise (ASMED) program, these funds are still quite limited when it compared to capitalizing the requirements of a growing Afghan market economy.

The first priority should be to leverage as much dormant Afghan capital as possible by sharing in the capital costs and thus reducing the overall risk to a business project. The U.S. DoD seems to be taking a related approach via the more recent Deputy Undersecretary for Economic Stabilization, Paul Brinkley initiative in Afghanistan which seeks to bring major private U.S. companies and other investors into the mix. That too is effective in reducing the risk factor. This approach was shown to be quite effective in Iraq.

Taking the Next Step – Major Capital Infusion

However, some are arguing for a large investment fund to make access to capital easier, say \$100 million to \$300 million or more, akin to the capital 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. Indeed, the architect of the Polish-American Enterprise Fund is a Board member of AACC.

Today there are some 18 operating banks in Afghanistan with multiple branches all over the country. They have shown a high degree of profitability, particularly lately as banking sectors have lagged in the West. Mechanisms to incentivize longer-term commercial lending via an Investment Fund in the form of a revolving trust fund, making both *loans* and *equity* capital available to Afghan businesses and also supplementing commercial lending by qualifying Afghan banks, have begun to receive Donor attention.

The critical element in mechanisms 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.

Also, risk insurance is recently becoming more available with the Afghan-owned Insurance Corporation of Afghanistan (ICA) leading the way. Donor funds could be very effective in increasing investment by increasing the availability of risk insurance to investors thus reducing the risk premium on capital.

We businesspeople at AACC and colleague organizations believe these are ideas whose time has come. Indeed, AACC members have actually produced a model *US Afghan Investment Fund, USAIF*.

There is a large amount of Afghan citizens' private capital, much of it in Dubai but elsewhere around the world as well, that is not presently being invested in the country and could be with the right deal. Availability of reasonably-priced capital, reduced risk and technical assistance to access the capital are sorely needed. Afghan and colleague entrepreneurs will do the rest.

U. S. Government Private Sector Activity:

USAID, often through their presence in the Provincial Reconstruction Team bases (PRTs) and via their USAID Contract Implementers in general, and the USAID ASMED program in particular, are making a number of private sector 'distributions', usually expenditures 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.

DoD has dispersed some \$1 billion dollars this year on a variety of expenditures at PRTs and Forward Operating Bases (FOBs) in their effort to increase stability. A lot has gone to private firms performing services like construction for the military.

USAID also has several large programs to help create the "enabling environment" for business. One targets regional trade and economic growth via The Trade Access and Facilitation for Afghanistan (TAFA) effort and the other, the Economic Growth and Governance Initiative (EGGI) seeks to boost government Ministries' capacity to handle economic issues and challenges. Another big one dealing with government's capacity to deal with financial issues is coming down the pike. These efforts seek to strengthen *the government's capacity* to perform critical governing tasks of importance to the private sector. But as history has shown, improved governance follows greater dispersion of economic wealth in the country. The "horse" here is the legitimate market economy and the cart is "good governance".

Sustainability

- The key to security and stabilization in Afghanistan will be in the sustainable jobs, jobs and more jobs plus the products and services produced by the private sector operating in the market economy.
- It will be the broad dispersion of commercial power that will drive better governance and not a whole lot vice versa.
- Only the market economy and its resultant sustainable livelihoods can sufficiently bring forth the hope for the future and will to engage that the Afghan people need to persevere against an implacable enemy.
