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SmartLessons

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The Importance of Private Sector Development in Conflict-Affected Countries

Paul Collier estimates that 73 percent of the poorest billion people in the world live in countries affected by conflict.¹ In his book "The Bottom Billion," conflict is the first of the "traps" responsible for keeping the populations of some countries in poverty. He argues that low or negative economic growth in a country dramatically increases the chance of conflict.

It is estimated that by the year 2011, 60 percent of the staff and resources of the U.K. Department for International Development (DFID) will be deployed in countries affected by conflict. But how can DFID work with the private sector in conflict-affected countries to break the link between conflict and low growth? We know that the complex links between growth, peace, and the private sector are key to development and yet are often overlooked or poorly understood. We know that peace-building interventions must be market-sensitive, and that market development must be conflict-sensitive. It is also now widely accepted that addressing the role of the private sector in building peace and growth must be tackled early. Beyond these key lessons, however, the Afghan experience offers further important insights.

The Afghan Context

There has been conflict of some form in Afghanistan for most of the past three decades. Beginning with an insurrection against a revolutionary regime in the late 1970s, it evolved into a religious jihad against occupying Soviet forces in the 1980s. After their departure, the country descended again into civil war and factional fighting in the early 1990s until the Taliban took effective control in 1996. Following the defeat of the Taliban regime by coalition forces in 2001, there has been insurgent

activity in parts of the south and east of the country until the present day.

Throughout this entire period the private sector has continued to operate. Unsurprisingly, Afghanistan has seen a shift from formal to informal business and a corresponding shift from licit to illicit activities. Agriculture and livestock have declined in importance, with external migration and the industrial base of the economy eroded to almost nothing.² Opium production and smuggling have risen dramatically, and the narcotics industry is now estimated to account for a third of the gross domestic product (GDP)³, with complex and well-integrated value chains stretching across the country.

The impact of conflict on the government has been almost as dramatic. Years of under-investment and low pay have led to a civil service with low capacity, strong links to warlords, and widespread patronage. Fourteen years of Communist rule fostered a government bureaucracy that is at best suspicious of business and at worst openly hostile.

It is, therefore, perhaps unsurprising that an estimated 90 percent of the Afghan economy exists in the informal sector. Fewer than 200 businesses with revenues of \$5 million or more paid any tax to large taxpayers' office

² International Alert (2006); "Local Business, Local Peace: The peacebuilding potential of the domestic private sector."

³ UNODC (2008); "Afghanistan Opium Survey."

¹ Collier, Paul (2007); "The Bottom Billion"; Chapter 2, Oxford University Press.

this year.⁴ And the likelihood of other businesses moving into the formal sector is low, when the government raids their bank accounts for disputed taxes without warning.⁵

Lessons Learned

Despite the difficulties, several lessons are emerging from DFID's work to improve the enabling environment for business in Afghanistan:

1) *Business does take place in conflict-affected environments.*

Despite the difficulties imposed on the private sector due to the security situation and the poor legal and regulatory environment, businesses are operating profitably in Afghanistan. One remarkable success has been the telecommunications sector. There are now four mobile phone companies operating in the country.

The leading mobile operator in Afghanistan, with over two million customers, is Roshan, a joint venture between the Aga Khan Fund and two private sector companies. Roshan has managed to extend its network to remote parts of the country using an innovative model where local tribes are paid a bonus if booster stations that are located in their area remain operational for the whole year. Telephone masts make attractive targets for antigovernment forces, and telecom companies faced high costs providing security to protect remote infrastructure. Roshan saved over \$1 million by adopting this community-based model and better operational performance from their masts. They have recently rolled out their mobile money transfer service in Afghanistan, based on technology pioneered in collaboration with DFID in Kenya.

2) *Reforming the business environment is always political.*

In a country where tribal loyalties often have more influence than formal government systems, building a broad coalition for reform is crucial. Changes to the security situation or the business environment will often represent a threat to vested interests. Many businesses, particularly those linked to the illicit narcotics industry, have a lot to lose from improvements in security or reforms that support licit businesses. Strong support from the private sector for enabling environment reform is therefore vital.

DFID has recently launched the Afghanistan Investment Climate Facility (AICF) a multidonor facility led by the private sector and resourced to address the problems this sector faces in doing business in Afghanistan. Its structure ensures that it is the problems perceived by the private sector that get tackled. A proposal to support a telephone hotline for exporters who encounter problems in exporting their goods from Afghanistan has recently been approved by the Board, who are all members of the private sector. Information from the call center will be made widely available to government departments that can tackle problems such as nuisance taxes on main transport arteries.

⁴ Data from the Revenue office, supplied by Adam Smith Institute (01/28/09) – exact figure was 188 businesses with revenues >\$5 million or >100 employees.

⁵ FT; Jon Boone (April 2008): "Afghan tax raid sparks cash exodus."



Women in Afghanistan make payments on the loans that they have been given for their businesses.

Through the Microfinance Investment Support Facility for Afghanistan (MISFA), DFID is addressing the constraint imposed on businesses by a lack of access to capital. MISFA is an independent body that provides both loan capital and technical assistance to private financial institutions. The Afghan government, the private sector, and donors are all represented on the Board. The governance structure has been carefully designed to protect the institution from falling prey to capture by any of the groups involved, by ensuring that no group has sufficient weight to make decisions on its own. MISFA has been successful in increasing access to finance to nearly 500,000 micro-entrepreneurs and small businesses.

3) *Be prepared to work with unusual partners.*

In Afghanistan, DFID works alongside a number of actors that are not typical development partners. In Helmand Province, the military presence dwarfs DFID's resources; both human and financial. The military has over 8,000 personnel in Afghanistan, the majority of which are based in Helmand, and spends some £1.2 billion per year—approximately 60 times the amount DFID spends in Helmand.

One "quick win" is to increase the amount of produce procured locally. Initial estimates suggest that increasing local procurement could provide over one thousand sustainable jobs, and that \$10 million in extra income could be generated for local Helmandis at no extra cost to the British taxpayer. In the longer term, DFID hopes to support a program to strengthen the market for local agricultural produce, with the aim of supporting a viable alternative to poppy production for local farmers. In conflict areas, it is particularly difficult to resist direct support in favor of market-based solutions, but our experience is arming us

with new arguments and evidence to persuade our partners. Indeed, because we work with unconventional development partners, donor harmonization is more of a challenge, and more vital than ever.

Looking Forward

DFID Afghanistan's new Country Plan, which was approved this month, includes a renewed focus on growth and private sector development (PSD). While the instruments of PSD may not be that much different, the processes we follow will be heavily tailored to the conflict context. The office would welcome input from members of the PSD cadre in the design and evaluation of programs, and would be happy to share lessons with offices in other conflict-affected countries that are grappling with similar issues.



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