

Introductory Remarks by Graciana del Castillo
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I am Graciana del Castillo, Associate Director of the Center on Capitalism and Society, and I am delighted that you could be here for this important debate. This weekend, as I saw the cover pages of *The Economist* and the *NYT Magazine* whose titles read “Obama’s war” and “His Long War,” major articles in the *FT* and *NYT* and was the topic of all TV talk shows, I knew that the conference is taking place at a critical time—both for Afghanistan and for the US.

Why is Afghanistan at the top of the agenda? The political and security situation has deteriorated significantly since 2006 and the elections and troop enlargement may have deepened the ethnic divisions and continues to feed the insurgency. What has gone wrong? Could this have been prevented? What are the lessons for other countries attempting the transition from war? Is there any hope for the future? Will a military surge, with “development on the side” make a difference? Or we need a comprehensive strategy to jumpstart the Afghan economy? I will argue in favor of the latter.

Since we are fortunate to have Prof. Nadiri discuss Afghanistan from his unique “insider” perspective, I will draw some observations from my experience—documented in my recent book on *Rebuilding War-Torn States (Oxford)*—to answer some of these questions.

Why is Afghanistan at the top of the agenda?

War-torn states often have a disproportionate large political weight relative to their economic weight in the world economy. Iraq, for example, strained relations between the United States and Europe, created a split among the permanent members of the Security Council, and it often led to violent opposition to US policies across the world. US recognition of the unilateral independence of Kosovo in February 2008 and Russia’s recognition of independence in Abkhazia and South Ossetia following the Georgian war in August of that year, led to the worst confrontations between the United States and Russia since the end of the Cold War. The War in Afghanistan—as many have pointed out—could “make or break” Obama’s administration. No wonder there is so much attention on it.

What has gone so wrong?

After more than two decades of continuous conflict that killed 1.5 million people, and with the rout of the Taliban in November 2001, Afghanistan embarked on a complex multi-pronged transition: from war to peace; from a repressive, militaristic theocracy to a society based on democratic principles, the rule of law, and respect for human rights; and from a state-controlled, war-torn economy to reconstruction and private sector-led economic development. This transition meant nothing less than changing the political economy of the country from one based on unaccountable and arbitrary military rule, oppression, and illicit economic activity to one based on democratic, civilian governance, rule-based authority, a licit private sector, and political freedom. We need to accept that such a process will necessarily take time.

Despite high expectations and important progress in certain areas, Afghans feel disappointed by the transition: security in many parts of the country, particularly the south, has deteriorated sharply, and the country is back in conflict. Civilians have suffered casualties and the humiliation of having their homes searched by foreign troops is culturally unbearable for the Afghans. Even in the more secure areas, human security is weak and living standards have not improved as it was expected following the end of the conflict. Furthermore, lack of productive alternatives turned farmers to growing poppies. Afghanistan has yet to create a viable economy.

Much attention has been given in the press—and even in policymaking circles—to the political transition and to military and security issues to the neglect of the economic ones. This is despite the fact that failure to create viable economies and give groups affected by the war a stake in the peace process has been a major reason for the dismal record (Edmund S. Phelps mentioned earlier that roughly half the countries that come out of war revert to war within a few years and the other half end up largely aid dependent). A peace dividend in terms of better living conditions and rewarding jobs are necessary for peace to be longlasting.

As Prof. Phelps stated in the *Foreword* to my book, it could have been expected that when wars stopped, countries would have found their footing again and set about to make up the lost ground. This has hardly been the case and economic reconstruction of war-torn states has proved more elusive than in the past. This is certainly the case of Afghanistan.

Many analysts like to mention the Marshall Plan in relation to economic reconstruction in Afghanistan. But the political economy of peacetime was quite different following the two world wars than it has been since the end of the Cold War. The former involved a number of industrial countries with well-educated labor forces, rather homogeneous populations, and developed socio-economic, security and political institutions that could be adapted to economic reconstruction. After the wars ended, former combatants did not have to live with each other, so national reconciliation was not paramount.

By contrast, many of the civil wars and other forms of internal conflicts of recent decades resulted from economic and political underdevelopment, were often triggered by ethnic, religious, or ideological factors, and involved failed states or breakaway provinces. Reconstruction thus took place within a context of inadequate human and institutional capacity for project implementation and lack of resources that made large levels of aid imperative, even in countries with large natural resources. This situation made aid difficult to administer and to be channeled effectively and without corruption.

Since US military intervention and the Bonn agreement of late 2001, government tax revenue in Afghanistan has been below 7 per cent of gross domestic product. Warlords have been left to control a large part of customs revenues collected at the borders. Furthermore, donors channel a large part of their aid—up to 75 percent of it at times—outside the government budget. Also, a large part of the international assistance goes to

finance the security forces. For example, out of US assistance amounting to \$10.4 billion in 2009, \$5.6 went to funding the Afghan National Security Forces (ANSF). In the short run, this situation has not allowed the government to provide basic services and create lawful employment. In the long run it raises the issue of whether the institutions that the international community is supporting are sustainable once aid withers.

Successful reconstruction requires moving away from a largely illicit war economy to one in which the rule of law and legal activities predominate. The move in Afghanistan was in the wrong direction, with drug production becoming entrenched in the post-conflict economy since 2001.

Almost two years ago in a *FT* piece, Prof. Phelps and I pointed out that the international community was not helping Afghanistan to stand on its own feet. After decades of war and several years of severe drought, Afghanistan started the transition to peace with a per capita annual income of about \$200. Humanitarian aid was needed to save lives and feed the population but it was *not* accompanied by sufficient and effectively channeled reconstruction aid. Without reconstruction aid there cannot be the development of businesses, the productivity growth and the sustainable employment that enable people to support themselves and have a meaningful life.

The independence of the central bank and the “no overdraft” rule for budget financing adopted by the Afghan government under strong pressure from the International Monetary Fund—a desirable policy framework for countries in the normal process of development—has proved too restrictive. In the absence of well-funded development banks, the existing framework has deprived the country of *any* financing flexibility to carry out critical activities that could have contributed to the consolidation of peace, particularly at the local level.

The main sources of growth in the economy relate directly to the large presence of the international community and indirectly to the illicit drug economy. This does not offer any possibility of genuine economic development, and will never allow the country to get out of its aid dependency.

Is there a viable option?

To create employment it is necessary to reactivate production. Is it possible to turn the entrepreneurial spirit of the Afghans away from producing drugs into lawful production of cotton or textiles? Although the US has given up crop eradication—which often kills subsistence crops and pollutes water at the same time—it has considered paying farmers for not producing. This is also the wrong policy. What Afghanistan needs is to reactivate production.

The replacement of the illicit economy requires viable options. Both the US and the European Union assist their farmers through loan and price support programs and other incentives. If donors want to “do good”, they should channel reconstruction aid through the government budget—following the mechanism described by Prof. Phelps earlier—to enable the government to provide subsidies or other incentives (such as price support

programs) and support a five-pronged economic reconstruction strategy. Such strategy would create economic dynamism and inclusion through the short-run reactivation of investment and trade. Although I have no time to go into the details of this strategy, they are discussed in chapter 15 of my book. Afghan is a large and diverse country so any strategy would have to be adapted to local circumstances.

The five-pronged strategy could focus on (type of investment shown in brackets)

- Provision of subsidies to domestic enterprises to hire and train targeted groups, and produce for domestic and foreign markets (DD, DF);
- Provision of subsidies or price support to agricultural production for the domestic and foreign markets (DD, DF);
- Creation of special “reconstruction zones” for domestic and foreign firms to produce exclusively for exports (DF, FF);
- Promotion of investment by micro- and small-sized enterprises (MSEs) for the domestic markets (DD);
- Promotion of investment in infrastructure, by both national and international companies (DD, FD).

Such a strategy – or any similar one producing and adding value to fruits, vegetables, grains, lavender, textiles or anything else that Afghans can produce – could help the country to stand on its own feet. By increasing dynamism and social inclusion this strategy would create a good economy. It would also be a way of establishing the legitimacy of the Afghan government and decreasing the attractiveness of the insurgency.