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## ECONOMIC INCENTIVES AND DEVELOPMENT INITIATIVES TO REDUCE OPIUM PRODUCTION

Christopher Ward, David Mansfield, Peter Oldham and William Byrd



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## List of Acronyms

ADB	Asian Development Bank	IMF	International Monetary Fund
AHDP	Animal Health Development Project	IRRILP	Integrated Rural Rehabilitation to Improve Livelihoods and Curb Poppy Production
AICC	Afghan International Chamber of Commerce	ISAF	International Security Assistance Force
AIGF	Afghan Investment Guarantee Facility	JPT	Joint Planning Team
AKDN	Aga Khan Development Network	LIPW	Labor Intensive Public Works
AKF	Aga Khan Foundation	MAIL	Ministry of Agriculture, Irrigation and Livestock
ALPs	Alternative Livelihood Programmes	MENA	Middle East and North Africa
ALP-S	Alternative Livelihood Programmes-South	MEW	Ministry of Energy and Water
AMPS	Agricultural Marketing and Production Support	MFI	Micro Finance Institutions
AREDP	Afghanistan Rural Enterprise Development Programme	MHPs	Micro-hydel Projects
AREU	Afghanistan Research and Evaluation Unit	MISFA	Micro-finance Support Facility of Afghanistan
ARIES	Afghanistan Rural Investment & Enterprise Strategy	MRRD	Ministry of Rural Reconstruction and Development
ARMP	Afghanistan Rural Micro-credit Programme	NABDP	National Area Based Development Programme
ARTF	Afghanistan Reconstruction Trust Fund	NAPCOD	New Afghanistan Project for Cotton and Oil Development
ASAP	Accelerated Sustainable Agriculture Programme	NDCS	National Drugs Control Strategy
ASMED	Afghanistan Small and Medium Enterprise Development	NEEP	National Emergency Employment Programme
CADG	Central Asia Development Group	NEEPRA	National Emergency Employment Programme for Rural Access
CADP	Commercial Agriculture Development Project	NERAP	National Emergency Rural Access Programme
CARD	Comprehensive Agriculture and Rural Development Strategy	NGO	Non-Governmental Organization
CDCs	Community Development Councils	NPP	National Priority Programmes
CFDT	<i>Compagnie française des textiles et des fibres</i> (French cotton promotion corporation)	NRAP	National Rural Access Programme
CIDA	Canadian International Development Agency	NRVA	National Rural Vulnerability Assessment
DACAAR	Danish Committee for Aid to Afghan Refugees	NSP	National Solidarity Programme
DDAs	District Development Assemblies	O&M	Operation and Maintenance
DFID	Department for International Development	OTF	On The Frontier Group
DTIS	Diagnostic Trade and Investment Study	PAL	Project for Alternative Livelihoods
EC	European Commission	PDPs	Provincial Development Plans
EHLF	Emergency Horticulture and Livestock Project	PDT	Peace Dividend Trust
EIRP	Emergency Irrigation Rehabilitation Project	PEP	Private Enterprise Promotion
EPAA	Expert Promotion Agency of Afghanistan	PHDP	Perennial Horticulture Development Project
EQUIP	Education Quality Improvement Program	PPP	Public-private Partnership
ERR	Economic rate of return	PRGF	Poverty Reduction and Growth Facility
FAO	Food and Agriculture Organization	PRR	Priority Restructuring and Reform
FDI	Foreign Direct Investment	PRT	Provincial Reconstruction Team
GDP	Gross Domestic Product	RAMP	Rebuilding Agriculture Markets Programme
GSE	Global Sales Exchange	SHGs	Self Help Groups
GTZ	Gesellschaft für Technische Zusammenarbeit or German Technical Cooperation	SMEs	Small and Medium Enterprises
HARDP	Helmand Agriculture & Rural Development Programme	UNAMA	United Nations Assistance Mission in Afghanistan
HASIL	Helmand Agricultural Solutions for Improved Livelihoods	UNDP	United Nations Development Programme
HCDA	Horticultural Crops Development Authority	UNICEF	United Nations Children's Fund
I-ANDS	Interim Afghanistan National Development Strategy	UNODC	United Nations Office for Drugs and Crime
ICARDA	International Center for Agricultural Research in the Dry Areas	USAID	United States Agency for International Development
IDA	International Development Association	VET	Vocational Education and Training
IDLG	Independent Department for Local Government	VFUs	Veterinary Field Units
IED	Improvised Explosive Device	WatSan	Water and Sanitation Programme
IFC	International Finance Corporation	WTO	World Trade Organization

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## EXECUTIVE SUMMARY

### I. BACKGROUND

1. This report is about how to progressively reduce over time Afghanistan's dependence on opium – currently the country's leading economic activity – by development initiatives and shifting economic incentives toward sustainable legal livelihoods. These aspects will form an essential component of the broader counter-narcotics strategy, which also includes law enforcement, political and administrative actions, improving security, better governance, awareness-building, and demand reduction and treatment for Afghan problem drug users. The report does not cover these other topics, although as emphasized in the Government of Afghanistan's National Drugs Control Strategy (NDCS), it is only through a holistic strategy which encompasses all key elements that the country will escape from its dependence on opium. In particular, without strong economic and development underpinnings, other counter-narcotics efforts cannot achieve sustained success.

2. Specifically, the report identifies additional investments and policy and institutional measures to support development responses that can counterbalance the economic advantages of opium. It analyses ways to change the relative incentives between licit and illicit cropping and to help enhance rural livelihoods for the poor, under better governance and security conditions. The report puts forward concrete recommendations, and the expected impacts on growth, poverty reduction and the opium economy are assessed.

3. The report first briefly discusses the policy context (Chapter 1) and provides an overview of the opium economy (Chapter 2), focusing on how different segments of the rural population interact with it. The report then analyses the scope for increasing value added, competitiveness and productivity in agriculture (Chapter 3) and for promoting enterprise development and off-farm employment (Chapter 4). The complementary role of further investments in rural infrastructure is examined in Chapter 5, and measures for strengthening governance are analysed in Chapter 6. In Chapter 7 issues that cut across all counter narcotics efforts are examined. A final chapter looks at implementation, and at issues of prioritization, synergies and phasing (Chapter 8). The recommendations of the report are encapsulated in a matrix at the end of this Executive Summary

### **The Counter-Narcotics Challenge**

4. Afghanistan is a desperately poor, war-ravaged country. The usual challenges of post-war reconstruction are made even more difficult by the continuing insurgency, by the age-old centrifugal forces that have always made Afghanistan hard to govern, by the extreme weakness of modern institutions, and by widespread corruption and lack of rule of law.

5. In the last two decades, Afghanistan has become the world's predominant supplier of illicit opiates, accounting for over 90% of world production and trade. Total gross revenues from the illegal drug trade in Afghanistan are equivalent to over one-third of licit GDP. Millions of Afghans benefit directly or indirectly from the opium economy.

6. The government's strategy, with global backing, is to fight drug trafficking and to progressively reduce opium production over time. Where farmers are better off and clearly have viable alternatives, law enforcement measures can be taken. Where farmers are poor, or where landless labourers are involved, government policy is to develop viable alternatives for



the rural poor, and only then use sterner measures to enforce a ban on opium poppy cultivation.

### **What Can Be Achieved Over What Time Frame**

7. Afghans engaged in opium production can be broadly categorized in four types:
  1. *Better-off farmers who are not dependent on opium.* The exit of these farmers from the opium economy is largely a function of security and governance, and of legal market opportunities.
  2. *Smaller farmers currently dependent on opium but with some potential for producing for legal markets.* Where there are good markets for legal crops and livestock, and provided that a modicum of security and good governance are present, these farmers may be expected to shift away from opium in the medium term
  3. *Poor farmers in remote areas currently highly dependent on opium, with little potential to produce for the market and scant local labour opportunities.* Over the longer term, these farmers can move away from opium if value can be added to local on-farm and off-farm production and to labour. Out-migration is likely to play a significant role for this group.
  4. *The landless, currently highly dependent on providing labour for opium production (through wage labour or sharecropping).* Adding value to labour, developing employment opportunities, and facilitating orderly migration are exit paths for this category over the longer term.
8. The challenge is thus to enhance the access of farmers (particularly poor farmers) and rural labourers to markets, land, water, credit, food security and employment – at least in adequate measure to provide a minimum legal livelihood.
9. Legal livelihoods can only be sustained under conditions of decent governance and security that allow the development of licit markets, the accumulation of assets and the growth of normal economic activities and relations. It is, therefore, also essential to ensure security and to support better governance and effective grassroots institutions. This will strengthen the reciprocal relationship of responsibility and trust between rural people and their local and central government.
10. Where these conditions can be put in place, experience shows that reductions in opium poppy cultivation can be achieved. For example, in those parts of Badakhshan province where households are in close proximity to urban centres, with access to both agricultural commodity and labour markets, and where the writ of the government can be maintained, reductions in opium poppy cultivation have been obtained in a relatively short period of several years.

### **II. ENTRY POINTS**

11. Four areas of development have the most relevance as entry points for shifting economic incentives away from opium and toward the legal economy: (i) agriculture, irrigation and livestock; (ii) rural enterprise development; (iii) rural infrastructure; and (iv) local governance.

#### **Agriculture, Irrigation and Livestock**

12. Agriculture, irrigation and livestock are prime areas for intervention. They account for up to half of GDP, support some 80% of the population, and are the main activities of

those who are engaged in opium production or at risk of becoming part of the poppy economy.

13. The greatest counter-narcotics impact is likely to result from interventions which reach the largest number of rural households, particularly the poor, and bring the most income and employment. The predominant farming system of the poor is anchored in cereals production for household food security, with most households having food self-sufficiency for only a few months of the year. Investments in raising cereals productivity would improve household food security and progressively release agricultural land for higher-value, labour-absorbing licit crops with market opportunities.

14. Afghanistan is an arid land where most agricultural production requires irrigation. Irrigation is thus essential for restoring livelihoods and promoting the transition to higher-value cropping. There is enormous scope for improving water productivity on 1.3 million hectares, for rehabilitating existing traditional and modern systems on up to 800,000 ha, and for expanding the irrigated area by several hundred thousand hectares through both large and small-scale irrigation schemes. Current rehabilitation programmes cover less than half of rehabilitation needs and do not provide for extending the irrigated area or for improving productivity of water use. Accelerated and scaled-up investments in irrigation would have a high impact against the drivers of the opium economy, and would provide broadly spread benefits, with the typically important multiplier effects of irrigated agriculture throughout the rural economy. There would also be a positive impact on governance, as irrigation management builds social capital and gives farmers a fixed asset stake in governance, security and market development.

15. All Afghan rural households tend to have at least some livestock, and adding value to livestock is a first-class entry point to reduce the dependency on opium of poor farmers and landless households (Types 3 and 4), even in more remote areas.

16. Many areas of the country have potential for producing high-value horticultural, industrial or export crops such as cotton, oilseeds, fruits and nuts, and vegetables. Although these opportunities in large part directly affect better-off farmers (Types 1 and 2), they also have good scope for creating employment for the poor at production and processing stages. The key is development of technical packages, processing and marketing. Business models – the value chain approach, export promotion, and contract growing – have been successfully tested and have potential for scaling up. New high-value crops also have potential: a good example is saffron, which has been piloted with UK support.

17. For maximum impact on the opium economy, further investments should be focused on integrated agricultural support programmes, on irrigation, and on livestock. The policy and institutional constraints adversely affecting these programmes should be addressed. The focus needs to be on reorganizing production systems around market-driven supply chain approaches, increasing the endowment of productive assets, and expanding the involvement of the private sector. Selective investments, either private or in partnership between private and public sectors, in developing horticultural, industrial and export crops, with possible regional focus, should be undertaken where there is a viable business model.

## **Enterprise Development**

18. The job and wealth creation impacts of rural enterprise development are considerable, and support to private enterprise development represents a good opportunity to achieve poverty reduction and counter-narcotics objectives.

19. Afghanistan faces a long and challenging agenda before it can build a modern, private enterprise-driven economy. There are problems of competitiveness due to appreciation of the Afghani (in real terms) and high wage rates; an unfavourable business climate with difficult access to land, poor power supply, corruption and high transaction costs; productivity impaired by poor infrastructure and services and by inadequate human resources; and strong competition from imports. Nonetheless, the generally market-oriented and liberal policy environment and the entrepreneurial character of the Afghan people create scope particularly for expanding the informal (micro-enterprise) sector and for building up small and medium-scale enterprises in certain import-substituting activities (vegetable oil, poultry, dairy, wool, processed foods, soaps, footwear, etc). Export products with potential include dried fruits and nuts, medicinal herbs, silk, leather, skins, carpets, etc.

20. The most direct impacts on the opium economy would be obtained by focusing on rural enterprise, as that is where opium farmers and labourers are located. It is also in rural areas that lower costs per job or enterprise created typically are found. Support to private rural business development would need to be accompanied by formation of groups and associations of farmers as required for development of viable business activities on a competitive basis, by targeted investments on a public-private partnership basis where needed, and by policy reforms and institutional development to increase competitiveness and develop enterprise across sectors. On the government side, MAIL should share the driver's seat with MRRD, and USAID and MISFA should be brought in as key partners. Improving outreach of financial services in rural areas would be an essential complement. Longer-term impacts could be achieved through vocational training and support to migration.

### **Rural Infrastructure**

21. Rural infrastructure programmes are effective in improving livelihoods and in helping build governance. Roads and rural water programmes have a broad reach nationwide and a strong positive impact on poor communities and on the economic activities of the poor. Thus they can contribute to economic growth and poverty reduction, and over the longer term to the replacement of the poppy economy with legal rural livelihoods. Rural roads, in particular, contribute to the growth of the legal market economy and to better governance, and thereby enhance incentives for licit production. In addition, rural access improves governance: 108 out of Afghanistan's 396 districts currently have no road access to their provincial capital.

22. The major National Rural Access Programme (NRAP) and its predecessors have already improved 9,000 km of rural roads and have connected 3,000 villages (10% of the nation's total) to market centres during 2002-6. Rehabilitation of the remaining 75% of the nation's estimated 30-50,000 km of rural roads would have a potentially large impact on livelihoods and governance, thereby encouraging and facilitating the shift away from poppy. In addition, improvements in the policy framework and programme implementation for rural water supply and electrification could, combined with increased financing, significantly improve living standards and contribute to growth.

### **Local Governance**

23. Afghanistan has made remarkable progress in community-based rural development since 2002. Some 18,250 Community Development Councils (CDCs) have been established in over two-thirds of the nation's villages, and block grants have financed small-scale rural infrastructure and development projects. This is one of the few programmes in Afghanistan which has clearly delivered results in the eyes of rural people. There are also District Development Assemblies (DDAs) serving about one-third of the population. These organizations, especially the CDCs, have strong local ties, can implement local projects, potentially could play an advocacy role vis-à-vis the government, and may potentially serve as development platforms to negotiate and channel support from national programmes and agencies. Further strengthening of these institutions will help build conducive conditions for the growth of the licit rural economy.

### **III. SIX PRIORITY SETS OF INTERVENTIONS**

24. Matched against criteria of high impact, feasibility and political economy, six priority intervention sets targeted at the entry points discussed above have been identified for large-scale additional support. These interventions could have a considerable impact in improving incentives to engage in the legal economy, and over the longer term would help reduce opium production.

#### ***Intervention 1: An “Integrated Programme” for rural development and governance***

25. A large impact on livelihoods, and hence on the opium economy, would be obtained by linking comprehensive support to rural development (reorganizing production systems around market-driven supply chain approaches, private rural enterprise development, rural infrastructure, access to social services) with governance building. Many programmes already exist to deliver both rural development investments and a certain degree of governance building at the village level, but they are characterized by lack of coordination and continuity, a supply-driven character, and fragmentation of objectives and activities. The result at the community level is lack of a critical mass of impacts to improve livelihoods and influence farmers to move away from opium.

26. There are, however, three already successful approaches which have potential, if combined, to create a critical mass of impacts on rural livelihoods, and hence to generate stronger incentives to move away from the opium economy: (1) the emergence of CDCs and clusters of CDCs as local development partners that can serve as entry points for further development initiatives as well as building social cohesion and adopting participatory planning; (2) the success of a number of NGO facilitating partners in offering integrated development services to communities; and (3) the growing effectiveness of the National Priority Programmes in delivering sectoral investments – in rural infrastructure (NRAP, WatSan), in agriculture (EHLA) and in social services (EQUIP, Health).

27. The innovation proposed is to scale up and complete existing initiatives so that rural communities would have access to a critical mass of support that would allow them to reorganize production systems along market-driven lines and to develop the physical and institutional infrastructure needed to support this shift toward commercial activity. The elements of such an integrated programme would include the following:

- Design and implementation would be Afghan-led, within national policy and the government budget, and financing could – in principle – be channelled through the Afghanistan Reconstruction Trust Fund (ARTF).
- Delivery by full service field-based implementing partners, typically NGOs; the greatest synergies would be achieved if the same partner can implement the entire package in an area.
- Scaling up from existing operations in order to capitalize on field presence and experience, and targeting poorer and more vulnerable areas.
- Support to farmer organizations set up around commodities or activities and to structuring of supply chains for higher value production, linked to private sector downstream processing and marketing.
- Strengthening of the productive asset base, especially through linkages to the rural finance system and to enterprise development programmes (see Intervention 4 below).
- Links to – or integration with – the programmes for strengthening CDCs.
- Linkages to other national priority programmes in order to achieve synergies.

28. The feasibility of this integrated approach has been demonstrated by the success of such programmes in several provinces. One programme supported by DFID in Badakhshan “contributed substantively towards the overall reduction in opium poppy cultivation in its target areas.” Impacts on the opium economy would be felt within several years in areas which are in close proximity to provincial centres, and would be high more generally in the medium to longer term once the programme achieves greater development impact in less accessible areas. In a province like Badakhshan, for example, in the more accessible parts of the districts of Kishim, Faizabad and Baharak, the integrated programme could bring down overall levels of opium poppy cultivation in the province by around 50% over a five to eight year period. In Helmand this kind of approach, combined with an improved security environment, could be expected to make a considerable dent in levels of opium poppy cultivation in the central districts, where as much as 50% (around 51,000 ha in 2007) of the province’s total opium poppy is currently grown.

29. Feasibility studies could be carried out in 2008 (cost \$500,000). Indicative incremental costs, assuming a start in 2009 and roll-out to cover about 10,000 villages (one-third of the total number in Afghanistan) by 2011, are estimated at \$30 million in 2009, rising to \$90 million in 2011. The estimated indicative total cost for an initial three year programme during 2009-2011 is \$180 million.

30. A number of implementation, policy and institutional measures are needed for this approach to be successful. These include: progressive strengthening of CDCs as focal points for development; strengthening of provincial and local planning processes; development of appropriate contract arrangements for service delivery with NGOs, farmer organizations, CDCs, etc.; development of structured linkages to existing and planned rural development and enterprise development programmes; and strengthened agricultural policy, planning and programme oversight, including stronger MAIL/MRRD collaboration.

***Intervention 2: Expanding agricultural land under irrigation***

31. As discussed above, irrigation is key to restoring livelihoods and promoting transition to higher-value cropping. Accelerated and scaled-up investments in irrigation would have a high impact against the drivers of the opium economy. Currently, the good performance of irrigation programmes under Afghan leadership and execution demonstrates their feasibility and strong community demand throughout the country. Irrigation investments have a typical life of 25-50 years, so sustainability is likely, although arrangements for operation and maintenance need to be put in place.

32. An irrigation and agricultural water management sector review should be carried out in 2008 (cost \$1 million), and a phased ten-year programme for increased investments should be prepared and financed. Estimated indicative investment costs are on the order of \$1.2 billion, of which \$125 million would be for completion in the short to medium term (2008-2012) of the rehabilitation of existing traditional irrigation on up to 500,000 ha; \$250 million for the physical and institutional modernization in the medium term (2010-2015) of existing large-scale irrigation schemes on up to 250,000 ha; and up to \$800 million in the medium to long term (2012-2018) for the development of new diversion structures, hydropower and large-scale irrigation on up to 150,000 ha.

33. A key supporting measure required is that concerned government agencies work out a framework for cooperation with each other and with NGOs and other outreach organizations to provide irrigation and cropping advice to farmers. For new irrigation schemes on trans-boundary waterways, constructive dialogue with neighboring riparian countries will need to be initiated.

### ***Intervention 3: Improving returns to livestock***

34. As discussed above, investment in livestock is a first-class entry point to reduce the dependency of the poor on opium. Scaled-up support is feasible: there are national programmes underway to strengthen veterinary services and to support small-scale initiatives in dairy and poultry, with considerable possibilities for scaling up. Other parts of the livestock economy should also be supported, but here further design work is required to delineate activities most relevant to the opium economy. There should be particular focus on the poorest, on women, and on extension to areas least served by development programmes and with susceptibility to opium. High-potential mechanisms to improve livestock value include sheep fattening, cashmere fibre development, and skin garments.

35. A preparation study should be carried out in 2008 (cost \$1 million). Indicative investment costs in dairy and poultry for the period 2009-2012 are \$120 million, including \$60 million for extension of the cooperative dairy model to a further ten areas and \$60 million for extension of the semi-commercial and household poultry models to ten more provinces. Investment costs for other value-added activities need to be determined. The key supporting measure required is to ensure that the transition to privatized but universally accessible veterinary services is carried through, and that services are available to the poorest.

#### ***Intervention 4: Rural enterprise development***

36. Rural enterprise development would have a potentially high impact in providing legal livelihoods and shifting incentives away from opium. The government is developing a proposal for a massive and innovative Afghanistan Rural Enterprise Development Programme (AREDP). The programme is still at the early design stage, so the discussion in this report is preliminary and indicative. As presently conceived, AREDP is intended to provide full services to both micro and small and medium rural enterprises. Focusing on both import substitution and export development, the programme would work at two levels: rural micro-enterprises with less than 10 employees, and rural small and medium sized enterprises (SMEs) with 11-250 employees. The idea is to provide services adapted to the scale of the enterprise, facilitating access to finance, providing “end-to-end” business development services, putting in quality control, providing policy support as needed, and promoting partnerships between micro-enterprises and small and medium scale businesses. Management of these services would be contracted out. The institutional model would create links to other national programmes and work through the CDCs, linking local mobilization of communities with business development. A key element would be the formation of groups and associations at the grassroots level in rural areas, promoted and facilitated by CDCs. One proposal for example is to contract with communities to supply raw materials for agro-processing.

37. The programme is intended to be longer-term, nationwide and large. It has a proposed time horizon of 10 years, highlighting the need for long-term commitments. A pilot project and feasibility studies will be carried out in 2008 (the latter estimated to cost \$1 million). A rough preliminary estimate of the net financing requirement for the programme during 2009-2018 is \$550 million. Currently indicated programme targets with this level of financing are very ambitious and would need to be reviewed: 900,000 micro enterprises created, 12,000 SMEs, 2.1 million long-term jobs, and \$2 billion in annual production value.

38. Feasibility remains to be demonstrated during the design stage, but clearly this is potentially a very large and important programme. AREDP would provide a massive alternative labour market to opium poppy. The multiplier effect of such an intervention would further increase wage labour opportunities and the opportunity cost of allocating labour to opium poppy cultivation.

39. Next steps will be critical. Donors should work in close and intensive partnership with the government to help it develop the programme on a sound basis. All relevant government and national agencies should be involved. In particular, MAIL should share the driving seat with MRRD. Government should make a particular effort to bring in the local private sector, USAID and MISFA as key partners. Programme design should emphasize building local capacity in business development.

40. Finally, attention needs to be devoted to improving the business environment and to aligning and harmonizing approaches of business support programmes (see Box A). Another related priority is a Diagnostic Trade and Investment Study (DTIS, estimated cost \$500,000), including an import substitution and counter-narcotics lens.

**Box A: Agenda for Improving the Business Environment and Business Support Programmes**

The report makes many recommendations that would help improve the business environment and enhance the impact of business support programmes:

- *Access by Afghan trucks to neighbouring countries* should be negotiated in transit and trade agreements.
- *Grants and other support in current business development services need to be streamlined and transparent*, and the services should be built up to be locally run.
- *Pooled financing should be considered to ensure consistency and coherence of matching grants for investment.*
- *Investments in Industrial Parks should be scaled up* in response to existing strong business demand.
- Attention should be paid to *setting and supporting export standards.*
- Government and partners should work together to *further strengthen the Customs Service.*
- Support should be provided to the *development of representative business and civil society organizations* that have a stake in anti-corruption measures and in improved security.

***Intervention 5: Local procurement***

41. A quick action that would have high impact would be a massive increase in local procurement by the foreign community. A worldwide study found that only 4-9% of the benefits of international peace-keeping budgets stay in the host country. The feasibility of sharply increasing local procurement has been demonstrated by the US lead (switching, for example, from \$58 million of annual spending on imported drinking water to locally procured water), and other sizeable opportunities are evident. The multiplier effects in the economy of hundreds of millions of dollars of extra local purchases would be extraordinary. The bulk of such procurement would be high-value agricultural produce, and much of it could be grown in opium-vulnerable areas: the US, for example, is proposing to procure fresh fruits and vegetables in Nangarhar, formerly a major opium producing area to which opium is returning in many localities. In addition to the economic benefits, the dividend in terms of trust and “hearts and minds” would also be considerable.

42. All governments supporting the Afghanistan Compact should make firm commitments to sharply increase local procurement in 2008, with a view to achieving a target of, say, 50% local procurement by 2009, and instruct relevant agencies to prepare feasibility studies and to make institutional preparations (e.g. for hiring local purchasing and inspection staff) to achieve this target. In addition, the operations of the Peace Dividend Trust, which has been supported by DFID amongst others to foster local procurement, should be scaled up and fully financed (cost \$2 million in 2008-9).

***Intervention 6: An integrated production and market development programme for suitable crops such as cotton, targeted initially at Helmand province***

43. Afghanistan has in the past demonstrated comparative advantage in cotton production. Revival of the cotton sector could have a high impact as cotton has a relatively high value, grows in areas such as Helmand where opium is also widely grown, and the standard business model is similar to that of opium. However, the feasibility of major investments in the cotton sector is not clear at present, and attempts to date to revive the cotton industry have encountered many problems. Major new investments in plant and equipment together with a high level of support to the business, at least initially, would be required to rebuild the cotton economy on a profitable and sustainable basis. There are viable commercial models for



small-holder cotton development practised in many countries, in particular the attractive nucleus factory and out-grower contract farming model, which reduces farmer risk by providing inputs, advice and a guaranteed market and price, and reduces business risk by binding out-growers to a contract relationship with a single industrial buyer. Other industrial crops such as oilseeds may also be economically viable, and their prospects would need to be assessed as well. There are evidently political economy issues, at both local and central levels; government policy in practice has taken a statist approach, although this may change with the reforms occurring in MAIL. In addition a number of economic and technical issues need to be addressed before considering major investments.

44. Despite these uncertain prospects, cash crops such as cotton present considerable possibilities, and the business model is prima facie highly attractive. It is therefore recommended that an immediate sector review and pre-feasibility study should be carried out. The indicative budget for the study is \$500,000.

#### **IV. OTHER PRIORITY ACTIONS**

##### **Adding Value to Key Ongoing National Priority Programmes**

45. Ongoing National Priority Programmes are having high impact, particularly: (1) the National Rural Access Programme (NRAP) for rural roads; (2) the National Solidarity Programme (NSP) for community development; (3) the Micro-Finance Support Facility of Afghanistan (MISFA) for rural finance; and (4) the Water and Sanitation Programme (WatSan) for rural drinking water supply. The impact, particularly the opium-relevant impact, of these programmes can be enhanced by increased financing and by improvements in the programmes.

46. **NRAP and rural roads.** There are strong linkages between rural access and the counter-narcotics agenda. Investment in rural roads should be scaled up, with substantial additional financing provided for NRAP, subject to policy and institutional changes and to improvements in programme design and implementation. Financing of rural roads currently outside NRAP should be brought within the programme. To enhance counter-narcotics impacts, priority should be given to poor areas and to areas where market linkages can be strengthened, and to linking isolated districts to administrative centres. Implementation should prioritize community buy-in, emphasize labour-intensive construction, and provide for locally managed and executed maintenance. An indicative additional budget of \$300 million could be allocated for NRAP during 2011-2014.

47. **NSP and community development.** Community-based rural development can play a role in moving the counter-narcotics agenda forward. NSP should be strengthened and further scaled up. Additional financing should be provided to continue the roll-out of CDCs and to finance further block grants, albeit it at lower levels of funding, in order to consolidate and sustain the CDCs. CDCs should be empowered step by step to take on local service delivery and governance functions in limited functional areas, and progressive engagement with CDCs as focal points for local development should be encouraged and followed up. Counter-narcotics considerations should be mainstreamed in the district and provincial planning process. An indicative supplementary budget of \$100 million for NSP during the period 2008-9 is proposed.

48. **MISFA and rural finance.** Opium credit plays a major role in locking rural people into the business, and increasing outreach of rural financial services is an important way to change the incentive structure. In addition, provision of financial services is vital for private sector-led rural economic growth, and would support the priority intervention sets proposed above. Ongoing initiatives to improve the outreach and coverage of rural financial services should be strengthened, by: (i) completing the process of maturation of micro-finance institutions; (ii) developing new areas of finance for rural areas, in particular innovative solutions for financing agriculture and rural enterprise; and (iii) increasing rural outreach significantly.

49. **WatSan and safe water in rural areas.** The provision of safe water forms an essential component for improving rural livelihoods, and ongoing safe water programmes should be improved and scaled up. A sustainable low-cost strategy for operation and maintenance should be developed, a water resources assessment carried out to determine the effect of drought, and a study conducted to revise and strengthen WatSan programme planning and management and to resolve current implementation problems.

### **Preparing Further High-Impact Activities For Later Implementation**

50. A number of activities are high-potential areas for engagement, but there is a need to carry out studies or preparation before the scope for further interventions is clear.

51. **Promoting high-value agriculture and labour-intensive processing.** There is considerable growth potential for high-value agriculture and labour-intensive processing, which will be key elements in improving incentives for the legal economy. Current initiatives have stimulated some increased investment and activity in the private sector, and more private sector involvement will be essential for moving production systems toward higher-value commodities (as proposed under Interventions 1 and 4). However, the many current initiatives are ill-coordinated. A first step should be stocktaking and evaluation, to provide the basis for preparing strategies for scaling up interventions, many of which can then be promoted through the proposed integrated programme and through AREDP. Areas that need to be addressed include the following: (i) supporting high-value horticulture production, with a focus on opium-vulnerable provinces that are currently under-served; (ii) effectively supporting the fruits and nuts processing and export sectors along the entire value chain; (iii) market development and agricultural export promotion; (iv) development of sub-sector policies and investment plans for industrial crops and agro-processing; and (v) contract growing, particularly for industrial crops.

52. **Rural employment and adding value to labour.** These are key mechanisms for providing alternatives to opium. However, opportunities for improving the employment prospects of the largely unskilled labour force and for adding value to migrant labour have not been exploited. A demand-driven vocational training programme needs to be designed and financed, and a study should be carried out to identify entry points for higher-value and more humane migration, and to develop a roadmap for this purpose.

53. **Rural electrification.** Rural electrification can make an important contribution to rural well-being and to rural economic productivity, but little has been done systematically so far in this area. What is needed is a *national policy framework for rural electricity development*. Such a framework should (i) set out ways to facilitate private investment, including rules under which the private sector should operate; (ii) spell out subsidy policy to

help reduce high initial capital costs of rural electric power; (iii) specify ways to promote renewable energy technologies; and (iv) propose institutional options for larger rural energy projects (1-10 Mw). Also required is the establishment of a **central agency for facilitating rural electricity access**. Based on institutional and policy improvements along these lines, increased **financial support** to rural electrification should be provided.

## V. INSECURE AREAS

54. Development programmes are encountering difficulties in as much as one-third of the country due to insecurity. Ominously, the coincidence between opium poppy and insecurity is becoming increasingly, apparent. Growing insecurity needs to be factored into development planning, and some tough choices present themselves, often requiring judgment calls based on the local conflict and security situation on the ground. One option is to reduce the presence of all foreigners in the field – and at the policy table. Afghans should lead and implement programs both in Kabul and in the field. Another option is to scale back some of the more aggressive military interventions and give priority to more integrated development approaches and community partnerships – with a low-key role for the military. One diplomat with field experience said: “There is a need to create an environment of trust, to support the Afghan army and police as a people’s defence force, and to leave development to civilian agencies. If you chase terrorists, you create an unstable environment.” Box B outlines some suggestions for operating in insecure environments in Afghanistan.

55. In the extreme case of Helmand, the window for development initiatives to counter poppy is very narrow. It may be possible to invest heavily in the enclave in and around Lashkar Gah where security is adequate, generating a “development pole” impact. For example, rural enterprise and industrial parks could be promoted, together with some specific agro-industrial investments to develop contract growing (e.g. for cotton). Labour-intensive public works may also remain an option. In rural development, continuation of the current DFID-funded NGO programme is a high priority, and there may be opportunities for expanding certain short cycle horticultural crops through contract growing, including new crops such as mint. NRAP’s rural road coverage could be expanded in areas where the security situation is still manageable but where opium poppy cultivation is extensive or where its return is considered likely. This could apply in Nad e Ali, Nawa Barakzai and Lashkar Gah. Linked to this, responsible local governance is a critically important pathway, and the apparent success of NABDP in Kandahar in working with District Development Assemblies and promoting thousands of labour-intensive micro-projects could be replicated. Finally, it may be possible to promote investment in human capital through a pro-active education programme, if necessary in educational institutions outside the province. These measures taken together could help provide economic alternatives to rural people that can be taken up as the security situation improves. There should be no illusion however about prospects for quick success, particularly if conflict and insecurity continue at current levels.

### **Box B: Suggestions for Dealing with Insecurity**

- Work through decentralized planning and programming mechanisms, to ensure that the local administration and local people are aware and on board
- Select only villages that are willing to sign a cooperation agreement and to give a community security guarantee
- Maximize local ownership and community engagement through working with community institutions (CDCs and others), local contracting, labour-intensive works, etc.

- Remove all “foreign badging” – or perhaps even government badging where this is essential for working in the most insecure areas, and be thoroughly Afghan in the field.
- Use local implementing partners and locally recruited staff, preferably from the communities themselves, including local facilitators, “barefoot engineers”, and technical monitors.
- Give priority to relevance: the project has to be at the top of the local community’s priorities, and preferably one that gives rural people a stake in stability, security and good governance.
- Use decentralized and participatory monitoring and evaluation approaches.

## VI. HIGH LEVEL POLICY AGENDA

### Key Cross-Cutting Policy and Institutional Issues

56. Above the programme level there are a number of issues that constrain development across the board in Afghanistan and where a political-level consensus may need to be developed or – where it already exists – to be translated into action. These issues require constructive and persistent dialogue amongst all partners, leading to consensus and, most importantly, to change. Decision-makers will face some unpalatable trade-offs, requiring good understanding and sustained political commitment to move forward with the chosen options.

57. **Increasing Afghan ownership and leadership.** All programmes should be within the Afghan government-determined strategy, and need to be accountable to the Afghan government. The existing National Drugs Control Strategy (NDCS) provides a good basis for the Afghan government to exert leadership, although prioritization and sequencing will be essential. Afghan leadership and management of key ministries and programmes should be improved as necessary in the interest of ensuring sound policies, programmes and implementation. Institution-strengthening efforts need to continue and should be further improved based on sound Afghan leadership, and technical assistance from donors must be fully supportive of government leadership and sustainable capacity building. The government should engage in open dialogue about counter-narcotics strategy, priorities, and instruments with all concerned donors.

58. **Enhancing aid effectiveness.** The effectiveness of the measures recommended in this report could be greatly increased by better harmonization and alignment of aid. Government and international partners should implement their commitment to funding National Priority Programmes, and should channel aid flows through the ARTF and the national budget. Capacity strengthening should be provided to help the government steer the National Priority Programmes and to manage the related budget flows efficiently. Joint programming – rather than just “coordination” – should be the rule. This will require bilateral programmes to surrender national badging and “give up control to gain Afghan ownership”.

59. **Applying counter-narcotics mainstreaming to development activities.** “Mainstreaming” is the process of appropriately enhancing the counter-narcotics outcomes associated with development programmes, ranging from agriculture and rural development to health and education. Mainstreaming is agreed government policy, but implementation has been very slow. Yet it can usually be implemented with modest extra effort. Counter-

narcotics mainstreaming guidelines should be fine-tuned and generalized. Government should help agencies to apply the guidelines systematically.

60. **Long-term commitment should be the watchword, not short-term expediency.** Clearly, further development interventions on a broad front, beginning in the immediate future, are essential if improvements in governance and the prospects for Afghanistan's longer term development are not to be undermined by narcotics. However, there is an asymmetry between the political expectations of government and donors for rapid changes in the opium economy – and the reality of the one to two decades realistically needed before the opium economy dwindles. So-called “quick impact projects” have been implemented, but these have had at most very limited sustainable results. Effective counter-narcotics efforts are a combination of economic development, provision of social services, and better governance and the rule of law. Although significantly scaled up development action is essential straightaway (as well as better deployment of existing resources), achieving counter-narcotics goals will take considerable time, massive and sustained financial commitment, and political vision and stamina. The message of “start now but plan long-term” should be consistently transmitted in all policy dialogue.

61. **Piloting, innovation and the private sector.** In addition to these broader issues, and while recognizing that no short cuts to phasing out opium in Afghanistan exist, there will be a premium on innovative thinking and economic policies, experimentation, pilot development initiatives, scaling up based on positive experience, dropping failures, etc. Particular attention will need to be focused on effective support to private initiative, i.e. how to put public resources combined with private sector expertise and entrepreneurship effectively to use in a transparent manner to help jump-start, scale up, and sustain promising economic activities that will over time shift incentives away from opium.

### **Consistency, Perseverance and Partnership Are Essential – Under Afghan Leadership**

62. Overall, the progressive elimination of the opium economy in Afghanistan will come about through the creation of a web of good governance and incentives in favor of legal economic activities. This requires a broad-based governance building and development effort over many years. There are no short cuts. If opium poppy is to be eliminated, even in a small geographical area, a long-term and multi-sectoral effort is required to foster the needed governance and security conditions, and to put in place the critical mass of infrastructure, markets and services that can create a sustainable licit economic growth dynamic. Much is already happening and very large investments are being made, but the dividend will be in the medium to long term, and will be reaped through consistent approaches, persistence in the face of short-term setbacks, and massive, coordinated and sustained investments. This provides a daunting challenge for the Government as well as its donor partners.

63. Financing should be directed not only to new initiatives but also to scaling up and improving many excellent existing programs. Chasing quick fixes in the hope of rapid reduction of opium production creates illusions and undermines long-term impacts. A strong institutional framework needs to be built, based on the promising community institutions already set up. Planning and investments should be guided by empirical evidence: successful National Priority Programmes like NSP, NRAP and MISFA need to be backed, and innovations piloted and tested exhaustively. The government's thoughtful and sound counter-narcotics strategy needs to be mainstreamed in development policies and

programmes. And above all, partnership and integration need to become universal practice, under strengthened Afghan leadership.

## SUMMARY OF RECOMMENDATIONS

### I. Six priority intervention sets

Cost	Government Actions	Partner Actions	Impacts and Security
<b><i>1. An “Integrated Programme” for rural development and governance (8.2.1)</i></b>			
Study (2008): <b>\$500,000</b>  Investment (2009-2011): <b>\$180m</b>	<ul style="list-style-type: none"> <li>▪ Consolidate evaluations of ongoing programmes and prepare an Integrated Programme for scaling up and replication nationwide, with an initial three year investment phase 2009-2011 (3.3.1)</li> <li>▪ Strengthen CDCs as focal points for development (6.3.4, 6.4.2)</li> <li>▪ Strengthen provincial and local planning processes (6.4.2)</li> <li>▪ Implement contract arrangements for service delivery with facilitating partners: NGOs, farmer organizations, CDCs etc. (3.4.1)</li> <li>▪ Strengthen agricultural policy, planning and programme oversight, and strengthen MAIL/MRRD collaboration (3.4.3)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Harmonization and alignment within MRRD/MAIL strategies, ARTF and government budget (3.4.2)</li> <li>▪ Support and capacity building for MAIL. (3.4.3)</li> <li>▪ Finance investment of the Integrated Programme through ARTF and government budget (7.2)</li> </ul>	High potential impact, especially on those most dependent on opium (Types 2-4) /a Sensitive to insecurity. Need to adopt security guidelines (7.6, Box 19)
<b><i>2. Expanding agricultural land under irrigation (8.2.2)</i></b>			
Sector review (2008): <b>\$1m</b> Ten year investment programme (2008-2017) <b>\$1.2b</b>	<ul style="list-style-type: none"> <li>▪ Carry out irrigation and agricultural water management sector review and prepare phased ten year investment programme (3.3.3)</li> <li>▪ Develop framework of cooperation MEW/MAIL (3.3.3)</li> <li>▪ Assess issues of riparian rights and transboundary water sharing agreements, and initiate dialogue where needed (3.3.3)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Participate in sector review and preparation of investment programme (3.3.3)</li> <li>▪ Help finance investment programme through ARTF &amp; gov't budget (7.2)</li> </ul>	High potential impact on all dependent farmers (especially Types 2 and 3) Moderately sensitive to insecurity.
<b><i>3. Improving returns to livestock (8.2.3)</i></b>			
Review (2008): <b>\$1m</b> Four year investment programme (2009-2012): <b>\$120m</b>	<ul style="list-style-type: none"> <li>▪ Review of dairy, poultry and opportunities for livestock value-added, and preparation of a four year investment programme (3.3.4)</li> <li>▪ Complete transition to privatized but universally accessible veterinary services (3.3.4)</li> <li>▪ Pursue reform and institutional development for MAIL (3.4.3)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Participate in sector review and preparation of investment programme (3.3.4)</li> <li>▪ Help finance investment programme through ARTF and government budget (7.2, 8.2.3)</li> </ul>	Very high impacts, especially on most dependent (Types 3 & 4) Sensitive to insecurity. Need to adopt security guidelines (7.6, Box 19)
<b><i>4. Rural enterprise development (8.2.4)</i></b>			
Preparation study (2008): <b>\$1m</b> DTIS study (2008): <b>\$500,000</b>  Ten year programme (2009-2018) <b>\$550m</b> Initial three year phase (2009-2011): <b>\$200m</b>	<ul style="list-style-type: none"> <li>▪ MRRD and MAIL to develop the proposal jointly, with support from concerned national agencies and donors (4.3.1)</li> <li>▪ Include USAID and MISFA as principal partners (4.3.1)</li> <li>▪ Introduce measures to improve the business environment, including: (i) access by Afghan trucks to neighbouring countries (3.4.1); (ii) pool financing and streamline and align incentives, subsidies and current business development services (4.4.1); (iii) scale up Industrial Parks in response to business demand (4.4.2); (iv) improve setting and supporting of export standards (4.4.2); (v) strengthen the Customs Service (4.4.2); (vi) DTIS study of trade policy with an import substitution and counter-narcotics lens (4.4.2) and (vii) support development of representative business and civil society organizations (4.4.3)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Close and constructive support to preparation (4.3.1)</li> <li>▪ Help finance investment programme through ARTF (7.2, 8.2.4)</li> </ul>	Very high potential impacts, and good employment potential benefiting the highly dependent (Types 3 and 4)  Moderately sensitive to insecurity

/a See Section 2.3. Type 1 (better off) farmers are not dependent on opium; Type 2 (marginal) farmers are dependent on opium; Type 3 (poor remote) farmers are more dependent and Type 4 (landless labourers) are highly dependent on opium.

Cost	Government actions	Partner actions	Impacts and security
<b>5. Local procurement (8.2.5)</b>			
Support to PDT (2008-9): <b>\$2m</b>	<ul style="list-style-type: none"> <li>Require compliance and accountability of signatories of Afghanistan Compact to increase proportion of local procurement and of local labour content of construction (4.3.1)</li> </ul>	<ul style="list-style-type: none"> <li>Set local procurement targets, to reach (say) 50% by 2009, prepare feasibility studies, make institutional preparations (4.3.1)</li> <li>Scale up and finance PDT (4.3.1)</li> </ul>	High potential impacts for all Types of farmers. Sensitive to security risks Adapt procurement measures to security & food safety requirements
<b>6. An integrated production and market development crop for suitable crops such as cotton, initially targeted at Helmand (8.2.6)</b>			
Sector review and pre-feasibility study (2008): <b>\$500,000</b> Investments: <b>tbd</b>	<ul style="list-style-type: none"> <li>Carry out sector review and pre-feasibility study, including of public/private partnership and contract farming options (3.3.2) and of applicability to Helmand (7.7)</li> </ul>	<ul style="list-style-type: none"> <li>Support sector review and pre-feasibility study, and help finance resulting proposals (8.2.6)</li> </ul>	High potential impact on Types 1 and 2, potential employment for 3 and 4 Sensitive to insecurity, develop security guidelines

## II. Adding value to key ongoing National Priority Programmes

Cost	Government actions	Partner actions	Impacts and security
<b>1. NRAP and rural access (8.3.1)</b>			
Seven year investment programme (2008-14): <b>\$400m</b>  Financing gap: <b>\$288m</b>	<ul style="list-style-type: none"> <li>Develop rural roads policy and investment planning mechanism</li> <li>Strengthen coordination amongst providers, with beneficiaries</li> <li>Define institutional responsibilities at all levels</li> <li>Develop a capacity building programme</li> <li>Prepare new, low cost standards for rural road construction</li> <li>Design and implement strategy for road maintenance</li> <li>Adopt low cost and labour-intensive technologies</li> <li>Set up a simple M&amp;E system to collect economic data (5.4.1)</li> </ul>	<ul style="list-style-type: none"> <li>Finance investment through ARTF and government budget (7.2, 8.3.1)</li> </ul>	Very high impact on rural economy, including Types 3 and 4 in remote areas  Sensitive to insecurity. Need to adopt security guidelines (7.6, Box 19)
<b>2. NSP and community development (8.3.2)</b>			
Phase II of NSP (2007-9): <b>\$120m</b>  Supplementary financing required (2008-9): <b>\$100m</b>	<ul style="list-style-type: none"> <li>Complete roll out of CDCs countrywide, finance block grants for consolidation of CDCs (6.3.1)</li> <li>Strengthen linkages to stable facilitating partners (6.3.2)</li> <li>Assess possible continuation and scaling up of NABDP, DDAs (6.3.3)</li> <li>Mainstream counter narcotics in district, provincial planning (6.3.3)</li> <li>Strengthen CDCs as focal points for development (6.3.4, 6.4.2)</li> </ul>	<ul style="list-style-type: none"> <li>Provide further financing through ARTF and government budget to continue the NSP programme (7.2, 8.3.2)</li> </ul>	Strong governance and rural development impacts on all Types Sensitive to insecurity. Need to adopt security guidelines (7.6, Box 19)
<b>3. MISFA and rural finance (8.3.3)</b>			
<b>Tbd</b>	<ul style="list-style-type: none"> <li>Complete process of maturation of MFIs (4.3.3)</li> <li>Develop new areas of finance for rural areas, especially innovative solutions for financing agriculture and rural enterprise (4.3.3)</li> <li>Increase rural outreach significantly (4.3.3)</li> </ul>	<ul style="list-style-type: none"> <li>Continue to provide financial and technical support as needed</li> <li>Encourage and support new areas of finance and expanding rural outreach</li> </ul>	Access to finance key driver for rural development and shifting incentives away from opium; sensitive to insecurity; adopt security guidelines
<b>4. WatSan and safe water in rural areas (8.3.4)</b>			
<b>Tbd</b>	<ul style="list-style-type: none"> <li>Develop sustainable low cost strategy for O&amp;M (5.3.2)</li> <li>Conduct water resources assessment for sustainability and expansion (5.3.2)</li> <li>Conduct study on programme planning and management, resolve current implementation problems (5.4.2)</li> </ul>	<ul style="list-style-type: none"> <li>Participate in sector review</li> <li>Continue to provide financial support</li> </ul>	Strong livelihood benefits, especially for poorest Sensitive to insecurity. Security guidelines(7.6)



### III. Recommendations on preparing further high impact activities for later implementation

#### 1. Promoting high value agriculture and labour-intensive processing (8.4.1)

- **Support high-value horticulture** with a focus on opium-vulnerable provinces that are currently under-served. MAIL and MRRD to work together through AREDP (3.3.2).
- **Support fruits and nuts processing and export sector** all along value chain, with actions on the policy and institutional constraints before further major investments (3.3.2).
- **Evaluate value chain approach** linking producers, processors and export markets in preparation for the AREDP programme (3.3.2).
- **Support market development & agricultural export promotion:** AREDP to develop plan, identify investment opportunities, help build commodity export associations (3.3.2).
- **Expand industrial crops and agro-processing:** Sector studies of prospects for oil seed development should be carried out and investment pursued under AREDP (3.3.2).
- **Promote contract growing:** A detailed study of experience and opportunities, and conclusions implemented with investment support under AREDP (3.3.2).

#### 2. Rural employment and adding value to labour (8.4.2)

- **Promote skills development:** A demand-driven vocational training programme to be developed and financed (4.3.2).
- **Support flexible migration:** A study to identify entry points to higher value and more humane migration, and to develop a road-map for this (4.3.2).

#### 3. Rural electrification (8.4.3)

- Prepare a **national policy framework**, covering ways to facilitate private investment, subsidy policy, and institutional options for larger projects (5.4.3).
- Set up a **centralized agency for facilitating rural electricity access**, and **increase financial support** (5.4.3).

### IV. Key cross cutting policy and institutional issues for dialogue (8.5)

**Increase Afghan ownership and leadership:** All programmes should be within an Afghan government strategy, accountable to government. Improvements in the quality of Afghan leadership should be treated as a priority. Unremitting capacity building efforts (7.1).

**Enhance aid effectiveness:** Government and partners to finance National Priority Programmes and channel aid flows through the national budget. Capacity strengthening for government to steer NPPs and manage budget flows efficiently. Joint programming – rather than just “coordination – should be the rule (7.2).

**Move from vision to action on mainstreaming:** Counter-narcotics mainstreaming guidelines should be adopted and applied systematically (7.3).

**Pursue long-term commitment rather than short-term expediency:** Political expectations for rapid change do not match the 1-2 decades needed before the opium economy dwindles. Counter-narcotics requires combination of economic development, provision of social services, better governance and the rule of law. This requires strong near-term actions but will take considerable time, vision and sustained commitment and resources (7.4).

### V. Taking account of insecurity, including in Helmand (7.6, 7.7, Box 19)

#### Suggestions to deal with the insecurity situation in general

- Work through decentralized planning and programming mechanisms, ensuring local administration and local people are aware and on board.
- Select only villages that are willing to sign a cooperation agreement and to give a community security guarantee.
- Maximize local ownership and community engagement, working with community institutions (CDCs etc.), local contracting, labour intensive works etc.
- Remove all “foreign badging” – or perhaps even government badging when necessary on security grounds, and be thoroughly Afghan in the field.
- Use local implementing partners and locally recruited staff, preferably from the communities themselves.
- Give priority to relevance: the project has to be at the top of the local community’s priorities, and provide a stake in stability, security and good governance.
- Use decentralized and participatory monitoring and evaluation approaches.

#### Additionally for Helmand, building on the current valiant, thoughtful and well managed development effort

- Invest heavily in the enclave in and around Lashkagar to create a “development pole” impact, including promoting the business park model.
- Finance agro-industrial investments such as cotton, working with farmer groups through negotiated contracts that pay guaranteed market prices.
- Push hard on the local participatory agenda, including cooperation agreements and community security guarantees and working both at NSP/CDC and (as in Kandahar) NABDP/DDA levels. Support District Development Fund to finance labour intensive public works at adequate wage rates. Strengthen linkages between CDCs/DDAs and strong facilitating partners.
- Expand NRAP’s rural road coverage in areas vulnerable to poppy but where security is still manageable: Nad e Ali, Nawa Barakzai and Lashkargah.
- Implement programmes as far as possible through NGOs without government badging, and with locally recruited staff.
- Promote massive investment in human capital through a positive action educational programme, including in institutions outside of the province.

## CHAPTER 1: THE POLICY CONTEXT

1.1 *Since the fall of the Taliban in 2001, Afghanistan has made real progress in re-establishing political institutions and pushing ahead on economic reform.* A new Constitution has been adopted, nationwide elections have been held to select both a President and a Parliament, and there are moves toward establishing more effective forms of sub-national government.

1.2 *Economic growth has been high at an average of over 10% per year.* Although data on the Afghan economy are weak, overall economic growth has been at double-digit rates. Private investment has risen sharply from an estimated US\$ 22 million in 2003 to over US\$ 400 million in 2006. Gross Domestic Product is estimated to have risen by 47% between 2004 and 2006 and government fiscal revenue increased by 85% (DFID 2007). The Government of Afghanistan (GoA) estimates that sustained real growth rate of licit GDP of 9% per year is required to provide tangible improvements to the country's population while compensating for the contraction caused by the progressive phasing out of narcotics (Islamic Republic of Afghanistan 2007a: 9). Priority investments for growth are high-value agriculture, the productive use of state assets, mining and extractive industries, and regional cooperation and transit trade in energy and goods.

1.3 *However, structural conditions for sustainable growth are largely absent.* The challenge is significant. Afghanistan remains one of the poorest countries in the world. Per capita GDP is estimated at only \$325 and social indicators are some of the worst in the world. And whilst economic growth rates are high, approximately 80-90% of economic activity is estimated to be informal (World Bank 2005a: 5), human capital is poorly developed, and the bulk of investment and development activity as well as a large portion of recurrent expenditures are still financed through international aid. Corruption is considered endemic, and Afghanistan is currently ranked 172 out of 180 countries included in Transparency International's corruption perceptions index.

1.4 *Insecurity is on the rise and represents a major impediment to development.* Growing insecurity is perhaps the biggest constraint on reconstruction and development efforts. Government officials estimate that 35% of the country is currently inaccessible due to deterioration in the security situation.<sup>1</sup> And whilst the security situation is at its most acute in the southern provinces, particularly Kandahar, Helmand and Uruzgan, development agencies are finding it increasingly difficult to operate in a range of provinces, including among others Balkh, Badakhshan, Wardak and Logar.

1.5 *Ominously, the links and synergies between opium poppy and insecurity are becoming increasingly apparent.* Estimates suggest that the size of the opium economy is significant at approximately 30% of licit GDP, and opium is thus Afghanistan's leading economic activity. UNODC's recent Opium Poppy Survey for Afghanistan reports that cultivation is becoming increasingly concentrated in the insecure south and east of the country whilst declining in the relatively more stable north (UNODC 2007: i). ***There should be no illusions about the prospects for quick success against opium, particularly if conflict and insecurity continue in many parts of the country.***

1.6 *Clearly, security, application of the rule of law, better governance, and political leadership, as well as sustained international support, will play a critical role in reducing opium production over time.* In this regard, there is a strong case for interdiction actions against larger and medium-sized drug traders as well as opium processing laboratories, and for removal of figures associated with the drug industry from positions in government (see, for example, Ward and Byrd 2004, and Byrd and Buddenberg, 2006). Eradication (destruction of poppy while it is growing in the fields) is a blunt instrument that must be used cautiously and judiciously, and aerial spraying – which is currently

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<sup>1</sup> Personal communication with senior government official, 3 September 2007

being advocated in some quarters – would be counterproductive as it would further alienate the rural population, increase the gap between Afghans and their government, likely stimulate popular support for anti-government interests, and further worsen insecurity (Mansfield and Pain 2007).

1.7 *But without changing economic incentives and expanding opportunities for rural households currently dependent on the opium economy, real progress against the drug industry will continue to be elusive.* If the underlying economic incentives and (in many parts of the country) lack of other opportunities for the rural population are not addressed, any short-term gains against the opium economy will prove ephemeral. This has been demonstrated by experience in Afghanistan and elsewhere (Commission for Narcotics Drugs 2005; GTZ 2005; Mansfield and Pain 2006, 2007). Thus even though it is by no means the whole picture, the economic development side is an essential component and prerequisite for sustained success against drugs in Afghanistan. As emphasized in the Government of Afghanistan's National Drug Control Strategy (NDCS, see 2.2 below), it is only through a holistic approach that encompasses all of the components of the strategy that the country will escape from its dependence on opium.

1.8 *This report is about how to progressively reduce over time Afghanistan's dependence on opium through development initiatives and by shifting economic incentives toward sustainable legal livelihoods.* These changes will form an essential component of the broader counter-narcotics strategy, the other elements of which are not covered in detail in this report.

1.9 *More specifically, the report identifies additional investments and policy and institutional measures to support the development responses that can counterbalance the economic advantages of opium.* It is the purpose of this report to analyse ways to change the relative incentives between licit and illicit cropping and to improve rural livelihoods for the poor, under better governance and security conditions. The report puts forward concrete recommendations in this regard, and the expected impacts on growth, poverty reduction and the opium economy are assessed.

1.10 The rest of this report first provides an overview of the opium economy (Chapter 2), focusing on how different segments of the rural population interact with it. The report then analyses the scope for increasing value added, competitiveness and productivity in agriculture (Chapter 3) and for promoting enterprise development and off-farm employment (Chapter 4). The complementary role of further investments in rural infrastructure is examined in Chapter 5, and measures for strengthening governance are analysed in Chapter 6. In Chapter 7 issues that cut across all counter narcotics efforts are examined. A final chapter looks at implementation, and at issues of prioritization, synergies and phasing (Chapter 8).

## CHAPTER 2: THE OPIUM ECONOMY

### 2.1 THE SCALE AND NATURE OF THE PROBLEM

2.1 *Afghanistan is far and away the world's largest producer of illicit opium.* To many, Afghanistan has become synonymous with opium production. The United Nations Office for Drugs and Crime (UNODC) has estimated that 193,000 hectares of opium poppy were cultivated in Afghanistan during the 2006/07 growing season. This represented a 17% increase over the 2005/6 area of 165,000 ha and an almost doubling in total area devoted to cultivation of the crop since 2004, when there was an estimated 104,000 ha of opium poppy grown in Afghanistan.

2.2 *Production is increasingly concentrated in five southern provinces and has been declining elsewhere.* The disaggregated data show a growing concentration of opium poppy cultivation in the southern provinces of Helmand, Kandahar, Uruzgan, Dai Kundi and Zabul. These five provinces alone accounted for 69% of total cultivation in 2007, up from 61% in 2006. This contrasts markedly with a fall in the level of cultivation in the northern, northeastern and central provinces in 2007, most notably in the province of Balkh where cultivation is estimated to have fallen from 7,232 ha in 2006 to zero in 2007. Badakhshan province, which has been a major producer since 2001, also saw significant reductions in the amount of land allocated to opium poppy. Given the temporary nature of such dramatic reductions in cultivation in the past, for example in the province of Helmand in 2003 and in Nangarhar in 2005 and 2006, the sustainability of these current low levels of cultivation in the north remains a major question.

2.3 *The opium economy thrives in remote or insecure areas where markets for other crops are lacking.* The coincidence of growing insecurity in the southern region and increasing levels of opium poppy cultivation highlights the fact that opium poppy is a low-risk crop in a high-risk environment. It can generate relatively high revenues for farmers, but its main attraction lies in the fact that the market for opium functions in remote areas with limited physical infrastructure and where insecurity often prevails. Traders make cash advances and purchase at the farm gate. They pay the transport costs, they pay the bribes to those manning the checkpoints, and they take the physical risk of travel in insecure areas. This favourable market access for farmers does not exist for other agricultural crops in Afghanistan.

2.4 *Generally, opium is at its most concentrated in conditions of insecurity and where rural people cannot otherwise earn a decent livelihood.* The return of widespread cultivation across many districts of Nangarhar and the growing insecurity in the province highlight the links between insecurity, lack of alternative livelihoods and opium production. Reductions in cultivation have not been sustainable where security and viable legal livelihood alternatives are not in place.

### 2.2 THE CURRENT COUNTER NARCOTICS STRATEGY

2.5 *Afghanistan's counter-narcotics strategy is to improve the rule of law, to strengthen and diversify legal livelihoods, and to improve governance.* The Afghanistan National Drugs Control Strategy (NDCS) was written in May 2003 and subsequently updated in January 2006. The overall goal of the NDCS is to achieve a sustained and significant reduction in the production and trafficking of narcotics with a view to complete elimination. The strategy has four priorities:

- Disrupting the drugs trade by targeting traffickers and their backers
- Strengthening and diversifying legal rural livelihoods
- Reducing the demand for illicit drugs and providing treatment for drug users
- Strengthening state institutions both at the centre and in the provinces

2.6 *Counter-narcotics is thus linked to the wider process of rebuilding the Afghan state, and needs to be integrated into national development planning and programmes.* Under the NDCS, the Ministry of Counter Narcotics coordinates (and monitors) development efforts of the line ministries responsible for delivering both development and drug control outcomes in the provinces. The NDCS is based on the experience of other illicit drug producing countries and recognizes that no single project or programme can address the multiple factors that have led to the expansion of opium poppy cultivation in the country. The NDCS approach is that tackling the drugs issue cannot be isolated from the wider state building process and that the counter narcotics issue has to be integrated into national development planning. Counter narcotics has, therefore, been made a cross cutting issue under the Interim Afghanistan National Development Strategy (I-ANDS), and the NDCS calls for counter narcotics policy to be “mainstreamed” in both national and provincial plans and strategies. The targets in the NDCS are also enshrined within the Afghanistan Compact.

2.7 *If adequate means of livelihood are not available, eradication will undermine the goals of state building and development.* The challenge is thus clearly a long-term one. The NDCS recognizes that without economic alternatives in place a sudden reduction in illicit drug crop cultivation is likely to have negative repercussions on governance, security and economic growth. It therefore calls for interventions to be appropriately phased and sequenced so as to initiate the transition from illicit to licit livelihoods in different areas without undermining the overall goal of a prosperous and stable Afghanistan. The NDCS position is that the standing opium crop should only be eradicated in those areas where there are viable legal alternatives to opium poppy. Thus the NDCS recognizes that the transition to licit livelihoods takes time and that there is a need to maintain a balance between drug control and wider development objectives. This understanding of the sequencing of eradication and development outcomes is founded on a review of international experience (Foreign and Commonwealth Office 2003). For example, the *Thematic Evaluation of Alternative Development* undertaken in 2005 for the Commission for Narcotics Drugs in Vienna concluded that “the eradication of illicit crops on peasant farms lacking viable alternatives undermines development” (Commission for Narcotics Drugs 2005: 12/13).

2.8 *Where rural people have livelihood choices, eradication can increase incentives to reduce poppy cultivation. If choices are not available, eradication will pauperize the population and damage their frail ties to the state.* Field evidence from Afghanistan demonstrates that for households with diverse livelihood opportunities and which are not dependent on opium production, eradication or the threat of it, combined with the establishment of the necessary governance and security conditions needed for longer-term economic growth, can raise the opportunity cost of opium poppy cultivation and facilitate its abandonment. However, in areas where opium poppy cultivation is most concentrated and where legal livelihoods are limited, there are simply no alternatives, and eradication can only further marginalize already vulnerable socio-economic groups, resulting in pauperization, migration, and damage to the nascent relationship between citizen and state.<sup>2</sup>

### **2.3 THE ROLE OF OPIUM POPPY IN RURAL LIVELIHOOD STRATEGIES**

2.9 *Opium is a high-value crop well adapted to Afghan conditions, with a strong impact on rural incomes and employment.* In Afghanistan’s current economic and political climate there are distinct advantages to cultivating opium poppy. Opium is a high-value, low-weight commodity for which there is steady demand. Opium poppy is so well suited to Afghanistan’s climatic conditions that it produces yields of opium and morphine that are higher than the global average. As a crop, opium maximizes returns on scarce irrigation water. Opium has brought very substantial economic opportunities to both farmers and laborers, and has increased the overall level of activity in the rural economy through the multiplier effect the opium trade has on the wider economy. The total farm gate value of the opium crop in 2007 is estimated at \$1 billion (UNODC 2007: i). There are sufficient

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<sup>2</sup> See Mansfield 2006b, 2006c; Mansfield and Pain 2006.

returns at each stage of the supply chain and, despite Afghanistan's fractured infrastructure, there are well-linked markets in terms of credit, purchase, transport and processing. Some estimates suggest that as many as 5.6 jobs are created in the rural non-farm economy for every hectare of opium poppy cultivated (Mellor 2005).

2.10 *The benefits of opium are very different between large landowners and the poor.* It is critical to recognize, however, that the economic advantages associated with cultivating opium poppy differ according to the assets that farmers have at their disposal. There is a considerable difference between the factors that drive a large landowner with 20 hectares of land, 24 family members, some of whom are sending remittances from Pakistan, two tractors, and a general store in the local bazaar, to cultivate four hectares of opium poppy, and the factors impelling a sharecropper, with 12 family members, solely dependent on the income derived from agriculture, to cultivate only a half of a hectare of opium poppy on the landlord's land (giving the bulk of the final crop to the landowner as a payment for working on his land and for the credit advanced early in the year). For the relatively few large landowners, opium poppy represents a high-value crop that can accrue even greater value if it is sold after the harvest season when prices rise. Landowners who contract out land to sharecroppers can earn as much as two thirds of the final opium yield (despite contributing only 20 percent of the total costs of production). They may also have the financial resources to purchase opium in advance at rates considerably below the harvest price (Mellor 2005). Returns to a landlord can be as much as 1,400% higher than those of a sharecropper (Mansfield 2002; Mansfield 2004b ; Mansfield 2007c).

2.11 *Nonetheless, opium is often poor people's only means of access to credit and land.* The traditional credit system, known as *salaam*, which provides an advance payment on a future crop, has increasingly favoured opium poppy cultivation over other crops. In areas where opium poppy cultivation has become entrenched, access to credit is dependent on a farmer's willingness to cultivate opium poppy. The willingness to cultivate opium poppy and possession of the requisite skills have increasingly determined sharecroppers' access to land, and the rental value of land is determined by potential opium yield rather than wheat productivity. Under such conditions there is no other crop or activity that can provide the same range of benefits, and when cultivation declines or is suppressed, the opportunities for income from farming plummet, driving people off the land, or forcing them further into poverty (Mansfield 2006c).

2.12 *Opium is also an invaluable source of employment for the rural poor.* Opium poppy cultivation creates a large demand for itinerant labour to weed and harvest the crop. Based on UNODC's estimate that 193,000 hectares of opium poppy were cultivated in the 2006/07 growing season, the crop would have generated approximately 70 million labour days, of which potentially one-third would have been for hired labour (Mansfield 2004a). Where a household has more than one male able to follow the staggered weeding and harvesting seasons, the off-farm income generated from opium poppy can last up to five months, and it is usually higher than the on-farm income such a household might earn through sharecropping.

2.13 *Thus rural people have varying degrees of dependence on opium, and responses need to recognize degrees of dependence and of poverty.* Rural people's dependence on the opium economy is largely a function of their factor endowment and access to markets. A broad distinction can be made (Mansfield and Ward 2006: 3) between: (i) better off and not dependent farmers; (ii) more marginal dependent farmers; (iii) poor, highly dependent farmers; and (iv) the landless (see Table 1). As a general rule, **better off farmers (Type 1)** have more diversified livelihood strategies. They reside in areas in close proximity to provincial or district centers, they cultivate a variety of crops including high-value horticulture, and they have better access to land and irrigation, and to the commodity and labour markets. They are not dependent on opium for a decent living and could be considered to be "opportunistic producers", for whom application of the law is the primary instrument of drug control. **More marginal farmers (Type 2)** have less access to markets and lower land and water endowments. They have fewer or no alternative sources of income to opium. **Poor, highly dependent farmers (Type 3)** may live in low potential areas, often remote and mountainous, and with very limited market

access or alternative income earning potential. In addition, there are the *landless (Type 4)*, typically labourers with very few farming assets such as a few head of small livestock, who can be very dependent on opium. When the opium economy shrank in Nangarhar in 2005, labourers lost \$1,000 in wages, and turnover of businesses and shops halved. More marginal farmers and labourers can be considered to a greater or lesser extent dependent on opium for their livelihoods. Although this rough typology needs to be treated with great care as poppy cultivation is very dependent on local factors, it does serve to identify the target population for development responses to the opium economy: the more marginal, poor farmers and labourers either engaged in the opium economy or vulnerable to the incentives it presents.<sup>3</sup>

**Table 1: Typology of Opium Producing Areas and Farmers within Them**

	<b>Type 1 Not Dependent</b>	<b>Type 2 Dependent</b>	<b>Type 3 Highly Dependent</b>
<b>Access to markets/services/ Governance</b>	<ul style="list-style-type: none"> <li>Close to district and provincial centers</li> <li>Government can impose will with minimum reaction</li> </ul>	<ul style="list-style-type: none"> <li>Accessible but limited physical infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>Remote</li> <li>Government presence and service delivery limited</li> <li>Government cannot impose will beyond district centre</li> </ul>
<b>Land cultivated (winter+summer)</b>	<ul style="list-style-type: none"> <li>Larger cultivable land (&gt;15 jeribs)</li> </ul>	<ul style="list-style-type: none"> <li>Medium sized (&gt;7.5 &lt;15 jeribs)</li> </ul>	<ul style="list-style-type: none"> <li>Small cultivable &lt;7.5 jeribs)</li> </ul>
<b>Irrigation</b>	<ul style="list-style-type: none"> <li>Canal or main river</li> </ul>	<ul style="list-style-type: none"> <li>Canal and river but also karez and mountain spring</li> </ul>	<ul style="list-style-type: none"> <li>Karez and mountain spring,</li> </ul>
<b>Land Tenure</b>	<ul style="list-style-type: none"> <li>Landlord</li> <li>Owner cultivator</li> </ul>	<ul style="list-style-type: none"> <li>Owner cultivator</li> <li>Tenant</li> </ul>	<ul style="list-style-type: none"> <li>Owner cultivator</li> <li>Sharecropper</li> </ul>
<b>No. of Crops</b>	<ul style="list-style-type: none"> <li>Double Crop</li> </ul>	<ul style="list-style-type: none"> <li>Double crop, limited in summer</li> </ul>	<ul style="list-style-type: none"> <li>Single Crop</li> </ul>
<b>Cropping</b>	<ul style="list-style-type: none"> <li>Diversified</li> <li>Poppy 30%-50%.</li> <li>Wheat</li> <li>Vegetable for sale</li> <li>Fruits/nuts for sale</li> </ul>	<ul style="list-style-type: none"> <li>Poppy 50%+</li> <li>Wheat</li> <li>Vegetables –some for sale</li> <li>Fruits/nuts –some for sale</li> </ul>	<ul style="list-style-type: none"> <li>Poppy 70%+ Wheat 20-30% vegetable solely for consumption</li> </ul>
<b>Population density</b>	<ul style="list-style-type: none"> <li>1 –1.5 per jerib</li> </ul>	<ul style="list-style-type: none"> <li>2 –3 per jerib</li> </ul>	<ul style="list-style-type: none"> <li>3.5 to 5 per jerib</li> </ul>
<b>Livestock</b>	<ul style="list-style-type: none"> <li>Sale of dairy products and cattle</li> </ul>	<ul style="list-style-type: none"> <li>Some sale of dairy products</li> </ul>	<ul style="list-style-type: none"> <li>Goats/sheep</li> <li>Dairy cow for milk products for household</li> </ul>
<b>Off farm</b>	<ul style="list-style-type: none"> <li>Limited</li> </ul>	<ul style="list-style-type: none"> <li>Daily wage labour – poppy during harvest</li> </ul>	<ul style="list-style-type: none"> <li>Daily wage labour - mainly poppy throughout season</li> </ul>
<b>Non Farm</b>	<ul style="list-style-type: none"> <li>Salaried (NGO, Govt), trade, transport</li> </ul>	<ul style="list-style-type: none"> <li>Construction</li> <li>Semi Skilled</li> </ul>	<ul style="list-style-type: none"> <li>Limited</li> </ul>
<b>Credit</b>	<ul style="list-style-type: none"> <li>Little debt</li> <li>Various sources of credit, gives loans</li> </ul>	<ul style="list-style-type: none"> <li>Some accumulated debts</li> <li>Variety of sources</li> </ul>	<ul style="list-style-type: none"> <li>Accumulate debts significant</li> <li>Opium only source of loans</li> </ul>
<b>Opium Sales</b>	<ul style="list-style-type: none"> <li>Some time after harvest</li> </ul>	<ul style="list-style-type: none"> <li>Pre harvest, some surplus</li> </ul>	<ul style="list-style-type: none"> <li>Pre harvest</li> </ul>

2.14 *The lesson is that alternatives to opium have to address the problems of the marginal and vulnerable by supporting their access to land, credit, food security, employment – at least in adequate measure to provide a minimum livelihood.* Given the different roles that opium poppy plays in household livelihood strategies, replacing only one of these, such as access to income, credit or food security, with a licit alternative will not be sufficient to eliminate opium poppy on a sustainable basis. Table 2 shows the multiple advantages of the opium economy and the types of development responses needed to provide poor and vulnerable rural people with credible alternatives to opium. The development responses are essentially those that will rebuild the rural economy on a profitable and sustainable basis, including the provision of infrastructure, notably irrigation and roads, support to improved value added in farming and livestock, the promotion of high-value agricultural crops, the development of agro-processing and non-farm income opportunities, and the provision of finance.

2.15 *The challenge requires a broad-based governance building and development effort over many years.* There are no short cuts. Some of the complexity of the incentives that may draw rural people into the licit economy – or keep them in the opium business – can be seen from the recent study of localized reductions in opium production in Badakhshan (see Box 1). If opium poppy is to be

<sup>3</sup> See Mansfield 2004a: 10, 2006a: 10, 40; Maletta 2004.

eliminated sustainably, even over a small geographic area, a broad-based and multi-sectoral effort is required over a number of years to create the needed governance and security conditions, and to put in place the critical mass of infrastructure, markets and services that can create a veritable growth dynamic. Much is already happening, and very large investments are being made, but these have been fragmented and not within a programmatic approach and not with a counter-narcotics lens. The dividend will be reaped in the *medium to long term*, and will require *consistent approaches, persistence* in the face of short term setbacks, and *massive, coordinated and continuous investment*. This provides a daunting challenge for the government and its partners.

**Box 1: Changing Incentives Led to Localized Reduction of Opium Production in Badakhshan**

In 2006, opium production declined in some areas of Badakhshan but persisted in others. Why? *In areas close to urban centres, there has been a move away from opium.* In central Barak, near to population centres, markets for high-value agricultural produce have improved, livestock prices have revived, and wage labour rates have gone up. Many farmers have moved out of opium.

*Higher returns and greater security of income in licit activities drove this shift.* Essentially, the combination of high-value cash crops with higher livestock prices and the growth of the labour market with attractive wages meant that farmers could get higher returns than if they grew opium. They could also achieve greater security of income, given the risks of opium cultivation.

*Essentially, the growth of markets for licit produce changed the economics.* There were several contingent and highly localized factors that aided this shift. First, the high labour demand of opium was a key factor, as the local opportunity cost of labour rose. Second, traders for alternative crops offered similar financing and marketing arrangements to opium to reduce market risk. Third, past engagement with opium has allowed farmers to restock herds, which paid off with the revival of the livestock economy. The increase in herds has led to an increase in demand for fodder crops and wheat (for the straw), thereby further displacing opium poppy. Dairy production also proved profitable.

*The provision of public goods and services also helped.* The economic incentives described above combined with improved availability of public goods and services and increased physical security. Taken together, these incentives encouraged farmers to switch out of opium, and the switch may well be permanent if these conditions are consolidated.

*In remoter areas of the province, farmers continued to grow opium.* In remoter areas of Barak and Jurm, many farmers continued to grow opium. Essentially these are poor mountain economies with very small farms and scarce water. Cash cropping is limited. Poor roads and transport prevent a shift to high-value horticultural production. In this area, the classic drivers keep poor farmers in the opium economy.

*Sources: Mansfield 2007a: I, 23; 2006a: 13,14*



**Table 2: Development Responses to Counterbalance Opium’s Advantages for the Rural Economy**

Asset	Advantages of the Opium Economy	Development Responses
<b>Land</b>	<ul style="list-style-type: none"> <li>• Preferential access to land for sharecroppers with experience of poppy cultivation</li> <li>• Only poppy can pay the high land rents: in areas where poppy is concentrated the rentable value of land is inflated to such a degree that farmers cultivating legal crops would not be able to meet their rent</li> <li>• High returns per unit of land, preferred crop for those with limited land holdings.</li> </ul>	<ul style="list-style-type: none"> <li>• Increase agricultural land under irrigation (winter and summer seasons)</li> <li>• Promote high-value horticulture and cottage level agro-processing to provide value added</li> <li>• Increase income from livestock and by-products</li> <li>• Develop non-farm income opportunities, for example through skills development and development of market linkages</li> </ul>
<b>Water</b>	<ul style="list-style-type: none"> <li>• High return per unit of water, poppy particularly attractive in single crop areas</li> <li>• One of few crops to meet capital and recurrent costs of tubewells</li> </ul>	<ul style="list-style-type: none"> <li>• Increase agricultural land under irrigation (summer and winter)</li> <li>• Integrated approach to improving value added in farming through water efficient techniques/technologies and high value added production packages</li> </ul>
<b>Credit</b>	<ul style="list-style-type: none"> <li>• Advance payment on future crop facilitates purchase of agricultural inputs</li> <li>• Those that cultivate opium poppy, particularly the resource poor, are considered “creditworthy”. They can access credit, including consumption credit, and are able to repay both seasonal and outstanding loans</li> </ul>	<ul style="list-style-type: none"> <li>• Advance payments on other crops (orchards, onions, cumin) sometimes available, promote market linkages</li> <li>• Contract growing, including provision of agricultural inputs</li> <li>• Improve credit opportunities for consumption and investment through MISFA</li> </ul>
<b>Labor</b>	<ul style="list-style-type: none"> <li>• Labor-intensive crop, significant labour opportunities created during weeding and harvesting periods</li> <li>• Maximizes utilization of unremunerated family labour, including women</li> <li>• Sharecroppers receive greater share of final crop when they cultivate opium than they do for legal crops</li> <li>• Food provided for those harvesting opium poppy</li> </ul>	<ul style="list-style-type: none"> <li>• Develop labor- intensive agro processing opportunities such as in dried fruits</li> <li>• Raise opportunity cost of family labor by expanding potential income earning opportunities for women, including livestock, poultry, dairy, agro processing, etc</li> <li>• Develop non-farm income opportunities</li> <li>• Cash For Work during periods of peak labor demand in areas where strong law enforcement against cultivation is occurring</li> <li>• Improve access to agricultural inputs for sharecroppers to allow greater share of larger final yield of legal crops</li> </ul>

## 2.4 REDUCING OPIUM PRODUCTION: WHAT CAN BE ACHIEVED OVER WHAT TIME FRAME

2.16 *Opium poppy cultivating households are diverse and dynamic, and their decision as to how much land to dedicate to opium is influenced by a range of different factors – not just price.* Policies and programmes that treat opium poppy farmers as homogenous will not only be ineffective, they could prove counter productive. It is necessary to work with the diversity that exists amongst opium poppy cultivators. Understanding the contribution of the different socio-economic groups involved in opium poppy cultivation and the multiple benefits (for example social, economic and political) they derive from their involvement in the opium economy are critical to identifying the entry points for developing effective strategies for the sustainable elimination of the crop in Afghanistan.

2.17 *Experience shows that reductions in opium poppy cultivation can be achieved in a relatively short time period in areas with good markets, decent security and a modicum of governance.* Where households are in close proximity to provincial centres, with access to both agricultural commodity and labour markets, and where the writ of the government can be maintained, reductions in opium poppy cultivation have been obtained in relatively short time periods. In these areas, there is greater diversification in cropping systems and a shift to high-value horticultural production (see Box 2). Under these conditions, vegetable traders "mimic" many of the advantages of the opium trade, offering advances, purchasing at the farm gate and absorbing transportation and transaction costs. The same pattern of trade can be seen in many of the provinces in which opium poppy is currently cultivated (Mansfield 2007b).

### Box 2: When Net Returns From Other Crops are Not So Different From Poppy

With low opium yields, falling farm-gate prices for opium and rising wage labour rates, the returns on opium poppy in two districts of Badakshan in 2006/07 began to look little more attractive than those from a range of other crops, including wheat (see Table below). Households that had sufficient labour to manage their own crop could still achieve a reasonable net return from opium when the by-products of opium poppy cultivation, such as seed for oil and the stalks for fuel are included. However, for those that needed to hire labour during the peak period of the harvest (when wage labour rates typically spike at Afs 500 per day plus food), the net returns for opium poppy were considerably less.

#### Potential Net Returns on Winter Crops in Jurm and Baharak, Badakshan (Afghanis/jerib)

	With family labour	With some hired labour
Opium poppy	29,580 (\$296)	22,580 (\$226)
Wheat (low yield)	15,520 (\$155)	
Wheat (medium. yield)	27,520 (\$275)	
Onion (improved)	33,200 (\$332)	30,200 (\$302)
Onion (local)	13,857 (\$139)	10,407 (\$104)
Potato	29,500 (\$290)	

Not only was the price of opium falling and that of labour rising, but returns from other crops were more attractive. In the case of wheat, for example, the increase in both livestock prices and the size of herds greatly increased the value of wheat straw to the extent that wheat straw brought twice the returns of wheat grain. This, combined with the low cash cost of inputs on wheat and the universal use of only family labour on the wheat crop, made wheat a competitive crop. Potato and improved onion were also competitive with opium – but not traditional onion varieties, which underlines the need for agricultural improvements in the package of counter narcotics measures.

Source: Mansfield 2007a

2.18 *Farmers in these areas can combine wage labour opportunities with high-value cash crops and livestock production.* These farmers can thus not only generate a higher return to

household resources but also obtain greater security than from cultivating opium poppy. In this scenario “security” is not only a function of the different income streams available acting as a safety net against crop or market failure, but is also a consequence of the household operating within the “rule of law” and therefore being less vulnerable to harmful interventions by both state and non-state actors. In this situation a household will also typically be a recipient of public goods such as education, health, physical infrastructure, as well as physical security, thereby improving economic opportunities and extending social contract between the state and community. Experience in other former opium poppy growing areas in countries like Thailand and Pakistan illustrate that once these gains are consolidated, farmers are unlikely to return to opium production even when farm-gate prices increase significantly.

2.19 *However, it is also clear that the pace of reduction in cultivation will not be uniform over time and location.* As discussed above (2.3), those cultivating opium poppy are not a homogenous group but differ according to both their access to assets (including governance and security) and their corresponding level of dependency on opium poppy cultivation as a means of meeting their basic needs.

2.20 *The process of moving from illicit to licit livelihoods is likely to be very different in the more remote areas where agricultural commodity and labour markets remain constrained.* Limited natural assets, such as land and water, combined with poor roads and high transportation costs, preclude the shift to high-value vegetable production. Little wage labour employment is available locally. Insecurity and poor governance stymie the growth of the legal economy. More often than not the political and financial interests of local powerbrokers reinforce high levels of dependency on opium production and prevent households from making sustainable shifts to legal economic options. Especially in such areas, attempts by local and central authorities to reduce opium poppy cultivation can be viewed negatively and seen as part of a wider attempt to reinforce their political and economic grip over the area. Counter-narcotics efforts can also impact on the legal economy, reducing disposable income and consequently sales and employment opportunities, and further weakening the relationship between the state and local communities. In more remote areas where these conditions prevail, eliminating opium poppy is likely to take a generation. This is apparent from experience in Thailand and Pakistan, among other countries.

2.21 *Development programs that offer farmers real livelihoods alternatives would need to have as many characteristics as possible that “mimic” the attractions of the opium economy for these different socio-economic groups.* Programmes should focus particularly on smaller and poorer farmers and laborers (Types 2, 3 and 4) for whom choices are very limited at present. Programmes need to avoid adopting a strategy of simply attempting to replace the relatively high level of income from opium as derived by the resource-rich (Type 1 farmers). Interventions are needed that improve the access of smaller farmers (Type 2 and 3) to those assets to which they currently have access only through their willingness to produce opium poppy. ***Improving access to credit, land and off-farm and non-farm income opportunities to the poor should be a priority.*** Table 3 lists some of the development responses that should be emphasized to address the situation of these Type 2 and 3 farmers, as well as the Type 4 landless. For those farmers who are not economically reliant on opium poppy cultivation (i.e. Type 1 farmers), greater emphasis should be given to applying social and legal pressure and establishing an enabling environment for greater private sector investment.

2.22 *Considerable thought also needs to be given to provincial and regional economies.* Areas of potential economic growth need to be prioritized rather than spreading efforts too thinly across a wide geographical areas and where the development impact is likely to be limited. It has to be recognized that there are many geographical areas in Afghanistan that are unlikely to offer viable legal alternatives to opium poppy cultivation given their location, the productive capacity of the land, and current population densities. From both a drug control and

development perspective, the proportion of development funding that should be allocated to these areas needs to be carefully considered. This is not to say that these areas or their populations should be ignored, and clearly attention and resources should be devoted to “stay in place” economic solutions and the provision of public goods, but particular effort should also be given to establishing the necessary “pull factors” in areas of higher economic potential so as to increase the legal livelihood opportunities for those moving to them from more marginal areas.

2.23 *Along with economic incentives, state building and improving governance are indispensable for opium reduction.* In creating the framework conditions for exit from opium, there is no substitute for state building and extending the presence of the state and service delivery of the state in areas where there has been little or no direct relationship between the government and rural communities for the best part of two decades, if not longer.

**Table 3: Indicative Opium Producer Profiles and Exit Routes From Opium**

Type	Typical Profile	Programmes with Counter-narcotics Impacts	Exit Route From Opium	Indicative Timeframe
<b>Better off farmers</b>	Diversified livelihood Living close to provincial or district centers Varied crops including high value horticulture Access to land and irrigation Access to commodity, credit and labour markets Not dependent on opium, “opportunistic producer”	Enabling environment for private sector investment Improvements in physical infrastructure Application of rule of law regarding both illegality of opium poppy cultivation and support of private sector investments	Exit will largely be a function of security, governance and economic growth	Short-run (roughly 1-3 years)
<b>Less affluent farmers, dependent on opium</b>	Marginal Small landholding Not food self-sufficient Some vegetables, dairy or fruits and nuts for sale Intermittent irrigation Seasonal wage labour Some accumulated debt	Integrated farming programmes High value agriculture Contract growing Irrigation Livestock development Enterprise development Credit Rural infrastructure Governance	Provided that security can be assured and local and national governance further developed, these programmes indicated should enable such farmers to quit opium	Medium-term (roughly 3-8 years)
<b>Poor highly dependent farmers</b>	Marginal Very small landholding or sharecropper Food self-sufficient for only a few months Almost no cash sales except opium Where sufficient household members, year-round wage labour	Integrated farming programmes Livestock development Micro enterprise development Labour intensive infrastructure works Vocational training Governance Investments in areas of greater economic potential	Provided security and governance are present, these programmes should over time enable such farmers to quit opium Migration to areas of greater economic potential will play a major role	Long-term (roughly 8-20 years)
<b>Landless labourers</b>	Very poor Sheep and goats Handicrafts Year round wage labour	Livestock development Micro enterprise development Labour intensive infrastructure works Vocational Training Governance Investments in areas of economic potential	Provided security and governance are present, these programmes should enable landless labourers to eventually quit opium Migration to areas of greater economic potential will play a major role	Long-term (roughly 8-20 years)

## **CHAPTER 3: INCREASING VALUE ADDED, COMPETITIVENESS AND PRODUCTIVITY IN AGRICULTURE**

3.1 The economic challenge of opium is overwhelmingly a rural one: opium is the most valuable agricultural activity, and it provides income and employment for hundreds of thousands of Afghans. As discussed in Chapter 2, opium plays a key role in the rural economy, employment and poverty reduction. Increasing value added in non-opium agriculture is thus an essential pathway to the long-term reduction of opium cropping.

3.2 This chapter first examines the characteristics of the farming economy and of Afghan farmers and looks at growth potential (Section 3.1). Subsequent sections (3.2 and 3.3) look at current development interventions in agriculture and at opportunities for further engagement that can impact on the opium economy. Constraints to further opium-reducing development in agriculture are then discussed (Section 3.4). A final section (3.5) summarizes recommendations and assesses the expected growth, poverty reduction and opium economy impacts.

### **3.1 CONTEXT AND OPPORTUNITIES FOR ENGAGEMENT**

#### **Agriculture and Poverty 3.1.1**

3.3 *Afghanistan is predominantly a rural and agricultural country.* Afghanistan is a mountainous, poor, landlocked, largely rural country, with about 85% of the population living in the countryside in scattered hamlets and villages. Agriculture accounts for up to half of GDP, but its contribution varies considerably with the weather (49% in 2002/3, but only 36% in 2004/5). Over time, there is likely to be a progressive decline in the sector's share in the economy as the industry and service sectors grow faster than agriculture. The sector currently employs about two thirds of the labour force. In 2002/3, the most recent year for which figures are available, the total work force was estimated at 7.7 million, of whom 5.2 million (68%) were in agriculture.<sup>4</sup>

3.4 *Afghan rural households are typically poor, operating at subsistence level, and food deficit.* A large proportion of Afghans – probably at least one-third – live below the poverty line, and a significant percentage have insufficient calorie intake. Most of the rural population is at risk of falling into deep poverty in the face of fluctuations and shocks – economic, security-wise, or others. The rural economy suffered badly during the years of conflict, with all the main drivers of growth – technology, roads, irrigation, education – suffering enormous deterioration. Most rural people engage in subsistence farming activities, producing wheat and owning a few head of small livestock. Households are large, averaging 11.4 members. Most farm households are not self-sufficient in food and are dependent on income from family members who work outside agriculture and often elsewhere in Afghanistan or even in neighboring countries. These characteristics apply especially to land-poor rural households.

#### **The Structure of Afghanistan's Agriculture Sector 3.1.2**

3.5 *Farming is largely a subsistence activity, and irrigation is essential to achieve good yields.* Farmland tends to be confined to small plots in ribbons stretching along deep valleys. Farms are generally small: the average size of the reported 1.28 million farms is 5 ha (Maletta 2007). Only about 8% of farms are over 10 ha, and just 8,000 farms are over 50 ha. Most farm households do not cover family food needs from farming, and few farms generate a marketable

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<sup>4</sup> See Perisic n.d.: 7; IMF 2006b: *passim*, especially 12.96

surplus. In addition, 23% of rural households are landless, and these constitute the bulk of the very poor (Vulnerability Analysis Unit, MRRD, 19 August 2004). The dry climate makes irrigation a necessity in many areas: of the total cultivable land (6.5m ha), approximately 3 million (43%) is at least partially irrigated. Irrigated agriculture accounts for 80% of crop production.

3.6 *Afghanistan produces food crops, a range of export and industrial crops, and livestock products.* **Food crops** account for over two-thirds of the cultivated area and are typically grown for subsistence. Wheat is the predominant crop, grown on 80% of the cereals area. About 40% of the cereals area is rain fed, and 60% receives some form of irrigation. Although most households are not self-sufficient, some larger farms produce a cereals surplus that is marketed locally. Once self-sufficient in cereals and in some years a small exporter, Afghanistan has relied on varying levels of cereals imports in recent decades, particularly during the drought years of the late 1990s. High-value cash crops cover **traditional export crops** of dried fruits and nuts, fresh fruits and vegetables, and **industrial crops** such as oil crops, cotton and sugar beet. **Livestock products** include sheep and goat meat, hides, skins and wools from small stock, chicken, eggs, and dairy produce.

### **The Cereals Sub-sector 3.1.3**

3.7 *The cereals economy has rebounded since 2001.* Cereals production has doubled since 2001, except for the drought years of 2003/4. Wheat yields rose from an average 1.0 t/ha in 2001/2 to 1.82 t/ha in 2006/7. Average rain fed wheat yields of 1.1 t/ha and irrigated wheat yields of 2.8 t/ha are comparable to those of neighbouring countries (World Bank 2005a). The area planted to cereals increased from 2.1 million ha to 3.0 million ha during the same period. There has been considerable effort by projects, NGOs and FAO to boost productivity through provision of seeds, fertilizers and improved irrigation. Over half the wheat area is now sown with improved seed, and average fertilizer use on irrigated wheat is an impressive 180 kg/ha. In 2007, Afghanistan will meet 90% of its wheat requirement. The current rise in the world price of cereals, and consequently of the cost to all households of buying food, increases the incentives to produce more cereals. However, climatic conditions are highly variable, and yields and production are consequently vulnerable (Mansfield 2007a: 22; Perisic n.d.: 7; World Bank 2005b: 5-6).

3.8 *The lesson is that, although cereals are low value and not very labour-intensive compared to other crops, their place in livelihoods strategies, particularly for the poor, means that cereals can play a significant role in helping reduce incentives for opium production.* Almost all farm households produce cereals, and food security is the top priority for all households, particularly for the poor who are most vulnerable to the attractions of the opium economy. In addition, there are important linkages to the livestock economy, with wheat straw an important animal feed (see, for example, Box 2 in 2.4 above). Thus although cereals production is in principle low return, it has an important role in both subsistence and cash economies, and further improvements in wheat productivity would have an impact on livelihoods. Extension of access to inputs and services to more remote areas, and most importantly investment in irrigation, would improve the livelihoods of the vulnerable poor. Investment in increasing cereals productivity would therefore improve household food security and progressively release agricultural land for higher-value, labour-absorbing licit crops with market opportunities.

**Table 4: Cereals Production ('000 tons)**

Production (000 tons)	2001/2	2002/3	2003/4	2004/5	2005/6	2006/7
Cereals	2,108	5,373	3,057	5,243	4,447	5,584
- of which wheat	1,597	4,362	2,293	4,266	3,363	4,484

Sources IMF 2006b: 80-1; MAIL 2007a

**Nuts and Fruits 3.1.4**

3.9 *Nuts and fruits are expanding cash crops.* Area reported under perennial nut crops (primarily almonds, walnuts, pistachios) in 2004/5 was 14,000 ha, up from 11,000 ha in 2001/2. The area under fruit trees in 2004/5 was reported as 106,000 ha, of which grapes accounted for 53,000 ha. The fastest growing fruit crops, based on the reported increase in planted area during 2001-5, were berries (up from 6,600 ha to 9,000 ha) and figs (up from 3,300 ha to 7,400 ha). Current sales of nut and fruit tree seedlings by nurseries suggest expansion of about 12,000 ha per year, an annual rate of increase of 10%, with apricots, plums and almonds showing the strongest growth. Already production of nuts is reported to have gone up from 17,800 t in 2001/2 to 24,000 t in 2004/5 (IMF 2006b: 82-3).

**Table 5: Fruits and Nut Production In 2005**

	000 ha	000 tons
Watermelon	20.0	233
Melon	25.0	250
Apricot	8.0	n.a.
Berries	9.0	n.a.
Figs	7.4	n.a.
Almond	12.0	n.a.
Other nuts	2.0	n.a.
Grapes	57.6	388
<b>Total</b>	<b>122.6</b>	<b>871</b>

Source: MAIL 2007

3.10 *There are prospects for further growth and exports.* There is a large internal demand and huge export potential. The current value of exports (2006) is \$70 million for fresh fruits and \$111 million for dried fruits and nuts. Experts estimate that, if productivity and quality can be improved, the sector can contribute \$1.5 billion to exports within 10 years from a level of \$100 million in 2005 (OTF 2006). Government targets are more modest, aiming at \$250 million by 2015 (MAIL 2007a; IMF 2006b: 82-3).

3.11 *However, realizing this potential will prove difficult under current conditions and will require sustained support.* At the production level, it is essential to ensure sustained and consistent improvements at all stages, from planting of orchards through management to picking, drying and packing. The industry will need to ensure that only good varieties are planted from controlled and certified nurseries. Extension advice – preferably from the industry itself – will be needed to ensure properly maintained trees and proper harvesting and field grading. Downstream, processing and storage need to be upgraded (and here the problem of electricity is a constraint). Export markets need to be (re)built, starting first with traditional markets, notably India. Box 3 shows how all these constraints apply to one leading commodity – raisins (Perisic n.d.: 6; IMF 2006b: 114).

3.12 *The lesson is that, if the significant constraints can be overcome, nuts and fruits offer good alternatives to the opium economy, although special consideration needs to be given to including small farmers and the poor.* Afghanistan enjoys comparative advantage for these

products, which have high value-added and labour absorption, good downstream profitability in processing and packing, and broad geographical growing range. In more accessible and secure areas there are existing mechanisms by which traders purchase fruits and nut crops prior to harvest, provide packing material and pay the farmer (or others) to harvest the crop. As with opium, the trader pays for transportation and transaction costs. Potential for substituting for opium is quite good – and the substitution is very hard to reverse, once orchards are established. A good private sector dynamic is already established, although significant constraints still need to be overcome (see 3.4 below). Smaller farmers can participate, particularly through farmer groups. Economies of scale apply to the processing, quality control, standards, etc. downstream, and here a “rural enterprise” type of approach would allow smaller farmers to reap some of these economies through associations and links with larger, export-oriented traders and processors. Ways such as this to ensure that small producers and the poor can be included in private sector-led horticulture development need to be devised.

### **Box 3: Reviving Cash Crops is Hard – The Case of Raisins**

*Reviving the raisin market, where Afghanistan was once an important exporter by world standards, is proving difficult, with diminished skills, poor organization and weak processing capacity eroding comparative advantage.*

Raisins are one of Afghanistan’s principal export commodities. In the 1960s and 1970s, Afghan raisins were an important export by international standards, with good markets especially in India and other regional countries. There is thus perceived to be tremendous potential. However, production approaches are now outdated, yields are low, processing facilities have deteriorated, and packing and marketing are sub-standard. In the meanwhile, other countries have filled the gap and Afghanistan has not just to revive but to catch up. In the 1980s there were eight raisin processing factories in Kabul: today, only one is operating. Nationwide, only eight factories out of 31 are still working. Farmer organisation is lacking, and farmers are consequently getting an inadequate share of value. Farm-level production, processing and marketing issues need attention to increase productivity and quality. Production issues have been studied under a RAMP contract.

*Improvements are required at all stages of the value chain, and in the export and shipping process. Pilot work by CADG in Kandahar has shown that processing and packing can be improved. Export procedures need to be simpler and more transparent. Transit and shipment procedures are a major source of loss of value and of business: CADG shipments through Pakistan were three times offloaded (truck to train, train to container, container to ship), and could spend several weeks in baking heat in a railway siding.*

Improvements to quality and price at the farm and processing levels and improvements in export procedures are possible, and would greatly increase value added and incentives to expand production. In their absence, Afghanistan may lose even existing markets.

*Source: Lister and Brown 2004: 1,11,23-5*

## **Fresh Produce 3.1.5**

3.13 *Fresh fruits and vegetables are produced throughout Afghanistan, largely for the local market (with some regional exports). According to MAIL, most production falls in a four-month period, coming to market at around the same time, consequently with low producer prices. Lack of pre-cooling and refrigerated storage is a constraint to extending the marketing season: there is only 10,000 mt of storage in the country (World Bank 2006a).*

3.14 *Market prospects for fresh fruits and vegetables are in principle good. Demand in towns is growing rapidly, and the expatriate community of some 100,000 people comprises a high-potential market for fresh produce.*

3.15 *The sector is, however, vulnerable to insecurity and to transport problems. Delivering fresh produce requires roads to be of good quality and open at all times. “Informal taxes” both*



on domestic roads and on exports are also a problem. In the case of exports, the problem of transshipment at the frontier – Afghan trucks are not allowed to enter either Pakistan or Iran – is a major cost and risk, especially for the lower-value and more perishable cargo.

3.16 *The lesson is that there is considerable potential for import substitution in fresh produce in direct competition with opium, but constraints need to be resolved.* Fresh produce typically offers high value, short cycle and ready market, all characteristics of opium. The potential for competing with opium is considerable, although the perishable nature of fresh produce is a constraint. Producer services need to be developed, there need to be investments in facilities, including refrigerated storage, and rural roads (see Chapter 5), and policy, institutional and security problems need to be resolved. Development needs to be market driven and private sector-led, in partnership with government where needed.

### **Industrial Crops 3.1.6**

3.17 *Despite comparative advantage, industrial crop production has not revived.* Afghanistan used to produce a wide range of industrial crops for local processing by government-owned agro-industry. This included sugar beet, cotton lint and oil, and other vegetable oils. Cotton was a major crop, occupying (in 1978) 112,000 ha, much of it in Helmand province which is well suited to the crop. Beet occupied 5,000 ha (3,000 ha in the Jalalabad area). Since 2001, there have been efforts to revive these crops, but with little success so far. Oil seed crops appear to have declined (IMF 2006b: 82). Cotton production did revive in the south, but on a local scale only, and cotton hectareage fell from 60,000 ha in 2001/2 to 37,000 ha in 2004/5. The ginnery in Helmand has operated only intermittently, and the raw cotton is often sold to traders from Pakistan. Nevertheless, the potential is great; for example, if production area could be restored to levels prevailing prior to the conflict and the average farm size planted to cotton is one hectare, over 100,000 farm families would benefit.

3.18 *The constraints are partly economic, partly organizational.* Inefficiency and poor governance in state-owned companies, including corruption, which in effect “tax” producers through low prices and delays in payments, among other problems, are serious constraints. Competition from imports may make it hard to re-establish profitability, although Afghanistan potentially has comparative advantage in some of these crops, at least for import substitution. Sector organization is a major constraint, with considerable underutilized processing capacity in state hands. Privatization of state owned enterprises in the agro-processing sector has been tried, including a sugar beet plant and a cotton ginnery. The sugar plant could not offer farmers a sufficiently attractive price (UNDP 2007). The privatized ginnery in Balkh dates from the 1940s and is in very poor shape (see 3.2). The parastatal ginnery in Helmand is working inefficiently and is not providing farmers with adequate or appropriate incentives, while the issue of establishing competing private ginneries has been contentious. Prospects for reviving old state-owned plant are limited: most is obsolete and too inefficient to be worth rehabilitating (IMF 2006b: 12.90-1).

3.19 *The lesson is that revival of industrial crops could have a significant impact in shifting incentives away from opium, but it would require policy, institutional and investment measures.* It is likely that Afghanistan could revive production of industrial crops, with better organization and governance and measures to improve profitability and provide farmers with quality services and more stable market outlets. This could have a favourable impact in terms of reducing the opium economy, as industrial crops have some characteristics similar to opium. They are relatively high-value and can provide a good cash income for farmers, small farmers can participate, the crops are labour-intensive particularly at harvest, and the production support system provided by agro-industrial plants can parallel that in the opium economy (provision of extension, seeds and chemical inputs, access to credit, assured market outlet). There is scope

for increased private sector investment and management, where needed in partnership with the public sector.

### **Livestock Potential 3.1.7**

3.20 *Afghanistan is a traditional livestock country and was in the past self-sufficient in livestock products.* Livestock – largely sheep and goats – have traditionally been an integral part of most farming systems in Afghanistan, and range pasture, covering some 45% of the land area, has traditionally supported a large livestock population. In the 1970s the country was self-sufficient in meat and milk and had significant exports of animal fibre and high-value processed products (carpets and skin garments).

3.21 *However, war and drought have seriously impaired the livestock economy.* Pastoral livestock numbers fell by 50% in the late 1990s, due to the war (which disrupted trekking routes) and to the severe nationwide drought. Particularly affected have been the poorest (including the nomadic Kuchi people), for whom livestock are the principal resource (Mansfield 2007a). This drop in herd numbers in turn curtailed the availability of sheep for fattening, the mainstay of meat supplies to urban centres. With the reduction in hostilities and return of favourable rains, livestock numbers have begun to recover. However, poor nutrition and disease contribute to low fertility and productivity, and pasture areas are being reduced and degraded. The country now has rapidly growing imports of frozen chicken, eggs and dairy products. Average meat consumption has dropped to just 10 kg per annum (World Bank 2006a).

3.22 *The lesson is that livestock development could be a means of reaching the poorest and most remote communities, thereby reducing their vulnerability to opium.* More generally, revival of the livestock economy is a priority for poverty reduction. In addition, because livestock are owned by almost all farmers – including by the poorest and those living in the remotest areas – promoting livestock would have an impact on incentives with respect to the opium economy, including in the remoter upland areas that other development interventions cannot easily reach.

## **3.2 CURRENT DEVELOPMENT INTERVENTIONS IN THE SECTOR**

### **Government Growth Strategy for Agriculture 3.2.1**

3.23 *Government sees agriculture as a priority growth sector.* The Agriculture Sector Development Strategy, approved in 2005, proposes to establish the framework conditions and environment for strong growth in private agriculture and agro-industry, with particular emphasis on the cereals, horticulture and livestock sectors. To implement this programme, the government is undertaking a number of development programs in the agriculture sector (Perisis n.d.: 6; World Bank 2006a: 2).

### **Programmes Supporting Agriculture and Horticulture 3.2.2**

3.24 *A number of large programmes have been developed in the agriculture sector, particularly in horticulture.* In addition, many alternative livelihoods projects have contributed to the sector. Examples include:

3.25 *USAID has funded a number of programmes in the agricultural sector, which have typically combined support to production with market development, following a “value chain approach” that identifies and resolves key bottlenecks* (see Box 4). The Rural Agricultural Marketing Programme (RAMP) focused on developing marketing chains. RAMP has now been

succeeded by the Accelerated Sustainable Agriculture Programme (ASAP) which will continue much the same work. Three regionally-based Alternative Livelihood Programmes (“ALPs”) also are supporting agricultural market chain development together with related investments such as irrigation. All of these projects have assisted horticulture at farm and marketing levels.

3.26 The EC has launched the Perennial Horticulture Development Project (PHDP) to provide assistance at the planting and farm level and to support the development of farmer organizations.

3.27 The Emergency Horticulture and Livestock Project (EHLA) is World Bank-financed (\$20 million grant), and MAIL and GTZ implemented. The horticulture component supports rehabilitation and expansion of orchards in four northern provinces and around Kabul on a matching grants basis. It also supports the establishment of a joint public-private Horticulture Development Council of Afghanistan (HDCA) for research, piloting new crops, market development, and capacity building.

3.28 The Asian Development Bank has launched a \$40m five year Commercial Agriculture Development Project (CADP) aimed at strengthening the agro-processing and marketing systems.

**Box 4: Implementing the “Value Chain Approach”**

Considerable work to develop the fresh fruits and vegetable “value chain approach” has been undertaken. Much of this was supported by USAID under RAMP, and now under ASAP. Special efforts in Nangarhar have resulted in the construction of a packing and grading warehouse that is HACCP-accredited, and in trial export shipments of pomegranates to the Gulf. Ongoing work includes investments in cold storage and promotion of production near good roads to ensure quality.

Various implementing partners such as Roots of Peace and CADG have had considerable success in facilitating small-scale exports to neighboring countries and beyond.

*Source: Authors*

**Agro-industry 3.2.3**

3.29 *New agro-industrial investments have been made that can link back to local producers.* Much of Afghanistan’s agro-industrial plant is old and run down (see, for example, Box 3). However, there has been some limited new investment, and several sizeable new agro-industry investments appear to have potential for backward linkages to producers, and the owners have expressed interest in piloting “livelihoods development” relationships with farmers.

3.30 **Spinghar Vegetable Ghee Company** is a \$10 million investment set up in 2004, with a capacity to produce 400t of ghee daily. Raw materials are currently imported, but the company says that it would like to work with producers’ groups in contract farming arrangements (Perisic n.d.: 18).

3.31 **NAPCOD** is a joint investment of \$12 million for cotton ginning and seed processing, between a partly public French company and the Afghan government. The investment benefited from guarantees from the Afghan Investment Guarantee Fund (AIGF). In 2006 NAPCOD took over an old existing ginnery and purchased cotton from 4,600 farmers. The company, which also provides seed and extension services to farmers, expects to be working with 20,000 farmers by 2008. Next steps are to promote farmers’ associations, provision of credit and extension services, and development of a contract farming model agreement. There are, however, reports that NAPCOD has run into difficulties, with farmers avoiding their obligations and other local (state run) ginneries purchasing cotton at higher prices. One of the

investors commented: “local commanders don’t want it to succeed.” In addition, the plant is extremely old, and the operation suffers from frequent breakdowns and power cuts (Parto et al 2007; Perisic n.d.: 19).<sup>5</sup>

### **Contract Growing and Industry Organization 3.2.4**

3.32 *Contract growing is being practiced on a small scale.* Under contract grower models, the company provides inputs and guidance to out-growers and buys their product under contract. In some models, there is a nucleus estate with out-growers located around it. In other cases, the contracting company may simply be a wholesaler or processor with no production activity. Afghanistan had experience with contract growing with farmers on the Helmand irrigation scheme. The cotton company built success by providing extension services, inputs and an assured cotton market and price. This set-up has long since disappeared, but there are cases of contract growing in Afghanistan today. An example is that of CADG, which began in 2002 to contract canola, grapes, cotton and other crops for export. Contract growing primarily of wheat seed production is also currently being promoted by five micro-finance organizations and is being tested with the saffron pilot in Uruzgan (see Box 5 below).<sup>6</sup>

3.33 *Various professional associations are coming together to provide common services.* NGOs have built associations in various provinces to improve marketing and input supply. RAMP has worked with the newly established Kabul Consortium for grape exports in Kabul and with the Fresh Fruit Exporters Association of Kandahar.

### **New High-value Crops 3.2.5**

3.34 *Considerable efforts have been invested in piloting possible new high-value crops, notably saffron.* With support from DFID and other agencies, new crops are being introduced. With DFID funding, MAIL has been working with ICARDA to introduce *saffron*. The programme is to establish a national platform, to conduct research, to import top-quality planting material, to train extension staff, and to develop markets. Saffron is a bulb with a five-year cycle that mimics opium in being labour-intensive with high returns. Women are involved in all stages of the crop, especially processing. This highly interesting niche crop is now being tried in various locations in Afghanistan. Reports from Uruzgan, where commercial Dutch buyers have been investing in contract growing with farmers, look promising (see Box 5). At present market demand is not much of a problem as Afghan production is less than one ton against global production of about 300 tons, and market demand is strong. If the commercial contract growing model is extended to other suitable areas, Afghanistan production could reach 100 t per year. This has the potential to increase the incomes of up to 30,000 farm families by as much as \$1,000 a year, and to earn up to \$40 million in foreign exchange.

#### **Box 5: Saffron Is Being Piloted Commercially In Uruzgan**

Working with Provincial Department of Agriculture and two Afghan NGOs, the Dutch have introduced saffron to Uruzgan province, where it is proving successful. Yields typically exceed those of Iran (13 kg/ha), where the product fetches \$400/kg, or \$5,200/ha. A private company, Global Sales Exchange (GSE), supplies planting material, trains extension workers and supervises their work with farmers, helps with processing, and guarantees purchase of all produce at prices linked to world market prices. Credit will be provided by credit unions supported by WoCCU under the MISFA umbrella.

*Source: Authors.*

<sup>5</sup> The cotton sector clearly has some potential but also suffers from policy, economic and technical constraints which need to be tackled before enterprises such as NAPCOD can become properly viable – see paragraph 3.52 below, and also section 8.2.6.

<sup>6</sup> See Zia and al 2005: 7, 32-3; Perisic n.d.: 17; Byrd 2007: 23

3.35 *Other niche products that have been tested include mint and cumin.* Parallel DFID-funded work by ICARDA has led to the establishment of eight *mint* producers' associations, producing mint for drying and for mint water and mint oil. This has considerable potential, including in main opium-producing provinces. There are good export prospects – and again women play a major role in the production cycle. *Cumin* also has been tested.

### **Irrigation 3.2.6**

3.36 *There has been considerable support to the irrigation sector.* Several donor-assisted programmes are under implementation by the Ministry of Energy and Water (MEW). For example, the Emergency Irrigation Rehabilitation Project (EIRP) is World Bank-financed (\$40 million Credit and \$35 million ARTF grant).<sup>7</sup> The project finances rehabilitation of small irrigation schemes in all five river basins of Afghanistan. The initial project target was 1,280 small schemes covering 110,000 ha, 160 medium schemes covering 120,000 ha, and 20 large schemes covering 50,000 ha, for a total area of 280,000 ha. As of September 2007, 570 sub-projects had been approved (for \$36 million) and 350 completed (for \$11.1 million). After a slow start, implementation is going well, with the total area already rehabilitated reaching 400,000 ha, in excess of targets. By project completion in September 2008, almost 500,000 ha will have been rehabilitated, almost double original targets. A second-phase project is under preparation. Other donor-financed irrigation programmes include a \$15 million irrigation programme in Balkh, and an \$80 million programme for the Western Basin (both ADB-financed). The EC is financing a major water management programme for the Kunduz Basin.

### **Livestock 3.2.7**

3.37 *Current support to veterinary services is designed to establish an autonomous private network of veterinary field units and clinical services.* Government veterinary services were largely destroyed during the decades of conflict. Starting in the late 1980s various donor-funded NGOs and international agencies – led by FAO and UNDP – provided very modest services by training community-based veterinary paraprofessionals and establishing Veterinary Field Units (VFUs). Since 2001, donor-funded NGOs have worked to develop a sustainable national network of privatized VFUs that provide regular veterinary care on a fee-for-service basis. Currently there are some 500 VFUs – all managed through NGOs – together with about 120 government veterinary clinics. An Animal Health Development Project (AHDP) funded by the EU is helping to transform the VFUs into an autonomous network and to privatize the government clinics. The Afghan Veterinary Association, which has been supported by RAMP, is developing as the representative of private veterinary services.

3.38 *New programmes are supporting poultry and dairy development, particularly for small and poor farmers and women.* Support to animal production hitherto has been weak. Pilot projects for poultry and dairy development were initiated in 2000, implemented by FAO with bilateral funding. Building in part on this experience, the World Bank-financed EHLIP livestock component supports dairy development based on the Indian Amul system of a cooperative dairy with local milk producers associations (World Bank 2006a: 9-20). It also supports village poultry production by women's groups, together with veterinary services. The approach is essentially a public-private partnership (PPP) one, with a demand-driven program, a private sector basis in cooperatives and associations, and cost sharing of investments. In addition, the local Coca Cola producer, Habib Gulzar, has plans to set up a dairy, to be supplied by dairy farming associations.

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<sup>7</sup> See World Bank 2007a: 6; World Bank 2003: 4-5

### 3.3 SUGGESTED FURTHER INTERVENTIONS TO COUNTERBALANCE THE ADVANTAGES OF THE OPIUM ECONOMY

3.39 This section will discuss possible further interventions that might contribute to counterbalancing the advantages of the opium economy. Chapter 2 (Tables 2 and 3) pinpoints a number of agricultural development responses to tilt incentives away from opium, particularly:

- Promoting an *integrated approach* to increasing value added in farming, and improving access to services, particularly to inputs
- Promoting *high value agriculture* and *labour-intensive processing*
- Increasing agricultural land under *irrigation*
- Improving returns to *livestock*

Taking these four areas of focus in turn, this section examines what are the development interventions where more could be done in the short or longer term to enhance agricultural growth and to reduce incentives to participate in the opium economy.

#### Integrated Support to Farmers 3.3.1

3.40 *The most effective means of providing integrated packages in agriculture is through implementing partners such as NGOs.* Chapter 2 points to the need for an integrated approach to augmenting value added in farming through water-efficient techniques and technologies and high value-added production packages. This requires access to proven technologies and to improved planting material, fertilizer and pesticide, credit, harvest and post-harvest technology, and (above all) profitable markets. In other poor countries it has proven virtually impossible for public agencies to provide this range of services, and attempts to rely solely on the market are unlikely to work in Afghanistan's difficult environment. The best solution is provision of integrated packages by field-based implementing partners such as NGOs. The focus needs to be on reorganizing production systems around market-driven supply chains, increasing the endowment of productive assets, and expanding the private sector's involvement.

3.41 *These NGOs should work with community organizations, in particular farmer organizations, which can be developed so that ultimately they can take over responsibility from the NGOs.* These field-based NGOs should also work closely with the private sector and other national programmes to ensure integrated service delivery: examples include credit provision (working with MISFA, see 4.3.3) and seeds and planting materials (through the private sector or MAIL). The focus should be on profitability and sustainability; cost sharing or free services or transfer of assets should only be provided to establish activities that can be self-sustaining afterward. Integrated packages along these lines are being delivered through various donor-supported programmes. Examples include AKDN's programme in Badakhshan and GTZ's Project for Alternative Livelihoods (PAL) in the Eastern Region, run with DACAAR and Afghanaid as implementing partners (see Box 6). ***Recent evaluations have shown the economic and counter-narcotics impact of these integrated programmes. Successful models can be scaled up and replicated throughout Afghanistan, with due attention to the variation in local conditions.***<sup>8</sup>

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<sup>8</sup> See, for example, Aga Khan Foundation, Afghanaid and Concern 2007. Also see 6.3.2 below for a discussion of the role of "full service" NGO facilitating partners in the NSP programme.

**Box 6: AKDN Has Had Good Success In Integrating Production, Community Mobilization, Marketing, etc. in its Agricultural Programmes**

Farmers in Badakhshan requested help in developing commercial scale poultry farming. This required a range of support, from market survey through farmer organization, production techniques, construction of poultry houses, animal husbandry and veterinary, and market development. First, AKDN's enterprise development team conducted a market survey of the potential of commercial scale poultry farming in Badakhshan. The engineering section did the estimation and design of the poultry farms, and the community development team identified potential poultry farmers through CDCs. The enterprise development team then organized poultry keeping and business management training and linked farmers with the veterinary services (VFUs) for necessary inputs. As a result, many profitable poultry businesses were established. Now all the eggs in local markets are locally produced, and chicks are supplied to the market from local sources.

In silk sector development, the process started with a production potential survey, which was jointly done by all the teams. Then the community development team recruited trainees from different villages, and the agriculture team worked with farmers on mulberry plantations and cocoon production. The enterprise development team helped establish marketing systems. AKDN has many other examples which illustrate the success of the integrated approach in agriculture. These include: cashmere processing, agriculture input supply, seed multiplication, honey production and sale etc.

*Source: Aga Khan Foundation, Afghan Aid and Concern 2007.*

### **Promoting High-value Agriculture and Labour-intensive Processing 3.3.2**

3.42 *Afghanistan could further develop a range of export and import-substituting products.* The potential for expanding export crops is high, including dried fruits and nuts, and fresh produce (see 3.1). Import substitution could occur for dairy produce, oil crops and fresh fruits and vegetables. Current import levels that might be displaced are on the order of \$200-\$300m. The following paragraphs explore how these potentials may be developed, pulling economic activity away from opium.

#### *SUPPORTING HIGH-VALUE HORTICULTURE PRODUCTION*

3.43 *The potential of high-value horticulture is strong.* Current development programmes (see 3.2.2 above) are based on successful models, and are likely to succeed. For example, the fruit orchard development being promoted by EHLP is based on research and development work from the 1970s, revalidated in 2002, and on the results of two pilot NGO projects (World Bank 2006: 4). Experience in Turkey, India and China since the 1970s shows that major investments in production, processing and marketing can result in state-of-the art perennial fruit industries.

3.44 *Despite the considerable investments that have been occurring in high-value horticulture, there is certainly scope for more investments, although current inefficiencies need to be addressed.* EHLP focuses on just four provinces, but it has been designed as a national programme to be expanded as experience develops and further resources become available. There is an opportunity to support the programme with additional resources, particularly in provinces where there is pronounced poverty and opium vulnerability. Support to this development in other parts of the country could represent an important contribution to rural incomes, employment and poverty reduction. However, the current lack of linkages and coordination between programmes and the resulting overlaps and inefficiencies (see 3.4.2 below) would need to be addressed before further investment could be justified. An opportunity to provide consolidated support to high-value horticulture, from production through

processing to market, is also presented by MRRD's recent proposal for a massive and integrated rural enterprise development programme, AREDP (see 4.3.1 below). This programme is expected to undertake in-depth studies to identify the best economic prospects in high-value horticulture.

3.45 *There is also a need to develop instruments to reach poorer farmers.* Farm size does not necessarily inhibit profitability, especially for high-value cropping. Orchard crops and vegetable crops in principle can be grown efficiently on a small scale. However, development programmes chasing hectare targets typically overlook the needs of smaller farmers. EHLP has a provision for smaller farmers to form groups, and such groups can certainly reduce the costs of delivering assistance. The success of this approach and the scope for promoting horticultural farmer associations should be ascertained, and programmes designed to ensure access by poorer farmers.

3.46 *There may be scope for extending certain short cycle horticultural crops in vulnerable provinces, including Nangarhar, Helmand and other southern provinces.* Interventions with farmers to help establish new tree crops would be very difficult in conditions of insecurity. However, there is scope for creating market opportunities for short cycle, high-value crops, as has been done with initiatives for contract farming of chili peppers in Helmand. Other high-value crops that could be expanded in southern provinces include alfalfa and mint.

- ***Further support to development of high-value horticulture should be provided, with a focus on opium-vulnerable provinces that are currently under-served. Prior to provision of further support, MAIL and MRRD need to identify the best economic opportunities and to work together through AREDP and other programmes, ensuring that all interventions are streamlined and dovetailed with each other. Instruments to ensure the participation of poorer farmers are an imperative. The innovative and successful DFID-supported programme to identify and develop new high-value crops should be continued and strengthened.***

#### *SUPPORTING THE DRIED FRUITS AND NUTS PROCESSING AND EXPORT SECTOR*

3.47 *The dried fruit and nut sector has particular features that make it suitable for further development and scaling up in Afghanistan's difficult environment.* Afghanistan certainly has a comparative advantage in dried fruits and nuts, reflected in the profitability of exports. Also, the industry is relatively less vulnerable to insecurity and poor transport networks; for example, produce can be stored on the farm in the event of roads being inaccessible. Development of the dried fruits and nuts sector thus appears to have potential for sustainable and profitable growth, and the market is enormous: the value of the global dried fruit and nut market is estimated at \$2.2 billion, only 2% of which is captured by Afghan producers (Parto et al 2007:18).

3.48 *Recent programmes to support the sector show that there are considerable problems.* USAID's RAMP and the CADG programmes have gone a long way to pinpointing remaining constraints in the value chain, and investments can resolve some of these. However, there are also major policy and institutional constraints (see Box 3 above and 3.4.1 below) that are holding back growth.<sup>9</sup>

- ***Further investments and capacity building in the dried fruits and nuts sector are required all along the value chain. However, progress needs to be made with the actions to address the policy and institutional constraints set out in Box 3 above and in Section 3.4.1 below, before further major investments can be effective. In addition, the improvements to strengthen Afghanistan's overall business environment***

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<sup>9</sup> See also the broader constraints to enterprise development and competitiveness discussed in 4.4, especially 4.4.2.



***and competitiveness discussed in Chapter 4 (4.4.2) would help the revival of the dried fruit and nut sector.***

#### *THE VALUE CHAIN APPROACH*

3.49 *There is strong evidence of multiple constraints throughout value chains, and a value chain approach can address these systematically.* The case of raisins illustrates the usefulness of the “value chain development” approach, rather than “sectoral” interventions at the levels of production, marketing, processing etc. Much knowledge has already been garnered, particularly under RAMP, and this approach has been applied in several projects. For example, in 2006 USAID put together an Agricultural Marketing and Production Support (AMPS) designed to support entire value chains in three agricultural areas of Afghanistan. The program was specifically conceived as an “alternative livelihoods” program in 11 provinces where opium was to be banned and eradicated. AMPS was to start with a market assessment to identify 2-3 horticultural products in each area, and then provide inputs and extension advice to farmers and support to markets (e.g. development of cold stores, help with packaging, grading etc). A priori, this approach is one that could be applied to a number of high-potential crops and products. There is, however, a surprising lack of objective and documented assessments of these kinds of approaches (Byrd 2007: 1; Perisic n.d.: 3).

- ***Experience with value chain approaches linking producers, processors and export markets should be thoroughly evaluated in preparation for the AREDP programme (Perisic n.d.).***

#### *MARKET DEVELOPMENT AND AGRICULTURAL EXPORT PROMOTION*

3.50 *Market development is important in tapping the potential of agriculture.* A well-organized marketing system is perhaps the most powerful incentive for agricultural development. Improvements are required at all stages of the value chain, in the export and shipping process, and also in the development of agro-industry. RAMP, working with private producer and exporter associations, has built up much knowledge in this area. Establishment of the Horticultural Crops Development Authority (HCDA) is being supported under EHLF. The agricultural export sector is also being assisted by the Export Promotion Agency of Afghanistan (EPAA), the chambers of commerce and various USAID programmes.

3.51 *Countries around the world have been successful in developing horticultural exports.* Many countries in Africa have developed public/private partnerships in agricultural export promotion and facilitation, often with government or project support. The classic example is Kenya, where an entrepreneurial private sector, willing farmers and light government support have developed a horticulture export industry that supports 100,000 families. In West Africa there are World Bank-financed projects to support the growth of agricultural exports, particularly horticultural products.

- ***There is considerable scope for further export promotion, based on successful experience in comparable countries and working with industry bodies like producer and exporter associations and with the HCDA. The AREDP programme should be employed to help build strong commodity export associations (Byrd 2007: 1; Perisic n.d.:3).***

#### *INDUSTRIAL CROPS AND AGRO-PROCESSING*

3.52 Industrial crops could offer economic growth with impacts on the opium economy, but so far development attempts have had little success. The constraints – partly economic, partly organizational – were discussed above (3.1.6). Yet the potential is considerable, and current

movements in prices of edible oils are changing the economics. Programmes in many countries have supported development (see Box 7), and there is no reason why Afghanistan should not do the same. The impacts on opium areas like Helmand of production and marketing of alternative high-value crops like cotton could be considerable (see 7.7 and 8.2.6). However, there may be some environmental constraints: cotton is not well suited to some of the increasingly saline soils, for example in Helmand, and improper pesticide use can pose risks.

- ***Under AREDP, sector studies of prospects for cotton and oil seed development should be conducted. These should evaluate financial profitability and economic comparative advantage as well as environmental impacts and risks, and should recommend policies and investments (for example start-up assistance, matching grants, cost sharing, short to medium term support, market development, etc.) to help establish and sustain agro-industries. Options for an integrated production and market development programme for suitable crops such as cotton, initially targeted at Helmand province, should be actively explored and evaluated (see 8.2.6).***

**Box 7: Development Of Industrial Crops and Agro-Processing to Stimulate Agriculture**

In the absence of agro-processing capacity, Afghanistan will remain an exporter of low-quality primary produce. It is unlikely that infant agro-industries can simply emerge and survive without some form of support. Examples from the East Asia “miracle” show that a range of measures may be used to stimulate agro-processing.

*Malaysia* developed its oil palm refineries by taxing unrefined oil palm exports and using the proceeds to support its refineries. Now the refineries are sufficiently competitive and the export tax has been lifted. In the 1980s, *Thailand’s* agriculture sector was in decline, and a policy to protect and diversify the agricultural base was pursued. Government offered promotional privileges to large export-oriented processing industries, including extendable tax holidays, duty draw-back, reduced electricity prices, lower freight charges on national carriers, and tariff protection as high as 40-50% on processed foods to protect a new industry. In addition the government financed programmes to enhance export quality. These industries also benefited from subsidized credit extended to farmers who participated in out-grower schemes. Furthermore, bilateral trade negotiations were employed to win reduced tariffs from importing nations. Thailand was able to simultaneously develop its own brands and, with international investment, to export in sectors where it already had developed a comparative advantage (for example in pineapples, where Dole had invested). Agro-industry grew at a rate of 33% a year from 1986 to 1993.

*Source: Jomo and Rock 1998.*

**CONTRACT GROWING**

3.53 *Contract growing is an attractive model, but there are constraints.* The advantage for the farmer is that he receives a package of inputs and advice and has an assured market outlet, usually at an agreed price or price formula. The advantage for the processor is a supply of raw materials of predictable quality, quantity and price. This mechanism matches the structure of the poppy business, and therefore is a good way to help farmers to change their crop. Problems identified are: (i) lack of established steady demand for most crops – there is a need for processing capacity, for example for edible oils; and (ii) lack of institutions that can facilitate (and finance) these arrangements, Should a partner organization be brought in to do this? Or should incentives be provided to the private sector?<sup>10</sup>

3.54 *There is considerable international experience to learn from.* This formula has worked for cotton in Africa (the CFDT model in several countries), for coffee (the cooperative model in Kenya), for tea (the KTDA factory and out-grower model pioneered by Britain’s

<sup>10</sup> See Zia and all 2005: 33 for a good discussion of these issues. Also Perisic n.d. 9

Commonwealth Development Corporation and others), for tobacco (private company and out-grower models in Zimbabwe), for mango and dates in India and Pakistan etc.

- ***Contract growing arrangements through private sector processing and marketing firms are a priority area for development, and a detailed feasibility study of experience and opportunities should be carried out. Potential in suitable crops such as cotton, including especially in Helmand, should be a priority area for investigation (see 8.2.6).***

### **Increasing Agricultural Land under Irrigation 3.3.3**

3.55 *A top area for further investment – currently under-financed – is agricultural water, including watershed management, storage, irrigation development and on-farm water management.* In order to restore livelihoods and promote transition to higher-value cropping, irrigation is essential. This is not given enough emphasis in the I-ANDS, and the search for “quick impact projects” has meant that little “alternative livelihoods” financing goes into irrigation. Yet the need is enormous. The scope for further irrigation rehabilitation alone is considerable. Afghanistan has 1.0 million ha of traditional river and stream irrigation, 50,000 ha irrigated by springs and karezes, and 250,000 ha of modern government run schemes. Much of this irrigation infrastructure is severely degraded.

3.56 *Current programmes are being carried out effectively, but their scope needs to be broadened and financing increased.* Existing rehabilitation programmes are performing well under Afghan leadership and execution. Rehabilitation costs are low (less than \$250/ha) and rates of return are high (the programme requires a minimum ERR of 15%). However, these programmes cover less than half of total rehabilitation needs. A second phase EIRP project is about to start, but considerably more investment is required, not only in rehabilitation but also in watershed management, new water storage projects (enabling irrigation to be practised in drier years) and modern irrigation technology to save water (for example drip irrigation). In addition, attention needs to be given to areas not currently well covered, such as improved water management and advice on irrigated cropping. A second phase of the ongoing rehabilitation programme is under preparation, for possible financing by the World Bank (\$120 million) and ADB (\$80 million). In addition, the Saudi Fund for Development may cofinance. This programme is likely to focus on large-scale irrigation and hydropower, leaving a gap for financing of other irrigation and agricultural water management priority investments (World Bank 2007: 6; World Bank 2003: 4-5).

3.57 *There may be scope for new large scale multi-functional development.* Afghanistan possesses considerable untapped surface water resources, and many of these could be developed for large scale irrigation, associated with hydropower. A feasibility study under EIRP of a possible Kokcha River irrigation scheme has shown that 160,000 ha of land could be improved or developed for irrigation, at an average cost of \$4,000/ha, which is below the average cost of successful modern irrigation schemes in the region. The project could also be multi-functional, generating 100 MW of hydropower, which would improve economic viability. There is also scope for other large scale development, for example on the Amu Darya and its tributaries. There are however, issues over water sharing with riparians.

- ***An irrigation and agricultural water management sector review should be carried out and massive extra financing provided to implement a phased ten-year programme covering irrigation rehabilitation and expansion (topping up the existing programmes), watershed management, new storage, modern irrigation, and development and dissemination of improved water management and irrigated cropping packages. The review should also assess issues of riparian rights and transboundary water sharing. The Ministry of Energy and Water (MEW) and the***

*Ministry of Agriculture, Irrigation and Livestock (MAIL) need to work together in this endeavor and to cooperate with NGOs and other outreach organizations.*

### **Improving Returns to Livestock 3.3.4**

3.58 *Investment in livestock is a first-class entry point to reduce the dependency of the poor on opium.* As discussed above (3.1), improving returns to livestock offers a direct route to addressing the needs of the most vulnerable and thereby reducing the incentives to participate in the opium economy. There are national programmes underway to strengthen veterinary services, but the financing and sustainability of these programmes are uncertain. Current small-scale initiatives in dairy and poultry are showing the way for pro-poor and sustainable development, and there are possibilities for scaling up ongoing programmes. Other areas of the livestock economy – in particular sheep fattening and development of downstream high value-added activities – also deserve more attention, as they offer opportunities for reaching the poorest and most remote communities.

- *Top priority should go to ensuring that the transition to privatized but universally accessible veterinary services is carried through, whilst ensuring that services are available to the poorest.*
- *The results of the initiatives in dairy and poultry to date should be studied in detail, and further support should be provided, with particular focus on the poorest, on women, and on extension to areas least served by development programmes and with susceptibility to dependency on opium poppy cultivation.*
- *Mechanisms to enhance livestock value added should be devised and associated programmes supported. High priority areas are sheep fattening and cashmere fibre development; improving wool quality for the carpet industry; and production of karakul sheep pelts.*

## **3.4 CONSTRAINTS AND POLICY AND INSTITUTIONAL RESPONSES**

3.59 This section looks at the major constraints to agricultural growth and to enhancing value added in agriculture, and at the possible policy and institutional responses to resolve those constraints. The constraints discussed are: (i) the hindrances to competitiveness and profitability of Afghanistan's agricultural production; (ii) the often ineffective and inefficient delivery of public support programmes in the sector; (iii) the weakness of sector policy development and planning; and (iv) growing insecurity.

### **Improving the Competitiveness of Production 3.4.1**

3.60 *In order to be competitive, Afghanistan's agriculture needs to become more commercial.* The difficulties that Afghan farmers face in competing with imports even in the case of products enjoying heavy natural protection underlines the need to improve competitiveness. This means improving productivity at farm level, providing added value through better marketing and processing, and better farm to market linkages. This in turn requires a focus on supporting enterprise development (see Chapter 4) and taking a comprehensive value chain approach. It also means having the necessary infrastructure – transport, electricity and irrigation – in place. The following paragraphs discuss actions that need to be taken on some of the principal constraints:

- *Improving transport and the road network is a priority.* An inadequate road network leads to high costs for moving farm produce, and the ban on Afghan vehicles entering Pakistan and Iran results in very high transshipment costs and product losses. There

are also constraints, delays, spoilage and other costs that affect exports shipped through neighbouring countries like Pakistan. Among recent improvements is the sharp increase in the number of trucks operating in Afghanistan from 30,000 in 2001/2 to 83,000 in 2004/5, 90% of them privately owned. However, the poor state of the road network leaves many areas inaccessible and makes for excessively high transport costs. Measures to improve the rural road network are discussed in Chapter 5. Improving and enforcing transport standards would enable Afghanistan to negotiate transit in Afghan vehicles through neighboring countries, thereby reducing costs. *Access by Afghan trucks to neighbouring countries should be negotiated in transit and trade agreements (IMF 2006b: 92; World Bank 2007: 10).*

- *Effective services to farmers are essential for lowering production costs.* Producer services are key to improving productivity. New government policy identifies an essential public sector role for MAIL in terms of planning, financing, quality control and supervision of service delivery. Service delivery is, however, to be carried out through private and NGO organizations (see Box 9). *In line with its new policy, MAIL should carry out its essential public sector role, and contract for service delivery through farmer organizations, NGOs etc.*
- *Targeted support is needed.* General production subsidies in agriculture are not advisable (see Box 8). However targeted support programs – such as investment promotion, start-up grants, capital cost sharing, land allocation etc. – will be important for encouraging investment in the sector. Support is, for example, already being usefully applied in cost sharing and technical support for development of nurseries, orchard planting and building of stores. AREDP is proposing a blend of start-up grants (e.g. innovation grants) and support to accessing market finance. Careful monitoring and safeguards are required to ensure that “support” does not encourage unsustainable investments or crowd out normal market development by the private sector. Much criticism has been leveled at certain donor programmes for “giving things away”, undermining market processes and produced no lasting development impacts. *Targeted support to production and marketing carries some risks but is well worth considering for industrial crops for which Afghanistan has underlying comparative advantage, particularly if there is a focus on opium-vulnerable areas.*

#### **Box 8: Should Production Subsidies Be Ruled Out?**

Background work for this report extensively analyzed the case for and against subsidies on agricultural production as a means of encouraging farmers to move out of opium production. The conclusion was that general agricultural production subsidies are not advisable. In particular, production subsidies for *wheat* would not work. The characteristics of wheat – relatively low value, low labour intensity, and correspondingly high usage of Afghanistan’s scarce land and water resources – make it a poor and unsustainable alternative to opium poppy in the Afghan context. Moreover, given that in good harvest years the country already comes close to self-sufficiency in wheat and there are no export prospects, stimulating substantial increases in wheat production would be counterproductive.

In addition, the fiscal cost of a wheat subsidy would be enormous. The current price of wheat is in the range of about \$150 a ton. To raise the gross margin on wheat to equal that of poppy, a price of \$455/ton would have to be paid, three times the market price. Such a massive subsidy on one crop would greatly distort relative prices. The impact on the opium economy would be very modest, as the opium trade would certainly respond by bidding up the price to the point where incentives to avoid the subsidy and continue to cultivate opium poppy would become overwhelming. Moreover, since opium cultivation easily can shift across many parts of the country, a wheat subsidy would need to be implemented on a nationwide basis in order to reduce opium production rather than merely displacing it to other parts of the country. Hence the fiscal cost would be staggering – of the order of \$2 billion annually, some 30% of GDP and three times current fiscal revenues. It would be difficult to prevent the benefits of the subsidy from accruing to landowners, i.e. the better off. And finally, in practical terms administering such a system in Afghanistan’s weak governance environment would be virtually impossible.

This does not mean that targeted investments and operating support for certain specific agricultural products,

particularly those that can shift incentives away from opium, should be ruled out. Various options are discussed in this report, including *inter alia* start-up assistance, matching investment grants, cost sharing, short and medium term support, market development, etc. The proposed integrated production and market development programme for suitable crops such as cotton in Helmand is an example (see 8.2.6).

Source: Ward et al 2007:6.4.A

### **Enhancing Synergies Amongst Programmes 3.4.2**

3.61 *Programmes should work closely together to reduce duplication of effort and provide effective developmental services, and there is an acute need for consolidation around national priority programmes.* There are numerous donor-assisted programmes in the agricultural sector, but their effectiveness is impaired by lack of coherence and effective coordination among them under government leadership. There are gaps, overlaps and incoherence. Information on programmes and achievements is rarely exchanged, and results are not monitored and fed back into policy and programming. A striking example is the three horticulture development projects which sit alongside each other within MAIL (EHLP, PHDP, ASAP: see 3.2 above). Despite good intentions and attempts at coordination, these three programmes have little interaction and lack joint programming. The problems are essentially as follows:

- Weak strategic framework (now strengthening)
- Lack of Afghan government leadership (now improving)
- A strong supply-driven impetus from donors and NGOs, each keen to take the initiative

3.62 There have been recent improvements, with the stronger lead taken by MAIL and increased donor willingness to work with that institution (see 3.4.3 below). However the problem remains acute.

- *All partners need to align agricultural programmes within the new strategic framework provided by MAIL (see below) under Afghan government leadership, and to give priority to joint programming at central and provincial levels, and to transparency, information exchange and knowledge management. Key areas for better cooperation are horticulture and livestock.<sup>11</sup>*

### **Strengthening Sector Policy Development and Planning 3.4.3**

3.63 By contrast with the rural development sector where MRRD has maintained strategic focus and attracted donor financing to effective National Priority Programmes, the agricultural sector has been characterized by lack of vision, weak public institutions, and scattered interventions. Now MAIL is reforming, with an emerging strategy, an institutional reform programme, and a promising vision of its own (policy and planning) role, and of the role of executing agencies such as NGOs (see Box 9).

- *Capacity building of MAIL should focus on enabling it to fulfill its strategic roles. Donors should help MAIL by all means possible to work closely and programme jointly with MRRD and MEW. Many studies have already been undertaken of export crop development, oil crops for import substitution, and livestock. These need to be reviewed and if necessary further developed to ensure that proper economic analysis is included, and that any needed adjustments to policy to permit profitability and sustainability are clearly identified.*

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<sup>11</sup> See also Chapter 7, where issues of Afghan ownership, National Priority Programmes, and aid effectiveness are discussed.

### Dealing with Insecurity 3.4.4

3.64 As for all rural programmes, agricultural programmes have encountered problems of insecurity, which are constraining implementation, particularly in the south. The Ministry of Energy and Water's irrigation rehabilitation programme has encountered increasing insecurity in Helmand, Kandahar, Zabul, Uruzgan and Nimruz. In Kandahar, the programme was active in all districts and had identified 223 schemes for rehabilitation, but only one-third of these (75) have been completed, and the level of new approvals is greatly reduced. In Uruzgan, of 48 schemes identified, only five have been taken to design stage. In Helmand, only three of the 16 schemes identified have actually been rehabilitated. Insecurity and risk are factors in implementation capacity too: MEW's regional offices in insecure areas are "losing good staff by the day". The response, as for other rural programmes, has been to rely more on community ownership: community leaders will typically accompany staff on site visits and assure their safety.

#### Box 9: Changes at the Ministry of Agriculture, Irrigation and Livestock (MAIL)

Long viewed as a bastion of top-down *dirigisme*, the Ministry of Agriculture (MAIL) has over the last two years begun to recast itself in the new mould of lean and efficient government.

The ministry has given priority to *strategic planning*, preparing (1) a master plan, (2) a strategy (for ANDS) with seven programmes, and (3) an Implementation and Investment Programme, with projects in each of the seven programmes. Seven working groups were set up, each headed by a MAIL Director-General. For the first time, these documents were not just prepared by expatriate technical assistance – MAIL staff were involved in the planning process, and have become familiar with concepts like privatization, participation, M&E etc.

*Institutionally*, MAIL is going through simultaneous change processes. Organizational changes are introducing a new organigram. Capacity building is going ahead on a continuous basis. In the meantime, staff are getting hands-on experience with implementation. The ministry has been through PRR: 14,000 MAIL staff in 2004 are now down to 10,000. About 20% of staff have "passed" PRR and are now confirmed in PRR positions. They are the object of capacity building, and they receive \$200 a month (rather than \$40 for non PRR staff). "PRR makes a difference," a senior adviser commented. The ministry remains, however, heavily concentrated at headquarters and provincial levels: MAIL has only 220 staff in Afghanistan's some 350 districts.

In its policy and strategy documents, MAIL has set three main *policy priorities*:

- **Reduce the vulnerability of the poorest:** a baseline is being established as a benchmark by which to measure progress; an FAO-executed project, FAHM, is doing a survey to assess levels of poverty among farmers (the overlap of FAHM with NRVA should be checked).
- **Withdraw MAIL from direct interventions** and focus on a "steering and regulatory role", ensuring service delivery through farmer organizations, NGOs etc. With this in mind, MAIL is developing a partnership protocol with NGOs, spelling out respective roles. MAIL is planning to keep a list of accredited agricultural NGOs and contract with them for service delivery. For example, EHLP has funds for NGO facilitating partners.
- Prepare the ground for *private sector development*, e.g. by working on land tenure and water rights.

MAIL has set three *program priorities*: (1) food security (livestock, irrigation, agro-processing, transfer of new technology); (2) development of horticulture for export; and (3) livestock for import substitution (poultry, dairy).

A key objective is to *consolidate – or at least coordinate – existing donor programs*. The Minister commented: "A year ago, donor programs were a patchwork. Now we are trying to work with donors, filling gaps" The Minister admits that there are shortcomings. The only way is to "communicate, coordinate and collaborate". But even so, there are agricultural projects that the ministry knows nothing

about. MAIL helped the USAID-financed credit project ARIES through all the hoops and committees, offering them office space in the ministry, but once effective, ARIES “disappeared and we don’t know their address”.

One remaining weakness is the inadequate *collaboration with MRRD and MEW*. Despite encouraging words, there has been little collaboration in the past with MRRD, the natural partner of MAIL. There are signs, however, that collaboration with MRRD may be improving. A positive indication is the recent close collaboration between the two ministries in drafting the Comprehensive Agriculture and Rural Development Strategy (CARD) under the auspices of the Senior Economic Adviser to the President. Once approved, CARD is expected to become the main coordination mechanism for agriculture and rural development. Two other areas where closer collaboration would be desirable is in the provision of rural credit and in rural enterprise. In addition, following the recent separation of irrigation from MEW, serious coordination problems remain, and MAIL is struggling to take over the MEW’s important portfolio of irrigation work.

*Source: Discussions with HE the Minister and with senior MAIL staff*

- *As in the case of other programmes, there is a need to work through decentralized planning and programming mechanisms and to optimize community engagement (especially through CDCs). Implementing partners should use locally recruited staff, and work with a community security guarantee.*

### **3.5 EXPECTED GROWTH, POVERTY REDUCTION AND OPIUM ECONOMY IMPACTS**

#### **Overall Impacts 3.5.1**

3.65 *Increasing value added in agriculture across the board has high potential to reduce poverty and to have an impact in terms of shifting incentives away from the opium economy.* Growth of orchard and industrial crops will primarily benefit the better-off landowners and smallholders (Types 1 and 2, see 2.3 above), but will also have important impacts on poverty and the opium economy through employment effects in the longer term. Growth in food crop and livestock production and productivity would have a broad impact across the entire rural population (including for the poorer farmers, Types 3 and 4) and would directly reduce poverty, thereby also supporting counter-narcotics objectives.

3.66 *Expanding the area of irrigated orchard crops can provide economic growth, exports and a viable replacement for opium for landowners and many farmers.* The distribution of benefits is broad, with more than 600,000 farmers working in this sector, and with an average area of less than 1/3 ha per farm (MAIL 2007a). Orchard crops are grown widely across the country, including in areas where poppy is currently concentrated. Growth impacts would thus be good (particularly for Types 1 and 2, but also for Type 3 farmers), and under conditions of decent governance and security, expansion of orchard crops could be expected to provide incentives for these farmers to avoid opium poppy cultivation.

#### **3.5.2 Targeting Maximum Counter-narcotics Impacts**

3.67 *Amongst the numerous possible interventions in agriculture, the maximum counter-narcotics impact is likely to come from the interventions which are broadly spread and bring the most income and employment to poor households.* Investment in integrated support programmes (3.3.1) is a very good candidate for scaling up and could be targeted to the key Type 2-4 farmers, although there are policy and institutional issues that would need to be resolved. Investment in high-value agriculture (3.3.2) would have its highest impact in the irrigated plains and peri-urban areas, where poppy is less prevalent, and could be predominantly taken up by larger landowners (Type 1). However, where more labor-intensive high-value crops are involved, these will increase demand for labor and (maybe at least to some extent) sharecropping. Promotion of certain high-value crops (the saffron example is an excellent one)



or in certain areas could have considerable impact on more marginal (Types 2 and 3) farmers. Pilot initiatives in developing high-value agricultural and processing activities, whether for export or import substitution, could have strong demonstration effects and encourage imitative scaling up over time by Afghan farmers and businesses. A comprehensive programme for contract farming of cotton could have a significant impact on incentives, with potentially high impact in opium areas such as Helmand (if security conditions permit). Further investment in irrigation (3.3.3) and in livestock (3.3.4) would have a strong counter-narcotics impact, although questions about operations and maintenance of irrigation need to be examined.

- ***The policy implication is that for maximum impact on the opium economy, further investment should be focussed on integrated support programmes, on irrigation, and on livestock, and the policy and institutional constraints to these programmes should be addressed. Support to higher value added cropping could be through the proposed AREDP programme (see 4.3.1 below).***

### **3.5.3 Mitigating Possible Risks**

3.68 *There is a risk that agricultural development activities may actually facilitate and enable greater areas of poppy to be grown.* Improving or extending irrigation can make it easier to grow poppy. Poppy could continue to be cultivated alongside the alternative crops promoted by development programmes. Newly established orchards, for example, can sustain an intercrop for the first three to four years – and poppy could be a suitable intercrop.<sup>12</sup> Settling refugees back into the community may actually provide more labour to service the poppy economy. A programme that provides alternative crops for farmers may still make many landless labourers redundant, as the alternative crop may have much lower labour requirements. In such cases, the landless may well seasonally migrate to where poppy cultivation is occurring, helping opium to flourish somewhere else.

3.69 *Measures to mitigate these risks need to be identified at the programme design stage.* The Afghan government’s policy of “mainstreaming” counter narcotics into all development programmes (see 7.3 below) requires that the risk of negative impacts be identified at the beginning of programme development, and mitigation measures built in, taking account of the specific drivers that affect each of the different categories of rural people engaged in opium production (see 2.3). Regarding the risk of loss of employment, alternative provision, e.g. labour-intensive public works or rural enterprise development, may be needed, although in the longer term increasing agricultural value added should generate some longer-term compensatory employment in production, processing and packing.

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<sup>12</sup> However, orchards would crowd out poppy over the mid- to longer-term.

## CHAPTER 4: FOSTERING ENTERPRISE DEVELOPMENT

4.1 Chapter 3 detailed ways in which increased value added in agriculture could help change relative incentives between licit crops and opium poppy and provide viable alternative income and job opportunities in agriculture.

4.2 Experience in other opium poppy growing countries such as Thailand and Pakistan highlights the limitations of licit agriculture in terms of its ability to grow rapidly and, in effect, replace opium production. In addition, the capacity of Afghanistan's poor mountain economy to sustain the large and growing rural population at an increasing standard of living inevitably faces stark limits. Out-migration – internal, rural to urban, or external – is a way forward in this situation. Thus how to accelerate enterprise development and job creation in the urban sector and to assist migration also need to be examined.

4.3 This chapter first looks at the role of private enterprise and its growth potential, and at ways of adding value to labour (Section 4.1). The following sections then discuss current interventions to support business and human resource development (Section 4.2) and the scope for scaling up and for new initiatives (Section 4.3). Ways to overcome the pressing constraints to doing business are examined in Section 4.4, and a final section (Section 4.5) sketches out the possible impacts of further programme interventions and related policy and institutional changes.

### 4.1 CONTEXT AND OPPORTUNITIES FOR ENGAGEMENT

#### Private Enterprise in the Afghan Economy 4.1.1

4.4 *Government is committed to establishing macroeconomic stability and free enterprise, encouraging private sector-led development and foreign direct investment.* To this end, emphasis has been put on maintaining a freely convertible currency, low tariffs and no quantitative restrictions on imports (with very few exceptions, mostly on religious grounds). Afghanistan is also committed to fiscal prudence and has embarked on a macroeconomic and reform programme supported by the IMF's Poverty Reduction and Growth Facility (PRGF).

4.5 *GDP growth has been fast, but future growth will depend on the investment and productivity performance of private enterprise.* The very rapid growth and high levels of investment described in Chapter 1 suggest a dynamic economy on a fast development track. They have in fact resulted in strong income growth, high demand and rising labour absorption. However, growth has been from a low base and has been inflated by very high levels of external transfers, conditions typical of a post-conflict economy. Whether recent rapid growth can be sustained and consolidated depends on whether structural change can be effected, with more sustainable growth drivers. Provided that macroeconomic stability is maintained, growth will depend in large measure on the investment and productivity performance of private enterprise.<sup>13</sup>

4.6 *The economy is dominated by a strongly entrepreneurial informal sector accounting for 80-90% of business.* Despite its large size and energetic character, this dominant informal economy has structural characteristics that make it a poor springboard for sustained rapid economic growth over the medium- to longer-term. It lacks the flexibility for technological modernization and productivity improvements; it does not invest in staff development; growth is limited by lack of capital; product standards are erratic; and above all, informal sector

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<sup>13</sup> See IMF 2006b: 75, Perisic n.d.: 5; Pain 2006: 5

enterprises are too small, disparate and not organized to move beyond local markets and clienteles. Byrd (2007: 1-5) concludes that Afghanistan's economy is essentially in an "informal equilibrium not conducive to growth".

4.7 *The formal sector is relatively small and urban-focussed, and private sector representative bodies are weak.* There are reckoned to be about 150 major businesses in the country, and about 3,000 other businesses are large enough to be registered with the Afghan Investment Support Agency or with the Ministry of Commerce.<sup>14</sup> Very few large or medium-sized businesses are rural-based. Construction is the most important single sector. Organization of the formal private sector is weak and fragmented: there are, for example, *three* chambers of commerce in Kabul. The strongest, the AICC (promoted by USAID), has some 7,500 members, including all the big 150. There have been hopes to use the AICC as a centre for promoting private sector enterprise, but it is currently "riven by discord". There are 82 Board members because "no one trusts anyone else".

4.8 *The lesson is that although the current high-growth environment does offer some opportunities to generate incomes and employment to counterbalance the opium economy, maintaining growth rates and scaling up business enterprise will require structural change.* The dominance of the informal sector with its low capital requirements and high labour absorption allows easy entry for rural entrepreneurs and rural-urban migrants. Scaling up, however, will be a significant challenge, and rapid improvements in productivity and incomes that could offer real alternatives to the wages and profits of the opium economy will be hard to come by. Formal enterprise clearly offers some potential but has high investment costs per job created and is dogged by constraints in the business and policy environment (see 4.4 below).

## **Employment and Adding Value to Labour 4.1.2**

4.9 *Employment is an important component of rural incomes.* Most rural households include both farm and non farm employment in their incomes, and non-farm employment is a key means of improving livelihoods. It increases incomes and reduces vulnerability by offering employment at little or no entry cost to landless households. There is also complementarity with farming, especially where households are farming to feed themselves, as non-farm income allows purchase of cash inputs. In general, there is a strong linkage between farm and non-farm growth. Typical non-farm employment may be in downstream processing and packing activities which add value to agricultural production, or in unrelated activities such as carpets (which can be based on wool from Afghan sheep), the garment industry, construction materials, the gem industry, bicycle and vehicle repairs, services such as restaurants and cleaning, and retail (Perisic n.d.: 7,8; Pain 2006: 5).

4.10 *The opium economy has provided first-class employment opportunities for Afghanistan's rural population.* Many thousands of workers are migrating internally in pursuit of wages that can reach as high as \$10 per day during the opium poppy harvest (plus lodging, meals, etc.). In addition, where poppy is grown it provides employment for both household members and other local people, enabling them to stay in their homes and communities rather than embarking on migration in search of work. Residing in a poppy growing area has typically been correlated with low levels of migration (Ghobadi and all 2005). By contrast, when levels of opium poppy cultivation have fallen significantly, out-migration has increased. This has been witnessed in parts of Nangarhar following the implementation of the opium ban in 2005 and 2006, as well as in Ghor in 2006 following crop failure (Mansfield 2005a and 2006b).

4.11 *Nonetheless, the opium economy is vulnerable to increases in wage labour opportunities in other economic activities.* Experience in other opium producing countries

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[www.procurementdirectory.af](http://www.procurementdirectory.af)<sup>14</sup> Source:

highlights the crop's vulnerability to rising wage labour costs.<sup>15</sup> Similar experiences have been seen in the provinces of Nangarhar and Badakhshan in Afghanistan (see Box 2 in 2.4 above). When salaried employment and substantial wage labour opportunities are available in licit activities, households have been unwilling to allocate family members to work on cultivating such a labour intensive crop as opium poppy – particularly when opium prices are falling. Neither, if there are relatively high wage labour rates, does it make sense to hire in labourers for opium poppy cultivation to substitute for this now gainfully employed family labour (Mansfield 2006b and 2007b).

4.12 *The non-opium economy will, however, be hard pressed to create the needed alternative jobs.* Growth in employment has been high during the recovery period, but this is not sustainable (4.1.1) – and non-opium employment will drop in the short run if the opium economy declines, due to multiplier effects on aggregate demand.

4.13 *Where local employment opportunities are not available, internal or external migration is the typical recourse when rural households are forced to shift out of the opium economy.* Current internal migration is ad hoc, without any kind of organization or support. Urban areas in Afghanistan offer few opportunities or lodgings for unskilled migrants (Opel 2005). Migration outside of Afghanistan also takes place in an informal and precarious manner. Often it has its own costs in terms of human smuggling. Afghans are targets of deportations and exploitation in neighbouring countries.

4.14 *Afghanistan's labour force is largely unskilled and hence cannot attract high wages.* Decades of war have left the Afghan workforce polarized between a small elite of foreign-educated professionals who are eagerly competed for and a huge mass of labourers with scant marketable skills.

4.15 *The lesson is that offsetting the employment and wage attractions of the opium economy will require significant efforts to develop rural employment opportunities, to add value to labour and to assist in migration and reinsertion.* Key ways to improve the quality of labor supply include: demand-driven vocational training and education, and facilitating internal and external migration.

### **Sources of Growth 4.1.3**

4.16 *Opportunities for rural non-farm growth exist in agro-processing, precious stones and carpets, as well as services.* International experience has been that development of non-farm rural industry is feasible, and can contribute significantly to growth (see Box 10). In addition to the agricultural growth opportunities discussed in Chapter 3 above, studies show potential for revival of traditional rural non-farm exports – carpets, minerals, leather garments etc. Already growth has been rapid, but for many products Afghanistan has still not regained the position that it held in the 1970s. There is also scope for increasing value in-country to improve earnings (OTF 2006). One example is in carpets, where most of the cutting and finishing of Afghan carpets is currently being done in Pakistan. Some 60% of Pakistan's carpet exports in fact originate in Afghanistan. It is estimated that an extra \$63 per sq m of value could be readily captured through greater efficiency and improved design and branding alone, and that

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<sup>15</sup> Kusvie (1960) provides an interesting account of the impact post-World War II industrialisation had on opium poppy cultivation in Yugoslavia. "In some villages this has led to a decrease in the skilled labour which is essential at the time of the cutting of the capsules and collection of the opium, so that over considerable areas the capsules remain un-incised and no opium was obtained, or the incisions were made by unskilled labour, which resulted in a decreased yield." In India in 1995, "The concentration of poppy growing caused higher costs mainly due to higher labour prices for harvesting... Many farmers expressed disinterest in continuing to grow poppies due to higher labour costs and low profit" (Nystom et al 1995). A similar phenomenon was experienced in southern Afghanistan in 1999 (see UNDCP n.d.). In China a drop in production in 1999 was attributed to "the shortage of manpower for lancing, which is a labour expensive and expensive process" (International Narcotics Control Board 2000: 80).

the value of Afghanistan's entire carpet industry would increase between two and five times if companies finished goods in country and sold directly to overseas markets, rather than exporting through intermediaries. There is also potential for larger-scale operations, with possible foreign direct investment (FDI) in mineral extraction and marble mining and working.

**Box 10 : Asian Countries Have Helped Rural Industry to Become an Engine Of Growth**

Many Asian countries have relied on rural industries to raise rural growth rates, including product processing and construction materials. China is an example of success in an initially unpromising economic and institutional environment (Byrd and Lin 1990).

Pre-conditions for success include access to land, markets, finance and electricity. Afghanistan would not be alone in finding these pre-conditions challenging. In Asia, typical promotion measures have included: access to finance; market development; support to the development of associations and industry bodies; skills development and entrepreneurship development; and improvements in policy and the enabling environment.

*Sources: Pain 2006: 5; Perisic n.d. 4,6, 13-14*

4.17 *In view of Afghanistan's dramatically unbalanced trade position, import substitution presents very large opportunities.* In 1982 the country's trade was relatively balanced, with imports and exports of about \$700 million. Principal exports were natural gas, dried fruits, carpets and rugs, and karakul sheepskins (Illinois Institute of Technology, n.d.). By 2006 (1385) officially recorded exports were down to one-quarter of 1982 nominal levels (\$168 million), and imports had surged to \$3.2 billion. This enormous trade deficit reflects the unprecedented levels of international assistance that Afghanistan has been receiving in recent years, as well as large unofficial re-exports of goods that in many cases were officially imported. But nevertheless, the imbalance in agricultural products is remarkable, given that this was and is the sector in which Afghanistan has significant comparative advantage, as demonstrated by past export performance. Key agricultural products that are promising candidates for import substitution include edible oil, sugar, dairy produce, cotton and textiles, and wool.

4.18 *However, over the medium term development of exports of agriculture-based processed goods will be essential.* Over time, Afghanistan will need robust export growth in order to reduce the country's dependence on aid, and as the opium economy and associated financial inflows are phased out. Agro-processing should be a relatively attractive prospect for export development from a medium-term perspective, given Afghanistan's comparative advantage in certain horticultural and livestock products.

## **4.2 CURRENT DEVELOPMENT INTERVENTIONS IN THE SECTOR**

4.19 A number of development interventions have been undertaken to promote private enterprise in Afghanistan. The most important are discussed in this section under the four categories of business development services and investment promotion (4.2.1), enterprise finance (4.2.2), industrial parks (4.2.3) and vocational training (4.2.4).

### **Business Development Services and Investment Promotion 4.2.1**

4.20 *Business development services have been established to offer intensive (free or heavily subsidized) support to small businesses.* The leaders in the field have been the USAID-funded Rural Agricultural Market Program (RAMP) (2004-2006) and its successor project Accelerated Sustainable Agricultural Program (ASAP). These projects have acted as umbrellas for a range of facilitating partners to implement project activities. Some notable successes have been achieved in bringing Afghan produce to market and in creating awareness of what needs to be

done to increase competitiveness (see the agricultural examples in 3.2 above). Support includes market chain studies, trial shipments, assistance with storage facilities, business fairs, etc. More recently, the USAID-funded Afghanistan Small and Medium Enterprise Development (ASMED) programme has been established to build capacity for businesses to associate and provide mutual services to members, to carry out market studies and to collect regular market information for the agriculture sector. Both IFC directly and the IFC and World Bank-supported PEP/MENA programme also provide support to business development, including project identification and entrepreneur capacity building.

4.21 *These programmes tend to be focused on the more developed areas and on towns, and there are problems of coordination and overlaps.* Coverage under enterprise development programmes has tended to be where market linkages are already good. The RAMP project concentrated on the most agriculturally developed areas. New projects are even more focused on such areas. The Japanese/ADB \$18m Rural Business Support Programme will cover just four provinces where similar projects already exist – Balkh, Bamiyan, Kabul and Nangarhar. The ASMED project is concentrated in Kabul, Nangarhar and Herat with partner offices in Helmand, Kandahar and Badakshan.

4.22 *There have also been problems of sustainability linked to the dominance of foreign advisers.* Enterprise development can be made more sustainable if greater attention is given to creating locally-run business development services and investing more in support services. Too much reliance at present is on engaging international business development services and not enough on building local capacity.

4.23 *Attempts have also been made to attract foreign direct investment.* USAID has tried to attract international investors through a combination of financial support and an appeal to demonstrate “corporate citizenship”. Dole was invited to set up orchards and a juicing plant for the domestic market, and Land o’ Lakes to run a dairy plant at Mazar. Problems of land ownership, the high cost of doing business, and corruption make foreign direct investment an uncertain prospect. Experiments continue, however: Nestlé and the Dutch firm GSE are currently investing under partnership agreements.

## **Enterprise Finance 4.2.2**

4.24 *Access to finance is a key driver of development – and of the opium economy.* The key role of finance in facilitating all aspects of rural development and agricultural production is well documented. In Afghanistan, after 30 years of disruption, there is very strong demand for financial services but scant institutional basis for providing the services. Interest in developing financial services has been sharpened by the fact that credit provision and advance payments are one of the strengths of the opium system. A backlog of opium debt has built up in some areas, exacerbated by drought and eradication (or coercion not to plant), which has locked the poor into the opium economy. In the absence of alternative financing mechanisms, the only solutions households can employ are returning to opium poppy cultivation, flight, distress sales or the handing over of a female child to creditors. Alternative sources of finance have been developed under a number of innovative programmes that have been started since 2001, mostly targeted at enterprise development but some at offering alternatives to opium-based credit (Mansfield 2007a: 22; Zia and all 2005: 8-9). The largest initiative is the Micro-Finance Support Facility for Afghanistan (MISFA), an apex organization set up for the micro-finance movement in 2002.

4.25 *MISFA has achieved phenomenal outreach – but still only meets 8% of projected credit needs.* By mid-2007 there were 15 micro-finance institutions (MFIs) with 224 branches in 23 provinces and 385,000 clients. The MFIs are currently disbursing \$7 million each month and adding more than 10,000 clients per month, with a target of 600,000 clients by the end of 2007.

As in other countries, micro-credit has been very successful in financial terms, with a repayment rate of 96%. The MFIs are able to cover 83% of their operational budget: three have reached operational self-sufficiency, and most are expected to do so by the end of 2007 (Zia and all 2005: 6 ff; World Bank 2007a: 17). MISFA was the subject of an independent review in mid-2006, and was rated “best practice”, with “phenomenal breadth of outreach” and good penetration of the poorest. However, unmet demand is still enormous: in mid-2006 only 5% of the bankable poor were serviced by MFIs, and only 8% of projected credit needs were being met (Islamic Republic of Afghanistan 2006: 10).

4.26 *Outreach to rural areas and lending to agriculture are more limited.* Most MFI activity is in urban and peri-urban areas. About 17% of lending is for handicrafts in both urban and rural areas. Some 16% of lending goes for agriculture. Innovative rural financing mechanisms include: (1) land mortgage, (2) contract growing (see 3.3.6 above), and (3) equipment leasing (Perisic n.d.: 20-1; Zia and all 2005: 7).

4.27 *Mechanisms were designed and tested to address the problem of accumulated opium debt.* In 2005 MISFA tried out an opium debt refinancing facility, with DFID providing \$10 million in financing. Overall, it was found that providing credit for opium refinancing or alternative livelihoods did not work unless other full-service programs were present to provide technical and institutional support.

4.28 *MISFA is trying to spread its rural programs nationwide.* MFIs are deepening the market by linking to existing community institutions and to trader networks, and by continuing to adapt products to the needs of agriculture and off-farm enterprise. This general expansion will certainly have an impact on the opium economy, although it is being constrained in some areas by insecurity (see 4.4.3 below).

4.29 *Credit for medium-sized rural enterprises has been lacking, but there are new initiatives in term financing for SMEs.* MISFA has an SME window (current funding \$9 million) which is disbursed through four local banks. The programme includes training for participating bank staff. IFC also has a line of credit of \$3.5 million to the First Microfinance Bank (a joint venture of IFC, GTZ and AKDN/ARMP) for SME lending (\$5-30,000). BRAC has joined with the Netherlands, UK and IFC to set up BRAC Afghanistan Bank: current activities are limited, with about 2,000 loans made, of an average size of \$8-10,000. The situation may also be improved by another USAID project, Afghanistan Rural Investment and Enterprise Strengthening (ARIES), which is scheduled to be rolled out in all 34 provinces. ARIES is aimed at strengthening funding for rural enterprises through existing local banks and MFIs, and through creation of credit unions. USAID has also promoted equipment leasing through the Afghan Financing Company. Lease facilities granted to date total \$3.5 million, largely for agriculture.

### **Industrial Parks 4.2.3**

4.30 *Industrial parks are being established in major towns to provide a secure, fully serviced environment for businesses.* Under various projects, a number of industrial parks are being set up in the major towns. They provide full services in order to attract investors. A particular plus is that electricity is guaranteed through own generation. The World Bank is supporting the development of the Hassan-e Shahi Industrial Park at Jalalabad, a \$25 million investment in a Free Economic Zone and with good transport access to Pakistan. The Park will provide 300 serviced plots, including assured electricity supply from six 1.2 MW generators. It is expected that the Park will generate considerable employment, particularly in carpets, leather goods, garment manufacture, and food processing. Industrial parks may help draw surplus labour from the countryside, including from poppy areas, to urban areas. The Jalalabad park, for example,

will draw labour from the districts adjacent in which poppy has been grown. USAID (through its ALP-South) is developing a business park in Helmand.

#### **Vocational Training 4.2.4**

4.31 *Despite its importance for employment, little attention has been paid to vocational training so far.* Vocational training is an important element in enterprise development, helping to retrain persons for non-farm roles, either to use in the locality or providing a skill for them to use elsewhere (migration strategy). Vocational skills training is considered to be a National Priority Programme. Donors (predominantly the Government of Japan) have assisted in establishing 19 vocational training centres around the country. However, few courses have been offered, demand has not been matched with supply, and standards have been poor. It appears that there is a tussle between ministries over responsibility. Nevertheless, the market is vast: a UNDP report on markets for SMEs saw potential for development of commercial vocational education and training, especially in the construction industry (Altai Consulting 2005: 153).

### **4.3 POSSIBLE FURTHER INTERVENTIONS TO COUNTERBALANCE THE ADVANTAGES OF THE OPIUM ECONOMY**

4.32 As in Chapter 3 (3.3), this section will discuss possible further interventions that might contribute to helping counterbalance the advantages of the opium economy. The interventions are discussed under three headings drawn from the development responses to the opium economy listed in Chapter 2 (Table 1): promoting enterprise (4.3.1); developing non-farm income opportunities (4.3.2); and financing (4.3.3).

#### **Promoting Enterprise 4.3.1**

##### *ENTERPRISE DEVELOPMENT*

4.33 *Government is proposing a massive and innovative rural enterprise development programme, AREDP.* Current enterprise development programmes are fragmented, not well linked to government strategy, and overly focused on urban areas. The Ministry of Rural Reconstruction and Development (MRRD), recognizing the importance of boosting business in the rural areas, is proposing a new national Afghanistan Rural Enterprise Development Programme (AREDP). The programme is still at a nascent design stage, so the specifics given in this report are only indicative. As presently conceived, the programme is designed to fill two major gaps in the rural economy that are constraining the growth of rural enterprises – absence of finance, and absence of skills, market knowledge and market structures. To ensure consistency of policy and programmes in the sector, AREDP would work under a policy coordinating body – the Enterprise Development Council consisting of major concerned ministries.

4.34 *AREDP would provide full services to both micro and small and medium enterprises.* Focusing on both import substitution and export development, AREDP would work at two levels: micro enterprises with less than 10 employees, and small and medium sized enterprises (SMEs) with 11-250 employees. AREDP would provide services adapted to the scale of the enterprise, facilitating access to finance, providing “end-to-end” business development service support, putting in quality control, providing policy support as needed, and promoting partnerships between micro enterprises and small and medium scale entrepreneurs. Management of these services would be contracted out. The institutional model would create links to other national programmes and work through the DDAs and CDCs (see Chapter 6), linking local mobilization of communities with business development. A key element would be the formation of groups and associations at the grass-roots level in rural areas, promoted and



facilitated by CDCs. One proposal for example is to contract with communities to supply raw materials for agro-processing.

4.35 *The programme is intended to be longer-term, nationwide and massive.* AREDP is intended to be a 10-year programme, highlighting the need for long-term commitment. The net financing requirement over this period is estimated at \$550 million. Currently indicated programme targets with this level of financing are very ambitious: 900,000 micro enterprises created, 12,000 SMEs, 2.1 million permanent jobs, and \$2 billion in annual product (MRRD 2007a).

4.36 *The proposal is to work with proven “champion products” where Afghanistan can be competitive, at least in the longer term, but also to respond to emerging demand.* The idea is to select a few proven “champion” product lines from possible import substituting products and from exportable products where there is scope for adding further value (see list of prospective champion products below). For each champion product, AREDP would carry out an economic feasibility study to check that there is potential for long-term competitiveness. Where imports currently undermine profitability and discourage investment, the study will analyse the measures needed in the short and medium term to get investment off the ground. The champion product approach is designed to induce investment into sectors with proven potential. But there will also be flexibility to respond to demand for other products or services – this would apply especially to farming and to enterprises supplying larger SMEs.

**Table 6: Prospective Champion Products**

<b>Import Substitution</b>	<b>Adding Value to Exports</b>
<ul style="list-style-type: none"> <li>▪ Vegetable oil</li> <li>▪ Poultry</li> <li>▪ Dairy products</li> <li>▪ Wool and yarn</li> <li>▪ Processed foods</li> <li>▪ Soap and detergents</li> <li>▪ Matches</li> <li>▪ Iodized salt</li> <li>▪ Bottled water</li> <li>▪ Fish products</li> <li>▪ Wood products</li> <li>▪ Footwear</li> <li>▪ Macaronis</li> <li>▪ Potato chips</li> <li>▪ Disposable utensils</li> </ul>	<ul style="list-style-type: none"> <li>▪ Medicinal herbs</li> <li>▪ Saffron</li> <li>▪ Silk</li> <li>▪ Leather</li> <li>▪ Karakul skins</li> <li>▪ Dried fruits</li> <li>▪ Fresh fruits</li> <li>▪ Carpets</li> </ul>

*Source: MRRD 2007b*

4.37 *Numerous issues surround the early draft of the proposal.* Among the issues at this early stage are the following: (i) coordination between the nine ministries reportedly involved; (ii) linkages to ongoing programmes, some of which by-pass the government process; and (iii) aligning with (and not undercutting) the financial terms of existing financial service providers.

- ***Next steps in the development of the AREDP proposal will be very important. All partners should work together, MAIL should share the driving seat, and government should make a special effort to bring in USAID and MISFA as principal partners. Particular emphasis should be given to building local capacity in business development.***

#### **LOCAL PROCUREMENT**

4.38 *The “Afghan content” of most international spending in the country is very limited.* A 2005 global study found that only 4-9% of benefits of peace-keeping budgets stay in-country.

Peace Dividend Trust (PDT), an NGO financed by CIDA, DFID and USAID (see Box 11), is working very actively on increasing the level of local procurement by all international groups in Afghanistan: *Buy Afghan* or *Afghan First*. The Afghanistan Compact contains a commitment to buy Afghan goods, but there has been little implementation and no monitoring of compliance. Currently the British military, for example, do not buy any food locally, on security and food safety grounds. Even drinking water has been imported, despite the existence of 36 local water bottling companies operating in Afghanistan. Extremely stringent regulations regarding food safety and security make it very difficult for Afghans to become vendors of agricultural produce to the international community, especially the military. Construction is another major sector where Afghans can find employment and where billions of dollars currently are being spent, yet the Afghan content of many contracts is extremely limited.

**Box 10: Peace Dividend Trust Facilitates Business Development**

An international NGO, the Peace Dividend Trust (PDT) was commissioned to carry out a study of the benefits of peace-keeping budgets. Subsequently, since 2006 CIDA, DFID and others have funded PDT to try to develop local procurement. With an initial target of facilitating \$5 million of business, in fact \$43 million has been achieved.

With a small staff (currently five expatriates and 12 national staff), PDT is managing five activities designed to increase local procurement:

- **Matchmaking:** PDT does market research for buyers, for example finding a supplier of water for the US military in-country. Currently, PDT is trying to match US army fresh vegetables requirements with a USAID-funded packaging plant at Jalalabad that is HAACP certified.
- **Website and directory:** PDT maintains [www.procurementdirectory.af](http://www.procurementdirectory.af) which has a roster of 3,000 businesses across 20 sectors. Most businesses have been visited. Employees and turnover are documented, with information updated every three months. The website is being expanded to become a “business to business platform”.
- **Advocacy:** With the slogans *Buy Afghan* and *Afghan First*, PDT works with ISAF and other agencies to promote local procurement. The most notable example is drinking water. The US army had been spending \$58 million a year to airfreight water in from Dubai. Now the US military has an Afghan First policy and is buying water from Cristal.
- **Tender distribution:** PDT collects tenders from ministries, gazettes etc., and advises local firms through a monthly publication, mass e-mailing and a library of tender documents.
- **Capacity building:** PDT does training in the new procurement law and regulations. So far they have trained 200 companies. As a result, nine businesses have won contracts worth \$4.8 million.

*Source: PDT.*

4.39 *A quick action that could have high impact on enterprise development would be a massive increase in local procurement by the international community in Afghanistan. Change is possible: the US army was spending \$58 million a year on imported bottled water alone. Recently, after advocacy and “matchmaking” by NGOs, the US military has developed an Afghan First policy under which it is buying locally bottled water and is also looking to buy peppers, tomatoes, cucumbers, and potatoes locally, including from a HAACP-qualified packing plant in Nangarhar. USAID is also promoting a “Mazar Farm” project, a large farm to be set up with the specific aim of supplying the international military forces in the country. It appears that this will be a foreign enclave operation, so that although employment will be created, there will be little other local value added and little local development dynamic.*

4.40 *Despite policy decisions and the evident benefits, there has been little progress. The UK – and ISAF forces generally – do have a local procurement policy, but there has been little implementation. This is an area for creative and energetic work: local purchase of food and a requirement to include local labour in construction contracts could inject up to \$1 billion every*

*year* into the Afghan economy. This could benefit exactly the rural populations who will suffer from the phasing out of opium, in particular those who might be involved in cultivation of, or labour supply to, opium. Increasing employment in construction would provide a very direct and rapid alternative to engagement in opium, particularly for the poorest. The dividend in terms of trust and “hearts and minds” would also be considerable.

- *All governments supporting the Afghanistan Compact should make firm commitments to sharply increase the value of local consumables procurement in 2008, with the objective of reaching, say, 50% by 2009; they should instruct relevant agencies to prepare feasibility studies and make institutional preparations (e.g. for recruitment of local purchasing and inspection staff) to meet this target. Construction contracts should specify maximum local materials and labour content, and give preference to Afghan contractors. Support to PDT should continue.*

## **Developing Non-farm Income Opportunities 4.3.2**

### *SKILLS DEVELOPMENT*

4.41 *To fill the critical local skills gaps, and to prepare Afghans for higher-tech employment at home and abroad, skills development is essential.* However, international experience demonstrates that unless vocational education and training programmes are tied to growing sectors and economic activities, demand-driven, and efficiently managed, they are likely to fail; these lessons must be factored into the design of vocational education and training (VET) programmes in Afghanistan. *A demand-driven VET programme needs to be drawn up and financed.*

### *FACILITATING MIGRATION*

4.42 *Diplomatic and commercial initiatives to facilitate labor migration and employment of Afghans in neighboring countries could make overseas work opportunities a more serious tool for reducing dependency on opium.* Government could encourage overseas working through the development of bilateral protocols and commercial contracting arrangements: for example, the promotion of licit contract labour companies to recruit and train labour to replace Pakistani, Indian and Iranian labour. Similar efforts were undertaken in poppy growing areas in Pakistan in the 1980s and 1990s. *A study should be carried out to identify entry points to higher-value and less restricted migration, and to develop a roadmap for policies in this area.*

### *(LONGER TERM) URBAN DEVELOPMENT*

4.43 *Investment in developing small and large urban centres would absorb labour and support out-migration from poor rural areas, including those prone to opium.* With only 25% of the population currently living in towns and growing land pressure in rural areas, urbanization will continue, and expansion of local industry to help absorb surplus labour will be critical. However, the I-ANDS plans only for urban services and land titling. Robust urban development could absorb labour and encourage people to migrate from the more overcrowded and remote poppy areas. Urban centres could act as “growth poles” that influence the economy and governance conditions in their hinterland, and help counterbalance opium in progressively increasing areas around them. *Although clearly a longer-term strategy, development of small and larger urban centres will be very important and will need to be supported by sound, private sector-based policies as well as necessary planning.*

## **Enterprise Finance 4.3.3**

4.44 *Rural financial markets are developing faster than anticipated, and there is considerable further potential.* In the next phase of MFI development, more innovative solutions for financing rural businesses could be explored: further development of leasing, which is proving particularly appropriate for agriculture and agribusiness; targeting weak links in the product chain; matching grants for business development; lines of credit; and help to “kick start” new businesses and markets.

- ***MISFA and its family of MFIs need to work to complete the process of maturation of MFIs, with full support from government and donors, and – in coordination with AREDP – to push out into the newer lines of finance for rural areas and of small and medium scale enterprises.***

#### **4.4 CONSTRAINTS AND POLICY AND INSTITUTIONAL RESPONSES**

4.45 This section looks at the major constraints faced by business in Afghanistan and at some of the priority policy improvements and institutional reforms that could facilitate enterprise development. The constraints discussed are: the current lack of alignment of support programmes (4.4.1), the weak business environment and lack of competitiveness (4.4.2), and poor governance and insecurity (4.4.3).

##### **Need for Alignment of Support Programmes 4.4.1**

4.46 *There is a multiplicity and diversity of approaches that can lead to overlap and duplication, and sometimes programmes undermining each other.* The donor-driven nature of enterprise development programmes, weak leadership by government and poor coordination by donors, and the multiplicity of facilitating partners, each with its own different objectives, have resulted in a diversity of approaches. For example, in a country where private businesses of any scale number only a few hundred, there are no less than three chambers of commerce at the national level (Afghan Chamber of Commerce, International Afghan Chamber of Commerce, and American-Afghanistan Chamber of Commerce). A multiplicity of business development programmes are now being set up. Better coordination and information sharing – or, better still, joint programming – are required to ensure that services are spread evenly and do not undermine each other. Over-concentration of services in some areas should be avoided.

4.47 *Similarly, partial grant assistance can help establish businesses, but the terms should not be widely different across programmes.* Enterprise development involves reducing risk by improving knowledge (especially of markets) and through off-setting some of the investment costs through grants or subsidies. Use of matching grants to off-set business costs has been tried in a number of countries, and business development services have been successful in many places – for example export development services in Ecuador and India. The model has been successfully applied world-wide. However, a consistent and transparent approach to this endeavour will help avoid duplication and assist in fostering a more competitive environment. For example, MISFA expresses fears that AREDP may undermine credit services and repayment discipline with low interest or free services that up until now borrowers have been willing to pay for. These concerns are currently being discussed between AREDP/MRRD and MISFA.

- ***There is a need to have common and standard policies regarding the degree of financial support that may be offered in programs. A mechanism, led by government, needs to be established to ensure a fair and consistent approach (here AREDP could play a significant role). Incentives and subsidies implicit in current business development services need to be streamlined and transparent, and the services should be built up to be locally run. Pooled funding to administer matching grants for targeted investments should be considered.***

## Strengthening the Business Environment and Competitiveness 4.4.2

4.48 *There are a number of structural and institutional problems which limit Afghanistan's competitiveness.* These include: (i) an over-valued foreign exchange rate; (ii) high labour costs; (iii) a weak enabling environment including widespread corruption; (iv) poor infrastructure; and (v) weak institutions. Related to all of these aspects, strong competition from imports, often further exacerbated by subsidies or other factors driving down production costs in neighbouring countries (e.g. nationwide subsidies on energy in Iran), is widely seen as an important factor hindering the start-up of domestic industries, giving rise to arguments for infant industry protection.

- i. *Appreciation of the Afghani is harming competitiveness.* This appreciation is probably largely a result of the high level of drug and aid related inflows. This could impede growth and diversification of exports and also hinder import substitution. More active exchange rate management, i.e. the classic macroeconomic solution of exchange rate depreciation, would help reduce over-valuation of the exchange rate. However, this option could be pursued only to a certain extent, and not to the point where it significantly increases inflation, as that would be counter-productive. The key to increasing exports will be diversification and improving productivity, including lowering the costs of doing business, and the same improvements would also enhance prospects for import substitution (IMF 2006a: 7-8).
- ii. *Wages in Afghanistan are significantly higher than in neighbouring countries.* One problem is the high levels of drug- and aid related transfers referred to above, which stimulate demand in the labor market and, in the case of the opium economy, push up rural wage rates directly. Daily agricultural wages in Afghanistan average \$1.90, compared with \$1.70 in Pakistan, \$1.10 in India, and \$1.25 in Iran. Afghan wages also, at least seasonally, reflect competition for labour from poppy. At harvest time, wage labour rates in opium areas can rise to as much as \$10 per day with food, accommodation, cigarettes etc. also provided (Pain 2006: 4; IMF 2006a: 12).
- iii. *The enabling environment for business in general and for exports as well as import substitution imposes considerable constraints.* The first Investment Climate Assessment (ICA) for Afghanistan identified access to land, electricity, financial capital and the problem of corruption as the main constraints businesses perceived hindering their activities. **Access to land** is slow, costly and insecure. Businesses are plagued by **lack of access to electricity** and the poor quality of supply when it is intermittently available from the grid. **Access to finance** is very limited despite the establishment of a number of banks in the country. And **corruption** is generally perceived to be widespread, with Afghanistan now ranking 172 out of 180 countries surveyed in Transparency International's corruption perceptions index. The **business environment** is generally poor: high cost and slow business start up, difficult credit access, untrustworthy judiciary and slow contract enforcement. With regard to exports in particular, there is a lack of **trade facilities** and slow, heavy and corrupt **export procedures**. **Transaction costs for exports and in general** are very high: efforts to improve customs procedures have lowered transaction costs somewhat,

but also made importation easier. Exports are hampered by other countries' procedures, in particular transit procedures in Pakistan (IMF 2006a:13-19).

- iv. *Productivity is impaired by poor infrastructure and services and by inadequate human resources.* Despite substantial investments, the road network remains inadequate (see Chapter 5), municipal services are poor, and electricity costs are very high, in addition to the problems of access to and quality of supply mentioned above. Lack of reliable electricity leads most businesses to rely on generators for power, which costs five times as much as the grid and requires additional investment. Human resources are generally poorly trained, with a largely illiterate population, and there is a serious shortage of skilled labour, especially managerial and technical skills, mainly reflecting lack of investment in human capital during the conflict (IMF 2006a: 17-19).
- v. *The institutional base is weak.* There is a lack of modern business institutions like effective business associations, efficient business support services, farmers associations, commercially oriented cooperatives, etc. Government institutions to support private sector development, as in the case of other sectors, suffer from major weaknesses in capacity, leadership and management.

4.49 *Strong import competition hinders start-up of domestic industries.* New enterprises typically have high failure rates, and risks are increased given the weaknesses outlined above: the business sector is weak and competition from imports is strong. Even well-established foreign firms may founder in Afghanistan's difficult environment. Land o' Lakes, for example, has withdrawn from the Mazar-i-Sharif dairy plant after failing to make money. Combined with cost advantages enjoyed by some neighboring countries and Afghanistan's relatively liberal trade and tariff regime, competition from imports may make it very difficult for even potentially viable businesses to get started. Thus measures need to be considered to encourage start-up of import-competing domestic economic activities on a sustainable basis.

4.50 *In the face of these constraints, Afghanistan has only a few compensating advantages to offer,* essentially those that have made the illicit economy so vibrant: a generally market-oriented overall policy environment, few legal constraints on labour markets, and a generally untrammelled informal sector. Although the agenda is long, any measures to rectify these constraints could have a considerable impact in enterprise development. The following paragraphs explore several areas where actions could be considered, including in the shorter term (Pain 2006: 3; IMF 2006a:15).

#### *IMPROVING THE BUSINESS CLIMATE ON AN ENCLAVE BASIS (INDUSTRIAL PARKS)*

4.51 *Industrial Parks can provide services and also act as a channel for development support.* While effectively addressing the problems with Afghanistan's business climate on a widespread – let alone nationwide – basis will take a long time likely measured in decades, it should be possible to provide the necessary improvements (in particular dealing with access to land, electricity, and to some extent finance as well as limiting corruption) on an enclave basis – especially through efficient, well-managed Industrial Parks. The main attraction of Industrial Parks is the provision of good services – land, electricity, bonded warehousing, and essential services. Industrial Parks also could be a suitable platform for innovative and effective measures to offset some of the more specific disadvantages suffered by Afghan businesses, for example matching grants for start-up investments, possible pricing of electricity at international rates on a transparent basis, access to finance through credit collateralized on the basis of land and facilities on Industrial Parks, business support services, etc.

- ***Following a review of experience thus far in Afghanistan, measures should be instituted to provide efficient, commercially-oriented management of Industrial Parks and to scale them up in response to business demand.***

#### *SETTING AND SUPPORTING EXPORT STANDARDS*

4.52 *Setting and supporting standards is critical for developing exports.* In order to be traded internationally, goods (especially agricultural and agro-processed goods) must meet international standards and have the requisite phyto-sanitary certificates. For these to be recognized, the necessary government inspection systems must be in place and up to standard. The government has set up an Afghanistan National Standards Authority as a semi-autonomous body under the Ministry of Commerce. Its mandate includes introducing and applying international export standards to assist Afghanistan's penetration of international markets. Strengthening this body should be a priority. In addition, private sector companies will need to increasingly improve their standards and look to certified production systems (such as HAACP) in order to be able to sell on foreign markets.

- ***Support should be provided to the Afghanistan National Standards Authority and to the development of private sector self-regulatory bodies.***

#### *STRENGTHENING THE CUSTOMS SERVICE*

4.53 *Improving the Customs Service is critical.* The Customs Service is a key actor in administering border protection, facilitating trade and raising government revenues. There are several programmes that support Customs. The World Bank-financed Emergency Customs Modernization and Trade Facilitation Project (\$31 million) aims to reduce transport related trade costs, reduce corruption and streamline border procedures through investments in infrastructure at key borders and through institutional development and capacity building. ADB and DFID also have been providing support. A Memorandum on the Foreign Trade Regime has been prepared, and transit and trade agreements are under preparation. However, much more remains to be done. Risks of corruption can only be overcome by strong systems and processes, capacity development, effective management, and adequate conditions of service and pay. Kosovo is a good example of where a landlocked country managed to develop an excellent Customs Service by providing good conditions of service, training and incentives. By paying better salaries than other government services and through comprehensive training, the Kosovo service attracted the best people to senior positions and managed to retain them (IMF 2006b: 92; World Bank 2007a: 10).

- ***Government and partners should work together to further strengthen the Customs Service.***

#### *REVIEWING TRADE POLICY WITH AN IMPORT SUBSTITUTION (AS WELL AS COUNTER-NARCOTICS)*

*LENS*

4.54 *The combination of an overvalued exchange rate, high domestic costs, relatively low import tariffs, porous borders, and other cost advantages of producers in neighboring countries exacerbate the difficulties in starting up new businesses and have generated pressures to increase protection.* Imports into Afghanistan are cheap and may overwhelm any incentives to establish import-competing businesses, even in activities for which Afghanistan should have a comparative advantage. In particular, agro-processing businesses, which would enhance value added in agriculture and expand downstream activities, may be vulnerable to import

competition and therefore difficult to get started on a viable and sustainable basis.<sup>16</sup> In some cases, anomalies in the tariff structure (e.g. higher tariffs on inputs than on outputs) may exacerbate lack of competitiveness. These problems have led to pressures to increase protection. The government has already raised tariffs on dairy produce (from 5% to 16%) and on soft-drinks and bottled water (over time from 5% to 40%). This latter change has encouraged investment and production by Coca Cola, but it is not clear whether the import protection was necessary, as the domestic price of Coke has not risen, implying that for one reason or another the import protection has not been effective. More recently, Nestlé is considering investing after the government agreed to raise tariffs on competing imports and to reduce tariffs on critical ingredients and packaging. MRRD, in its presentation of AREDP, calls for extension of protection to other agro products – eggs, frozen and live chicken, sugar and vegetable oil.

4.55 *However, the measures taken so far have been ad hoc, often in response to lobbying, unclear in their actual impact, and quite possibly poorly targeted.* It seems likely that measures taken to date have been excessive and ineffective. They may have encouraged over-investment in activities where Afghanistan does not have a comparative advantage or would not generate a great deal of additional employment. In any case, given Afghanistan's porous borders, high tariffs beyond a certain point would merely encourage smuggling. Thus trade-offs have to be made where protection issues are concerned, and more careful analysis should precede any decisions on tariffs than has been the case with recent changes. The possible benefits of infant industry protection need to be balanced against other desirable objectives of a tariff system; for example a relatively more uniform and less distorted tariff structure can facilitate customs revenue collection and minimize corruption. And the specific context of Afghanistan – notably its porous borders and widespread smuggling – needs to be factored into trade policy decisions.

4.56 *Alternative support measures may be used.* One alternative to encourage export industries could be to levy an export tax on unprocessed low quality exports to encourage their being locally processed. In addition, start-up assistance, matching investment grants, special pricing of electricity (at international levels), marketing support, etc. could be employed, as they were successfully in Thailand (see Box 7 in 3.3.2 above). Other possibilities, including some mentioned earlier, could include value-chain contracting, support to enterprise development, etc.

4.57 *A study of trade policy is needed, which takes into account the considerations discussed above and the need to develop import substituting activities as well as exports in areas of Afghanistan's (actual or potential) comparative advantage.* In the context of Afghanistan's accession to membership in the World Trade Organization (WTO), which has been initiated but will take quite some time to reach fruition, a Diagnostic Trade and Investment Study (DTIS) is under active consideration and may be conducted in coming months. This would be an appropriate vehicle for a careful analysis of the issues and trade-offs involved in choices about the tariff structure and how to enhance international competitiveness in Afghanistan's difficult environment.

- *A careful review of trade policy, perhaps through a DTIS and including an import substitution and counter-narcotics lens, should be conducted, and appropriate policy recommendations for the government and international partners developed on the basis of this analysis.*

### **Poor Governance and Insecurity 4.4.3**

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<sup>16</sup> There are reports of raw agricultural products (often of low quality) being exported from Afghanistan, processed in a neighbouring country, and then imported back into Afghanistan in processed form (e.g. raw cherries and fruit jam).



4.58 *Poor governance and insecurity are major handicaps to enterprise development.* Poor governance imposes very high costs, adding a quarter to firms' expenses. Afghanistan currently ranks 172<sup>nd</sup> out of 180 countries in Transparency International's corruption perceptions index (compared to 117<sup>th</sup> among 159 countries surveyed in 2005). Bribes reportedly average 8% of turnover, compared to 2% in Pakistan. Insecurity brings its own costs too: Afghan firms spend on average 15% of turnover on security, compared to 2% in Pakistan. As a result investors, particularly foreign investors, are risk averse and tend to avoid more insecure areas – or the country as a whole. The same constraints apply to public programmes supporting enterprise development. Insecurity seriously limits outreach, and working in insecure areas requires more to be spent on security by contractors and less on development. Programmes in insecure areas are also difficult to monitor and account for. The development of financial services, for example, requires a certain degree of security, and the expansion of MISFA programmes is being hindered by insecurity (IMF 2006a: 6-17).

4.59 *There is, however, a reciprocal relationship between enterprise and security.* Whilst a measure of security – and more generally of governance – is essential for the growth of businesses, the development of enterprises and wealth creation at the local level can also help promote security and governance. Licit businesses have a vested interest in the rule of law, good communications and markets, all of which help them to function more effectively. Chambers of Commerce or other business associations can be formidable lobbyists for improvement.

- *Further support should be provided to the development of representative business and civil society organizations that have a stake in anti-corruption measures and in improved security.*
- *For public programmes providing business development or financial services, there is a need to work through decentralized planning and programming mechanisms and to optimize community engagement (especially through CDCs). Implementing partners should use locally recruited staff, and work with a community security guarantee.*

## **4.5 EXPECTED GROWTH, POVERTY REDUCTION AND OPIUM ECONOMY IMPACTS**

4.60 The job and wealth creation impact of enterprise development is considerable, and support to enterprise development could represent a good opportunity for poverty reduction and counter narcotics. However, there is a long agenda before Afghanistan can build a modern, enterprise-driven economy, and the impacts on the opium economy will be consequently no more than gradual. Some entry points in the short run, such as Industrial Parks, matching grants or other start-up support, and value chain development should be explored.

### **Poverty and Employment Impacts 4.5.1**

4.61 *Enterprise development has direct poverty reduction impacts through job creation.* Although the measurement systems are far from perfect, existing enterprise development programmes do have significant employment impacts. ARIES, for example, claims to have created up to 70,000 jobs in just nine months. MISFA estimate that their programme has created on average 1.3 jobs per loan or about 800,000 in total.<sup>17</sup> The AREDP proposal (perhaps overly ambitiously) targets creation of an extra 2.1 million permanent jobs over a ten-year period. No data are available on the likely impact of vocational training or migration support

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<sup>17</sup> Afghanistan: World Bank Support for Microfinance, <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/0,,contentMDK:21166200~pagePK:146736~piPK:146830~theSitePK:223547,00.html>

programmes, but these also could be significant if programmes are well designed and properly implemented.

#### **Counter-Narcotics Impacts 4.5.2**

4.62 *It is likely that greater counter-narcotics impacts would be obtained by an aggressive programme of rural enterprise development, especially if there is a focus on agriculture and agro-processing.* Counter narcotics impacts of enterprise development are naturally diffuse and hard to measure. The model of “counterbalancing the advantages of opium” developed in Chapter 2 suggests that impacts would be achieved through investment in promoting enterprise, in developing non-farm income opportunities (through skills development, support to migration, and urban development), and in improving outreach of financial services. It is likely that the most direct impacts would be obtained by focusing on rural enterprises, as that is where the opium farmers and labourers currently are. It is also in rural areas that lower costs per job or enterprise created would also be found. If even part of the objectives proposed by AREDP are attained – 900,000 rural micro enterprises, 12,000 rural SMEs, 2.1 million jobs and \$2 billion in annual turnover – this would cause a very substantial shift in incentives toward the licit economy, especially if the effects were spread throughout rural areas, including poorer and more remote areas.

4.63 *Investments in formal enterprise and in urban development are both more expensive and longer term, and less directly linked to the opium economy.* However, to the extent that urban and formal enterprise development contributes to stable governance conditions and helps create a market for agricultural raw materials, it can be expected to shift incentives toward licit production. Jobs created will also provide opportunities for the vulnerable over the longer term.

- *The policy implication is that, for maximum impact on the opium economy, investment in enterprise development and related services, policies and institutions should be focused principally on rural areas. Support to rural business development should be accompanied by dialogue, policy reform and institutional development to increase competitiveness and develop enterprise across all sectors. One high-impact immediate action should be to step up local procurement sharply in 2008, with the objective of reaching, say, 50% by 2009, which could inject hundreds of million of dollars annually into the local economy.*

## CHAPTER 5: EXPANDING RURAL INFRASTRUCTURE

5.1 Chapters 3 and 4 looked at ways of directly affecting the incentive structure faced by rural people in Afghanistan. The present chapter will review the contribution that infrastructure (other than irrigation, discussed in Chapter 3) can make to supporting the development of licit livelihoods, a less direct but nonetheless essential part of the restructuring of the economy away from opium. The contribution that infrastructure can make to governance and the “social compact” between state and citizen will also be examined, a theme that will be further developed in the next chapter on governance (Chapter 6).

5.2 The chapter is structured in the same way as the preceding two: a look at the role of rural access, safe water and electricity in the rural economy and in supporting licit livelihoods (Section 5.1), a review of current programmes (Section 5.2) and opportunities for scaling up (Section 5.3), analysis of constraints and needed actions (Section 5.4), and a summary of expected growth, poverty reduction and opium economy impacts (Section 5.5).

### 5.1 CONTEXT AND OPPORTUNITIES FOR ENGAGEMENT

#### Rural Access 5.1.1

5.3 *Afghanistan’s difficult terrain and fragmented polity make rural access both expensive and essential.* The arduous geography and locally autonomous socio-political structures of Afghanistan have for millennia reinforced the poverty and centrifugal politics of the country. Heavy investment in trunk and access roads in the 1960s and 1970s wove a transport network that did begin to bind the country together and to bring some prosperity, although it was primarily focused on major national highways rather than on rural and market access roads. However, the system greatly deteriorated during the several decades of war, and much of it was largely destroyed. Despite major investments in recent years to rehabilitate the national highway network and sizable investments in provincial and rural roads, large parts of the country remain inaccessible by road: as many as 108 districts out of the total 396 districts currently have no road access to their provincial capital.

5.4 *Construction and rehabilitation of rural access roads therefore remains a priority for government.* Rural roads have been demonstrated by international experience as well as experience in Afghanistan to strongly stimulate economic growth through access to markets and services. They also can strengthen governance through easier communication and trade. GoA has therefore made rural road construction a top priority in the Afghanistan National Development Strategy (ANDS), building on considerable investments in this area since 2001 (Islamic Republic of Afghanistan 2007: ES10).

#### Rural Water Supply 5.1.2

5.5 *Rural water supply is vital for economic and social development.* Access to safe water improves health and productivity for both humans and livestock, and frees up time for productive activities by reducing time spent fetching water. Safe drinking water brings major benefits to health, particularly for women and children, reducing the incidence of water-borne diseases and peri-natal and infant mortality. Rural water supply can boost livestock production. Beyond the direct benefits, rural water also facilitates increases in school enrollment (particularly of girls) by freeing children from fetching and carrying water. Expanding access to safe drinking water is thus one of the government’s priorities for rural development.

### **Rural Electrification 5.1.3**

5.6 *Access to, and consumption of, electricity in rural areas is extremely low.* Considerable empirical work worldwide demonstrates the correlation between rural electrification and rural growth. Electricity in rural areas enhances communications and enables development of small manufacturing, irrigation, etc. Electricity is also an important basic good which transforms the life of rural households and villages, not least through its major advantages over other energy sources for lighting etc. However, Afghanistan's rural areas are currently poorly served with electricity, although the I-ANDS identifies "affordable and uninterrupted power" as a critical requirement for both economic and social development. Very few Afghans in rural areas have any access to electricity provided by public utilities, and Afghanistan's per-capita electricity consumption is extremely low. Lighting especially in rural areas is typically from candles, kerosene lamps or dry cell batteries, and cooking is done by burning biomass. Low-income households may spend more than 10% of their incomes on energy purchases. The capital investment needs of the rural energy sector have been roughly estimated at \$2.5-3.5 billion (World Bank 2005c).

### **Linkages to the Opium Economy 5.1.4**

5.7 *The lesson is that rural infrastructure underpins the development of both the rural economy and reciprocal relations of trust and engagement between rural people and the state, and hence contributes to the shift away from opium.* Direct poppy reduction impacts of rural infrastructure development have not been measured and would be difficult to correlate. However, development of rural roads does directly contribute to the development of the market economy, and rural electrification supports agricultural production and rural enterprise. Hence infrastructure development supports replacement of the poppy economy with licit livelihoods. Rural road programmes also generate local employment for both construction and maintenance. In addition, greater rural access should improve governance by strengthening the ties between town and countryside and giving rural people access to political and administrative fora. More generally, development of rural infrastructure, including water supply, represents visible provision of public services by the state, helping to develop a reciprocal relationship of responsibility and trust essential to development of both the licit economy and governance.

## **5.2 CURRENT DEVELOPMENT INTERVENTIONS IN THE SECTOR**

5.8 *Both rural access and rural water are the focus of National Priority Programmes.* The **rural access programme**'s achievements since 2001 have been considerable. Total spending on rural access under the national programme (LIPW, NEEPRA, NRAP) is estimated at \$193 million, and various rural development programmes of bilateral donors have also provided financing for rural access. The major rural roads program NRAP (formerly NEEP) has developed or improved 9,000 km of rural roads and connected 3,000 villages to market centres during 2002-2006. In addition, the program has generated 13 million labor days. However, programme outputs vary greatly across provinces, with less than 20 km rehabilitated in some provinces (Panjshir, Farah and Daikundi) and as much as 484 km in Kunduz. Cost effectiveness is also a question, given high and rising construction costs. In 2002 (under LIPW) average cost per km was \$9,300. By 2007 (under NEEPRA) it had reached \$30,000 per km (World Bank 2007b).

5.9 *Development of rural water supply is being undertaken under the auspices of MRRD's National Priority Programme WatSan, largely implemented through NGOs.* As in the case of rural roads, geographical coverage of rural water supply is patchy. However, the leading NGO involved, DACAAR, has implemented 36,000 water points nationwide serving seven million people (about one-third of the population). Water supply is NSP's most popular business line,

accounting for over one quarter of all sub-projects. Other NGOs and project providers also are active.

5.10 There have been some investments in *rural electrification*. Over 500 micro-hydro projects have been built since 2003 (MEW 2007). The International Assistance Mission, AKDN and Afghanaid are active in rural energy, and rural energy projects accounted by 2005 for 22% (1,587 sub-projects) of all NSP sub-projects. Four fifths of the NSP projects are diesel generators, the remainder micro hydel (< 25 kw).<sup>18</sup> A number of other government/donor programmes are planned or are starting up. The Afghan-French-German Energy Initiative works on micro-hydel and household energy, and supports the National Renewable Energy Research and Development Centre under MEW. Japan, USAID and ADB are also conducting studies and planning investments. There is currently very little private sector involvement in rural energy. Up to now, government policy has focused on restoring availability and access in the towns. MEW plans that by 2015 the urban access ratio should reach 90%, up from the current estimated level of 27%. The targeted rural access ratio is only 25% by 2015, up from the current estimate of 6-10%.

### 5.3 SUGGESTED INTERVENTIONS FOR ADDITIONAL ENGAGEMENT

5.11 Given the major needs, likely impacts on poverty reduction and improved livelihoods, and linkages to the governance and state building agenda, there is good justification for accelerating and expanding current programmes in rural infrastructure. This section discusses the feasibility of scaling up for rural roads (5.3.1) and for rural water supply (5.3.2), and looks at options for expanding electricity provision in rural areas (5.3.3).

#### Scaling Up Investment in Rural Access 5.3.1

5.12 *NRAP can be further scaled up if extra funding is available.* The need for more investment in roads is very great and urgent. The majority of Afghanistan's districts have not been touched, and the 9,000 km developed so far is only a fraction of the estimated 30-50,000 km needed to provide an economic minimum of rural access. In the Afghanistan Compact, the government has committed to providing road connectivity to 40% of all villages (giving access to 19 million people). The rural roads programme NRAP is being successfully implemented. It is a national programme with a well functioning Afghan-led implementation mechanism, so scaling up is possible (subject to some capacity constraints in the local construction industry). In fact, the programme faces a funding shortfall. Bridge financing is currently being provided by the Ministry of Finance, and although a new IDA credit of \$112 million will be available by January 2008, financing requirements are considerably in excess of funds committed. NRAP is thus an important and high-priority programme, and a good candidate for additional funding.

5.13 *However, NRAP's effectiveness needs to be improved.* The current high capital cost of road construction under NRAP threatens the sustainability of the program, and the lack of a sound maintenance strategy presents considerable risks to the sustainability of investments made. Scaling up should be accompanied by policy and institutional changes and by improvements in program design and implementation. Scaling up is also subject to security constraints, but there is still some scope for increasing coverage in opium poppy growing areas. The changes needed and the impact of security constraints are discussed below (Section 5.4.1).

5.14 *NRAP's coverage in opium poppy growing areas is high but could be further enhanced.* NRAP's coverage of opium poppy cultivating districts is relatively high, with 46% of those districts in which sub-projects are currently planned cultivating opium poppy in 2006 (the latest date for which district level figures were available). However, roll-out across the entire country

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<sup>18</sup> Many of the diesel projects have run into problems with financing fuel and maintenance however.

– but particularly in districts where opium poppy cultivation is at its most prolific – is constrained by the deteriorating security situation. This is reflected in the fact that, in the current planning proposed for 2008-2010, only sub-projects with a total value of \$1.5 million, out of the aggregate total of \$85 million available for sub projects, are to be implemented in the southern region (Helmand, Kandahar, Uruzgan, Dai Kundi and Zabul). Yet this region is responsible for almost 70% of the total national opium crop in 2007, and it is in these provinces that there is the greatest coincidence between opium poppy cultivation and insecurity. There are also a number of sub-projects proposed in districts in other regions of the country where opium cultivation could be considered extensive, or where the risk of widespread cultivation is relatively high. So far one-quarter of the allocated funds for subprojects has been allocated to these areas.

- ***Substantial additional financing should be provided for NRAP, depending on prioritization vis-à-vis other urgent programmes, and subject to policy and institutional changes and to improvements in programme design and implementation.***

### **Expanding the Programme for Safe Water in Rural Areas 5.3.2**

5.15 The rural water supply programme is moving ahead at a slow pace, and scaling up would require improvements in programme management and in implementation. The rural water program has been implemented under very successful NGO models. Demand from communities is strong. However, implementation rates are declining: DACAAR, for example, long the leader in the field, is currently working at a very low rate of implementation (about 800 schemes a year) in just six provinces. The problems are partly *technical*. Much demand is now in more remote and technically difficult and expensive communities. There are also issues of *sustainability*. The high-cost O&M model creates risks to sustainability. In addition, there are increasing water resource constraints – drought has affected 15% of DACAAR schemes, creating a risk of unsustainability of water sources. These issues have been identified by implementing partners as problematic. However, the principal issues constraining this important programme are *institutional* (see 5.4.2 below). These implementation, sustainability and institutional issues need to be resolved before scaling up would be feasible.

- ***A sustainable low-cost strategy for O&M needs to be developed. Survey work should be carried out to determine the effect of drought on existing schemes and on potential for future schemes. Institutional problems need to be resolved (see 5.4.2 below). Once these various issues are resolved, substantial new financing should be allocated to support accelerated implementation by implementing partners, typically NGOs, within the WatSan national priority programme.***

### **Rural Electrification 5.3.3**

5.16 *Models of community-based, public and private rural energy supply should be developed and financed.* Afghanistan has a wide range of modern energy resources, ranging from hydrocarbons to renewables. In most cases, decentralized systems based on renewables, diesel generators or batteries are likely to be more economic than grid connections (World Bank 2005c). The leading options include:

- i. Small hydel (< 1 Mw) under NSP, particularly where CDCs can implement joint projects.
- ii. Larger scale hydel (1-10 Mw), which in the absence of a private sector interested in this type of investment would probably need to be implemented by the public sector.
- iii. Private solutions in smaller urban centres that could be built around a sizable industrial demand e.g. for agro-processing.
- iv. Grid connections for rural communities close to urban centres.

- v. Diesel or solar energy systems for isolated communities, either CDC-implemented (but with clear and adequate provisions for supply of fuel and for maintenance) or possibly privately managed.
- *In conjunction with effective actions to address policy and economic constraints (see 5.4.3 below), financing of rural energy should be substantially increased.*

#### **5.4 CONSTRAINTS AND THE NEEDED PROGRAMME, POLICY AND INSTITUTIONAL RESPONSES**

5.17 Section 5.3 looked at the feasibility of scaling up rural infrastructure programmes. This section examines the main constraints to scaling up and recommends programme, policy and institutional responses (5.4.1-3). The section also examines the impact of political economy and security constraints and possible responses (5.4.4).

##### **Rural Access 5.4.1**

5.18 Based on the findings of the most recent policy review *Connecting Afghanistan* (World Bank, June 2007) and on further analysis, seven constraints to scaling up NRAP have been identified, which require responses at the programme, policy and institutional levels. These are discussed in the following paragraphs, together with the corresponding recommendations.

5.19 *There is need for a rural roads policy and for prioritized investment planning.* The programme has evolved with no policy framework or overall plan. Donor funding has been used in an ad hoc manner, with no multi-year rural access plan or investment programme. Priority needs to be given to rational development in line with: links to secondary roads; economic potential; and vulnerability. *Government should: (i) define a rural roads policy; (ii) establish a transparent mechanism for road prioritization and planning, incorporating equity and poverty reduction considerations; and (iii) develop a five year rolling program for investments in tertiary and secondary rural roads.*

5.20 *Coordination amongst providers and with beneficiaries needs strengthening.* The ministries directly concerned have not coordinated their efforts, nor have linkages to other national programmes such as NSP or to the PRTs been developed. The links with local and provincial planning processes have been weak. *A coordination mechanism amongst ministries, sub-national levels of government administration, donors and PRTs should be established.*

5.21 *The delivery mechanism remains very dependent on implementation partners, and needs to be increasingly taken over by the ministries or outsourced.* Public sector capacity needs to be strengthened. *Institutional responsibilities need to be defined at all levels, with a much stronger lead from government ministries (and including a community role in maintenance). A capacity building programme needs to be developed.*

5.22 *Costs and standards are very high, limiting expansion.* At current rates it would take a **hundred years** to upgrade the entire network. A shift to providing basic year-round access at minimum levels would reduce costs and allow an accelerated roll out. *New, low-cost standards should be developed.*

5.23 *There is no strategy for maintenance.* Only 25 km of the improved network is currently under a maintenance program. *A strategy for road maintenance urgently needs to be developed.*

5.24 *There is potential for using much more labor-intensive techniques.* Labour-intensive approaches would provide large numbers of jobs in road construction and maintenance. Such techniques, which were successful in Afghanistan in the 1970s, need to be revived and adapted based on global good practice. Labour-based operations could employ four times more labour, inject \$3-5,000 per km into the local economy, generate income multipliers in the range 1.5-2.8, and cost 25-30% less than comparable capital-intensive methods. Successful labour-based programmes have been run in countries like Botswana with a population density of just one person per square km – a fraction of Afghanistan’s population density. ***Low-cost and labour-intensive technologies should be adopted for rural roads (World Bank 2007b).***

5.25 *Economic data need to be collected to guide and justify the programme.* Monitoring and evaluation (M&E) needs to capture benefits and measure the cost-benefit relations of the program. This M&E could capture growth and poverty reduction impacts, and also aspects related to the opium economy (see 5.5 below). ***A simple M&E system should be set up early during the new NRAP programme.***

### **Rural Water 5.4.2**

5.26 The rural water programme needs to continue to be implemented through NGOs and others – but with stronger leadership on the part of the government. The rural water supply programme WatSan is in some ways the “poor relation” amongst the MRRD family of National Priority Programmes. Less attention has been devoted to it than to other programmes, and NGO implementation has been declining due to lack of financing and poor programme management. There is a pressing need for MRRD, as the mandated Afghan agency, to consolidate and expand the programme. A strengthening programme for MRRD central and decentralized services is needed, new policy and programme guidelines are required, and terms of engagement with NGOs and donors should be clarified.

- ***A study should be carried out to revise and strengthen the WatSan programme’s planning and management and to resolve the current implementation problems.***

### **Rural Electrification 5.4.3**

5.27 *A policy, a facilitating agency and financing are needed to overcome the barriers to rural energy access.* The fundamental constraints to rural energy access are low rural incomes and low density of the consumer base. Practical shortcomings also abound, including: (1) limited capacity to implement and maintain projects; (2) lack of equipment suppliers and spare parts; (3) high initial capital costs; (4) lack of credit; and (5) lack of knowledge about least-cost options and institutional models for sustainable expansion of access. What is needed is a ***national policy framework***. This framework should set out, first, ways to facilitate private investment, including rules under which the private sector should operate. In Nepal, for example, privately owned power units supply electricity to communities and SMEs in rural areas. Second the framework should spell out subsidy policy to help reduce high initial capital costs, whether for communities or for private investors. Third, it should specify ways to promote renewable energy technologies (as has been done successfully in Thailand, Brazil and Kenya). Finally, the framework should propose institutional options for larger rural energy projects (1-10 Mw). These options could include public/private partnerships, rural electricity cooperatives (as in Bangladesh), or rural energy corporations (as in Honduras). Also required is the establishment of a ***central agency for facilitating rural electricity access***. Such an agency could also coordinate research and access to best-practice information. NSP could help with some functions like providing technical expertise, establishing access to equipment suppliers and spares, etc. (World Bank 2005c).



- *A national policy framework should be developed, and an agency appointed to facilitate rural energy access and conduct research and information gathering on best practice options. Financing of rural energy should be increased.*

#### **Political Economy and Insecurity Issues 5.4.4**

5.28 *Roads, water supply and rural electrification are eagerly sought after and rarely attract political opposition.* Demand-driven community-based approaches, high labour intensity and local contracting increase ownership. Although political and community ownership is potentially strong, rural infrastructure programs are vulnerable to insecurity, which is growing and having a significant impact on implementation. DACAAR reports that it is now hard to get staff prepared to work in the more remote and less secure areas, although recruiting staff from the locality provides greater security and access.

- *As in the case of other programmes, there is a need to work through programming mechanisms and to optimize community engagement (especially through CDCs). Implementing partners should use locally recruited staff, and work with a community security guarantee.*

### **5.5 EXPECTED GROWTH, POVERTY REDUCTION AND OPIUM ECONOMY IMPACTS**

5.29 *In general terms, rural infrastructure programmes can be effective in improving livelihoods and in helping build governance.* The roads and, to a lesser extent, rural water programmes have a broad reach nationwide and a strong impact on poor communities and on the economic activities of the poor. Thus they can contribute to growth, poverty reduction, and in the long term to the replacement of the poppy economy with licit rural livelihoods. However, some more specific impacts can be expected from at least the rural roads programme, and these impacts are examined in this section.

#### **Growth and Poverty Reduction Impacts 5.5.1**

5.30 *Rural roads typically have a high impact on rural economic growth.* They increase economic growth through access to markets and services. Although NEEP/NRAP has not until recently collected data for economic evaluation of outcomes, there can be no doubt of the positive direct impact and multiplier effects of the programme. In addition, it has generated considerable short-term employment.

5.31 *Poverty reduction impacts of rural infrastructure are also considerable, and could be enhanced.* Lack of rural access is one of the sources of rural poverty. The poverty reduction impacts of rural roads can be enhanced in two ways: (1) by targeting the poor for construction and maintenance labour, and (2) by prioritizing access to poor communities. Results under NEEP/NRAP of targeting the poor for construction labour have been modest: only one poor household in five in project villages had someone employed through the programme. Initial planning for the programme assigned some priority to poorer areas, as measured by relative levels of year-round access to basic services, but in practice this was largely supplanted by a rather confused bottom-up demand-driven process and by some measure of access planning to try to link the rural roads requested to a coherent road network. The proposals above (5.4.1) for prioritized planning, for more systematic maintenance and for more labour-intensive approaches would enhance the poverty reduction impacts.

#### **Opium Economy Impacts 5.5.2**

5.32 *Rural access contributes to the growth of the licit market economy and to governance, and thereby influences incentives for licit production.* As discussed above (5.1.1), direct poppy reduction impacts have not been measured, but development of the market economy should create job opportunities for those currently dependent on poppy, and development of rural access should contribute to the replacement of the poppy economy with licit livelihoods. In addition, rural access should enhance governance, an important linkage (for example in the 108 districts currently without road access to their provincial capital). Over the longer term, rehabilitation of the remaining 75% of the nation's estimated 30-50,000 km of rural roads would have a potentially large impact on livelihoods and governance, and thereby on incentives associated with poppy.

5.33 *There is scope for expanding NRAP's coverage in areas in which the security situation is still manageable but where opium poppy cultivation is extensive or where its return is considered likely.* In line with the government's policy of "mainstreaming" counter narcotics in development programmes (see 7.3 below), the September 2007 appraisal of the next phase of NRAP assessed ways to enhance counter-narcotics impacts of NRAP and to mitigate possible negative impacts. The main recommendation of this exercise was to recommend increasing rural access in opium-vulnerable areas, particularly in the south and east. Given the relative shortfall in projects in the south and the east, this would be in keeping with the government's position on geographical balance as well. For the 20% of funds for sub-projects currently not committed, priority should be given to increasing delivery in the central districts of Nangarhar (Mohamand Dara, Shiwar, Bati Kot and Nazian) where the security risk is considered "medium"; and in Helmand (Nad e Ali, Nawa Barakzai, Lashkargah) and Kandahar (parts of Spin Boldak and Arghandab) where the security risk is high. This could play a role in containing both the problem of opium poppy cultivation and growing insecurity. DFID has in fact provided additional funding of \$15.4 million for NRAP in Helmand, to be implemented through MRRD as UNOPS will not operate in the province. Over the period 2002-7, 275 km of rural roads were developed in Helmand for \$4.2 million. The spending on roads per head of the population in Helmand over the period (\$5.40) was greater than the national average of \$3.80. Regarding the possibility that increasing rural access might create any risk of increasing opium production, no evidence of this was found by the September 2007 NRAP appraisal.

- *The policy implication is that for maximum impact on the opium economy, priority should be given to further expanding rural access, with focus on poor areas, areas where market linkages can be strengthened, and areas where opium poppy cultivation is extensive or its return is considered likely (subject to the security situation remaining manageable). Linking isolated districts to administrative centres should also be a priority. Implementation should prioritize community buy-in, emphasize labour-intensive construction, and provide for locally managed and executed maintenance.*

## CHAPTER 6: ENHANCING GOVERNANCE

### 6.1 CONTEXT AND OPPORTUNITIES FOR ENGAGEMENT

6.1 *Strengthening governance is a priority for reconstruction and stability in Afghanistan.* Along with security and development, governance is a critical element in building an effective and accountable Afghan State. It must be recognized up-front that based on its Constitution, Afghanistan is a unitary state with a centralized system of government. State responsibilities and services are handled through line ministries that have departments and sub-units at provincial and district levels. There are problems of lack of capacity at all levels, however. Moreover, it is at the decentralized levels – from local communities up to district and provincial levels of government administration – that the challenge of governance is greatest.

6.2 *Sound local governance is also a critical element in phasing out opium.* The linkages of governance with the opium economy were analyzed in Chapter 2 (Section 2.3). The development of responsible relationships between communities and their government is at the heart of the Afghan counter-narcotics strategy. In addition, community and local-level governance plays a vital role in the economic development process. Only when governance, security and livelihoods conditions are conducive can Afghanistan definitively succeed in its long struggle with opium. Investments in governance can thus pay significant medium and longer-term dividends with regard to counter narcotics objectives (see 6.2 below).

6.3 *Yet sub-national governance and government administration remain contested territory.* There is considerable debate regarding the roles, resources and responsibilities of the different institutions that have been developed at the village, district and provincial level in the last few years, and how they fit in with the unitary state mandated by the Constitution.

6.4 *The lesson is that development of good governance is integral to the growth, poverty reduction and counter-narcotics agenda but that attention is needed to some challenging issues, particularly at the local level.* Governance is central to the phasing out of opium, and current constraints hindering local-level governance need to be resolved. These issues are discussed in this chapter.

### 6.2 CURRENT DEVELOPMENT INTERVENTIONS IN THE SECTOR

6.5 Since 2002, two National Priority Programmes have been attempting to foster local-level development and governance structures: the National Solidarity Programme (NSP), which focuses on the village level; and the National Area Based Development Programme (NABDP), which concentrates on the district and provincial levels. This section discusses these programmes, impacts, and issues.

6.6 *NSP is designed to provide small-scale rural infrastructure and other projects to villages in line with their identified priorities, and thereby also to foster better local governance.* Currently, the National Solidarity Programme is the government's flagship for community-based rural development. This massive and extraordinarily ambitious programme is aimed at developing the ability of Afghan communities to identify, plan, manage and monitor their own development projects. Implementation is supported through contracted "facilitating partners", usually NGOs. NSP helps communities form Community Development Councils (CDCs), which then prepare community development plans. NSP provides block grants to communities to fund sub-projects that provide infrastructure, equipment and access to markets and services. Most sub-projects have been for small scale infrastructure, but some have been for improving agricultural productivity and human capital. From the initiation of the programme in mid 2003 until mid-August 2007, 18,250 CDCs have been formed. It is intended

that Phase II of the NSP will be rolled out to cover a further 4,000 villages within the next 2-3 years.

6.7 *At the higher level of districts and provinces, NABDP is designed to support local development and local governance.* The National Area Based Development Programme (NABDP) is a national programme designed to work at the district and – to a lesser extent – provincial level. Currently coverage is not comprehensive, as selected provinces are given priority by donors. For example, NABDP has been rolled out extensively in Kandahar due to donor priorities in view of the security situation. NABDP is currently in its second phase (2006-2008), in which it is supporting the formulation of district and provincial development plans, accompanied by funds for some projects at the district level. The programme is currently operating in 15 provinces and has so far facilitated the establishment of 167 District Development Assemblies (DDAs), covering 36% of the districts in Afghanistan.<sup>19</sup> Under NABDP more than 500 projects prioritized by district representatives are completed or ongoing.

6.8 *Block grants have created infrastructure, have generated employment, and have resulted in a high degree of public acceptability, particularly for NSP.* Block grants to communities (under NSP) and districts (under NABDP) have provided an impetus for economic growth. The rehabilitation of infrastructure has increased agricultural production and facilitated access to markets. Sub-projects have also created much needed rural employment, often recruiting people from within the community. Sub-projects have also created social infrastructure such as schools and clinics.<sup>20</sup>

6.9 *It is also envisaged that the CDCs could facilitate other development interventions.* CDCs could act as an entry point for other development investments by a range of development actors including government and non-government agencies, and in some cases this has already started.

6.10 *As mentioned above (6.1), investments in local development based on identified community priorities have the potential to pay significant medium and longer-term dividends with regard to counter-narcotics objectives.* The National Solidarity Programme has the widest outreach of any of the National Priority Programmes and is critical to increasing the legitimacy of the Government of Afghanistan. In areas where facilitating partners such as AKDN and DACAAR are engaged in a range of different sectors, CDCs serve as a platform *at the community level* for other economic investments that support the strengthening and diversification of legal livelihoods. Similarly, strengthening planning and implementation capacity *at the district and provincial level* under the NABDP has the potential to ensure that national programmes are more responsive to community needs, enabling investments in larger-scale infrastructure and enhancing the government's reputation for service delivery.

6.11 *Remarkably wide coverage has been achieved in a short time.* As discussed above, both NSP and NABDP are aiming at national coverage, although the deterioration in the security situation is constraining the roll out. By mid-2007 NSP had reached about three-quarters of the village communities in the country, in all 34 provinces. Coverage of NABDP is more limited, to date reaching districts including about one-third of the population.

6.12 *NSP has been effective, although some funding delays have partly impaired impact.* The establishment of CDCs has demonstrated an effective model for delivering rural infrastructure and development projects in line with identified community priorities (Box 12). After some understandable start-up delays, implementation has accelerated rapidly over time.

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<sup>19</sup> The status of these DDAs remains unclear given the constitutional commitment to elect District Development Councils.

<sup>20</sup> There are, as is common in community driven development (CDD) programmes, questions over the equity of distribution of benefits of the various sub projects implemented under NSP and NABDP.

One constraint has been slow disbursement of some NSP block grants, reflecting implementation outrunning programmed funding.

**Box 11: Success of NSP in Supporting Community Mobilization for Development in Badakhshan**

“Major strides in development have been achieved in Badakhshan through the implementation of the NSP. The formation of CDCs has created an enabling environment for sustainable development to take place. There is greater cohesion and a culture of debate and discussion on issues. The unified voice that is provided by CDCs did not previously exist. Now there is self-initiative in such areas as resolving internal conflict, paying the cost of vaccines and preventing the loss of livestock. Additionally, there is debate and discussion around planting domestic forestry in villages and there have been breakthroughs in establishing committees to collect user fees for the maintenance of completed projects.

“Communities are increasingly accepting, realizing, and understanding their rights and responsibilities. Under NSP, communities were able for the first time in history to implement community projects without using contractors. This milestone has built the confidence of the communities to undertake future projects.

“There is a trend among CDCs to ask for electricity projects or micro-hydel projects (MHPs), mostly through NSP funding. A number of MHP projects have been implemented very successfully. This success has demonstrated that such projects can be implemented in villages and it has spurred competition among the villagers for getting funding for MHPs. It has also inspired communities to mobilize their own money to create a number of small MHPs.

“One of the key achievements through the CDCs was the initiation of the process for the implementation of the largest water supply project in the province. The Jurm water supply project will cover twenty villages, at a cost of \$800,000. The unity of the twenty villages is an excellent reflection of the social cohesion which is facilitated by the NSP process. The communities from these villages formed two committees – a purchase committee and a monitoring committee – to both initiate the process and to monitor the completion of the project.

“Another significant achievement was the completion of the Baharak water supply project which provided water access to 700+ households. Upon completion of the project, the CDCs introduced a user fee of 30 AFN per household and they have hired four staff members for operation and maintenance. It’s a practical demonstration of the increasing self-reliance that the CDCs are instilling in communities and has been a breakthrough for these communities.

“Another noteworthy achievement was the establishment of 96 Self Help Groups (SHGs) in Ishkashim and Jurm. Out of the 46 groups in Jurm, half are women’s groups. Altogether, they have generated 2.3 million AFN in savings. The savings are now being used as an internal lending source. This has been a pilot project, with great success in meeting the need and urgency for mobilizing local resources.”

*Source: Adapted from Aga Khan Foundation, Afghanistan and Concern 2007.*

6.13 *Clustering of CDCs can provide economies of scale.* Individually, CDCs have turned out to be relatively small and numerous, which imposes constraints on the size of projects and meaningful prioritization on the part of communities. Early results suggest there is considerable potential for clustering of CDCs. A number of facilitating partners are already supporting this clustering, and in this regard have noted significant success with regard to mobilizing communities and their resources. Indeed, some facilitating partners see the development of these “meso-level” institutions as a natural next step, which also is consistent with the traditional *malik* system, under which *maliks* typically were responsible for an area encompassing half a dozen or so CDCs.

6.14 *In provinces such as Kandahar, “clusters” are being formalized as District Development Assemblies. This move may be promising, although there are questions and teething problems.* MRRD has also reported significant progress in clustering at the meso level through the development of District Development Assemblies (DDAs), most notably in Kandahar where the DDAs have been the channel for much financing of labour-intensive micro-projects (see 7.7 below). In Kandahar these DDAs are referred to as “interim” in those districts where NSP has not yet been implemented, and there are questions as to whether DDAs are sufficiently representative of divergent community interests where they have been developed prior to the establishment of CDCs. Facilitating partners in provinces other than Kandahar cite the absence of block grants at the district level as a major constraint on the roll out of DDAs and NABDP. The degree of coordination between NABDP and NSP also remains patchy.

### **6.3 SUGGESTED INTERVENTIONS FOR ADDITIONAL ENGAGEMENT**

6.15 NSP and NABDP have track records and are key instruments for building local development throughout the country, and on that basis enhancing government presence and thereby improving governance. These programmes should be strengthened and their role broadened.<sup>21</sup> This section discusses how to continue the programmes and assesses the need for adjustments to the implementation approach. Constraints and the appropriate policy and institutional responses are then discussed in the following section (6.4).

#### **Need for Further Financing to Continue the NSP Programme 6.3.1**

6.16 *Block grants are limited, and CDCs face a transition to a future development role without such large financing.* The NSP was initially seen as a five to six year national programme targeting all communities in Afghanistan. It has been evident that block grants are key to the success of CDCs. However, at present communities finishing two years of NSP are being told that they will not receive any more funding and that they should look elsewhere for funding for projects prioritized in their community development plan. Although this solution is ideal – NPPs or DDAs, for example, should be able to respond with the needed financing – it is unrealistic at this stage, as neither CDCs, nor NPPs, nor DDAs have the institutional capacity or financial resources to follow this idealized demand-driven approach. It is clear that continuation of block grants (albeit at lower levels than the initial block grants) will be necessary for communities to remain engaged in the short to medium term.

- *There is a need to fund the NSP Phase II and further roll out CDCs. Further financing of block grants (at lower levels of financing) should be provided to consolidate and develop the CDCs. Government and donors should work together to mobilize the necessary financing.*

#### **Need for Linkages to a Stable Development Partner 6.3.2**

6.17 *CDCs are doing best where they have broader and more integrated support from a stable development partner.* CDCs are proving more effective and are likely to be sustained in those areas where facilitating partners are in a position to support the initial block grants with capacity building to make CDCs institutionally sustainable and with support for other sectoral interventions. AKDN refers to this as *NSP Track II*, promoting initiatives that communities take to further their own development (as illustrated in Box 12). Only about 30% of these initiatives require financing, the rest require only better coordination and commitment from communities, e.g. in getting children into school, or reforesting hillsides. Where resources are

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<sup>21</sup> The future of CDCs and DDAs is under active review within Afghanistan. It is, for example, the object of a “national CDC consultation” in November 2007.

required, AKDN has access to funds and supports a range of different development initiatives, including infrastructure, horticulture, credit and SME. Other organizations including DACAAR and the Project for Alternative Livelihoods (PAL) are also adopting a more integrated model of rural development that can build on the priorities identified by CDCs.

6.18 *This integrated approach can be scaled up to cluster level and linked to National Priority Programmes.* A natural progression of this more integrated approach has been the “clustering” (at levels from district to province) of CDCs and facilitating partners in order to help support communities in engaging with National Programmes and line departments.

6.19 *Ways of continuing and extending the broad development role played by the facilitating partners should be developed.* The use of facilitating partners may be an effective mechanism both for NSP implementation and for further developing the capacity of CDCs as village-level development focal points. It would prove beneficial to build on the successes of those facilitating partners that have adopted a more integrated rural development model.<sup>22</sup>

- ***Government and donors should pursue options for supporting the facilitating partners so that they can assist in the further development of CDCs and DDAs both at the local level and in engaging with provincial institutions and National Programmes. Finding facilitating partners willing to adopt this approach in contested territory such as Helmand should be a priority.***

### **Assessing the Need for Continuing and Scaling Up DDAs and NABDP 6.3.3**

6.20 *DDAs are vulnerable if NABDP ends.* DDAs appear to be a potentially successful institutional model, although there has not yet been an independent evaluation. However, their creation is very recent and their sustainability is untested. If DDAs are to continue, provision of additional development financing through NABDP may be considered, and this could also help increase the effectiveness and legitimacy of district and provincial institutions. Technical support aimed at integrating counter-narcotics into such initiatives would also help ensure that counter-narcotics outcomes are enhanced. There is, however, uncertainty over the status of DDAs given the commitment to elect DDCs. In addition, the support programme – NABDP Phase II – has a short duration, inadequate to see DDAs through to any kind of maturity.

- ***Government and donors need to assess the role of DDAs and the possible need for further support through NABDP. If the model is assessed as successful, it should be generalized nationwide, and the NABDP extended with adequate funding both for technical support and for financing development. Counter-narcotics considerations should be “mainstreamed” into the district and provincial planning process.***

### **CDCs as Development Partners 6.3.4**

6.21 *CDCs are increasingly seen as key development partners at the village level.* There may be potential for using the CDCs as a development platform. Increasing numbers of development actors are looking to CDCs as their initial point of entry to rural communities, and under a 2007 Presidential By-Law, CDCs gained a legal existence independent of NSP. They are now legally empowered to receive and expend funds from different sources.<sup>23</sup> The World Food Programme, UNICEF, MISFA and other institutions are exploring how they might engage with CDCs so as to increase the outreach and effectiveness of their programmes. The initial

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<sup>22</sup> See also 3.3.1 above for a discussion of the need for such “full service” NGO partners to deliver integrated packages of agricultural support to farmers.

<sup>23</sup> The By-Law also assigns CDCs some explicit tasks of local administration, such as registering births and deaths etc.

design of MRRD's Rural Enterprise Development Programme (AREDP – see 4.3.1 above) builds on the successes of the CDCs and proposes to work through CDCs to identify private for-profit, self-help or common interest groups wishing to engage in productive investments.

- *In the next phase of NSP, progressive strengthening of CDCs over time to become focal points for development dialogue, prioritization, and oversight at the village level should be considered. Engagement at the cluster or district level could increase the effectiveness of development efforts.*

## **6.4 CONSTRAINTS AND POLICY AND INSTITUTIONAL RESPONSES**

6.22 This section examines key constraints to the governance support programmes, and recommends some policy and institutional responses. The constraints are: insecurity (6.4.1); political economy considerations (6.4.2); and issues regarding NGO engagement (6.4.3).

### **Insecurity 6.4.1**

6.23 *Insecurity is constraining NSP and NABDP in as much as one-third of the country.* Growing insecurity is constraining the implementation of all development programmes including NSP and NABDP. This is not just in the south where the security situation is at its most acute, but also in the north, west and east of the country. Recent reports suggest that facilitating partners for NSP are facing increasing difficulties in implementation, and that work undertaken has been targeted by anti-government elements. Some reports suggest that as much as 35% of the country is currently inaccessible (see Chapter 1). There is also evidence of unwillingness by some potential facilitating partners in the south to be seen to be implementing government programmes for fear of a backlash from anti-government elements. MRRD has developed a draft proposal for ways of implementing NSP in high-risk areas (see 7.6 below). This model could be applied *mutatis mutandis* to other national priority programmes.

6.24 *Yet operations still continue in parts of Helmand and Kandahar, with a measure of community support.* Despite prevailing levels of insecurity, both NSP and NABDP are operating in the southern provinces. For example, there are reports of 370 CDCs in the province of Helmand (although little is known about their institutional maturity). NABDP is undertaking some pioneering work in forming District Development Assemblies (DDAs) in Kandahar where NSP has not been able to operate (see 6.2 above). In these areas, local community members have guaranteed the security of MRRD staff and contractors (or at least provided warnings where they could not guarantee security). This approach has allowed for the establishment of 179 DDAs country-wide, including a number in Kandahar.

- *As in the case of other programmes (e.g. rural infrastructure, see 5.4.4 above), implementing partners should use locally recruited staff, and work with a community security guarantee. CDCs – the object of NSP support – should be the prime partners in ensuring NSP security and access. The draft MRRD proposal for implementation in high-risk areas should be reviewed and, once finalized, implemented, and its implications for other national priority programmes also could be considered.*

### **Political Economy Constraints 6.4.2**

6.25 *There are divergent views on whether CDCs can become the “lowest level of local government” or should rather remain entry points for development interventions.* At present, prospects for the former seem distant. MRRD sees the establishment of CDCs and DDAs as a platform for strengthened sub national governance, but other ministries, and most notably the new Independent Department for Local Government (IDLG), believe that the CDCs are and should remain civil society organizations, continuing to build on their success at delivering



small-scale rural projects based on village priorities, and also possibly serving as an interface for prioritization and oversight of development activities at the village level. Indications from ongoing field research suggest that, in general, rural people would prefer CDCs not to become “governmental”. Moreover, Provincial and District Governors, as well as representatives of line ministries, do not necessarily see CDCs as the point of liaison with local communities and may well choose to consult through existing systems like the well-established malik mechanism in many areas.

6.26 *The true degree of representativeness of a significant number of CDCs is questionable, and there are sometimes conflicts with other locally powerful people and traditional decision making bodies.* Some CDCs appear not to have been established on the basis of elections meeting the criteria set forth by NSP and in the CDC By-law.<sup>24</sup> This may at least in some cases limit the buy-in of the full community for CDCs to take on roles beyond delivering local projects. Moreover, there are reports of some local power brokers actively working against the establishment of CDCs, fearing that their traditional or assumed authority would be undermined by these new structures. Election results have also sometimes been contested, on occasions with violence, where existing elites have not been selected. Some facilitating partners have sought to overcome these problems by differentiating between the role of CDCs and traditional decision-making bodies such as shuras and by restricting CDC responsibilities to project delivery. Others have sought to ensure that traditional leaders and decision-making bodies are included in the consultation over community priorities and in subsequent implementation of sub-projects. However, there are concerns that if CDCs gain strength there is the potential for further conflict with local and regional powerbrokers.

6.27 *The situation is not helped by the continued strong centralization.* Despite commitment to decentralization, there is still an over-centralization of power and decision making at the central government level. The logic of decentralization in Afghanistan’s constitutionally-mandated unitary state is *de-concentration* of roles and responsibilities within Afghanistan’s centralized line ministries, with coordination, planning and oversight at the provincial and district levels. However, this is often resisted by ministries. Well-intentioned efforts to strengthen Provincial Governors and their offices have led in reported cases to micro-management (as opposed to coordination and oversight) on the part of Governors. This may further inhibit de-concentration, as ministries fear that de-concentration will not lead to better service delivery but rather to “capture” and micro-management by Governors. The ANDS planning process is, however, trying to enhance local participation in prioritization and planning, and the current review of the NDCS, for example, is recommending that counter-narcotics approaches be more effectively planned and implemented at the local level.

6.28 *The role and status of CDCs – and the DDAs – will likely develop progressively over time, and a step-by-step approach is advisable.* There is much to commend in the development of CDCs and DDAs so far. However, at the policy and institutional level there is continuing debate and varied practice regarding what they can or should be expected to do. Already CDCs are organs for some aspects of service delivery and development oversight, including some elements of local governance, and they could develop incrementally along these lines, especially if further block grants are successfully implemented. Expectations should, however, remain modest in the near future, and additional tasks should be assigned to CDCs only cautiously and gradually over time as their capabilities and roles are built up.

- ***Government and donors should work with CDCs, progressively empowering them to take on additional local service delivery and governance functions in limited***

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<sup>24</sup> Moreover, from the perspective of viewing CDCs as local government bodies at the lowest levels, CDC elections are not in accordance with Afghanistan’s electoral law and are not certified by the Independent Election Commission, raising further barriers to their gaining official status.

*functional areas, linked to other local service delivery and governance organs such as school management or health committees.*

### **Maintaining NGO Engagement and Innovation 6.4.3**

6.29 *NGOs have proved essential development partners, and they have generally worked well within the national programmes and budget.* For the last nearly three decades, NGOs have pioneered development approaches in Afghanistan and, since 2002, have worked as effective, often highly effective, implementing partners for the National Priority Programmes (NPPs). Several NGOs have been able to deliver the kind of broad-based, integrated development support that has proved most effective in improving livelihoods and in reducing incentives to opium cultivation (see 3.3.1 and 6.3.2). As the NPPs have moved forward with implementation and the government has taken more control of the development process, there have been correct and laudable moves to ensure that NGOs work within national policy and programmes, and that government and donor funding of NGOs goes through the national budget. Available information in fact suggests that cost-effectiveness of NGO interventions tends to be greater when they are implementing programmes through the national budget and where there is transparency and some degree of competition in their selection.

6.30 *Principled but pragmatic solutions are needed to allow the development effort to expand with the support of these experienced NGOs.* NGOs have sometimes encountered considerable difficulties in dealing effectively with ministries. One NGO recently “endured a tortuous five month negotiation” with MAIL for an emergency programme. It is important that the principles of government-led development and budgetization of development aid be maintained, but it is also vital to retain the commitment and innovative capabilities of NGOs as facilitating partners: they are often the only effective development agencies working at the grass roots level.

- *The principles of Afghan leadership and budgetization are absolutely key. Government, donors and NGOs should seek principled but pragmatic solutions to ensure that NGOs can continue to deliver effective and innovative development services on the ground in line with these principles. The inclusion of facilitating partners/NGOs is best initiated at the inception of a project idea – as AREDP is doing – so that facilitating partners can contribute to project design and programmes can get off to a rapid start based on existing facilitating partner/NGO capacity.*

### **6.5 EXPECTED GROWTH, POVERTY REDUCTION AND OPIUM ECONOMY IMPACTS**

6.31 *These economic and governance developments will have some growth, poverty reduction and counter-narcotic impacts, albeit diffuse and generally long-term.* The most direct and measurable effect of investments in NSP and NABDP lies with the economic activity generated by the sub-projects implemented. The impact of governance and community empowerment on growth and poverty reduction is more indirect and felt over the longer term. The counter-narcotics impact of strengthening sub-national government administration in Afghanistan is also diffuse and hard to measure.

6.32 *Short-term actions are nonetheless possible to strengthen the impact of governance on counter narcotics.* The potential role of CDCs in conflict resolution and security, which is the subject of an ongoing World Bank study, could be explored, although early indications are that this role may not be too great.<sup>25</sup> Second, counter narcotics could be “mainstreamed” into

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<sup>25</sup> Evidence from other countries e.g. Indonesia suggests that the CDC-type institutions are not very much used for conflict resolution beyond the project and development sphere.

Provincial Development Plans. This could not only enhance the counter-narcotics impact of development interventions at the local level, but raise awareness of the issues in planning fora. This would raise the profile and seriousness of the Plans, some of which are at present mainly aspirational and not very operational. These two actions could perhaps provide modest practical examples of the interaction between governance, security and the reduction of the opium economy (see 6.1 above).

- *The policy implication is that CDCs have the potential to play a role in moving the counter-narcotics agenda forward in discreet ways, and continued capacity building and financial support to them should be seen in that light, within their more general development roles.*

## CHAPTER 7: CROSS-CUTTING COUNTER-NARCOTICS ISSUES

7.1 The four previous chapters (Chapters 3-6) looked at how to tilt economic incentives away from opium production and toward licit livelihoods. The present chapter looks at other policy and institutional aspects that cut across sectoral or sub-sectoral programmes: issues of Afghan leadership (Section 7.1), of aid effectiveness (Section 7.2), of “mainstreaming” of counter-narcotics objectives into development programmes across the board (Section 7.3), and of long-term commitment versus short term expediency (Section 7.4). The chapter also looks at cross-cutting implementation issues: geographical balance (Section 7.5); the need to take account of the security situation (Section 7.6); the challenge of Helmand and the South (Section 7.7); and the political economy constraints to counter-narcotics efforts (Section 7.8).

### 7.1 INCREASING AFGHAN OWNERSHIP AND LEADERSHIP

7.2 *A major constraint affecting many development initiatives – including some of those recommended in this report – is weak ownership and leadership by Afghans. Within government, human capacity in the administration is still quite weak. Despite having some capable and trained staff, the general picture is of a poorly educated and ineffective administration. The problems of weak government leadership are aggravated by conflicting and often fragmented advice from international partners (ranging at the extremes from legalized production of opium for medicinal purposes to aerial spraying of poppy fields). However, there has been positive improvement in some ministries where, under strong Afghan leadership, capacity has been built up to run the organization and effectively deliver development programmes; indeed, this has been an essential ingredient in the successful National Priority Programmes.*

7.3 *Despite the severe constraints, far greater emphasis has to be given to Afghan ownership, leadership and management. The result of the weaknesses in the Afghan administration has been that foreign advisers, aid agencies and foreign governments have played a very large role in policy formulation. Foreign workers, NGOs etc. have also been very visible in the development effort. Leadership of the counter-narcotics effort is still heavily influenced by external agencies. There has been some improvement in the last two years, with a far more active Afghan role in policy determination and programme formulation – MRRD stands out as an example, and also MEW, while MAIL is catching up (see 3.4.3 above). The move toward increasing budgetization of aid flows is also a very positive step. However, development efforts – and the whole reconstruction effort – are at severe risk as long as there is either the perception or the reality that they are “foreign run”. Afghan ownership, leadership and management are essential, including in the particularly difficult area of counter narcotics.*

- *All programmes should be within the Afghan government’s strategy (NDCS), and accountable to the Afghan government. Afghan leadership and management of key ministries should be improved as necessary to ensure sound policies, programmes and implementation. Institution-strengthening efforts should continue and be further improved based on sound Afghan leadership, and technical assistance from donors should be fully supportive of government leadership and sustainable capacity building. The government should engage in open dialogue about counter-narcotics strategy, priorities and instruments with all concerned donors.*

### 7.2 INCREASING AID EFFECTIVENESS

7.4 *The multiple programmes reviewed in this report are all constrained by low levels of aid effectiveness in Afghanistan. This problem exists even though there are instruments that*

have been specifically designed to channel aid efficiently. The National Priority Programmes are the mandated instruments for ensuring aid effectiveness through a harmonized and aligned Afghan-led support programme. Since 2002, government and donors have agreed to put financing through the National Priority Programmes to ensure Afghan-led, coordinated and efficient development interventions. Each NPP was supposed to be designed by a Joint Planning Team (JPT) that includes representatives of the lead and support ministries, donors, UNAMA etc. In addition, the Afghanistan Reconstruction Trust Fund (ARTF) was set up to channel aid money via a pooled financing mechanism through the national budget.

7.5 *Despite these sound mechanisms having been put in place and becoming increasingly well-developed in recent years, only a small fraction of aid goes through the National Priority Programmes and the ARTF, and less than a quarter goes through the national budget. Most aid still by-passes the NPPs and ARTF. The Summary of the I-ANDS states “the manner in which much needed foreign aid is channeled also contributes to the weakness of the state. Less than 25% of aid goes through the national budget, resulting in parallel delivery structures and pay scales that undermine government legitimacy, reduce public service capacity and lead to policy incoherence” (Islamic Republic of Afghanistan 2007b).*

7.6 *Rural livelihoods programmes remain disparate and ill-coordinated, despite current attempts at coordination such as CARD and I-ANDS. The result of weak Afghan leadership and poor donor adherence to harmonization and alignment is some very messy and ill-coordinated development activities. In rural livelihoods programmes, for example, some donors have agreed to “consultations” but nevertheless finance programmes outside the budget with scant reference to either government or other agencies. The reaction to the resulting incoherences has been to try “coordination”: a Comprehensive Agricultural and Rural Development (CARD) approach is being developed to help coordinate central and regional planning in the sector, so as to avoid these overlaps. The I-ANDS has also kicked off the provincial development planning process to contribute to the national plan. But essentially, parallel, ad hoc and informal processes further burden an overstretched administration. Many programme managers say they “don’t have time for coordination”.*

7.7 *Donor-executed programmes have in-built perverse incentives, and ISAF commitments to provinces can further distort the aid framework. Two aspects tend to further undermine coherence. First, donor sponsored programmes tend to have large budgets and limited time to spend them. They therefore tend to plan alone in order to meet their targets. Second, donors are influenced by where they have other political, military or economic commitments. For example, donors will support actions in the provinces where they have an ISAF and PRT commitment, rather than financing NPPs on a nationwide basis (see, for example, the resulting lop-sided roll out of NABDP, described at 6.2 above).*

- ***The effectiveness of the measures recommended in this report could be greatly increased by better harmonization and alignment of aid. Donors should reaffirm – and implement – their commitment to financing National Priority Programmes and to channeling aid flows through ARTF and the national budget. Capacity strengthening should be provided to help government steer the NPPs and to manage the related budget flows efficiently. Joint programming under government leadership – rather than just “coordination” – should be the rule.***

### 7.3 MAINSTREAMING

7.8 A very considerable counter-narcotics impact could be obtained at little cost by the application of well thought-out mainstreaming guidelines. The mainstreaming concept is a response to the reality that opium production is indeed mobile and the problem is a nation-wide one. It is clear from experience that tilting incentives in the rural economy toward licit

livelihoods cannot be done through small localized projects, nor through short-term “alternative livelihoods” projects. The drug control effort has to be “mainstreamed” into the overall long-term development effort (Mansfield and Pain 2005: 2; Ward and Byrd 2004: 49, 91 ). Mainstreaming is, in effect, nothing more than seeing conventional development interventions through a counter-narcotics lens. Elements of this process include:

- Developing policies and programmes that are informed by the potential impacts on the illicit drug problem
- Adjusting the focus of development programmes and projects so that they recognize and take into account the potential impact they might have on the illicit drug problem, and taking steps to maximize positive impacts when conducting these activities
- Promoting coordination and encouraging programmes to be complementary in their interventions, at national, provincial and district levels
- Ensuring that programmes or projects do not inadvertently encourage illicit drug crop cultivation, trafficking or use

7.9 *These mainstreaming actions can usually be implemented with modest extra effort.* Many mainstreaming improvements may be obtained relatively easily by better coordination, networking and joint programming at the local level; linking to the extent possible with CDCs; and improving and systematizing coordination between National Priority Programmes at both local and higher levels.

7.10 *The objective of mainstreaming is to ensure that, where relevant, all development programmes help address the causes of the illicit drug problem in Afghanistan.* Effective mainstreaming, then, will include elements within development activities that target specific **areas** in which opium poppy is grown or target those **socio-economic groups** that are most dependent on opium poppy as a source of livelihood. Mainstreaming will also help build **synergies** with other activities that might maximize both development and counter narcotics impact. In other words, development programmes can be oriented toward target areas or vulnerable groups and work in synergy with other programmes to achieve maximum counter narcotics impacts, much along the lines of the methodology used in the present report.

7.11 *Although mainstreaming is national policy and has been endorsed by donors, implementation has been very slow.* Counter-narcotics mainstreaming was adopted as government policy in the I-ANDS. Moreover, the World Bank, ADB, the European Commission, and DFID have endorsed the mainstreaming approach and have started using it in development activities they are supporting. However, operationalization and delivery of mainstreaming have been disparate and slow.

7.12 *Some national ministries and aid agencies have begun to tackle the issue.* The Ministries of Public Health and Education have explored how their respective national programmes might contribute to education and prevention in the area of problem drug use. The Ministry of Agriculture (MAIL) has obtained technical support to integrate counter-narcotics issues into its development programmes through a DFID-funded FAO programme. The Ministry of Rural Rehabilitation and Development (MRRD) is also developing a strategy document to outline the role its important National Priority Programmes can best play in supporting drug control objectives. Various aid agencies have worked with government on mainstreaming guidelines and have attempted to engineer mainstreaming into projects (see Box 13).

- ***Counter-narcotics mainstreaming guidelines should be adopted and diffused, based on any necessary fine-tuning. Government should help agencies apply the guidelines systematically.***

**Box 12: Government and Donors have Developed and Applied Mainstreaming Guidelines**

In 2006 the World Bank, in consultation with government and other donors (particularly DFID, the EC, ADB and UNODC), developed a *mainstreaming guideline* to apply to development programmes to maximize their contribution to the drug control effort. Essentially this checklist asks to what extent the operation or activity: (1) contributes to the governance agenda; (2) maximizes synergies to deliver broad livelihoods impacts at the community and household level; (3) maximizes more specific counter-narcotics impacts by area coverage and by addressing the poorer target groups, with components which strengthen and diversify legal livelihoods; (4) identifies risks and develops an approach to ensure that the operation or activity supported “does no harm”; and (5) contains a monitoring and reporting capability that can effectively track outcomes.

This approach was initially applied to several ongoing World Bank-financed projects, notably the Education Quality Improvement Program (EQUIP) and the Health Sector Emergency Reconstruction and Development Project: action plans were drawn up and discussed with government in 2005/6. Implementation is underway.

During a joint World Bank/DFID mission in 2006, the approach was used to engineer mainstreaming in two World Bank projects: the Emergency Horticulture and Livestock Project (EHLP) at appraisal, and the Emergency Irrigation Rehabilitation Project (EIRP) at mid-term review. A series of simple improvements in project design and implementation was proposed. For example, in the case of EIRP, recommendations included measures to increase agricultural productivity through links to support services (extension, inputs, markets), to increase the use of community labour, and to link to other programs aimed at increasing the attractiveness of licit economic activity (both on-farm and off-farm) such as credit, agricultural services, vocational training, etc. The Mainstreaming Guidelines have more recently (October 2007) been used in the appraisal of the Bank-financed National Emergency Rural Access Project (NRAP).

#### **7.4 LONG-TERM COMMITMENT VERSUS SHORT-TERM EXPEDIENCY**

7.13 *There is an asymmetry between the political expectations of government and donors and the reality of the one to two decades realistically needed before the opium economy dwindles.* The Afghan government, donors and their governments typically have a short to medium-term political horizon in which results from counter-narcotics policies and investments are expected. Clearly, further development interventions on a broad front and beginning in the immediate future are essential if improved governance and Afghanistan’s prospects for longer-term development are not to be undermined by narcotics. Better deployment of existing resources also is necessary. However, the economic growth needed to displace the opium economy, and the development of the necessary infrastructure and governance to support it, will take at least one to two decades. Counter-narcotics requires the reinforcement of efforts in the near term, combined with a longer-term perspective and sustained commitment and investment.

7.14 *Quick-impact projects produce little long-term result.* There is a political imperative to show results in the very short term, so quick-impact projects have been very popular. Unfortunately these projects are short-lived in duration, their impacts are ephemeral, and costs have been high in relation to any achievements. No long-term impact of these projects in eliminating poppy cultivation has been demonstrated or reported.

- ***The need is for long-term commitment rather than short-term expediency. Truly effective counter-narcotics efforts are a combination of economic development, the***

*provision of services and infrastructure, and better governance and the rule of law. Reinforcing the development effort right away is essential, but to achieve results will take considerable time, massive and sustained financial commitment, and political vision and stamina.*

## **7.5 GEOGRAPHICAL BALANCE**

7.15 *Opium has, as some have predicted, proved footloose, although certain regional patterns are consolidating for the moment.* Compared with only about half a dozen provinces in the mid-1990s, in 2002 opium was being grown in 24 provinces. By 2005 opium was grown in 28 out of Afghanistan's 34 provinces. In 2007, despite growth in total output, it was only in the south that there was a dramatic increase in production: by contrast, there was a reduction in the north and north east, and opium was being grown in only 21 provinces. The lesson is, however, not that the problem has been solved in any one province, but that production will shift – and shift again – as the economics, security situation and politics change. In the past there was too much emphasis on providing assistance to the main opium producing provinces, and the neglect of non-opium producing provinces left them more vulnerable to the spread of cultivation which indeed occurred. The logic of providing aid only to those areas which are planting opium poppy on the one hand, or only to those which are reducing their opium production, is therefore quite false.<sup>26</sup> **Any** province might produce opium if the chance and the incentives are there. Strategy, common sense and equity suggest that it is vital to maintain the development effort in all provinces, even where opium has not been grown. A balanced approach providing aid to both opium producing and non opium-producing provinces (as part of a “containment” strategy) is therefore essential.

- *Levels of aid to provinces should not be solely determined by reductions in the amount of opium cultivated but rather by equity, poverty reduction concerns and economic opportunities. Aid should, however, be targeted as far as possible to address the drivers of the opium economy and to counterbalance its advantages (see Chapter 2, Table 1).*

## **7.6 TAKING ACCOUNT OF THE SECURITY SITUATION**

7.16 *There is a strong correlation between insecurity and poppy growing on three levels.* First, opium is a crop that thrives in ungoverned space (as discussed in Chapter 2). The opium economy (and competition over the financial and political advantages that are gained from involvement in it) is also one of the factors contributing to increased insecurity – opium poppy cultivation is also one of the primary responses to that insecurity (see 7.8 below). Currently areas where poppy is grown extensively and through which it is trafficked tend to be high-risk. A second level is anti-government elements (and ad hoc alliances that have formed between drug traffickers and these elements). A third level contributing to the nexus of insecurity and poppy is the presence and influence of warlords.

7.17 *Providing security is an essential component of the counter-narcotics effort, but PRTs by and large have not been successful in ensuring a safe environment for development programmes.* Ideally the presence of the PRTs should support and facilitate development activities, instead of development being seen as an instrument to legitimize the presence of the military. The PRTs should provide a credible bridge between security activities and the development agenda, and a conducive environment in which the latter can be pursued. It is not clear that PRTs have been able to provide this safe environment for development programmes.

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<sup>26</sup> This policy has, in the past, meant that some more remote and less easily accessible provinces missed out on state aid (e.g. Paktika).



Moreover, foreign military personnel rotate fast, which reduces the consistency of policies in PRTs and leads to a disconcerting tendency to always “try something new”.

7.18 *Where counter-insurgency operations are being conducted, the window for development narrows further.* Can the military provide an enabling environment for development actors, or does the military presence lead to greater insecurity for these actors? Overall, the presence of the military – and particularly counter-insurgency operations – can exacerbate insecurity, reversing the virtuous circle that links development and security.

7.19 *Once a vicious circle sets in, development options greatly shrink.* Security has deteriorated since 2005. This has two big effects. First, donor contributions get eroded as more is spent on security and less on delivery, and second, there is a slowdown in project delivery. The NSP, despite its local community orientation, has slowed down in about one-third of the country. By September 2007, NSP activities had been suspended in 695 communities in 13 districts due to security risks to staff (see 6.4.1 above).

7.20 *Yet the challenge of providing viable legal livelihoods remains, and development of economic activities, especially aimed at the rural poor, can reduce a population’s propensity to join an insurgency.* Development may not only improve livelihoods but also enhance the legitimacy of the government and enable it to win the hearts and minds of its constituents.

7.21 *Although in practice insecurity may stifle development, there are strategies that developers may use.* One is to work through government programming mechanisms, to ensure that the local administration and local people are aware and on board. The second is linked to this – to maximize local ownership and community engagement through working with community institutions (CDCs and others), local contracting, labour-intensive works etc. This may offer some protection against the insurgency. The third is to remove all “foreign badging” – and in some places perhaps even government badging, and to be thoroughly Afghan in the field. The fourth is to use local implementing partners and locally recruited staff, preferably from the communities themselves. The final approach is simply relevance: the project has to be at the top of the local community’s priorities, and preferably one that gives them a stake in stability, security and good governance – a productive fixed asset, for example, such as irrigation. The proposed modalities proposed for implementing NSP in high-risk areas (Box 14) indicate some of the adjustments that can be made to adapt to deteriorating security.

**Box 13: Adapting NSP to Deteriorating Security**

A recent draft paper has proposed some possible ways in which NSP facilitating partners (FPs) can mitigate the effect of insecurity on their programmes:

- **Cooperation agreement:** As a minimum condition of entry, communities must sign a cooperation agreement showing their willingness to work with the FP and to hold free elections.
- **Remote facilitation:** FPs may sub-contract for some or all services with local NGOs, interest groups or even individuals
- **Community guarantee:** the community must make a formal commitment to guarantee the security of the agents they work with
- **Agents selected by and/or from the community:** FPs may employ and train up members of the community or agents selected from the community, as community facilitators, social organizers, “barefoot engineers”, technical monitors etc.
- **Clustering:** CDCs may cluster for common services – for example the employment of a “cluster engineer” selected by the community.
- **Remote monitoring:** FPs may employ decentralized and participatory monitoring techniques

Plainly the above requires considerable flexibility on the part of both NSP and the FPs. Many of

the measures are, however, consistent with the principles of participatory development.

*Source: NSP in High Risk Areas, draft MRRD proposal*

## **7.7 HELMAND AND THE SOUTH – A SPECIAL CASE?**

7.22 *Southern Afghanistan produces nearly 80% of the total opium poppy crop.* Helmand province has emerged as the country's leading opium producer with half of national output – over 40% of world production.<sup>27</sup> In 2006 total opium income for farmers in Helmand amounted to an estimated US\$ 528 million, 10% of Afghanistan's total (licit) GDP and up from US\$ 347 million in 2006. More than 80% of farming families in Helmand are reported to be involved in poppy cultivation (UNODC 2007).

7.23 *The insurgency in Helmand, Kandahar and Uruzgan has boosted opium production.* The insurgency severely limits people's movements, making marketing of licit agricultural produce more difficult and dangerous. Opium, on the other hand, is often purchased at the farm gate. It appears that the insurgents have increasingly been encouraging farmers to grow the crop, to help finance the insurgency and to provoke the authorities into eradicating it and thereby embitter farmers further against the regime and its foreign supporters and strengthen support for the insurgency. This creates a near-impossible policy challenge: trying to establish governance and sustainable development in conditions where there is a fight against insurgents *and* a political necessity to "do something" about poppy.

7.24 *ISAF operations in Helmand are targeted at insurgents – and at development – not at poppy.* British and ISAF forces in the area are engaged in a bruising war against the insurgents. The ISAF forces are trying to win the hearts and minds of the population through development projects organized by the Provincial Reconstruction Teams – usually rebuilding productive assets. They certainly do not want to associate themselves with eradication of the poppy crop, which can have negative repercussions.

7.25 *A range of legal livelihood options have been explored in Helmand.* Since 2003, various donor programmes have run pilot projects in winter vegetables, fruit trees, grapes and nuts. Innovative activities currently under consideration include mint (for mint water or oil for aromatherapy) and alfalfa production. Money has been spent on refurbishing an oil mill, packing lines and the ginnery. However, none of these activities are likely to have a discernible impact on poppy given their small scale and the deteriorating security situation. At present security is very poor, and conflict has increasingly confined the work of these projects to a small local radius close to Lashkar Gah. Field work has dwindled. At the farm level, transport costs rise as risks increase, and farmers get less for their produce. The higher costs associated with insecurity make licit production more expensive and therefore less competitive.

7.26 *There is very considerable donor aid available for Helmand, but start-up and recurrent costs are high and implementation is increasingly constrained by insecurity.* Donors, particularly DFID, have provided sizeable amounts of aid for development activities in Helmand, although totals are small in comparison to the size of the local farm-level opium economy (half a billion dollars a year in the province). DFID has committed \$60 million over three years to the Helmand Agriculture and Rural Development Programme (HARDP). The money is allocated to: NSP \$20 million, NRAP \$26 million, MISFA \$10 million and WatSan \$4 million. DFID is financing NABDP in Helmand for a further \$10 million in 2007 on the model of NABDP's successful work in Kandahar developing DDAs and financing small local projects. Reports from Kandahar indicated that the 6,000 labour-intensive micro-projects financed have "reduced the numbers going to the poppy harvest". However, initial hopes that

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<sup>27</sup> Helmand produces more than 50% with 103,000 ha, followed by Kandahar with 16,500 ha and Farah with 15,000 ha.

these NPPs could be rolled out in up to six districts are unlikely to be fulfilled. Most development activities are now restricted to the two districts abutting the capital Lashkar Gah. DFID is also providing £5 million to Helmand Agricultural Solutions for Improved Livelihoods (HASIL), implemented through the very experienced NGO Mercy Corps. In addition to DFID support, USAID's ALP-S has a broad programme in the southern provinces including: the Southern Chili Network Programme; an infrastructure and community action programme (including cash for work); a veterinary and livestock programme; the Lashkar Gah electrification project; and the Lashkar Gah agro industrial business park, on which construction is soon to start. However, field work is increasingly constrained by insecurity (Box 15).

#### **Box 14: Deteriorating Security in Helmand**

##### **USAID experience in 2007**

“CADG reports three persons were murdered in this bi-weekly period in the Grishk area of Sangin District, Helmand Province. Attackers kidnapped and killed two persons at the Haji Din Bridge. This has suspended work at the bridge plus the nearby Meir Hamza Bridge. On July 18<sup>th</sup>, a CADG security guard was caught up in the crossfire after an IED explosion in Grishk and was killed.”

##### **USAID experience in 2005**

(The USAID) team disturbed the status quo, although they were never clear precisely when or how. When several workers were victimized by a carjacking, informants blamed common thieves, but the act might have been retaliation for giving too many jobs to members of the wrong clan. Later, in the same area, two Afghan workers were ambushed and killed. A party that set out the following day to transport the dead bodies to a cemetery in Kabul was also ambushed and its members executed. One man, an ethnic Hazara, was shot through the eyes. Local leaders blamed the Taliban. But the killings might have been ordered by poppy growers angry that the USAID project was depriving them of badly needed labor for the harvest. The police showed little enthusiasm for investigating the matter.

*Sources: (1) USAID Alternative Livelihoods Programme-Southern Region, Extract from Chemonics Report for the two week period July 16-31, 2007; (2) Hafvenstein (2007).*

7.27 *Can development be delivered in a war zone?* There is often an assumption made that development can and should be delivered at the same time as territory is being fought over, thereby influencing decisions on poppy growing as well as gaining the consent, or “hearts and minds” of communities. This is a call that can only be made on the ground: there will be times when the cost is just too high in men or money, or when development initiatives are simply impossible. The reflections recorded in Box 17 below could suggest that re-establishing security and governance has to take place *before* development measures can have any impact.

7.28 *Is a “softly-softly” approach feasible in some areas?* A possible alternative would be to scale back some more aggressive military interventions and give priority to more integrated development approaches and community partnerships – with a low key role for the military (see Box 16). One diplomat with field experience said: “There is a need to create an environment of trust, to support the Afghan army and police as a people’s defence force, and to leave development to civilian agencies. If you chase terrorists, you create an unstable environment.” However, as one NGO commented: “There is a tipping point where development programmes can no longer go out, as communities receive nothing from government, not even security. *Where government is hated, no development programme will work.*” Again, this is a call that can only be made on the ground: do conditions for development exist, or has security deteriorated to such a great extent that only political and military solutions can be effective?

7.29 If and where development remains an option, a number of possible new avenues have been suggested throughout this report. These include:

- An *integrated production and market development programme for suitable crops such as cotton*, proposed in Chapter 8 (8.2.6), could be feasible in Helmand, and could be a channel for considerable investments, potentially with significant impacts.
- There may be scope for *extending certain short cycle horticultural crops* in Helmand (3.2.5), and new crops such as mint might also be promoted through contract growing.
- It may be possible to promote further *rural enterprise and industrial parks*, with Lashkar Gah as a “development pole”, creating an enclave of secure and prosperous economic activity, although the restrictions that insecurity places on the movement of goods and people will be a major constraint (4.2.1, 4.2.3).
- NRAP’s *rural road coverage* could be expanded in areas where the security situation is still manageable but where opium poppy cultivation is extensive or where its return is considered likely. This could apply in Nad e Ali, Nawa Barakzai, and Lashkar Gah (5.3.1).
- *Responsible local governance and development* could be promoted through the further development of CDCs and DDAs (6.3.2). The apparent success of NABDP in Kandahar in working with district assemblies and promoting thousands of labour-intensive micro-projects could be replicated (6.3.2, 6.4.1)
- There could be an emphasis on maximizing *non donor-badged NGO development work*, with a special focus on integrated approaches (6.4.2, 8.2.1).

**Box 15: Security and Development in Uruzgan**

There is a growing risk of a vicious circle of deteriorating security undermining development initiatives and contributing further to the collapse of the counter-narcotics effort – and of the governance and development effort more generally. Some characteristics of one approach – in Uruzgan – may throw light on alternative options.

In this province the Dutch are working through National Programmes, NGOs and private companies to devise integrated approaches which can rebalance the incentive system away from poppy. Where NGOs are used, they are Afghan NGOs, preferably Uruzgan-based with a good reputation and credibility with local communities, and field officers are recruited from the local population. A national NGO, the Afghan Development Agency (ADA), is now present with 60 staff. Seventy two CDCs have been established. EQUIP is being implemented in coordination with CDCs and School Management Committees. Provincial planning has begun, with NABDP support. And private markets are working. Special features are the integrated approach – and the low key role of the military. The priorities are improved governance, markets, crops, basic health, education, and vocational training.

7.30 It must be kept in mind that there is already a valiant, thoughtful and well managed development effort in Helmand. It is unlikely that any radical new solution would suddenly emerge. But some of the initiatives recommended in this report, in particular those summarized above, are potentially promising and worth pursuing. There should be no illusions however about the prospects for quick success, particularly if endemic conflict and insecurity continue to be the norm. Some further, complementary options include the following:

- To *invest heavily in the enclave in and around Lashkar Gah where security is adequate*. The objective would be to create a “development pole” impact, with high

levels of economic activity that would increase demand for products from the hinterland and thereby create economic relations and a stake in stability.

- To *finance some specific agro-industrial investments*. For example, as part of the proposed integrated production and market development programme, a cotton ginnery could be established in or near the town paying guaranteed prices and providing credit, seeds, etc. This could give farmers throughout Helmand incentives to settle down and grow cotton (see 8.2.6).
- To *provide labour-intensive public works employment at adequate wage rates*. This would be designed to draw young men away from insurgents or warlords, who offer a monthly wage to the unemployed to take up a gun. Wages should not, however, be so high as to crowd out private businesses.
- To *push hard on the local participatory agenda*, both at the CDC level and, on the model of Kandahar (see 6.2 above), the DDA level. NABDP roll-out in Helmand could be supported to develop DDAs and to establish a District Development Fund to finance labour-intensive projects. The linkages between CDCs/DDAs and local facilitating partners such as Mercy Corps could be further financed (see 6.3.2 above).
- To *implement programmes as far as possible through NGOs without donor badging*, and where essential on security grounds without publicized government sponsorship, using locally recruited staff.
- To *promote substantial investments in human capital* through a pro-active educational programme, if necessary in educational institutions outside of the province.

## 7.8 POLITICAL ECONOMY OF OPIUM

### 7.8.1 The Role of Poppy in the Face of Insecurity, Anti-government Violence, and Corruption

#### *WHY OPIUM IS THE BEST CHOICE UNDER CONDITIONS OF INSECURITY*

7.31 *Under circumstances of insecurity, opium markets work best.* Under conditions of insecurity, traders of legal agricultural goods face a marked increase in the potential for crop losses due to delays caused by roadblocks or fighting, and they are unlikely to purchase agricultural products at the farm gate or provide advances. Insecurity deters travel due to the increase in transportation costs it imposes, and also due to genuine concerns over physical security. By contrast, opium markets work well: opium traders provide advances, travel to the farm gate to purchase the crop and cover the costs of transport and bribes to those manning the check posts. They also take the physical risk of travel in insecure areas.

7.32 *...and in an insecure environment, opium is the best crop choice.* Opium poppy thrives in an insecure environment: it is a low-risk crop in a high-risk environment. It is a high-value, low-weight commodity which traders are still willing to purchase at the farm gate and, if the security situation worsens, opium provides a liquid asset that can be easily transported by a fleeing family. In this environment it makes little sense to cultivate other crops even where there is the potential to do so. Indeed, the larger than average landholdings, plentiful irrigation, good soils, as well as a proximity to the provincial markets experienced by many farmers in an area such as central Helmand or Qandahar matter little when insecurity due to actions on the part of both insurgents and the government threatens the personal and economic security of the local population.

7.33 *The causal relationship between violence and opium is not at all clear-cut, but once violence has set in, it feeds the opium business, and chances for a “development solution” shrink, especially where government officials also are corrupt.* Opium production is associated with insecurity, conflict, corruption and increasingly anti-government violence in Afghanistan, yet opium and violence are not intrinsically linked (see 7.6 above). Corruption, insecurity and violence all exist in areas where opium poppy is not grown, and in Afghanistan predate the recent exponential rise in opium poppy cultivation in the southern provinces. Certainly in Afghanistan in the past, and currently in other parts of the country, the drugs trade has not been linked with such high levels of violence (UNODC 1998). The intensity of the conflict in the south most likely originated in an unplanned and unforeseen conjunction between politically-motivated anti-government activity and local opportunistic opium production and trade that then deteriorated in a spiral of violence, in which anti-government elements were able to portray themselves as “protectors” of the security of the rural population. But the other endemic factors, particularly corruption, enter into the equation as well. Both government officials and anti-government elements ended up in second-order conflicts over the extraction of revenues from the opium trade.

7.34 *The lesson is that ensuring security is the overriding consideration.* This truth, and the counter-productive side effects of development interventions when government cannot ensure security and is corrupt, are well illustrated by the case of Helmand, described in Box 17.

**Box 16: The Political Economy of Counter Narcotics in Helmand**

“In Helmand Province in 2005, the USAID plan was simple: hire local people for big public-works projects and put money in their pockets before the government started cutting down profitable poppy fields. This stopgap effort would be the prelude to large-scale infrastructure projects that would lift the local economy permanently. Easier said than done. Getting a multimillion-dollar project up and running plunged the team into a social, political and economic morass that eventually sucked them under. In a country with scant resources, every dollar shifted the local balance of power in unforeseen ways.

“The influx of international development companies distorted the Afghan economy, driving up the cost of housing and drawing educated Afghans away from vital but poorly paid jobs in, for example, education. Local power brokers, whether government officials or tribal leaders, eyed the Americans askance, worried that their own influence might be diminished. Big landowners schemed to steer benefits in their direction.

“The cash-for-work program showed progress. The project made every effort to extend its reach to remote valleys badly in need of development aid. But the hard realities of the poppy economy quickly reasserted themselves. The local government would plough under the poppy fields belonging to poor farmers just enough to mollify the central government, while powerful landlords paid the police to pass them by. After a particularly heavy rain in Lashkar Gah, a wall fell down directly across the street from the American military outpost to reveal a thriving poppy field. “Everyone in Helmand, directly or indirectly, depended on poppy income, including top officials. In June 2005 police raided the mansion of Helmand’s governor...”

But the reality of the situation was that ***no development action could be effective as long as the government could not ensure security or good governance.*** The USAID team leader wrote “We had come to Helmand thinking of opium as the local currency, and had tried to replace it with cash. But security was the real currency of Afghanistan. The traumatized population of Helmand would trade anything for it, follow anyone who could offer it.”

Sources: Grimes (2007: 2); Hafvenstein (2007).

## **The Varying Commitment of Different Groups to Opium Poppy Cultivation 7.8.2**

7.35 *The opium economy is not a “given” of either rural economics or local political economy. Rural Afghans are extremely dynamic and will adapt in response to development and law enforcement interventions.* There is a wealth of experience in Afghanistan that demonstrates this adaptability, including changes in land tenure and credit arrangements, and the movement of labour in response to fluctuations in levels of opium poppy cultivation. Indeed, short-term reductions in levels of cultivation in one area are quite often offset by increases in another due to one group or another adapting in response. For example, pressure to prevent opium poppy cultivation in the province of Nangarhar in the 2004/05 growing season led to increasing numbers of farmers in areas where few viable alternatives existed migrating to Balkh where they received preferential rates of pay for their work as itinerant harvesters. This adaptability applies also in reverse: when security, governance and economic opportunity exist, all segments may migrate out of opium.

7.36 *Few groups – least of all the better off – are committed to continued opium poppy cultivation if alternatives exist.* Most Afghans perceive opium as forbidden under Islam and would prefer to pursue legal alternatives were they available. Local elites, such as landlords and *maliks*, have been found to be some of the first to respond to improved livelihood opportunities and the threat of eradication and to move out of opium poppy cultivation. With the encouragement of traditional leaders and institutions or with support from CDCs, communities and social cohesion can play a role in fighting opium.

7.37 *However, poorer people have more constraints binding them to the opium economy.* Where opium is on the wane, this is often to the detriment of more marginal elements of the community, who find land, credit and wage labour opportunities more difficult to come by (Mansfield 2006b). This has sometimes led to relocation of farmers and opium poppy cultivation to more inaccessible and/or insecure regions, as well as further out-migration to neighbouring countries.

7.38 *Planned interventions need to recognize that some groups will lose out and that mitigating actions will be needed.* By understanding which groups are likely to experience a loss in access to assets due to reduction or elimination of opium poppy cultivation, it is possible to reduce the potential for increased vulnerability, alienation and opium poppy cultivation simply relocating to other areas. This is one of the primary objectives of mainstreaming counter narcotics in development programmes (see 7.3).

## CHAPTER 8: IMPLEMENTATION

8.1 This report has reviewed a number of areas of economic activity and development programmes related to the opium economy and has made a significant number of recommendations that could have direct or indirect impacts in shifting incentives toward the licit economy. This final chapter looks at how to implement these recommendations. Plainly, not all the recommendations can be implemented at one time, and some have more potential for impact than others. The chapter, therefore, first sets out criteria for prioritizing proposals (Section 8.1). Six priority sets of interventions are then discussed in detail (Section 8.2). Subsequent sections look at how to add further value to key ongoing programmes (Section 8.3), and at studies and other work that could be done to make ready further high-impact activities for implementation at a later stage (Section 8.4). Key cross-cutting policy and institutional issues for further dialogue are summarized in section 8.5. A final section (Section 8.6) provides a brief overview of expected impacts on the opium economy.

### 8.1 CRITERIA FOR PRIORITIZATION

8.2 *To prioritize and phase recommendations for intervention, a set of criteria has been developed:*

- **Impact of the intervention:** Would it have a broadly spread and important impact on the drivers of the opium economy? Would it benefit key target populations, notably poor farmers, the landless and women?
- **Feasibility:** What would the intervention cost, and what would be the cost-benefit relationship if that could be assessed?
- **Implementability:** Could the intervention be implemented in the Afghanistan situation? How would moral hazard issues of corruption etc. be handled?
- **Sustainability:** Could the impacts be sustained without continuous interventions?
- **Political economy:** What would be the political support and opposition to the measure? Who would gain and who would lose? Would there be political or governance benefits from the measure? Or risks and costs? Would the measure contribute to state building, institutional development, capacity building?
- **Multiplier effects:** What would be the knock-on or associated economic impacts of the measure? Would it contribute to growth? Would there be positive or negative multiplier effects on the economy? How would the impacts of loss of opium revenue, labour markets, access to land and credit etc. be compensated?
- **Results measurement:** Could the results be targeted and measured; how would it be possible to establish links between the measure and facts on the ground?

### 8.2 SIX PRIORITY INTERVENTION SETS

8.3 *Based on the analysis in this report, and matched against the criteria set out above, six priority intervention sets have been identified:* (i) an integrated programme combining support to farming, governance and integrated rural development; (ii) increasing agricultural land under irrigation; (iii) improving returns to livestock; (iv) rural enterprise development; (v) local



procurement; and (vi) an integrated production and market development programme for suitable crops such as cotton, initially targeted at Helmand province. Actions in these areas could have a considerable impact in improving incentives to engage in the licit economy, and in the longer term would contribute to the shrinking of opium production. This section explains the priority of each of the interventions as judged against the criteria, and summarizes the recommendations of the report on how to implement the intervention and what supporting institutional and policy measures need to be put in place.

### **8.2.1 Intervention 1: An “Integrated Programme” for Rural Development and Governance**

8.4 High impact on livelihoods, and hence on the opium economy, would be obtained by linking comprehensive support to rural development (reorganizing production systems around market-driven supply chain models, private rural enterprise development, rural infrastructure, access to social services) with governance building. Many programmes already exist to deliver both rural development investments and governance building at the village level, but they are often characterized by lack of coordination and continuity, a supply-driven character, and fragmentation of objectives. The result at the community level has tended to be a lack of critical mass of impact to improve livelihoods.

8.5 There are, however, three successful approaches which have potential, if combined, to generate the necessary critical mass of impact on rural livelihoods, and hence to create strong incentives away from the opium economy:

- The emergence of CDCs and clusters of CDCs as *development partners* that can serve as entry points for further development initiatives (see 6.3.4), and also building social cohesion and adopting participatory planning.
- The success of a number of NGO facilitating partners in offering *integrated development services* to communities. These services have ranged from capacity building and technical guidance through facilitation of other development initiatives, to financing of local investments. Box 18 describes the experience of one DFID-financed programme in Badakhshan. The virtue of integrated services is two-fold. First, they have the capability to address the broad range of rural people’s actual requirements (e.g. to create labour opportunities outside of the harvest season), rather than simply offering “top down” whatever product line the project is specialized in (e.g. orchard crops). Second, they can offer support along the entire value chain – e.g. from choice of crop to adding extra value to marketed produce, rather than focussing on only one dimension, e.g. just improved seeds (see 6.3.2, 3.3.1).
- The growing effectiveness of the *National Priority Programmes* in delivering sectoral investments both in rural infrastructure (NRAP, WatSan), in agriculture (EHLA), and in social services (EQUIP, Basic Package of Health Services).

8.6 On the basis of this experience, an “integrated programme” for rural development and governance is proposed – essentially expanding and scaling up nationwide models like those proven by AKDN in Badakhshan and by GTZ, DACAAR and Afghanaid in the Programme for Alternative Livelihoods (PAL) in the east, fully factoring in the differences in local circumstances.

8.7 The innovation proposed is to scale up and complete existing initiatives so that rural communities would have access to a critical mass of support that would allow them to reorganize production systems along market-driven lines and to develop the physical and

institutional infrastructure needed to support this shift to commercial activity. The characteristics of this integrated programme would include:

- Design and implementation would be Afghan-led, within national policy and budgets, and financing could – in principle – be channelled through the ARTF.
- Delivery by full service field-based implementing partners, typically NGOs. The greatest synergies would be attained if the same partner can implement the entire package in an area.
- Scaling up from existing operations in order to capitalize on field presence and experience, and targeting poorer and more vulnerable areas.
- Support to farmer organizations established around commodities or activities and to structuring of supply chains for higher-value production, linked to private sector downstream processing and marketing.
- Strengthening of the productive asset base, especially through linkages to the rural finance system and to enterprise development programmes (see Intervention 4 below).
- Links to or integration with the programmes for strengthening CDCs (see 6.3 above).
- Linkages to other national priority programmes in order to achieve synergy.

8.8 The expected *impact* on the opium economy would be felt even within a few years (as in the case discussed in Box 18) in areas that are in close proximity to the provincial centre. Impact would be high in the medium to longer term once the programme achieves greater coverage in less accessible areas. The approach would provide a critical mass of development support, capable of shifting incentives toward the licit economy, and providing needed institutional support. The development of governance structures would strengthen social cohesion, which is linked to security and – in time – to a “pull” away from poppy. In a province like Badakhshan, reductions in the more accessible parts of the districts of Kishim, Faizabad and Baharak could bring down overall levels of opium poppy cultivation in the province by around 50% over a five to eight year period. In Helmand, this approach, combined with an improved security environment (see 7.7 above), could be expected to make a considerable dent in levels of opium poppy cultivation in the central districts where as much as 50% (around 51,000 ha in 2007) of the province’s total opium poppy crop is currently grown.

8.9 As demonstrated by a number of ongoing programmes, this approach is *feasible and cost effective*, even under the difficult field conditions of Afghanistan. Activities can be pursued even in more difficult security situations, albeit at a lower levels of intensity. Community demand is strong, and the association of the agricultural programmes with CDCs would provide further credibility to these local structures. *Political economy* constraints include the ambiguity over the role of CDCs (see 6.4.2) and the continuing issues of inter-agency collaboration, particularly between MRRD and MAIL (see 3.4.3). The articulation of a broad range of rural development programmes through the CDC mechanism should enhance the *sustainability* of both the development and governance programmes.

8.10 The implementation, policy and institutional measures needed for the success of this approach have been discussed earlier. In summary, the *implementation measures* required are:

- Recent evaluations have demonstrated the economic and counter-narcotics impacts of ongoing integrated programmes. These evaluations should be consolidated during

2008, so that they can be “read across”, the most successful models identified, and a programme prepared for scaling up and replication nationwide (but tailored to local conditions in different parts of the country), with an initial three year investment phase during 2009-2011 (3.3.1).

- Government and donors should continue their support to NSP and CDCs and to DDAs (6.4.2).
- Implementing partners should be identified that are capable of delivering broad-based agricultural packages and support to CDCs and DDAs. Partners willing to adopt this approach in contested territory such as the southern provinces should be sought (6.3.2).
- The need for continuation and scaling up of DDAs and NABDP should be assessed and an appropriate programme prepared (6.3.3).
- Levels of aid to provinces should be determined by equity, poverty reduction concerns and economic opportunity. Aid should, however, be targeted within provinces as far as possible to address the drivers of the opium economy and to counterbalance its advantages (7.5).
- Security considerations should be factored in the programme design (see Box 19 below).

**Box 17: An Integrated Programme for Governance and Rural Development  
Successfully Contributes to Reduction of Poppy Cultivation in Badakhshan**

Between November 2004 and December 2006, the Aga Khan Foundation (AKF) in partnership with AfghanAid and Concern implemented the *Integrated Rural Rehabilitation to Improve Livelihoods and Curb Poppy Production (IRRILP)* to support sustainable economic and social development by introducing and strengthening alternative livelihood options in Badakhshan. The IRRILP has six **outputs**, the indicators for which were substantially achieved during the life of the project:

- Agricultural inputs and technical support to improve **agricultural production**: This largest component of the programme achieved targets in improving livestock and crop productivity, and in crop diversification.
- Improve **productive infrastructure**: Bridges, schools and irrigation projects were constructed.
- **Social capital and governance** strengthened through community mobilization & training: The target of 600 operational and effective village institutions, including over 400 CDCs and 156 women’s committees was achieved. Clusters of CDCs and common interest groups were assisted in addressing a range of community level issues and negotiating with district and provincial government.
- **Rural enterprises** created: The project supported business development services and promotion of micro-enterprises through training, and facilitation of access to micro-credit through self help groups.
- Increased **local capacity to implement development** in Badakhshan: Substantial capacity building work, training and joint research projects were undertaken with provincial government staff and line ministries. The Badakhshan Development Forum (BDF) developed into a key coordinating body in the province, assisting the government and communities in the provincial planning process and strengthening self-implementation of relevant programmes and projects.
- **Access to social protection** is increased and services are improved: A number of successful initiatives in opium demand reduction, non-formal education and child peer groups were initiated.

**Outcomes included:**

- Food aid dependency decreased from 34% of the population in 2001 to zero in 2006.
- All households in the target districts benefit from viable licit income generation activities.
- More than 600 effective village institutions are operational and have the capacity for continuing engagement in village development.

According to the evaluation, **IRRILP contributed substantively toward the overall reduction in opium poppy cultivation in its target areas.** The evaluation recommended continued investment in the programme in order to sustain the governance and economic development impacts and lock in the change in the incentive structure away from opium.

*Source: Aga Khan Foundation, Afghanistan and Concern (2007).*

8.11 **Indicative incremental costs**, based on experience under ongoing programmes and assuming a programme commencing in 2009 to roll out to cover half of NSP-supported villages (i.e. about 10,000 villages) by 2011, are estimated at \$30 million in 2009, rising to \$90 million in 2011. The indicative total cost for an initial three year programme 2009-2011 is estimated at \$180 million.

**Box 18: Suggestions for Dealing with Insecurity**

- Work through decentralized planning and programming mechanisms, to ensure that the local administration and local people are aware and on board.
- Select only villages that are willing to sign a cooperation agreement and to give a community security guarantee.
- Maximize local ownership and community engagement through working with community institutions (CDCs and others), local contracting, labour-intensive works, etc.
- Remove all “foreign badging” – or perhaps even government badging where this is essential for working in the most insecure areas, and be thoroughly Afghan in the field.
- Use local implementing partners and locally recruited staff, preferably from the communities themselves, including local facilitators, “barefoot engineers”, and technical monitors.
- Give priority to relevance: the project has to be at the top of the local community’s priorities, and preferably one that gives rural people a stake in stability, security and good governance.
- Use decentralized and participatory monitoring and evaluation approaches.

*Source: Section 7.6*

8.12 The **supporting policy and institutional measures** required are:

- The role of CDCs and DDAs should be strengthened progressively over time (and in line with the development of their capacity) to become focal points for development dialogue, and for some elements of local service delivery and governance at the village level (6.4.2).
- Government should strengthen provincial and local planning processes, in line with the constitutionally-mandated unitary state and unified national budget (6.4.2).
- All partners should align agricultural programmes within the new strategic framework provided by MAIL under Afghan government leadership, and give priority to joint programming at the central and provincial levels and to transparency, information exchange and knowledge management (3.4.2).

- Agricultural sector policy development, planning and programme oversight should be strengthened, and measures put in place to ensure that MAIL works closely and programmes jointly with MRRD (3.4.3).
- Structured linkages should be developed to existing and planned rural development and enterprise development programmes.
- Support and capacity building should be provided to MAIL (3.4.3).
- Studies leading to specific sub-sector strategies and investment plans should be conducted for export crop development, for oil crops for import substitution, and for livestock (3.4.3).
- MAIL should implement its new policy to contract for service delivery through farmer organizations, NGOs, CDCs etc. (3.4.1).

## **Intervention 2: Expanding Agricultural Land Under Irrigation 8.2.2**

8.13 As discussed in Chapter 3 (3.3.3), irrigation is key to restoring livelihoods and promoting the essential transition to higher-value cropping. Current rehabilitation programmes cover less than half of rehabilitation needs and do not provide for important investments such as watershed management, new water storage, modern irrigation technology, or advice on improved water management and irrigated cropping. Accelerated and scaled-up investment in irrigation would have a **high impact** against the drivers of the opium economy when combined with a more conducive security environment. Moreover, investments in irrigation would provide broadly spread benefits with the typically important **multiplier effects** of irrigated agriculture throughout the rural economy. Currently the relatively good performance of irrigation programmes under Afghan leadership and execution demonstrates the **feasibility** and strong community **demand** throughout the country. Irrigation investments have a typical life of 25-50 years, so **sustainability** is likely, provided that effective and sustainable O&M arrangements are put in place. There is also a positive impact on **governance**, as irrigation management builds social capital and gives farmers a fixed asset stake in governance, security and market development.

8.14 The implementation, policy and institutional measures needed for this approach have been discussed in the report (3.3.3). In summary, the **implementation measures** required are:

- ***An irrigation and agricultural water management sector review should be carried out.***
- ***A phased ten-year programme for increased investment should be prepared and financed,*** covering irrigation rehabilitation and expansion, watershed management, new storage, modern irrigation, and development and dissemination of improved water management and irrigated cropping packages.

8.15 **Indicative investment costs** for a phased ten year programme are roughly estimated to be on the order of \$1.2 billion, of which \$125 million would be for completion in the short to medium term (2008-2012) of the rehabilitation of existing traditional irrigation on up to 500,000 ha; \$250 million for physical and institutional modernization in the medium term (2010-2015) of existing large scale irrigation schemes on up to 250,000 ha; and up to \$800 million in the medium to long term (2012-2018) for the development of new diversion structures, hydropower and large scale irrigation on up to 150,000 ha (for example, the proposed Kokcha Scheme, see 3.3.3 above).

8.16 *Supporting measures* required are essentially institutional. First, as discussed above (3.3.3), the Ministry of Energy and Water (MEW) and the Ministry of Agriculture (MAIL) need to work out a framework for cooperation with each other and with NGOs and other outreach organizations. Second, the *proposed sector review* should assess issues of riparian rights and transboundary water sharing. In the case of new irrigation schemes on transboundary waterways, constructive dialogue with neighboring riparian countries will need to be initiated.

### **Intervention 3: Improving Returns to Livestock 8.2.3.**

8.17 As discussed in Chapter 3, investment in livestock is a first-class entry point to reduce the dependency of the poor on opium (3.3.4). The *impact* is considerable: improving returns to livestock offers a direct route to addressing the needs of the most vulnerable and reducing their incentives to participate in the opium economy, particularly in more inaccessible areas where the alternatives to opium poppy are typically limited. In a province like Nangarhar these are the areas where opium poppy has persisted even during periods in which the crop was effectively banned across the rest of the province. Scaled up support is *feasible*: there are national programmes underway to strengthen veterinary services and to support small-scale initiatives in dairy and poultry, with considerable possibilities for scaling up. Other areas of the livestock economy also could be supported – particularly sheep fattening and the development of downstream high value-added activities. *Community engagement* is strong. Increased support to these programmes could reach the poorest and most vulnerable communities, as well as the poor and women throughout the country.

8.18 The implementation, policy and institutional measures needed for this approach have been discussed in the report (3.3.4). In summary, the *implementation measures* required are:

- *A review of the initiatives in dairy and poultry to date should be conducted* to delineate entry points most relevant to the opium economy. There should be particular focus on the poorest, on women, and on extension to areas least served by development programmes and with susceptibility to opium.
- Mechanisms to further enhance livestock value-added should be studied, particularly *sheep fattening, cashmere fibre development, and skin garments*.
- *A programme for increased investment should be prepared and financed.*

8.19 *Indicative investment costs* for the period 2009-2012 are roughly estimated at \$120 million, based on the costing of the ongoing EHLP, including \$60 million for dairy (extension of the cooperative dairy model to a further ten regions) and \$60 million for poultry (based on extension of the semi-commercial and household models implemented under EHLP to ten more provinces. Costs for the livestock value-added activities would need to be estimated through an outline feasibility study.

8.20 The *supporting policy and institutional measures* required are to ensure that the transition to privatized but universally accessible veterinary services is carried through, and that services are available to the poorest. In addition, the reform and institutional development measures for MAIL and MRRD proposed earlier (8.2.1) would strengthen implementation of the livestock programme.

### **Intervention 4: Rural Enterprise Development 8.2.4.**

8.21 As discussed in Chapter 4 (4.3.1), the development of rural enterprise and employment has been relatively neglected within the rather overcrowded and tumultuous urban enterprise support arena. Government is developing an innovative Afghanistan Rural Enterprise

Development Programme (AREDP). Although the programme is still at the earliest stages of design and development and there are many open questions, it is clear that this could be a very **high impact** programme. Substantial counter-narcotics impacts would be obtained by an aggressive programme that promoted *enterprise specifically for rural areas*, as that is where the opium farmers and labourers currently are located (see 4.5.2). It is also in rural areas that lower costs per job or enterprise created would be found, and where much of the growth potential lies, particularly associated with agro-processing. If AREDP achieves even part of its overly ambitious target of creating 2.1 million permanent jobs, it would provide a massive alternative labour market to opium poppy. The multiplier effect of such an intervention would further increase wage labour opportunities and raise the opportunity cost of allocating labour to opium poppy cultivation.

8.22 **Feasibility** remains to be demonstrated, but the proposed articulation of AREDP through the CDCs and its linkages to other NPPs should give it the ability to reach a large population. There are important design issues that need to be resolved however. **Political economy** issues mainly relate to “turf”: already nine other ministries are slated for involvement. However, if these issues can be resolved, the programme is likely to make a substantial contribution to growth.

8.23 **Indicative costs** for AREDP have been estimated by MRRD at a net \$550 million over a ten-year period. The net financing requirement for an initial three-year phase during 2009-2011 is estimated at \$200 million. Critical next steps in the development of this important proposal are discussed in Section 4.3.1 above, including:

- As the implementation measures needed for this approach are still being worked out, the government should work intensively to develop the proposal, with close and constructive support from donors.
- All relevant government and national agencies should be involved. In particular, MAIL should share the driving seat with MRRD.
- Government should make a particular effort to bring in the local private sector, USAID and MISFA, the leader in the micro-finance field, as key partners.
- Particular emphasis should be given to building local capacity in business development.
- Attention needs to be given to improving the business environment and aligning and harmonizing approaches of business support programmes (see 4.4 above). Some of the present report’s recommendations are summarized in Box 20.

**Box 19: Improving the Business Environment and Business Support Programmes**

The report makes many recommendations that might be useful in improving the business environment and the impact of business support programmes:

- Access by Afghan trucks to neighbouring countries should be negotiated as part of transit and trade agreements (3.4.1).
- Incentives and subsidies implicit in current business development services need to be streamlined and transparent, and the services should be built up to be locally run (4.4.1).
- Pooled financing should be considered to ensure consistency and coherence of matching grants for investment (4.4.1).
- Scale up Industrial Parks in response to business demand (4.4.2).
- Attention should be paid to setting and supporting export standards (4.4.2).
- Government and partners should work together to further strengthen the Customs Service (4.4.2).
- A study of trade policy with an import substitution and counter-narcotics lens should be

conducted (4.4.2).

- Support should be provided to the development of representative business and civil society organizations that have a stake in fighting corruption and in better security (4.4.3).

### **Intervention 5: Local Procurement 8.2.5.**

8.24 As discussed in Chapter 4 (4.3.1), a quick action that could have high impact would be a massive increase in local procurement by the foreign community. In terms of *impacts*, the bulk of such procurement would be high-value agricultural produce, and much of it could be produced in opium-vulnerable areas (e.g. the proposed US purchases in Nangarhar). Benefits would to a large extent accrue to rural populations engaged in or emerging from the opium economy. Increasing the local labour content of construction contracts would absorb workers who otherwise might engage in the opium economy, in addition to having a significant poverty reduction impact. In addition to the economic benefits, the dividend in terms of trust and “hearts and minds” would also be considerable. *Feasibility* has been demonstrated by the US lead, and other sizeable opportunities are evident. Overtly, the *political economy* equation is highly positive: government and donors have universally subscribed to this approach in the Afghanistan Compact. Far greater reluctance persists at managerial and operational levels, and this needs to be overcome by political directive. The *multiplier effects* within the economy of up to \$1 billion of extra local purchases annually would be extraordinary.

8.25 The *direct cost implications* of this initiative would be minimal, largely continued support to the Peace Dividend Trust and the administrative costs of hiring extra local procurement staff. There should in the short to medium term be important cost savings as local produce and labour replace expensive imports.

8.26 The *implementation measures* required are:

- *All governments supporting the Afghanistan Compact should make firm commitments to sharply increase local procurement in 2008, with a target to reach, say, 50% by 2009*, and instruct relevant agencies to prepare feasibility studies and make institutional preparations (e.g. for hiring local purchasing and inspection staff) in order to meet this target.
- *Operations of the Peace Dividend Trust should be scaled up and fully funded* (4.3.1.2 and Box 8).

### **Intervention 6: An Integrated Production and Market Development 8.2.6. Programme for Suitable Crops Such as Cotton, Initially Targeted at Helmand**

8.27 Afghanistan has in the past demonstrated comparative advantage in cotton production. Revival of the cotton sector could have high *impact* as it is relatively high-value, and moreover cotton grows well in Helmand where opium is widely grown, and the standard business model to a large extent parallels that of opium. However, the *feasibility* of major investments in the cotton sector is not clear at present. Attempts to date to revive the cotton industry have encountered many problems (see 3.1.6, 3.2.3). Other crops may make sense, and their prospects would also need to be assessed. Major new investment in plant together with a high level of support to the business, at least initially, would be required to rebuild the cotton economy on a profitable and sustainable basis. There are viable commercial models for small-holder cotton development practised in many countries, in particular the attractive nucleus factory and out-grower contract farming model, which reduces farmer risk by providing inputs, advice and a guaranteed market and price, and reduces business risk by binding out-growers to a contract relationship with a single industrial buyer. Other industrial crops such as oil seeds may also be



economically viable (3.1.6), and their prospects would need to be assessed. There are evidently *political economy* issues, both at the local level (see 3.2.3) and at the central level, where government policy has remained committed so far to a statist approach. Recent changes in MAIL do, however, give grounds for some optimism that a shift toward a market-oriented private sector-led approach for cotton is possible.

8.28 Despite these uncertain prospects, industrial crops present considerable possibilities and the business model is prima facie highly attractive. It is therefore recommended that an *immediate review and pre-feasibility study* for an integrated production and market development programme for suitable crops such as cotton in Helmand should be carried out. Some of the issues that such a study would need to address in relation to cotton are outlined in Box 21. The *indicative budget* for the study is \$500,000, but subsequent investment requirements could be expected to be orders of magnitude greater.

**Box 20: Issues for a Cotton Production and Export Development Programme in Helmand**

While appearing quite promising, not least in light of the precedent of successful cotton development in the Helmand Valley in the 1960s and 1970s, an integrated cotton production and development program raises a number of issues, particularly in the present context of Afghanistan. These issues, which would need to be analysed and addressed at the feasibility stage, include *inter alia* the following:

- The study would need to ascertain that cotton indeed can and will crowd out opium, since both are annual crops and double-cropping is possible in large parts of Helmand.
- The longer-term suitability and environmental impacts of cotton would need to be assessed, based on experience elsewhere and in Helmand – questions relate to, for example, the use of cotton in some of the increasingly saline soils in Helmand, and the risks and effects of pesticide use.
- The integration of different elements of the value chain will be crucial. For example, support to cotton producers without requisite ginning and marketing arrangements would not be effective or sustainable.
- In particular, since the ginned cotton would be exported, development of export markets and associated standards and quality levels (including technical support to producers in this regard) will be essential.
- Costs will need to be estimated on a comprehensive basis for the entire program, with full development of the value chain.
- The economic and financial returns to the range of investments required – possibly including start-up assistance, matching investment grants, cost sharing, short to medium term support, market development, etc. – would need to be carefully evaluated in order to ascertain whether this is indeed a high priority for funding.
- The question of who benefits, i.e. among the four categories of the rural population discussed earlier (see Section 2.3 above), and the possible impacts of such a programme on land tenure, sharecropping, wage rates for rural labour, etc., would need to be addressed.
- In addition to general insecurity issues, programme-specific security considerations must be taken into account with appropriate mitigation measures, since this kind of initiative would be visible and may be targeted by anti-government elements or drug industry interests if it appears to be achieving success.
- Related, the political economy and governance dimension is important, including how to deal with the existing state-owned cotton ginnery in Helmand and the associated implicit “taxation” of cotton growers seen in the recent past.
- Effective and sustained implementation of such an integrated programme will be vital, and the study would need to look closely at various options; strong private sector leadership able to support the full value chain would appear to be essential,

- Sources of financing, and commitment of providers over the medium term, would need to be clarified.
- The exit strategy for phasing out major public financial support would need to be clear and transparent – withdrawing support in the absence of a well-planned and well-understood exit strategy could even result in reversion to opium; strong export demand, supported by adequate quality standards for the cotton produced and exported, will be an important ingredient in this regard.

### 8.3 ADDING VALUE TO KEY ONGOING NATIONAL PRIORITY PROGRAMMES

8.29 The six intervention sets discussed above (8.2) have been identified as being of high priority, not only because of their likely **high impact** but also because of their **additionality**: they provide a good framework for injecting substantial extra financing, with good prospects for having a significant impact on the opium economy over time. There are, however, many other programmes that could also contribute in a major way to the desired shifting of incentives away from opium. These programmes have been discussed in this report, and a number of recommendations have been made for scaling up and improvements in order to enhance impacts, including on the opium economy. This section briefly summarizes the recommendations of the report regarding **four ongoing National Priority Programmes**: NRAP and rural access; NSP and community development; MISFA and rural finance; and WatSan and rural drinking water supply. The thrust of the recommendations is to enhance the impact, particularly the opium-relevant impact, of these programmes. The subsequent section (8.4) then looks at **three additional programmes** where studies and other work could be done to prepare further high-impact actions for implementation at a later stage.

#### NRAP and Rural Access 8.3.1

8.30 The report discusses the strong linkages between rural access and the counter-narcotics agenda (5.1.4) and recommends further investments in rural roads, with substantial additional financing suggested for NRAP, subject to policy and institutional changes and to improvements in programme design and implementation. Funds could also be shifted from other, less government-led and possibly less effective, rural road programs to NRAP. Key recommendations for improvement (5.4.1) include:

- Develop a rural roads policy and a mechanism for prioritized investment planning.
- Strengthen coordination amongst providers and with beneficiaries.
- Define institutional responsibilities at all levels, with lead from government ministries.
- Develop a capacity building programme.
- Prepare new, low-cost standards for rural road construction.
- Design a strategy for road maintenance and progressively implement it over time.
- Adopt low-cost and labour-intensive technologies.
- Set up a simple M&E system to collect economic data.

8.31 To **enhance counter narcotics aspects**, priority should be given to poor localities, areas where market linkages can be strengthened, and areas where opium poppy cultivation is extensive or its return is considered likely (subject to security remaining manageable). Linking

isolated districts to administrative centres should also be a priority. Implementation should prioritize community buy-in, emphasize labour-intensive construction, and provide for locally managed and executed maintenance (5.5.2).

8.32 Current plans are for a new phase of NRAP with a seven-year budget of \$400 million. The financing of the first three years is assured from identified sources, largely a new IDA Credit of \$112 million expected to be available in January 2008. Subject to absorptive capacity (about which there is some question due to local contractor limitations), an *indicative additional budget* of \$300 million could be made available for the period 2011-2014.

### **NSP and Community Development 8.3.2**

8.33 Throughout this report it has been argued that development of good governance, including palpable government presence in delivering services to the people, is integral to the growth, poverty reduction and counter-narcotics agenda (*passim*, but especially 2.3 and 6.1). CDCs as successful vehicles for delivery of development investments in line with village priorities can play a role in moving the counter-narcotics agenda forward, and continuing capacity building and financial support to them should be seen in this light (6.5). The report, therefore, recommends further funding and strengthening CDCs under the NSP. Key recommendations, which are complementary to those above regarding the proposed integrated programme (8.2.1), include:

- Provide *further financing* to continue the NSP programme to complete roll out of CDCs countrywide and to finance block grants (albeit at much lower levels of resourcing) for consolidation and sustaining of CDCs (6.3.1).
- Strengthen linkages to a *stable development partner*, allocating adequate resources so that facilitating partners can support CDCs and DDAs (6.3.2).
- Assess the need for continuation and scaling up of DDAs and NABDP (6.3.3).
- *Mainstream counter narcotics considerations* in district and provincial planning (6.3.3).
- Strengthen over time the role of *CDCs as focal points for local development service provision and governance in limited areas*, with roles extending beyond the block grants (6.3.4, 6.4.2).

8.34 Phase II of NSP (2007-9) is currently rolling out with a budget of \$120 million. This level of financing imposes constraints on both outreach and block grants for investment. An *indicative supplementary budget* of \$100 million for the period 2008-9 is suggested.

### **MISFA and Rural Finance 8.3.3**

8.35 The role of opium credit in locking rural people into the business is discussed in the report (4.2.2), and increasing outreach of rural financial services is therefore a key step to changing the incentive structure. In addition, provision of financial services is vital to rural economic growth, and would support the priority intervention sets proposed above (8.2). Report recommendations regarding rural finance (4.3.3) include: (i) to complete the process of *maturity of MFIs*; (ii) to develop *new areas of finance* for rural areas, particularly innovative solutions in financing agriculture and rural enterprise; and (iii) to *increase rural outreach* significantly.

### **WatSan and Safe Water in Rural Areas 8.3.4**

8.36 Although direct links between rural water supply and opium are hard to establish, the provision of safe water forms an essential component in improving rural livelihoods, and the report proposes that the ongoing programme be improved and scaled up (5.3.2). Measures proposed are:

- A sustainable low cost *strategy for O&M* should be developed (5.3.2).
- A *water resources assessment* should be carried out to determine the effect of the drought on existing schemes and on the potential for future schemes (5.3.2).
- A study should be carried out to *revise and strengthen the WatSan programme planning and management* and to resolve the current implementation problems (5.4.2).

#### 8.4 PREPARING FURTHER HIGH-IMPACT ACTIVITIES FOR LATER IMPLEMENTATION

8.37 A number of activities reviewed in the report are high-potential areas for engagement, but in addition to supporting ongoing initiatives (with improvements in them as necessary), there is a need to carry out further studies or preparatory work before the scope for further interventions and major scaling up of these activities can be clarified. The activities concerned are in the areas of: (i) promoting high-value agriculture and labour-intensive processing; (ii) developing rural employment and adding value to labour; and (iii) rural electrification. This section summarizes the recommendations of the report in these areas.

##### **Promoting High-value Agriculture and Labour-intensive Processing 8.4.1**

8.38 The report analyzes the considerable growth potential for high-value agriculture and labour-intensive agro-processing, which will be key elements in improving incentives in the licit economy (3.1.4-6). There are many ongoing interventions, and current initiatives have stimulated some increased investment and activity in the private sector. More private sector involvement will be key to moving production systems towards higher value commodities (as proposed under Interventions 1 and 4). However, although further support is without doubt needed and pilot initiatives should continue to be pursued vigorously, an important step should be stocktaking and evaluation, in order to prepare strategies for scaling up activities. The proposed AREDP (see 8.2.4 above) would be a good vehicle to undertake the needed studies and strategy work, especially as AREDP could subsequently support required investments. Specific recommendations of the report in this areas include the following (see Section 3.3.2):

- *Supporting high-value horticulture production:* Further support to development of high-value horticulture should be provided, with a focus on opium-vulnerable provinces that are currently under-served (including Helmand). MAIL and MRRD need to work together, and AREDP would provide an opportunity to do so. The innovative and successful DFID-supported programme to identify and develop new high-value crops should be continued and strengthened.
- *Supporting the fruits and nuts processing and export sector:* Further investment and capacity building should be provided to the fruit and nut sector all along the value chain, but actions need to be taken on the policy and institutional constraints before further major investments.

- ***The value chain approach:*** The experience with value chain approaches linking producers, processors and export markets should be evaluated in preparation for AREDP.
- ***Market development and agricultural export promotion:*** The scope for further export promotion is considerable. The AREDP programme could be used to develop a plan for agricultural export development, especially in the fruits and nuts sector, to identify investment opportunities and to help build strong commodity export associations.
- ***Industrial crops and agro-processing:*** Sector studies of prospects for oil seed development should be conducted. These should evaluate financial profitability and economic comparative advantage and environmental impacts and risks, and should recommend what policies (start-up assistance, matching grants, cost sharing, short to medium term support, appropriate tariff protection, market development, etc.) might be needed to help establish and sustain agro-industrial production. Investments can then be pursued under the umbrella of AREDP.
- ***Contract growing:*** A detailed study of experience and opportunities in this priority area should be carried out, and conclusions implemented with investment support under AREDP.

## Rural Employment and Adding Value to Labour 8.4.2

8.39 Rural employment and adding value to labour are key mechanisms for providing alternatives to opium (4.1.2). However, opportunities for improving the employment prospects of the largely unskilled rural labour force and for adding value to migrant labour have not been exploited (4.2). Recommendations of the report in this area include the following:

- **Skills development:** A demand-driven vocational training programme needs to be developed and financed (4.3.2).
- **Flexible migration:** A study should be carried out to identify entry points to higher value and more humane migration, and to develop a road-map for this (4.3.2.b).

## Rural Electrification 8.4.3

8.40 Rural electrification can make an important contribution to rural well-being and to rural productivity, but little has been done systematically in this area so far (5.1.3). The report recommends that a **national policy framework** be developed, covering ways to facilitate private investment, subsidy policy, and institutional options for larger projects. The report also recommends that a **central agency for facilitating rural electricity access** be established. One important task would be a **programme of research and information on best practices**. It is also recommended that **extra financing** be provided for rural electricity development (5.4.3).

## 8.5 KEY CROSS-CUTTING POLICY AND INSTITUTIONAL ISSUES

8.41 Above the programme level there are a number of issues that constrain development across the board in Afghanistan and where a political-level consensus may need to be developed or – where it already exists – translated into action. These issues therefore require persistent dialogue amongst all partners, leading to consensus and, most importantly, change. The main cross-cutting issues for further dialogue discussed in the report include:

- **The imperative of increasing Afghan ownership and leadership:** All programmes should be within an Afghan government strategy, and must be accountable to the government. Improvements in the quality of Afghan leadership in some government agencies will be needed, and should be treated as a priority. Unremitting capacity building efforts should be implemented (7.1).
- **Enhancing aid effectiveness:** Government and partners should implement their commitment to financing National Priority Programmes and to channeling aid flows through the national budget. Further capacity strengthening should be provided to help government steer the NPPs and to manage budget flows efficiently. Joint programming – rather than just “coordination – should be the rule (7.2).
- **The need to move from vision to action on mainstreaming:** Counter-narcotics mainstreaming guidelines should be adopted and diffused, based on any necessary fine-tuning. Government should help all agencies to apply the guidelines systematically (7.3).
- **The imperative of long-term commitment rather than short-term expediency:** There is an asymmetry between the political expectations of government and donors for rapid changes in the opium economy and the reality of the one to two decades that are realistically needed before the opium economy dwindles. Effective counter-narcotics efforts inevitably are a combination of economic development, the provision of social

services, and better governance and the rule of law. This will take considerable time, massive and sustained financial commitment, and political vision and stamina (7.4).

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