

Leading Sector(s): Afghanistan's Growth Engine

By

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THESIS

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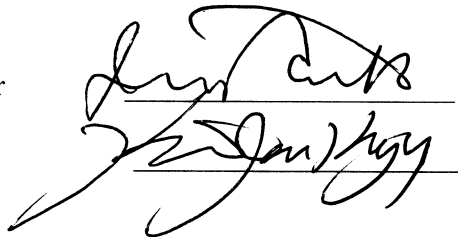
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ABSTRACT

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Many war torn countries like Afghanistan struggle to improve its economy with the help of international community. While international community inject heavy amount of financial aid to these countries for different reasons such as economic and social development, security concerns and poverty reduction, it is important to understand and decide on the direction of its expenditure; to avoid the dependence of the country to the foreign aid. Hence the structure of Afghanistan economy should be studied and investments should be done in the right place to boost the economic growth and help Afghanistan to stand on its own feet. A successful resource allocation and management, among different sectors in Afghanistan and accurate policies will lead to country's prosperity, such as it did in the South Korea after Korean War.

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Introduction:

Afghanistan is a country aroused from ashes. From 1970s it went through decades of war, starting by Soviet Union invasion and followed by years of civil war. Afghanistan in decades of chaos became a safety net for terrorism, with failed economy and unstable government.

US led attack to Afghanistan in 2001 opened a new stage in the Afghanistan's history. After decades of war, today people in Afghanistan experience relative peace. Many attempts with the help of international community and the United Nations have been taken in rebuilding and reconstruction of Afghan economy, governance and security.

Now that Afghanistan have the chance to reconstruct its economy, it is the responsibility of government to design the best strategy for economic development to manage the inflow of international aid and labor division in more efficient way to prevent the waste of capital.

In 2008, Afghanistan announced its very first National Development Strategy. Afghanistan National Development Strategy (ANDS) which target the period between 2008-2013 organized base on three pillars, social and economical growth, governance, law enforcement & human right and security. ANDS aim for a peaceful Afghanistan and reduction of poverty. The strategy designed based on private sector-led development and market led economy.

Under the economic and social development chapter, ANDS expressed great importance to agriculture and rural development, hoping and aiming to increase the agriculture productivity, reduce unemployment and food insecurity. Moreover, Afghanistan tries by investing on agriculture sector, reduce the opium production which in last decade has been one of the major obstacle for the country's security.

While it is important to consider the importance of rural area and agriculture sector in

economic development strategy of Afghanistan, Afghanistan government should avoid the risk of over estimation of the agriculture sector in designing economy development strategy for the long run.

The main focus of this paper is to find an answer on how is the current economic performance of Afghanistan? Which sector(s) can function as “Leading Sector (s)” in Afghanistan’s economy? And finally what government should do to facilitate and promote the work of suggested “Leading Sector(s)”?

By answering these questions, the author tries to prove that first, agriculture, even though it has been the main focus in economic growth, doesn’t have the potential to act as a potential engine for economic growth in Afghanistan. Second, among the remaining sectors, industry sector and service sector, in particular construction and transportation industries are capable of developing the economy of the country.

This paper will study three main sectors, agriculture, industrial sector and service in order to find the “leading sector” for Afghanistan economic growth.

Chapter one will review the economic performance of Afghanistan from 2001.

In chapter two, three main sectors, agriculture, industry and service had been evaluated in order to find the potential “leading sector(s)”.

Follow to chapter two, in chapter three the obstacle for development of leading industry will be discussed and the paper will provide possible solution to overcome the obstacles.

Literature Review:

By definition economic development is “an increase in real income per head as a desirable objective” (Meier, 1995) and economic development is a process that “includes the process and policies by which a nation improves the economic, political, and social well-being of its people.” (O'Sullivan & Sheffrin, 2003)

To increase income per head, countries take different approach. For instance in 50s and 60s, most countries follow import substitution. “There was general optimism with respect to what could government could accomplished by emphasizing planned investment in new physical capital, utilizing reserves of surplus labor, adopting import substitution industrialization policies, embracing central planning of change and replying on foreign aids.” (Meier, 1995)

It is debatable whether development strategies introduced by governments work in advantage or disadvantage of countries economy. Some scholars sees development as a spontaneous process with no organized plan while the opponent to this argument, argue that development should be base on an well organized and established plan. Anti strategic development supporter, have doubt on the governments' performance in dealing with market economy in addition to the problem of bureaucracy and corruption. However comparing these two arguments strategic approaches appear to be more efficient and wise for a country's development process. Indeed “states do exists, and governments do some things and abstain from others, and there is an important need to decide what, if anything, they should do regarding development.” (Malinvaud et al, 1997)

In order to have a sound economic strategy, two factors of financial cautiousness and social improvement should be considered. “Financial prudence demands that we take note of both identified economic costs of budget deficit... and long run risks of

macroeconomic instability. This can be done in assessing alternative choices of development strategies, paying full attention to direct as well as indirect effects of social development, in terms of their overall impact in enhancing the lives of people.” (Malinvaud et al, 1997)

Theories of economic development advanced after WW2 rapidly from structuralism, the linear-stages-growth model, and the neo-Marxist or dependency theory to 1980s neoclassical restoration.

Beginning with the structuralisms view, it defines a developed economy as an economy with large urban population and countries output is base manufactured products. Under this model the ultimate goal for a country is to reach to level of self sustained economic growth which is possible by reducing external demands for raw material exports, since underdeveloped country with rich natural resource, use the resources as the major source of their economy. According to structuralism economic growth is only possible by improvement of internal industries.

Moreover, structuralism pays great attention to technology as mean of development. Structuralism believes that most of underdeveloped countries lack technology in various sectors, which cause the lack of productivity in those sectors, comparing to sectors with rich technology. Therefore in structuralism view it is critical for an underdeveloped country to improve its technology in order to reach to development stage.

In addition, structuralism in international economics can be explained in a dual approach “where a modern economy (the export sector) coexisted with a backward and undeveloped one. The modern sector was maintained not through internal innovations and advancement but by purchasing new technology from the developed countries. As long as dualism persisted, autonomous economic development would be

impossible; that is, growth would be dependent on the industrial countries. Structuralisms argued that economic growth had to stem from internal demands.” (Contreras, 2009)

Therefore, the structuralisms argue that improvement of technology can be possible with government intervention. Even though structuralism agrees with capitalism and its importance for economic growth, they believe market on its own cannot perform successfully if the governments don't intervene. Many countries applied structuralism in their development plan such as Latin American countries, which also called as “import substitution” policies

Another influential approach in economic development field, mostly in Western Europe, is the stage theory. According to stage theory, the main causes of underdevelopment are internal factors, unlike structuralism which believe on external factors to be the main cause. It argues that the underdevelopment is mainly due to lack of domestic savings and investments. According to Harrod-Domar model the growth rate of gross domestic product depends positively on the national saving ratio and inversely on the national capital/output ratio. “If demand conditions were made right, said the model, the only bottleneck to growth was a lack of physical capital.” (Meier, 1995) Moreover Meier suggest that “ capital investment was critical not just for its own sake, as it were, but because it gave employment to labor that would otherwise be unemployed, and because that labor was paid, not out of its own marginal product, but out of the marginal product of capital.” (Meier, 1995)

Hence by massive injection of capital the problem can be solved. Also in stage theory, industrialization is believed to be the only way for a country to economically develop. Along the need for capital, right public policy and strong government intervention is also needed. For instance Western European countries through Marshall Plan (massive

injection of capital) and strong government intervention achieved to some level of economic development.

Early phases of development strategies, explain “ development in terms of some pattern of stages... at one extreme, Adam Smith referred to the sequence of hunting, pastoral, agriculture, commercial, and manufacturing stage.” (Meier, 1995) In recent times Walt Rostow generalized the stages of development to “the traditional society, the preconditions for takeoff, and the take off, the drive to maturity, and the age of high mass consumption.” (Rostow, 1960)

According to Rostow, the developing countries are mostly experiencing the preconditions or traditional stages in their economy. For these countries to reach to “take-off” level and become self- sustained, strong government intervention is necessary. Take-off stage is a critical stage in which massive productive activity led to structural transformation.

Rostow’s idea of the stages of development later on was the basis of the theory of production in which the investment and the growth of specific sectors and later recognition of “leading sectors” can be explained. Recognition of “leading sectors” is possible in any time and government can put allocate more resources in the “leading sectors”. Leading sector have the ability to provide significant effects on one country’s economy. The leading sector is a sector which can be profitable not only regionally but in international scale. In other words, they are the places in which innovation or utilization of capitals is concentrated. ”a frontal attack – a wave of capital investments in a number of different industries- can economically succeed while any substantial application of capital by an individual entrepreneur in any particular industry maybe blocked or discouraged by the limitations of the preexisting

market...[T]hrough the application of capital over a wide range of activities, the general level of economic activities is raised and the size of the market enlarged...[balanced growth] is a means of getting out of the rut, a means of stepping up the rate of growth when the external forces of advance through trade expansion and foreign capital are sluggish or inoperative.” (Hirschman, 1958)

In addition to structuralism and stage theory, the Neo-Marxist Approach is one of the main controversial pillars of economic development theories. In simple explanation according to Neo-Marxist theory developed capitalist state, make use of developing states. The main focus of this approach is the relation between developed and developing countries.

Neo-Marxists share the idea of exploitation with Marxist; however their approach is more international compare to original Marxist thoughts. “[Neo- Marxists] concluded that industrialized countries historically extracted surplus value from developing countries. Specifically, they argued that developed countries paid very low prices for the primary products imported from developing countries, transformed them into finished products and sold them back to developing countries at very high prices. This resulted in chronic poverty and misery in developing countries.” (Contreras, 2010) As a result, developing countries stay in poverty and not able to develop since they become the producer of low-priced raw material. The inward foreign capital from trade with developed countries don't help developing countries since, the flow of capital will be only for one sector, the raw material production. Therefore, other sectors in country stay undeveloped and country as general.

Finally the most recent approach to economic development is the Neo-classical approach. Neo- classical theory approaches the economic development field from different perspective. They reject the structuralism and neo-Marxist view and argue

that the underdevelopment of poor countries is mainly because of poor designed economic strategy. So, neo-classical economist strongly rejects the government interference in the economy. They also believe that there should be no market restrictions.

Neoclassical economic theory believes that the neo-Marxist theory is idealistic. Moreover, it discarded structuralists' argument that developing countries' troubles were because of structural barriers in the international economy, therefore for overcoming these barriers, strong domestic intervention should be done to overcome these barriers.

Chapter one

Islamic Republic of Afghanistan is a land locked country situated in the South Asia. The total area is 647,500 km². The country shares longest border line with Pakistan in the south and east boundary (2,430 km) and the shortest with China merely 76 km at the end of the Wakhan Corridor located in the North East. Tajikistan (1,206 km), Iran (936 km), Turkmenistan (744 km) and Uzbekistan (137 km) are other neighbor countries.

Afghanistan's population in 2008 was estimated by the United Nations at 27,208,000. The annual population growth rate for 2000–2005 is 3.88%, with the projected population for the year 2015 at 35,473,000. (United Nations, 2008) from total population, nearly 80 percent resides in rural areas which are mostly work in agriculture sector or related occupation such as processing or trading of agricultural products.

Until 2001, Afghanistan experienced a traditional economy base on agriculture and no modern institutions rather than planned economy. From 2001, collapse of Taliban and the end of civil war, Afghanistan try to rebuild its economy base on the free market principle and pro private sector (ANDS, 2008). This chapter will study the progress that Afghanistan made in past decade in the path to economic stabilization and development.

Considering the size of country, existence of civil war and need for reconstructions of the country, Afghanistan has high potential GDP. As of 2009, the nation's GDP is \$10 billion and the GDP per capita is \$1,000 which is one of the lowest in the world. (World Bank, 2010) Since the fall of Taliban in 2001, GDP of Afghanistan has grown at a fast pace as the table (1) elaborate at 2007 it reached to 16.17. The two digits GDP growth in 2003, 2005, 2006 and 2007 mainly show the rise of Afghanistan from

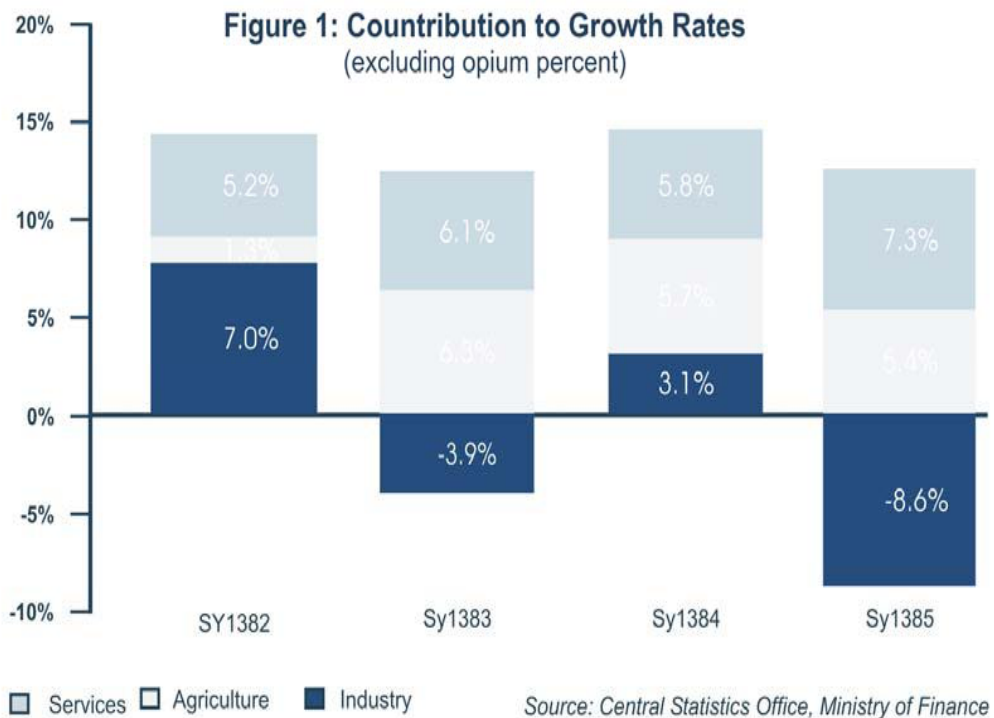
low. However GDP growth dropped from after 2007 to the lowest point in 2008 to 2.28%.

Table one: GDP-Real Growth Rate (Annual US\$%)

Year	GDP - real growth rate (annual \$US %)
2003	14.31
2004	9.4
2005	14.51
2006	11.18
2007	16.17
2008	2.28

Source: World Bank

In addition, Figure 1, shows the official estimation of sectors contribution to growth rate for four years (1382 (2003), 1383(2004), 1384 (2005), 1385 (2006))



The agriculture contribution due to the investment on the sector increased from 5.2% in 2003 to 7.3% in 2006, while the industrial contribution decreased dramatically to -8.6% as 2006. Moreover the contribution of different sectors on the GDP is one of the main factors to be considered in measuring economic development of Afghanistan. Table(2) present an official estimation of the share of different sector in the Afghanistan GDP in million Afghanis base on year 2003. Agriculture share in GDP increased from 87,610 in 2003 to 165,835million in 2009. The major contribution to this growth was the increase in cereal production. Industry sector also experienced a positive growth in GDP share from 38,263 in 2003 to 137,732 in 2009 with the main contribution from construction and manufacturing industries. On the other hand the GDP share in service industry tripled from 2003, from 68133 to 220,764 in 2003 with biggest share in transportation and retail and whole sale.

Table two: Share in GDP in million Afghanis base on year 2003

Sector	2002/ 03	2003/04	2004/05	2005/06	2006/0 7	2007/08	2008/ 9
Agriculture	87610	105209	110931	129309	153754	184134	165,5
Cereals and others	70144	81502	83472	102415	112198	136229	1120
Fruits	6035	6807	7385	7084	8333	10154	114
Livestock	11431	16901	20074	19810	33223	37751	422
Industry	38263	42645	62298	82785	105496	122549	137
Mining and quarrying	264	290	638	788	1203	1783	24
Manufacturing	29178	29835	40634	51401	68244	77553	848
Food, beverage, & tobacco	27659	28061	38412	48575	64746	73789	804
Textile, wearing apparel & leather	277	402	317	569	612	687	81
Wood & wood prod. incl. furniture	29	37	91	91	100	118	13
Paper, paper prod. printing, publishing	12	12	11	13	11	12	1
Chemicals & chem petroleum, coal, rubber, plastic	820	765	1041	1206	1535	1599	19
Non-metallic mineral except petroleum & coal	369	523	648	809	1061	1080	120
Metal basic	12	35	113	139	179	267	32
Electricity, gas, and water	121	280	311	461	593	645	68
Construction	8700	12240	20715	30135	35455	42568	497
Services	68133	80793	93470	115433	136844	184680	220
Wholesale & retail trade, restaurants & hotels	19282	20870	24290	28347	40711	51974	598
Wholesale & retail trade	18035	19396	22260	25838	37178	47078	543
Restaurants & hotels	1246	1474	2008	2510	3534	4896	55
Transport, storage and communication	20313	26596	24301	31384	30455	44778	516
Transport & storage	19554	25592	22922	29851	28505	40274	445
Post and telecommunication	759	1003	1379	1533	1950	4504	71
Finance, insurance, real estate and business	1289	2400	3381	4462	6491	9772	133
Finance	1256	2364	3336	4409	6418	9675	131
Insurance	4	5	6	7	10	13	1
Real estate and business services	28	31	38	46	63	84	9
Ownership of dwellings	10650	12042	13843	14918	14847	16505	190
Community, social and personal service	2160	2288	2819	3103	3760	4988	58
Producers of Government Services	10000	12000	14230	21860	27015	39976	515
Other services	4439	4597	10606	11358	13565	16686	195
Total	194006	228647	266699	327527	396094	491363	524
Less: Imputed bank service charge							
Taxes on imports	2570	4716	6008	11014	11579	14267	178
GDP at Market Prices	196576	233363	272707	338541	407673	505630	542

Source: Central Statistic Organization of Afghanistan

Chapter Two:

Figure one in the chapter one exhibited increasing contribution of agriculture sector in the growth rate; unlike industry which had negative growth. Despite current performance showed in the figure one, the author of this paper believes that the industrial sectors can work as leading sector for economic development of Afghanistan. To demonstrate the argument mentioned, factors such as land, climate, labor and capital should be study.

Afghanistan's total land is about 647,500 km² which is geographically located in 33 00 N and 65 00 E. About two-thirds of Afghanistan's landscape consists of rugged mountains. The Hind Kush Mountain, from northeast to southwest, divided the country to three main areas the southwestern plateau, central moorlands, and lastly northern plains.

The central highlands soil which is about two third of Afghanistan's land are desert-steppe or meadow steppe kind. At high altitudes, even though that the precipitation is sufficient, the growing seasons are shorter due to frost vulnerability. Therefore the chance for agriculture is limited.

The southwestern plateau (one-fourth of the land) soil is infertile desert. The growing seasons are adequately long but effective rainfall and irrigation is main challenges.

Only northern plains area's soil is the most productive area among others. In addition only major forested areas are in the eastern region. The forested area is located in the valleys of two major rivers, the Helmand and Harirud. The valleys know to have fertile soil. The arable land consist 12.13% of total area (8 million ha) which contain 0.21% of permanent crops which is placed in north and western part of

Afghanistan due to the existence of rivers such as Amu and better rainfall.

It is known that Afghanistan's climate is arid to semiarid with four clearly distinguished seasons. It has cold winters and hot summers. One unique feature of Afghan climate is the drastic change of temperature in a short period of time from day to night hours and also from summer to winter. "The highest temperature ever recorded under standard conditions was 49.9 °C (121.8 °F) at Farah in August 2009 and the lowest was -52.2 °C (-62.0 °F) at Shahrak in January 1964. Beside the Sistan Basin, Jalalabad and Turkestan, especially Sistan and All over Kandahar province where the summer heat is strong" (United Nation, 2008); generally, the Afghanistan climate is very dry. Clear sky at night and direct sunshine is one of the characteristic.

Traditionally Afghanistan economy has been base on agriculture sector. However many years of war and drought left farmers in the worse possible situation. "With a few notable exceptions, all rural citizens are poor in relative and absolute terms, lacking both physical and social assets. 80 percent of the Afghan populations live in rural areas, most of whom are engaged in agriculture to some degree, although many are also heavily engaged in processing, trading or marketing activities of agricultural products; 12-15 percent of total land area is suitable for cultivation; water constraints inhibit cultivation of up to one third of irrigated land; three million hectares of land are rain-fed, in a country of repeated droughts; 58 percent of villages have limited seasonal or no access roads (the average distance to the nearest road is 4.6 km). The continued high population growth projected for Afghanistan will imply continued decline in per capita levels of agricultural resources unless major investments are made in improved water management." (ANDS, 2008)

Due to large rural population, for reducing the poverty it is important to invest on agriculture sector, however considering the size of arable land, climate,

unemployment rate and rapid urbanization process, Afghanistan need to think of more fundamental solution for reducing the poverty and economic development. “While self-sufficiency is a household and social priority, economically it may not be the preferred option, because achieving a high level of dependency on domestically grown cereals would depend on using high-cost irrigation systems. A longer-term development framework might involve the importation of most cereals...Afghanistan will need to replace these sources of recent growth with other more sustainable and dynamic ones, such as processed agro-industry, manufacturing, and services, which would be driven by the private sector.” (World bank, 2010)

Rapid urbanization process is another reason for replacement from agriculture base economy to other sectors. Urban populations which have been estimated to be approximately 24% in 2008 have swelled in the past several years with 5.4% annual rate of change (2005-10 est.). (United Nations, 2008) more than 1.8 million refugees and many thousand migrants came to rural area after in 2002 Taliban government's collapsed. However, “There is a clear shortage of resources and capacity flowing in to the urban sector [in Afghanistan]. Building knowledge on key issues such as land, rural-urban linkages and community development will help ensure that urban development policies are properly designed and implemented. “(Nations Encyclopedia, 2010)

Considering the urbanization process and high population growth rate, nearly 4%, it is safe to say the agriculture sector alone will not be able to responsible the demand for food and job. The table below presents an estimation of total labor force from 2001 to 2008. Overall the labor force had 2 million increase from 2001 to 2008.

Indicator Name	2001	2002	2003	2004	2005	2006	2007	2008
Labor force, total	7,560,196	7,767,489	7,971,081	8,198,983	8,453,225	8,718,620	9,012,314	9,303,902

Source: World Bank

However, considering the rapid increase in labor force and population, as exhibited in the table below, the change in the employment ratio to population is not significant. From 2001 to 2004, employment ratio stayed in 53%. However there is a slight increase in employment ratio in year 2005 in which the employment increased by one percent from 53 to 54. The highest employment ratio as portrayed in the table, is 55.2 percent in 2008.

Indicator Name	2001	2002	2003	2004	2005	2006	2007	2008
Employment to population ratio, 15+, total (%)	53.9	53.9	53.5	53.9	54	54.4	54.7	55.2

Source: World Bank

Labor forces (human capital) in economy considered being one of the major elements of productivity Afghanistan is benefited from the abundant of labor force. However the unemployment rate is alarming. Abundance of labor forces and employment issues are some of major concern for Afghan government. The table below presents the unemployment rate from 2006 to 2010. From 2006 to 2009, unemployment rate was 40% which is ranked as the 13th country in the world with high unemployment rate according to United Nations data. (United Nation. 2010) Even considering the estimated 5% decrease from 40% to 35% in 2010, nonetheless the unemployment rate stays one of the major concerns in economic growth the country.

Year	Unemployment rate	Rank	Percent Change	Date of Information
2006	40.00 %	186		2005 est.
2007	40.00 %	183	0.00 %	2005 est.
2008	40.00 %	181	0.00 %	2005 est.
2009	40.00 %	183	0.00 %	2008 est.

Source: The United Nation Data



Source: The United Nation Data

Base on the fact that currently 80 percent of population is concentrated in rural area, it is safe to argue that one of the reasons (if not the main reason) of high unemployment rate in rural area is the lack of potential and capacity of agriculture sector in job creation and employment.

More importantly, government under the economic and social development chapter, Afghan National Development Strategy (2008-2013), gave great importance to agriculture and rural development, hoping and aiming to increase the agriculture productivity, reduce unemployment and food insecurity. Moreover, Afghanistan tries by investing on agriculture sector, reduce the opium production which in last decade has been one of the major obstacle for security and economy of Afghanistan. In order to achieve the target above, within ANDS, the Comprehensive Agriculture and Rural Development program (CARD) has been designed. CARD is a series of programs

planned to support farmer and poor people in rural areas. Government through CARD tries to provide diversified income sources by income support, direct provision of resources, skill education and market opportunities. However despite the fact that there have been many attempts in developing agriculture sector, in 2008-9, the share of agriculture to the GDP was only 165,835 million Afs (Table Two) which is very low in comparison with other sectors, industry 137,732 (millions Afg) and service 220,764 (million Afg).

In short, the high unemployment rate in rural area, size of arable land, population growth and rapid urbanization process are evidences which shows agriculture sector doesn't show promising performance for future economic growth of Afghanistan. Agriculture cannot function as leading sector in Afghan economy simply because of lack of potentials. In the absence of agriculture sector as main contributor in future economic growth of the country, two options will remain which are manufacturing and service sector.

In year 2008-9 industrial sector contribution to GDP was 25.4%. Most of industries are producing mainly for domestic consumption (chemical fertilizer, cement, medicine, flour, bread and other bakery products, meat, dry fruits proves, sugar, salt, soap, etc). The table gives an official estimation of the value of industrial production by sector in million Afghanis. Total industrial production has been increased by nearly three times from 1978 to 2009. Also the table divides the public industries from private industries. According to Afghanistan Center of Statistics the total value of production of government enterprises has decreased in 2008-9, while the value of private sector production increased from 7832.5 million Afs in 2007-08 to 7945 million Afs in 2008-09. (2010)

Value of Industrial Production by Sector (million Afs)				
Industries	1978	2006-07	2006-07	2008/09
Total product in the country	33181	12611	9218	9100.41
Governmental industries	13433	5579	1386	1155.11
Private industries	19748	7032	7832	7945.3
Factory Industries	4733	7032	7801	7913.2
Handicraft	15015	...	31	32.1

Source: Central Statistic Organization of Afghanistan

Moreover, the number of construction related enterprises increased rapidly. The table below shows the total number of main active industrial enterprises in which the construction material enterprises ranked second biggest after food industries.

Total number of Main active Industrial Enterprises				
Industries	No. Establishments			
	1978	2006-07	2007-08	2008/09
Total	243	742	808	831
Chemical	25	58	61	58
Construction material	13	84	93	101
Machinery & metal	17	78	86	78
Pharmacy	5	10	12	14
Printing	24	56	60	63
Carpentry & paper	6	47	50	45
Light industries	47	49	57	64
Food industries	67	199	206	212
Others industries	1	161	183	196

Source: Central Statistic Organization of Afghanistan

In addition to the number of construction enterprise, Gross Domestic Product by economic activity in constant price 2002/03 (Million Afghanis)'s table also shows an edge in construction industry. In 2003 the share of construction industry is reported to be 8700, while it increased to 49751 in 2009. In recent times, with the emergence of a new government slight economic upsurge have been witnessed with new industries being developed. Infrastructure facilities such as roads, rail communication and electricity have been upgraded to enhance a good living standard in Afghanistan. Among different manufacturing industries in the table, the construction industry

shows a better performance than other industries. During the Taliban regime, construction of dams, road and buildings were low. With collapse of the regime, the construction industry boosted.

In today's world one of the biggest contributors to world's GDP is the construction industry. Construction is one of the largest businesses in the energy consumption. The industry has the potential to generate huge employment. However Afghanistan is suffering from shortage of skilled labor. "There is anecdotal evidence of skilled labor coming in, notably in the construction industry, at moderately high wages, to take on diverse activities like masonry, plumbing and carpentry etc. While a supple and flowing local labor market is a great advantage for Afghanistan and the region, and many Afghans work in unskilled or other jobs in Pakistan, Iran, and elsewhere, many of the kinds of skills that are now being imported could be imparted to Afghans in a relatively short period of time through vocational training". (World Bank, 2010)

Investment in construction industry will help the development of other industries and sectors as well. For example, roads construction will help to increase the volume of trade. In addition Afghanistan has widespread deposits of copper, chromite, coal, natural gas, gold, iron ore, barite and lead, which can be useful in production of construction materials and as result export to other countries. Another obstacle to development of construction industry could be the need for capital which will be study in the next chapter.

Base on the Gross Domestic Product by economic activity in constant price 2002/03(Million Afghanis)'s table analysis, Afghanistan service sector also have potential to develop, in particular transport, storage and communication.

It is well known that a competent and practical road transportation network is essential for achieving economic development. Most of road transportation network

had been destroyed during three decades of war. From 2001, according to ANDS, donors contributed over \$3.3 billion to rebuilding the transport system between 2002 and 2007. The aid injection to transport sector resulted to development of the industry as shown the appendix one from 20313 (million Afg) in 2003 to 51654(million Afg) in 2009. The transportation sector is closely related to construction. The two industries complement each other work since development in construction sector will result in better roads and transportation system. For instance “Over 12,000 kilometers of roads have been rehabilitated, improved, or built. This includes the ring road system, national highways, provincial roads and rural roads.” (ANDS, 2008) the example above shows that the construction industry is closely correlated to the transportation system.

Next chapter will discuss the obstacle in the way to promote construction and transportation industry. The chapter will also try to provide some possible solution and recommendation.

Chapter Three:

Construction and transportation industry can be very promising industries in the current economic situation of Afghanistan, as the data elaborated in previous chapters. However there are several obstacles in promoting construction and transportation industry in Afghanistan. Some of these obstacles can be shortage of energy, security, skilled labor (human capital) and capital. All of the obstacles in the way to develop Afghanistan economy shares one factor in common which is capital. For instance, accessibility of capital helps government to invest on education system to enhance the capacity building, or build more power plants. Development of Afghan economy is a matter of how to provide capital and how to use and direct the capitals in the best efficient way.

Capital has broad definition in economics. According to neoclassical economics, one of the factors of production for creating goods and services is capital. Capital goods may be acquired with money or financial capital. Later studies of capital include other form of capital such as human capital, intellectual capital or knowledge capital as part of capital. (The New Palgrave Dictionary of Economics, 1994)

One of the poorest nation in the world is Afghanistan, have a big challenge in providing capital needed for increasing economic productivity. Country's Gross domestic saving (current US\$) in past decade (exhibited in chart below) is an evidence capital accumulation problem in Afghanistan. In the table below gross domestic savings are calculated as GDP less final consumption expenditure (total consumption). In 2008 the gross domestic saving was -838,851.693 which shows low saving.

indicator	2002	2003	2004	2005	2006	2007	2008
Gross domestic savings (current US\$)	- 842,020,536	- 1,557,628,857	- 1,705,467,110	- 1,008,149,656	- 679,607,361	- 885,744,608	- 838,851,693

Source: The World Bank

Therefore, the domestic saving and capital accumulation are not reliable sources for capital need in Afghanistan. The remaining alternatives are external assistance such as Foreign Direct Investments (FDI) and Foreign Aids.

“Various international organizations and foreign advisors recommend developing countries to rely primarily on foreign direct investment (FDI) as a source of external finance. They argue that, for several reasons, FDI stimulates economic growth more than other types of capital inflows. In particular, FDI is supposed to be less volatile, and to offer not just capital but also access to modern technology and know-how.” (Nunnenkamp & Spatz, 2004)

In order for a country to attract FDI, it is necessary for the country to provide favorable condition for investors, such as tax holiday, land and insurance of property right. Afghanistan showed to provide the favorable condition by low taxes, and custom tariffs in addition to providing free access to land for foreign investors. “[Afghanistan] exercise one of the lowest custom tariffs in the region; 2.5 percent (essential food and non-food products), 5 percent (raw materials and capital goods), 8 percent (petroleum sector), 10 percent (semi-manufactured products), 15 percent and 16 percent for respectively luxury and non-priority products. [In addition to] Low tax rates: corporate income tax is a flat tax of 20 % of net taxable income. [Also] all tax concessions in laws other than the Income Tax Law ceased to have any effect as of

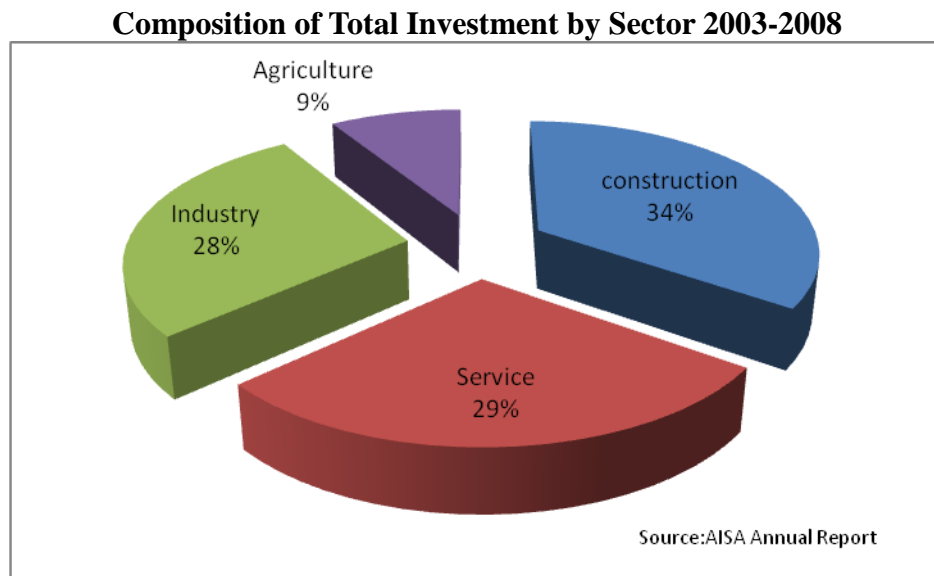
2004, June 21.” (AISA, 2010)

Total Investment in (Million US\$) Registered in Afghanistan(2003-2008)							
Sector	2003	2004	2005	2006	2007	2008	Total
Total Initial capital	721.98	656.69	565.41	1179.45	646.7	392.12	4162.35
Domestic	239.03	421.88	388.49	770.21	439.34	283.54	2542.49
Construction	52.09	195.42	201.45	131.58	141.41	167.78	889.73
Services	37.91	92.31	43.51	99.36	243.18	70.68	586.95
Industry	131.76	125.04	130.52	531.16	45.39	35.89	999.76
Agriculture	17.26	9.1	13.01	8.1	9.34	9.18	65.986
Foreign	482.95	234.81	176.92	409.24	207.36	108.58	1619.86
Construction	188.75	112.63	74.62	86.61	33.67	54.35	550.63
Services	63.42	88.61	52.53	256.85	130.11	37.97	629.49
Industry	14.87	32.27	48.1	29.62	7.61	13.07	145.54
Agriculture	215.9	1.28	1.65	36.14	35.96	3.19	294.12

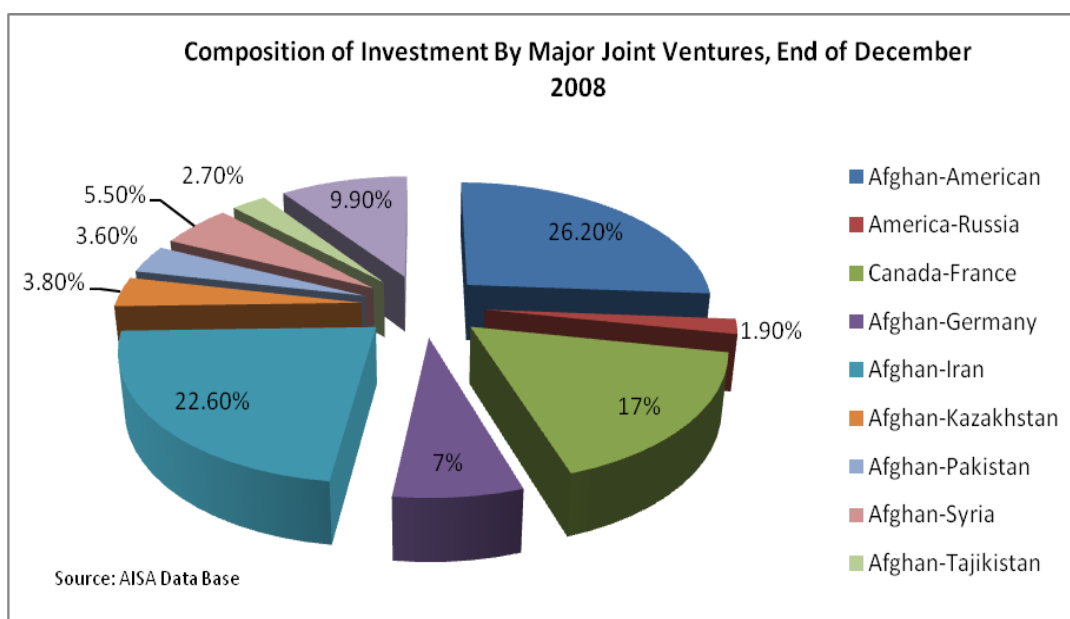
Source: AISA Database

The sum of investments in Afghanistan has followed a descending trend since 2003 apart from the year 2006. According to report provided by AISA, Afghanistan Investment Support Agency, in 2006 both domestic and foreign investment took an increasing swing but again decreased in 2007. “The foreign direct investment in Afghanistan has been falling all along except for the year 2006. It has fallen from the level of about USD 483 million achieved in 2003 to USD 108.6 million achieved in 2008. Most of the FDI which comes into Afghanistan is by those companies which are providing logistics or act as contractors of the UN, USAID, foreign NGOs or other donor agencies.” (AISA, 2010) The table above provides more detail information of each year investment by domestic and foreign investors from 2003 to 2008.

Furthermore, from 2003 to 2008, 1619.86 million US\$ have been invested to Afghanistan by foreign investors with 550.63 Million in construction sectors, second largest after investment in service sector (629.49). The investment in construction sector by domestic investors is also one of the highest investments after industry sector. The sum of investments, domestic and foreigner, in the construction sector equals to 1440.36 that is the highest among other sectors. As the chart below elaborate more in detail construction total investment in construction sector, domestic and foreign is 34%, the highest among three other sectors, agriculture (9%), industry(28%), service (29%).



Local knowledge is an essential factor for success of FDI, in the host countries and attracting more FDI to a country. Hence joint venture has been a favored arrangement of attracting FDI into Afghanistan. “Out of the total FDI of USD1.62 billion aboutUSD294 million has come through joint venture arrangement. Out of the total joint venture FDI about26.2% are through Afghan- USA joint venture followed by Afghan- Iran (22.6%).” (AISA, 2010) The table below shows a detail of major joint ventures in Afghanistan from 2003 to the end of 2008.



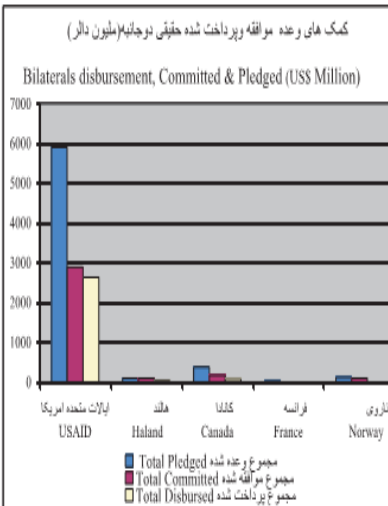
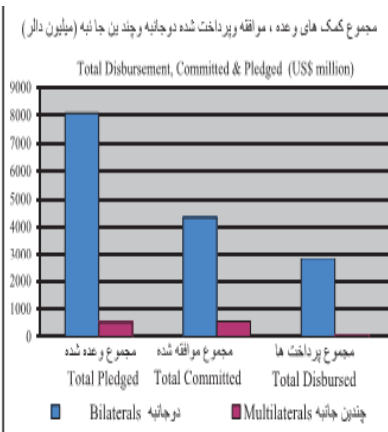
Creation of a center of attention to FDI in construction sector is also important for job creation and reducing the unemployment rate. Construction industry has a good potential in job creation. The table below shows the total number of employees created by registered companies in AISA from 2003 to 2008. The total job creation, by 2008 has been 627,991 in which 336,553 created by domestic companies and 291,438 by foreign companies. Among different sectors, job creation in construction sector, have the highest number of employment (total sum of 338.42). the current job creation statuses is a supporting evidence for directing more FDI and domestic

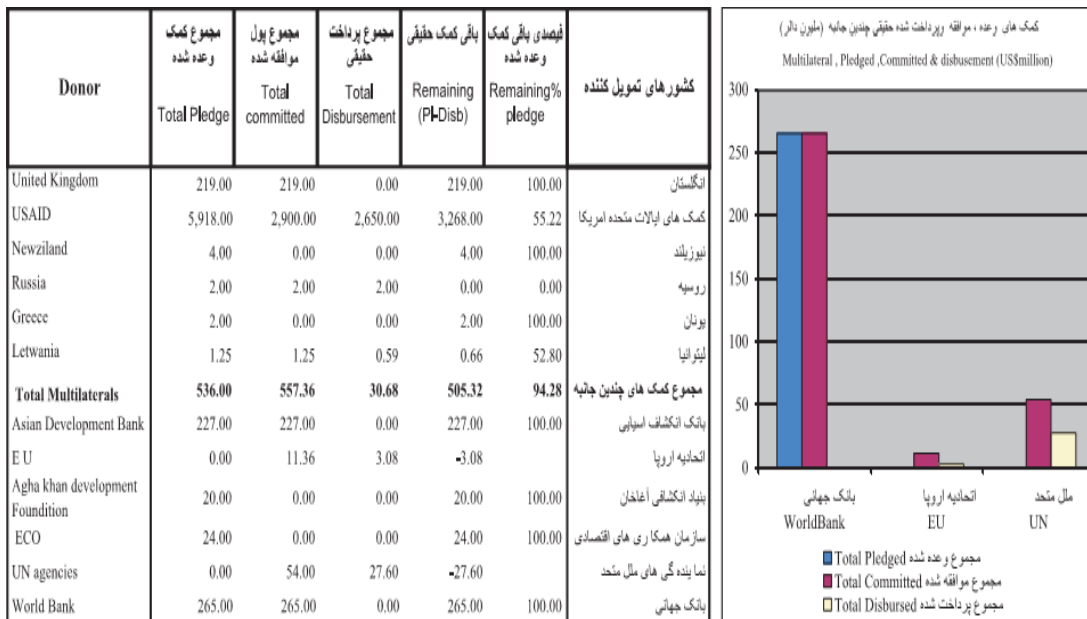
Total No. of Employees Created by Registered Companies in AISA (2003-2008)							
Sector	2003	2004	2005	2006	2007	2008	Total
Total Employees	254,612	89,752	86,458	67,933	46,812	80,191	627,991
Domestic	83,548	55,008	71,477	42,656	38,151	43,636	336,553
Construction	32916	28611	42759	22885	20080	29359	177,665
Services	31912	8701	7175	5032	8279	4818	66,539
Industry	9695	16580	20508	13736	9003	6970	76,649
Agriculture	9025	1116	1035	1003	789	2489	15,700
Foreign	171,064	34,744	14,981	25,277	8,661	36,555	291,438
construction	101416	18602	7182	13357	2987	17214	160,767
service	51897	14656	5741	8997	4106	18720	104,150
industry	2420	1467	1844	2469	1149	509	9,858
Agriculture	15331	19	214	454	419	112	16,663

investment, preferably joint ventures, to construction sector.

In addition to Foreign Direct Investment, from 2001, Afghanistan economy has been heavily dependent to foreign aids. There have been several international conferences with aim to assist the process of reconstruction, such as Bonn, Paris, London and Tokyo conference. The table below shows the number of donor countries and their contribution to Afghanistan (commitment, disbursement and remaining amount) in Million US\$. According to data provided by Afghanistan Ministry of Finance on donor contribution to Afghanistan, the total pledge has been 8, 624, 42 million US\$, from which 4,908,70 has been committed by donor country with remaining of 5,747,10 million US\$.

Donor	مجموع کمک وعده شده Total Pledge	مجموع پول موافقه شده Total committed	مجموع پرداخت حقیقی Total Disbursement	باقی کمک حقیقی Remaining (Pl-Disb)	باقیه کمک وعده شده (%) Remaining % pledge	کشورهای تمویل کننده
Grand Total:	8,624.42	4,908.70	2,877.32	5,747.10	66.64	مجموع کل
Total Bilaterals	8,088.42	4,351.34	2,846.64	5,241.78	64.81	مجموع کمک های دوجانبه
Australia	55.00	109.80	0.00	55.00	100.00	استرالیا
Belgium	9.36	9.50	12.50	-3.14	-33.55	بلجیم
Canada	390.00	188.16	92.94	297.06	76.17	کانادا
Denmark	70.00	43.64	0.00	70.00	100.00	دانمارک
Finland	15.80	15.80	0.00	15.80	100.00	فنلند
France	39.60	0.00	17.85	21.75	54.92	فرانسه
Germany	218.40	218.40	0.00	218.40	100.00	آلمان
India	450.00	200.70	0.00	450.00	100.00	هند
Iran - (IR)	50.00	0.00	0.00	50.00	100.00	ایران
Poland	3.43	3.43	2.46	0.97	28.28	پولند
Italy	98.38	0.00	0.00	98.38	100.00	ایتالیا
Japan	150.00	63.82	0.00	150.00	100.00	ژاپن
Korea (Rep. of)	3.00	0.00	0.00	3.00	100.00	جمهوری کوریا
Haland	116.00	116.00	48.30	67.70	58.36	هلند
Norway	135.00	110.00	20.00	115.00	85.19	نروژ
Pakistan	30.00	0.00	0.00	30.00	100.00	پاکستان
Spain	37.20	0.00	0.00	37.20	100.00	اسپانیا
Sweden	40.00	50.00	0.00	40.00	100.00	سوئد
Switzerland	15.00	9.89	0.00	15.00	100.00	سوئیس
Turkey	16.00	89.95	0.00	16.00	100.00	ترکیه





Source: Doner Assistance Database(D.A.D) Ministry of Finance

منبع : وزارت مالیه (دیتا بیس تمویل کننده کمک ها)

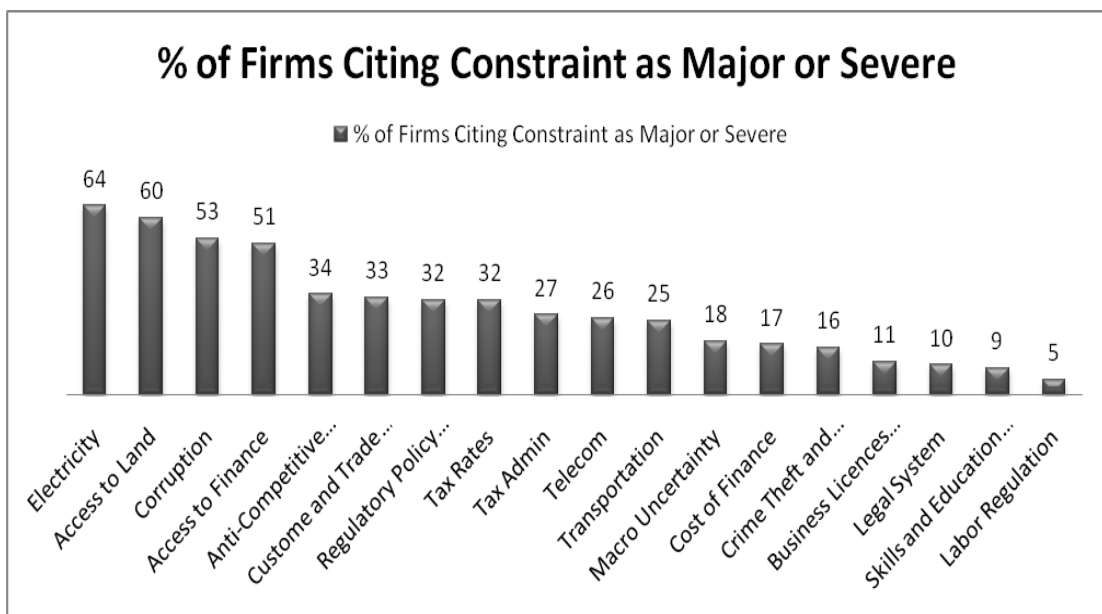
The current financial aids to Afghanistan, shows the promise of international society in rebuilding of Afghanistan. However there is no enough charity money for poor countries such as Afghanistan to help them out of poverty; sadly in many cases” poor countries remain prisoners of an abnormal aid system, where government agencies and NGOs create jobs, foreign aid substitute for tax revenue and aid development projects substitute for tax spending initiatives of local, regional, and state governments.” (Hubbard & Duggan, 2009)

The financial aids and external assistance can help as a tool to empower people to achieve to a level of productivity to manage a decent life. So the challenge is how to direct these financial aids and foreign direct investments to right sectors and at the correct direction. In addition it is essential to find a method of aid distribution in order to prevent, corruption and waste.

Currently Afghanistan pursues a pro private sector and market base economy. According to article 10 of constitution “The State encourages and protects private capital investments and enterprises based on the market economy and guarantees their protection in accordance with the provisions of law.” The current policy is favorable

to long term economic growth in Afghanistan. The pro private and business sector policies help to reduce the corruption and reduce the poverty; “Only business creates the jobs that pull people out of poverty... private individuals and companies employ people for pay, or people work for themselves as farmers who sell their crops, artisans who sell their wares, merchants who buy and sell what others make, or bankers who finance all of the above. It’s the only reliable path to mass propensity the world has ever known. (Hubbard & Duggan, 2009)

Due to the importance of private and business sector, providing a favorable environment for them is vital. World Bank group in 2007, conducted an Investment Climate Assessment (ICA) survey among 355 firms, in five major cities (Kabul, Mazar-e-Sharif, Herat, Kandahar and Jalalabad) covering six sectors (manufacturing (34%), trade (23%), services (17%), construction (15%), construction material (6%), transportation and communications (5%)) to assess the investment climate in Afghanistan. According to the survey, 64% of firms consider electricity as major constrain in doing business, followed by access to land, corruption, access to finance, anti competitive behavior. (Worldbank, 2007)



Source: AISA

In addition as 2009, among 183 countries studied by World Bank in easiness of doing business, Afghanistan is ranked as 167th with Chad in the bottom line of table and Singapore on the top of table with the first rank.

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Closing a Business
Afghanistan	167	25	149	170	128	183	53	183	162	183

Source: World Bank Group

As table illustrate, the ease of doing business, is measured with 9 indicators; in order starting with starting a business, dealing with construction permits, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing business. Afghanistan except for the two indicators, starting a business and paying taxes ranked very low.

The current statues of ease in doing business shows the fact, that Afghanistan need major reform in the indicators mentioned above. Policy makers in Afghanistan government shall seek to make policies which improve the business environment in the country. Business sectors will need to be protected by law. There should be great effort in Clarify and strengthen sound legal structure, property rights, legal organism that enforces decisions, revised investment, business, bankruptcy, insurance, transactions and financial laws and creat a predictable regulatory system. “Business development requires macroeconomic stability and an environment where there is a general reliance on the rule of law. While it is relatively easy to introduce a suitable legal and regulatory framework, it is considerably more difficult to ensure that it is effectively implemented. This requires that all parties, both public and private,

reliably abide by the legal system. It is critical that contracts can be entered into and enforced with disputes readily resolved. [It is government responsibility] in strengthening the institutions, including the establishment of effective commercial courts, responsible for the implementation of commercial laws. It is the endorsement and implement of key commercial laws and amendments to establish the basic legal and regulatory framework that will encourage [business] sector involvement in social and economic development and consistent with the Afghan conditions. The Government should ensure that ministries and agencies are able to competently administer commercial laws and regulations in an unbiased and predictable manner.”(ANDS, 2008) Also government needs to facilitate the bureaucratic process to speed the process of starting businesses in Afghanistan.

While it is government responsibility to improve a pro private and business environment, there is should be a central agency in charge of aid distribution. The agency will be in charge of directing the capital and aids to business sectors by granting large size loans and micro loans which are repayable to central government after the defined time period. To avoid corruption, in addition to law enforcement, the loans should be in the form of inputs to production such as machine for factories, vocational training and material for construction. In addition the government should invest the repaid loans revenue and taxes on infrastructure, corruption measures, and spend the revenue from loans on health, education and welfare.

Conclusion:

For the first time after decades of war, Afghanistan is experiencing relative peace and stability. Afghan government and people are on a crossroad to rebuild their country or fall in the path of destruction and poverty. Many organs such as law and justice, education and economy need to be reconstructing from zero. While there are different actors active in the process of reconstruction, the biggest part of countries reconstruction is on government's responsibility. It is government whom can provide different part of country with right policies in order to overcome the challenge of reconstruction.

In this paper the economic performance of Afghanistan from 2001 had been reviewed. The over fluctuation of GDP growth in Afghanistan shows need for rethinking about the economic policies. Over emphasizing on agriculture sector and less investment on other sector noted to be one of the main reason for slow economic growth in Afghanistan. Base on the GDP share of different sector in production level and employment rate, construction and transportation system had been proposed as leading industries for economic growth. However the main challenge in promoting these two industries is lack of capita. It is not possible for Afghanistan with a negative gross domestic saving to rely solely on domestic capital. Fortunately, from 2001 Afghanistan has been heavily supported by international aids and donor assistance. The correct use of international aid is a promising factor for economic growth in addition to foreign direct investments.

Nevertheless, the question is how the capital provided by financial aid and foreign direct investments should be used? Business sector promotion is an answer to this question. Strong business sector can help by producing employment and poverty reduction. It is government responsibility to insure and facilitate the process of

business establishment and business protection.

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