

Economic Activity and Financing in the Regional Context **Exploiting the New Opportunities**¹

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Excellencies, Ladies and Gentlemen.

First, on behalf of the World Bank let me thank the Government of Iran and the United Nations Development Programme for inviting the World Bank to this important event, which brings together the three neighboring countries of Afghanistan, Iran, and Pakistan to discuss cooperation for development.

Second, I would like to express my personal appreciation for this opportunity to be in the beautiful city of Tehran and to participate in this conference.

This conference is an opportunity for all of us who are here, and for the countries involved. But more broadly, this is a time of great opportunity—especially for Afghanistan but also for Iran, Pakistan, and other neighboring countries of Central Asia. In the case of Afghanistan, it is a time of opportunity for peace, for political stability, for economic development, and for social development and inclusion. For the neighboring countries, peace and stability can bring opportunities and choices in the form of expanded trade, investments, economic growth, and cooperation in a variety of areas.²

Historical Background

As earlier speakers have noted, in the past Afghanistan and the areas immediately surrounding it were at the crossroads of the world—for international trade in goods, for transmission of ideas, and as a nexus of civilizations. In the 13th century, for example, the world was more closely interconnected, through Afghanistan and Central Asia, than it was subsequently until the 19th century. Afghanistan, Iran, Pakistan, and the other countries of Central Asia retain a rich, and to large extent common cultural heritage reflecting these cross-currents.

¹ The views, ideas, and analysis presented in this paper are those of the author and should not be attributed to the World Bank or its affiliated institutions.

² These regional dimensions are discussed in the [Afghanistan Border States Development Framework](#), a paper prepared by the World Bank in November 2001.

Starting in the 19th century, worsening after the Russian Revolution, and culminating during Afghanistan's two decades of conflict, political and other blockages criss-crossed the region, leading to fragmentation and isolation. Creation of national borders, border restrictions, disparate political developments on different sides of the borders, ideological differences, wars and conflicts, and other factors all contributed to this fragmentation and isolation, as did the emergence of low-cost commodity transport by sea, which rendered the land routes through Central Asia increasingly uneconomic for long-distance transport between the centers of Europe and Asia.

Nevertheless, economic relations among at least some parts of the region remained strong, mostly informal and unsanctioned by governments. For example, unofficial trade between Afghanistan and its neighbors, especially Pakistan, has flourished before and during the period of conflict, despite efforts by authorities to restrict it. A recent study by the World Bank in collaboration with UNDP estimated that Afghanistan's imports and exports (not including drugs, weapons, and other illegal commodities) totaled around \$1.2 billion each in the year 2000, with the vast bulk of both imports and exports going through unofficial channels.³

Another important vehicle for economic integration, also informal, is the ubiquitous *hawala* money transfer system, whose interconnections permeate South Asia and the Middle East as well as Afghanistan and Pakistan, and whose networks extend to Europe and America. This system is fast, efficient, and trustworthy, and especially in the case of Afghanistan it has served as the vehicle for transfer of massive, life-saving remittances from the Afghan diaspora to their relatives in Afghanistan.

Although lively, these economic interconnections have remained largely restricted to trade in goods (most of them products from outside the region) and short-term financial flows. Moreover, these activities have persisted despite government restrictions rather than being facilitated by governments. Thus their dynamic effects on the countries concerned have been limited.

The Opportunity

There is now a historic opportunity to end the economic fragmentation and isolation of Afghanistan and the region immediately around it. Recent developments in Afghanistan have opened up tremendous opportunities, both in the short run and for the long run—for economic growth, economic relations, and economic cooperation in the region.

The most obvious opportunity is the potential for new, economic trucking routes, which will sharply lower freight transport costs and thereby stimulate demand and dynamic economic benefits. For Afghanistan, transit of cargo trucks and overflights by commercial aircraft will also generate much-needed revenue for the government budget. There is the opportunity for geography as opposed to politics to become the prime mover

³ See [Afghanistan's Trade Relations with Neighboring Countries](#), World Bank and UNDP, 2001 (available on the World Bank Afghanistan website).

in such trade flows. We must remember that the geographical distances in the region are often much shorter than the political divides—Islamabad is less than two hours by air from Tashkent, and Kabul is less than three hours' flight from Tehran.

Another area of opportunity is for large investments to take advantage of the changed situation. Some of these investment projects like roads are directly related to trade flows—indeed good-quality roads are an essential prerequisite for the flourishing of regional trade. There are also large needs for investments in telecommunications, energy, and urban water supply and sanitation and other urban services. Some of these investments will be domestically focused, but others will have significant regional implications.

Yet another potential opportunity, not exploited in the past, is the management of common or shared resources, the most notable being water. This will require government-to-government cooperation and willingness to take a new look, to an even greater extent than in the other areas discussed earlier.

And finally, Afghanistan's reconstruction process itself and associated demand and multiplier effects will have benefits felt not only in Afghanistan but in the region as a whole. However, it has to be kept in mind that Afghanistan's reconstruction is for Afghans and has to be led by Afghanistan.

Critical Prerequisites

The opportunities sketched out above will not materialize just on their own accord. Some critical prerequisites will need to be in place, and difficult issues tackled, in order for the region to become economically interconnected and dynamic.

The most obvious prerequisite is *peace and security*. This includes many dimensions, ranging from the progress of the peace process mandated by the Bonn Agreement to de-mining and drug eradication.

It is also essential to *build on and regularize existing linkages* rather than repressing them, for example in the case of trade and financial flows.

Reducing trade barriers is absolutely necessary to stimulate trade and bring it into official channels. Afghanistan's neighbors have restrictive trade regimes—high import duties (often as high as 20% or even higher) and in some cases quantitative restrictions on imports. These restrictive trade regimes, irrespective of the merits or otherwise of their objectives, simply do not work. On the contrary they direct resources and activities into smuggling, thereby also creating incentives for corruption. Moreover, the record of trade restrictions in stimulating dynamic, efficient, sustainable economic growth in the countries of the region has not been very good.

Afghanistan's government is firmly committed to maintaining the country's open trade regime, perhaps with a low uniform tariff for revenue purposes. The best policy for the neighboring countries is to move in the same direction.

Facilitating transit trade is very important for all of the countries of the region, but especially for Afghanistan. Transit trade issues become less important as trade barriers go down, since differential treatment of imports for domestic use and for transit becomes less. However, as long as the neighboring countries maintain their restrictive trade regimes, it is their duty not only under international law but in the interest of regional cooperation to facilitate the transit trade to Afghanistan. This means two things:

- Minimal administrative restrictions and procedures.
- Reasonable transport costs (by international standards) and administrative charges.

By the same token, Afghanistan needs to facilitate the trade transiting through Afghanistan from and to its neighboring countries, which will increase in volume as the region opens up economically.

Good governance also is essential for fully exploiting economic opportunities, both in each individual country and regionally. In this context, good governance implies viewing the government as a facilitator of economic activity, not as an obstacle to economic activity, and nor as a competitor to the private sector. Key aspects of good governance include:

- Maintaining law and order with security of property and contracts.
- Combating corruption—usually cited by private business as the biggest constraint hindering their activities.
- Avoiding corruption-related onerous regulations and bureaucratic red tape.
- Non-interference in people's economic affairs.
- Effective, non-intrusive regulation where required.
- International government-to-government cooperation where needed to facilitate economic activities—e.g. in transit trade or management of common or shared resources.

Without *an efficient, modern financial sector*, Afghanistan and its neighboring countries, and the region as a whole, will be unable to realize their full economic potential. This will require strong, effective institutions most notably the Central Bank, and international experience has amply demonstrated that commercial banks and other financial institutions should be in the private sector.

Last but not least, *adequate infrastructure* is necessary to exploit national and regional economic opportunities. This means not only construction and repair of essential infrastructure—such as roads and power systems—but also sound and efficient management of infrastructure. There are opportunities for private sector participation both in infrastructure investments and in infrastructure management. In some sectors like telecommunications, technological change has opened up entirely new possibilities for Afghanistan and its neighbors for competitive private sector provision.

Private Sector Transitions and Directions for the Future

Let me now turn to the private sector itself, which must be the engine of growth, both in Afghanistan and regionally. The opportunity is there for the private sector, it is waiting. But the private sector cannot just sit back and expect riches. The new opportunities will be a challenge that the private sector needs to rise up to.

In the case of Afghanistan, key areas for private sector development include agriculture (small farms); trade and transport (a growth area as the region opens up further); small-scale manufacturing (based to a large extent on agricultural and livestock inputs); and selected industries where transport costs are high and there is substantial domestic demand, for example cement. Other growth magnets will also emerge, but it is neither possible nor desirable for the Afghan government to try to “pick winners” in advance.

In order to take advantage of the new situation, the private sector will need to make some crucial transitions—from trade to production and trade (i.e. production for export); from short-term to longer-term activities; from informal financial transfers to longer-term financing of economic activities; from public sector enterprises to private sector-led growth; and from unofficial to (with government facilitation) open, formalized business activities.

These changes will not be easy, but the bravery and initiative of the Afghan people provide grounds for hope for Afghan business. At various times, and even after disappointments and heartbreaks, ordinary Afghans have made and are making some of the key transitions referred to above.

When an Afghan farmer plants a tree, he is making a long-term investment whose fruits come only after a number of years.

When an Afghan nomad raises a sheep or other livestock, he or she is making an investment that earns returns only over time.

When an Afghan woman starts weaving a carpet, it may take a year or longer to complete it.

And when an Afghan refugee family returns to their homeland, it may be betting all of its resources and even its personal safety on an uncertain future, whose benefits may come only after some time.

So the people of Afghanistan—poor people—are making long-term investments in their future and are taking risks with their very limited physical, financial, and human resources. What is needed is for the people of more substantial means—the businessmen many of whom are in this room today—to make similar decisions and transitions. In particular, to move out of short-term trade and finance and into longer-term activities.

Of course it is easy for people like me in the public sector or in international agencies to make suggestions that the private sector should do this or that. There are undoubtedly many constraints of which you—the businessmen—are well aware, which the governments participating in this conference need to know about and address. In short, we must listen to the private sector, with concentration and humility.

This conference, most of whose participants are from the private sectors of Afghanistan, Iran, and Pakistan, provides a rare chance for the three governments, for UNDP, and for me personally, to listen the private sector. I look forward to some valuable listening in the remaining sessions, and I would like to express a sincere hope that where constraints are identified that are emanating from government, this meeting will serve as a vehicle for resolving such problems.

Thank you.