

BTI 2008 | Afghanistan Country Report

Status Index	1-10	3.14	# 120 of 125	
Democracy	1-10	3.42	# 108 of 125	↗
Market Economy	1-10	2.86	# 119 of 125	➔
Management Index	1-10	4.44	# 89 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	28,6	HDI	0,35	GDP p.c.	\$	822
Pop. growth ¹	% p.a.	2,5	HDI rank of 177	173-	Gini Index		35,5
Life expectancy	years	46	UN Education Index	0,34	Poverty ³	%	-
Urban population	%	22.6	Gender equality ²	-	Aid per capita	\$	-

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day | UNDP, Afghanistan National Human Development Report 2004.

Executive Summary

Afghanistan saw major developments during the period under review. In September 2005, it held parliamentary elections for the first time in 30 years. The elected legislature comprised of the Wolesi Jirga (House of the People, lower house) and the Mesharano Jirga (House of Elders, upper house) is attempting to check the powers of the strong executive and consolidate democracy. Building these institutions has not made democracy truly functional and it remains hobbled. Hamid Karzai's popularity is waning as the government has failed to stabilize the situation and deliver basic services. The Afghan National Army (ANA) and Afghan National Police (ANP) have not yet given President Karzai the much needed leverage to assert and exercise control in the whole country. NATO forces as part of the International Assistance Force (ISAF) have expanded to 31,000 and have moved to areas in the south and east of Afghanistan, where the Taliban insurgency is taking place. Violence has increased and civilian and coalition casualties are on the rise; in 2006 alone, there were 4,000 deaths.

Afghanistan continues to be virtually dependent on foreign aid. A withdrawal by the international community would induce an immediate collapse of its institutions, including the ANA, ANP and other government agencies. International aid accounts for 90% of Afghanistan's total budget. Opium cultivation has increased to alarming levels. The UN estimates that more than 90% of the world's heroin supply comes from Afghanistan. An unprecedented 6,100 tons of opium was harvested in 2006, in defiance of all anti-narcotics regulations. Opium contribution to GDP is estimated at 40 to 60% according to the UN. Because the government has failed to provide alternative livelihoods to Afghan farmers, they continue with poppy cultivation, which earns them 10 times more than a traditional wheat crop. Given the dismal living conditions and weak economy, corruption has become a major challenge. The country ranks 117th out of 158 countries on the Transparency International Corruption Index. Corruption has

obstructed major foreign investments. Poverty is pervasive particularly in rural areas where 80% of Afghans live. They are disillusioned with their government as harsh living conditions, the lack of medical care, and violence affect their daily lives. Nearly one out of every four Afghan children dies at the age of five. The lack of access to potable water, health facilities and electricity indicate the mediocre level of development that has taken place despite the flow of foreign aid for developmental projects. Still, Afghanistan has the lowest per capita tax revenue generation of any country in the world. The Afghanistan Compact and Interim-Afghan National Development Strategy (I-ANDS) of 2006 are expected to bring about substantial change and reduce poverty and improve governance and security in the country.

History and Characteristics of Transformation

The country has witnessed many military interventions since its inception as an independent state in 1747. Its strategic location has always attracted big power rivalries. In the nineteenth century, it suffered because of the Great Game between Czarist Russia and British Empire. The British fought the Afghans in order to ward off the Russian threat to their empire. They invaded Afghanistan and their armies were defeated, but they were able to set up puppet regimes in Kabul to carry out the interests of the British. With the Russian Revolution in 1917, the Afghans declared their independence, signed a treaty with the Russians, and declared war upon the British. In 1919, King Amanullah made Afghanistan an independent state and reformed the monarchy by introducing liberal reforms.

All these years of wars and interventions had made Afghanistan weak and dependent on external resources. Palace rivalries continued and ultimately led to the overthrow of the last king, Zahir Shah, in 1973. President Daud declared Afghanistan a republic and put an end to the monarchy in 1973. The republican experience was short lived; in 1978, a socialist revolution took place and the new leader, President Nur Mohammad Taraki, aimed at transforming it into a socialist system. In 1979, the Soviets intervened to consolidate socialism in the country. Islamists, with assistance from the United States and neighboring countries, resisted the socialist government. Civil war continued and Afghan mujahedeen fought the government and the Soviet forces until they withdrew in 1989. Fighting continued between government and opposition forces until the communist government of President Najibullah finally collapsed in 1992.

The mujahedeen assumed control, but power wrangling continued among different mujahedeen factions. The mujahedeen attempted to transform the political system from a socialist to an Islamic system. At the end of 1994, a new political military force, the Taliban, emerged and captured Kabul in 1996. Their strict interpretation of Islamic law isolated the government internationally. It was only recognized by three governments:

Pakistan, Saudi Arabia and the United Arab Emirates. The rest of the international community did not approve of the new leadership and refused to recognize it, and continued to support the former regime of Burhanuddin Rabbani in exile. In 2001, the Americans attacked Afghanistan in the wake of the 9/11 terrorist attacks, to overthrow the government of Taliban and eliminate their al-Qaeda supporters. A new interim government was installed, and a moderate Pushtun leader, Hamid Karzai, was made the president under the Bonn Agreement.

As part of the Bonn process, the country held democratic presidential elections in October 2004 and parliamentary elections in September 2005. Hamid Karzai was popularly elected and has the support of his international partners, but he remains weak, as there is growing resistance from the Taliban. The latter are currently fighting not only against the government forces but also against the large international force in an attempt to free the country from foreign intervention and remove Karzai, whom they consider to be a puppet of the West.

Afghan history is full of interventions and internal political rivalries that have weakened and destroyed the social and political fabric of the country. Experimenting with different forms of government has also left an impact as it moved from monarchy to socialism, from socialism to an Islamist state, and now is experiencing democracy with an Islamic face.

Transformation Status

I. Democracy

1 | Stateness

Afghanistan has massive problems related to stateness. The state's monopoly on the use of force is minimal. Security is deteriorating despite the presence of the 32,000-strong International Security Assistance Force (ISAF), reflecting the government's incapability to provide security and deliver services to its population. The Taliban insurgency has posed a grave challenge to the authority of the government and international forces; in 2006 alone, it has claimed more than 4,000 lives, a fourfold increase over 2005. Suicide attacks have proliferated, from 27 attacks in 2005 to 139 in 2006. The government's efforts against the insurgency are weak as the Afghan National Army is still in the process of being built up. The government is mainly dependent on the international forces to provide security to the south and east of the country. The Afghan National Army, numbering 36,000 in January 2007, is not yet in a position to provide the country with much needed security and extend the government's legitimacy. Equipment shortages and low literacy rates have slowed the training of the army. The police force (around 50,000 at present) has lost its credibility amongst the Afghan populace because of corrupt officials. Growing insecurity, weak governance and corruption have led to the growing frustration of Afghans and diminishing trust in Karzai as a ruler.

Monopoly on the use of force

Ethnic divisions and rivalries continue between different ethnic Afghan groups, but no group has questioned the issue of citizenship and all are loyal to their country, believe in their Afghan identity, and consider themselves a nation-state.

State identity

Being an Islamic republic, Afghanistan has to follow laws in accordance with Islam; however, the constitution allows the practice of other religions. The international community has highlighted the population's religious intolerance by referring to the protests against the publishing of cartoons by a Danish daily in September 2005. Afghans took to the streets and the government found it difficult to restore law and order. The conversion of Abdul Rehman in March 2006 to Christianity, and his subsequent detainment, led to criticism from human rights

No interference of religious dogmas

organizations regarding religious intolerance in Afghanistan. He was released due to international pressure and was granted asylum in Italy. Religion is an integral part of the political system of Afghanistan.

Basic administrative structures exist in the country, but it will take a long time to make the central and provincial administrative institutions function effectively and without assistance from foreign donors. In 2005, Afghanistan established provincial governments and set up various ministries to cope with the situation; however, the population at large feels that they do not have a voice outside of elections, and that this voice is not heard beyond those governance structures that currently exist at the local level.

Basic
administration

2 | Political Participation

In 2004 and 2005, Afghanistan elected a president and a parliament through general elections. The completion of a series of elections, with the exception of district councils, was considered a major milestone that has given the Afghan government additional legitimacy. The elections, the first in 30 years, were generally regarded to be fair and free as liberals, conservatives, Taliban, former communists and women were allowed to run for office. No major vote rigging was reported; however, according to international norms, the elections were not up to the standard. However, critical voices argue that the presidential election was nothing more than checking a box at the expense of any real substantive mandate or change.

Free and fair
elections

Karzai has been democratically elected, but the population questions his effectiveness as a ruler, as his two years in office have not brought major changes to the lives of Afghans. Parliamentarians have spent one year in office and they have started to talk about their inability to make an impact and effectively legislate. The Taliban and their supporters are challenging the authority of the government through insurgencies and violent acts.

Effective power
to govern

Civic groups can assemble but Afghanistan lacks the kind of political freedom associated with a mature democracy. There are human rights organizations, women's rights groups and various NGOs, operating in the country, but their freedom is subject to threats from anti-government and anti-American elements. However, political party participation was not allowed for either the presidential or legislative elections.

Association /
assembly rights

The media in Afghanistan have made progress during the period under review, and have tried to make an impact. World Press Freedom Day is now celebrated in the country, the Afghan Independent Radio association has been established, and a number of private television networks have sprouted. However, some

Freedom of
expression

journalists and television networks have been threatened and attacked for their liberal, pro-Western views. When the new Afghan parliament came into existence, it was expected that journalists would be treated according to the law and there would be less opportunity to deprive them of their professional right. Conditions have instead worsened. Omid Yakmanish, a Tolo TV reporter, was beaten by a parliamentarian inside the parliament hall while covering a debate in May 2006. On 29 May 2006, the private TV station Aryana suffered great financial loss in a riot after a fatal traffic crash involving a U.S. army truck in Sara-e-Shamali. The rioters stormed the station in Kabul and damaged its property. According to Abdul Ghani Modaqiq, one of the Aryana TV managers, the damages amounted to about \$500,000. Aryana TV continued to broadcast live while under attack, showing the riots to Afghans across the nation.

3 | Rule of Law

The Afghan political system is presidential, as the 2004 constitution grants parliament a supervisory role vis-a-vis the executive branch. Major powers are vested in the executive as the head of the state and government, responsible for all of the major policy decisions. After assuming office in 2006, the Afghan parliament tried to assert itself and check the powers of the executive and hold the president accountable for government policy. After functioning for one year, the parliament has remained weak and has not provided the check essential to a democratic government. However, the executive, having the constitutional powers to assert and dominate politics, has not been able to do so due to growing Taliban insurgency and corruption.

Separation of powers

In theory, an independent judiciary exists, as provided in the constitution. However, the justice system remains weak and people are widely dissatisfied with it, citing illiterate and uneducated judges, protracted proceedings, and inconsistent rulings. This has led to the increased involvement of the Supreme Court, even in minor legal aspects of the country.

Independent judiciary

Legal or political penalties for officeholders who abuse their positions are currently minimal. The corrupt police department and weak judiciary have made it a difficult task for the government to bring offenders to justice. Many Afghan officials have been implicated in war crimes, but their abuses have not been punished. Anti-narcotics Minister Habibullah Qaderi acknowledged, without naming names, that some cabinet members are involved in the drug trade and direct foreign aid into trafficking. Abdul Karim Brahovie, Afghanistan's minister of tribal and frontier affairs, says that the government has become so full of drug smugglers that cabinet meetings have become a farce. Corruption permeates all aspects of Afghan society. Curbing corruption is absolutely critical to the future of the state and government.

Prosecution of office abuse

Constitutionally civil rights are guaranteed, but in practice they are violated and the weak judicial system does not give common Afghans the right to seek redress for the violations of these liberties. Civil liberties cannot be protected in an environment complicated by an insurgency and the presence of foreign troops and the Afghan army conducting military operations.

Civil rights

4 | Stability of Democratic Institutions

Democratic institutions in Afghanistan are still new and fragile, and have been slow in performing their duties. Various institutions were established in accordance with the Bonn Agreement, but making them functional is proving difficult. The justice system has yet to prove its role of providing justice to common Afghans. Governance remains to be improved.

Performance of democratic institutions

Democratic institutions in Afghanistan are not accepted by a significant segment of the political elite and the population. In fact, it seems reasonable to assume that many Afghans simply do not define democracy in Western terms. There are anti-government elements such as the Taliban, al-Qaeda and drug lords who have posed a challenge to these institutions. They have pointed to the role of outsiders in the establishment of these institutions, criticizing their credibility and ability to stand on their own. They consider Hamid Karzai and his regime a puppet government with no authority.

Commitment to democratic institutions

5 | Political and Social Integration

While the Afghanistan political system is based on democracy and ensures the role of political parties and their free functioning, a stable, moderate and socially rooted party system has yet to evolve. Political parties are required to register with the Ministry of Justice. Because elections were not party-based, the actual role of political parties in democratic Afghanistan has been questioned. There is currently a large number of registered parties, including the former parties of the mujahedeen such as Hiz be Islami, Jamiat Islami etc. Political parties were barred from running candidates in the 2004 and 2005 elections.

Party system

There are networks of farmers, women and human rights, anti-landmine groups, etc., which are trying to mediate between society and the political system. Given the low level of civic and democratic culture, such associations will have to work consistently to bring about the desired change in Afghan society and the political system. The Afghan Independent Human Rights Commission has been stressing that the government and the NATO-led ISAF should work more closely together and gather accurate information on targets to avoid civilian casualties in military operations.

Interest groups

Democracy is new for the citizens. Suffering from years of conflict, Afghans desire immediate results in improving their lives and achieving prosperity. They are disillusioned with their democratically elected government and democracy itself.

Consent to democratic norms

Taking into account the establishment of democratic institutions and return of over three million refugees, social capital has advanced in Afghanistan, but the growing problems of housing, unemployment, ethnic rifts, and family feuds have led to distrust among the population. Various international NGOs encourage social self-organization, but it requires continuous support.

Associational activities

II. Market Economy

6 | Level of Socioeconomic Development

Poverty and inequality are key features of Afghan society. Afghan society has been plagued by gender-related issues, income gaps and ethnic strife, preventing people from contributing positively to their country. All the key social and economic indicators depict a dismal state of affairs. The HDI ranks Afghanistan at 173rd out of 178 countries worldwide. While GDP growth rates have been high in the past two years, they have had a limited impact on the poor. Every second person is categorized as poor. Despite a comparatively low differential of boys going to school as compared to girls, the reasons are quite diverse; for example, 36.6% of the primary school-age boys and 12.1% of the girls are not attending school regularly because they have to work. Just over half (55.2%) of girls who start primary school complete their primary education (up to grade six), while 89.7% of boys who start primary school complete grade six. More than three million Afghan refugees in Iran and Pakistan are practically excluded from society.

Socioeconomic barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	4,037	4,585	5,952	7,308
Growth of GDP	%	-	15.7	8.0	14.0
Inflation (CPI)	%	-	-	-	-

		2002	2003	2004	2005
Unemployment	%	-	-	-	-
Foreign direct investment	% of GDP	-	-	-	-
Export growth	%	-	-58.6	-2.8	31.4
Import growth	%	-	31	-25.7	20.9
Current account balance	\$ mn.	-	-	-	-
Public debt	\$ mn.	-	-	-	-
External debt	\$ mn.	-	-	-	-
External debt service	% of GNI	-	-	-	-
Cash surplus or deficit	% of GDP	-	-1.7	-0.7	0.9
Tax Revenue	% of GDP	-	2.4	3.4	3.9
Government consumption	% of GDP	7.8	9.4	9.1	8.6
Public expnd. on edu.	% of GDP	-	1.6	-	-
Public expnd. on health	% of GDP	0.3	0.5	0.7	-
R&D expenditure	% of GDP	-	-	-	-
Military expenditure	% of GDP	-	-	-	9.9

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security | UNDP, Afghanistan National Human Development Report 2004

7 | Organization of the Market and Competition

The foundations of a competitive market economy are laid down by enacting and framing a range of laws, regulations, decrees and charters in various sectors like banking, domestic and foreign private investment, labor and insurance. However, the absence and inadequacy of laws that protect, for instance, the rights of creditors, is a serious obstacle for banks and financial intermediaries. In addition, there is no modern regulatory framework for leasing and insurance, and no law on non-bank lending. Corruption and difficulties in obtaining licenses, accessing credit and enforcing contracts significantly increase transaction costs for potential and current investors. The central bank and corresponding institutions still work under the umbrella of USAID. Though various institutions have been created with foreign assistance, they are not particularly functional, primarily due to

Market-based
competition

insufficient capacity and skills, widespread corruption, extremely low salaries for government employees, and a deficient rule of law. Moreover, about half of Afghanistan's economic activity takes place in the informal sector, and focuses mainly on drugs and opium. Other obstacles include poorly built and inadequate physical infrastructures, the dismal implementation and enforcement of property rights, the continued strength of former warlords and drug barons, and the weak writ of the government.

There is no formal legislation to protect against monopoly and cartel formation. The Commercial Competition Commission of Afghanistan was created in 2006 according to international standards, but it is not yet operational. Drug traffickers, some of whom are also members of parliament and occupy other high-level government positions, enjoy monopolies over most economic activity. Continued conflict and a deficient legal environment are impediments to free market practices.

Anti-monopoly
policy

Liberalization of foreign trade is limited only to the extent of certain initiatives and ideas. The country will not gain accession to the WTO until 2010. An open and transparent environment to foreign trade is absent. There is no physical infrastructure to handle the customs and border transactions. Transit and customs procedures and documents have yet to be streamlined to match the needs of Afghanistan's trading partners.

Liberalization of
foreign trade

The banking system is sound; no bank exhibits deficiencies in capital or liquidity. Non-performing loans are about 2.5% of the total loan portfolio, which is considered healthy. Capital markets are underdeveloped in Afghanistan. Bank credit is available to domestic and foreign investors on limited market terms, as the variety of credit facilities and instruments is limited. Lending is underdeveloped due to inadequate legislation and regulatory infrastructure. Public debt and equity markets are not available in Afghanistan. Most local firms rely on family and friends and the informal hawala system to obtain necessary funds. Afghanistan ranks 153rd out of 155 countries for getting credit, a measure of credit information sharing and legal rights of borrowers and lenders.

Banking system

8 | Currency and Price Stability

The Afghan government, with the help of international agencies, has been generally successful in bringing down inflation and stabilizing the foreign exchange regime. Da Afghan Bank (DAB) is officially the independent central bank of Afghanistan. However, it still works under the shadow of USAID. While the legal infrastructure is in place, the physical infrastructure and human capital needed to support DAB's operations, especially outside Kabul, remains weak and requires greater investment with a strong focus on both reconstruction and staff

Anti-inflation /
forex policy

development. The government's five year strategic benchmark includes strengthening of the central bank's supervisory functions, developing internationally accepted prudential regulations for all core sectors of banking and non-banking institutions, and the restructuring and liquidation of non-licensed or state-owned commercial banks.

Most available macroeconomic statistics are relatively useless because of the prominence of donor (rather than market-generated) monies in virtually all key Afghan economic sectors. Since the Afghan economy is by and large reliant on foreign assistance, the government's fiscal and debt policies have become hostage to the donor's interest. Despite the ongoing reform process, revenue collection, the budget deficit and international reliance make for a gloomy picture. The population's ability to pay taxes is still very weak. Operational costs are skyrocketing and poverty is on the rise.

Macrostability

9 | Private Property

Property right protection is weak due to the inadequacy of the regulatory system, meager resources such as property registries or a land titling database, disputed titles, the incapacity of commercial courts, and widespread corruption. The acquisition of a clear land title to purchase real estate or a registered leasehold interest is complicated and cumbersome. It takes an average of 252 days and costs 9.5% of the value to register property. Many businesses cite access to land as one of the biggest impediments to investment in Afghanistan. In addition, the existence of three overlapping systems – the Shari'ah, the Shura and the formal legal system instituted under the 2004 constitution – are confusing to both investors and legal professionals. Legal, regulatory and accounting systems are inconsistent with international norms. The legal framework for investment is inadequate, accounting and standards regimes have yet to be set up, and regulatory bodies are often understaffed, weak and corrupt. Reform programs, however, are in progress and rely heavily on foreign experts. Recent months have witnessed a number of prominent land disputes between the Kuchis (the semi-nomadic Kuchis seem to want to settle down more each year) and local villages. This has been particularly pronounced in Paktia and Nangahar.

Property rights

Private sector development and attracting foreign investment are national priorities. Under Afghanistan's private investment law, foreign and domestic private entities have equal standing. However, in real estate, foreigners may not own land, but they may lease it for periods of up to 50 years. There are more than 75 state-owned enterprises (SOEs) and state-run corporations under 16 different ministries. Though most are performing at minimal levels, only two have been privatized. SOEs own vast amounts of land and property around the country, and delays in the rationalization and liquidation of some SOE holdings further stalls

Private
enterprise

development and investment. The government has in some instances exhibited anti-competitive and protectionist bias in areas dominated by SOEs.

10 | Welfare Regime

More than half of Afghanistan's population is poor, and 80% live in rural areas. Though there is an acute shortage of skilled labor, employment opportunities are limited due to deficient skills, high demand and corrupt practices. There are no training and anti-corruption measures currently in place, though much had been planned for the 2007 budget. Allocation of external national budget resources are not determined by a consistent development policy based on equitable, poverty-oriented allocation formulas. However, one has to keep in mind the tremendous differences between Kabul and rural areas, or, even better, north of the Helmond River versus south of the Helmond River, where NO progress whatsoever has been made.

Social safety nets

Female parliamentarians are legally mandated by the constitution and Afghanistan has the largest number thereof in the world. However, discrimination against women in access to post-secondary education, employment and other spheres of society is evident. Equal opportunity and equal access to public services do not exist due to poverty, entrenched interests and corrupt practices. Daily routines have not changed much in most of the country for decades. The same is true for education; outside of Kabul, the typical school is a sixth grader teaching a first grader underneath a tree with virtually no equipment.

Equal opportunity

11 | Economic Performance

The Afghan economy has shown mixed trends since 2002. The real value of non-drug growth varied from 28% in 2002 to 11% in 2006. The afghani appreciated by about 20% in real effective terms over the 30 months to September 2005. Between March 2003 and October 2005, prices rose steadily by 36%, which was mostly attributable to a significant increase in rents and energy prices. The exchange rate remained broadly stable, fluctuating between AFN 49.5 and AFN 50.5 per U.S. dollar, from 2005 to February 2006, owing primarily to a slowdown in food prices, which was partly offset by an acceleration of rents and petroleum prices.

Output strength

Per capita income is on track to rise to more than \$400 by 2008/09, from \$299 in 2005/06. Assuming the pursuit of sound monetary and fiscal policies, inflation would decline further to 9% by the end of 2006/07, and to 5% a year thereafter. While revenue is projected to increase to 6% of GDP in 2006/07 from 5.5% in 2005/06, the authorities must accelerate the reform program to reach the "Afghanistan Compact" target of over 8% by 2010/11. Afghanistan's total trade

in 2005 was estimated by the Central Statistics Office (CSO) at \$5.4 billion, comprising about \$3.9 billion in imports and \$1.7 billion in exports (of which around \$1.2 billion represent re-exports). The trade deficit is registered at \$2.68 billion or 45% of GDP. Despite economic growth, political economic reforms and state-building efforts, revenue collection as a percentage of GDP is poor. The formal taxable economy accounts for roughly 10% of all productivity and 80 to 90% of economic activity in Afghanistan occurs in the informal sector, which has been largely responsible for recent economic recovery and dynamism. The informal sector, however, remains outside the reach of the state taxation system, another factor that undermines revenue mobilization. Besides, opium dominates by contributing almost 35 to 40% to the economy. Opiates, Afghanistan's only major export, play a significant role in enabling the country to finance the non-drug trade deficit while maintaining price stability and the value of the currency.

Despite improvement in economic indicators, the poverty rate remains high, and employment opportunities exist in only a few sectors financed by drug profits, like construction and trade. In view of the recovery in agricultural output, as well as continued sustained activity in construction, telecommunications and transport, the real GDP growth projection of 13.6% for 2005/06 remained unchanged. In 2006/07, as agricultural growth returns to its trend, economic growth is likely to moderate somewhat, to a projected 10.9%. International reserves were expected to increase further, to about \$1.7 billion at the end of 2006, equivalent to 4.8 months of 2006/07 imports. The budget will continue to be funded by domestic revenues and foreign grants. For 2005/06, it was estimated to be equivalent to 44% of the GDP, compared with estimated disbursements of 35% of GDP in 2004/05. Nonetheless, part of the external budget (equivalent to 21% of the GDP) is not funded and projects will not commence until the funding is secured. Increasing domestic revenues over the medium term is of critical importance. The authorities concurred that the revenue target for fiscal year 2005, which was slightly higher than the budget projection but, at 5.2% of the GDP, was still one of the lowest in the world. The proposed tightening of expenditure controls, combined with a strong revenue effort, should have helped contain the operating deficit, excluding grants, to no more than three per cent of the GDP for fiscal year 2006. The government estimates that sustained growth of 9% annually of GDP is required to provide citizens with a tangible sense of improvement in living conditions, and compensate for the contraction caused by the elimination of the narcotics sector. Projected growth for the fiscal year of 2006 at 11.7% and for 2007 at 10.6% should exceed this minimum.

The current account deficit is projected to improve gradually from 39.9% of GDP in 2006 to 33.8% in 2007 as grant aid tapers down. The deficit increases slightly, reflecting somewhat greater foreign direct investment and public loan inflows. Trade has the potential to become an important driving force. However, formal

trade flows with neighbors are relatively small (except for large-scale re-exports to Pakistan and Iran and reconstruction-related imports). With an average tariff of 5.3%, Afghanistan has one of the most liberal trade regimes in the region.

12 | Sustainability

Unexploded artillery and landmines (UXO) and its collateral impact are a major problem for the country. Drought, deforestation, overgrazing and desertification are further concerns. The influx of returnees and the internally displaced population has resulted in several problems including sanitation, contaminated water and soil erosion. Environmental awareness in society at large is nonexistent. Being an agrarian society, environmental concerns should have been more prominent in economic policy; however, they receive only limited consideration and are not reflected in the institutional framework.

Environmental
policy

The education budget does not meet education needs in Afghanistan. Currently, more than six million students are receiving an education, of which only 35% are girls. However, this is limited to primary education only, which is funded mostly by donor assistance. The state of Afghanistan's educational institution infrastructure is deplorable, and it is vulnerable to insurgencies and the violence prevalent in rural areas. There are no solid institutions for basic, secondary or tertiary education. Research and development is almost nonexistent. Investment in quality education, research and development is very low, as is evidenced by the budget. However, investment in education, research and development is a condition of transition. The persistence of the current situation may become a major impediment to reconstruction and development.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

The structural constraints on governance are massive. Lack of equitable access and the poor quality of education opportunities severely limit people's ability to participate productively in the economy. While there was an increase in the number of children attending school in 2005 and 2006, the same period saw schools being torched by the Taliban, which led to the closure of schools in the country's southern and eastern regions. The dearth of both qualified and experienced professionals is a significant constraint on the development of an effective, modern and responsive civil service, as well as a vibrant private sector. The government has been focusing on employing young and foreign-educated Afghans, but they lack the relevant experience and training to deliver effectively. As a landlocked country, the ongoing drought has negatively affected the Afghan economy. Transit trade related issues have been enmeshed in the overall deteriorating state of Pakistan-Afghan relations. In addition, the country still has no viable road or communication system linking the prominent urban areas to each other. Meaningful integration for the hinterland will take years to be realized.

Structural
constraints

The liberal democratic traditions of Afghan society are minimal. There is a forum for Afghan civil society and it has continued to promote and develop an informed civil society in the country, but, in a larger context, civic culture takes much longer to grow and take root. The tradition of a loya jirga has provided Afghans some form of political participation. The number of foreign and local NGOs has increased since the Taliban has been ousted, but they are viewed with suspicion for growing in size and strength, mishandling money or simply not delivering on what they have set out to do. The Afghan parliament questioned the activities of an estimated 4,000 NGOs operating in the country for allegedly profiting from aid money earmarked for reconstruction, and there are also concerns about the transparency of these organizations. At present, about three-fourths of foreign aid goes directly to NGOs instead of to the Afghan government for use in various development initiatives.

Civil society
traditions

During the period under review, Afghanistan was ripped apart by a violent Taliban insurgency in the southern and eastern regions. The NATO-led ISAF has been carrying out operations in these regions to bring security and establish peace. However, this goal remains elusive and conflict continues; death rates have soared and security has deteriorated, bringing into question the presence of such a large international force. The conflict is no longer described as ethnic; however, subtle rivalry and division remains between Pushtuns and non-Pushtuns. All desire a greater say in political affairs and call for power-sharing, which the present government is handling delicately.

Conflict intensity

II. Management Performance

14 | Steering Capability

Largely dependent on foreign aid and external forces for maintaining security and consolidating the current regime's hold on power, the political leadership is not able to set and maintain strategic priorities. America alone has given \$10.3 billion to rebuild Afghanistan in the fiscal years 2001 to 2006. Many foreign donors correctly believe that Karzai cannot deliver security and redevelopment without their sustained assistance. In January 2006, the government approved the Interim Afghanistan National Development Strategy (I-ANDS), a strategy for security, governance, economic growth and poverty reduction, but its success depends on assistance from donors.

Prioritization

In January 2006, the international community renewed its commitment to the country within the framework of the Afghanistan Compact, pledging \$10.5 billion (of which about 80% are new funds) at a high-level conference in London. The compact outlines five-year benchmarks to enhance security, governance, the rule of law, human rights, and economic and social development. While the government proposed I-ANDS, its implementation depends on funds from the donor community. Reform policy is therefore being executed by agencies and donors.

Implementation

A government that has been propped up by external support and lacks the capacity to ensure security or deliver basic needs to its population can hardly be innovative in policies or deemed visionary. Afghan regimes have not learnt from history and have a tendency to repeat past mistakes.

Policy learning

15 | Resource Efficiency

The government cannot sustain its operational costs and is dependent on international aid. During the period under review, the Afghan government spent only 44% of the money it received for development projects. Only a small percentage of all national budget resources are funded through domestic revenues. President Karzai has tried to recruit young, foreign-educated Afghans to public offices, but attracting professionals back to the country has been a difficult task. The brain drain continues, hindering the government's effort to reform the civil service. Decades of war, a low level of education and lack of training facilities has resulted in the scarcity of skilled technicians, qualified managers and educated professionals.

Efficient use of assets

A coherent policy is hard to pursue in the current environment of instability, deteriorating security, increasing corruption, and high dependency on international aid. These constraints have made coordination difficult.

Policy coordination

Corruption is rife at all levels of the system. The country ranks at 117th out of 159 in the Transparency International Corruption Perception Index. A World Bank survey considers corruption as the main hurdle for doing business in Afghanistan. While there are anti-corruption laws in place making the practice of giving or taking bribes illegal, there is limited enforcement. President Hamid Karzai has created an Anti-Corruption Commission to investigate corruption cases and refer suspects to the appropriate authorities; however, the commission has not forwarded any significant cases against public officials or private individuals. Low salaries for officials and poverty have been driving the increase in corruption.

Anti-corruption policy

16 | Consensus-Building

There is a consensus among the political actors on the goals of development and transformation. The implementation of the Bonn Agreement could not have materialized had there been major objections to democracy and a market economy. However, the need to deepen democracy and market reform remains, as emergent institutions are weak.

Consensus on goals

The government allowed Afghans from different ethnic and ideological backgrounds to participate in the parliamentary elections of 2005. The presence of jihadi, former communists, and moderate Taliban in the national assembly reflects the government's endeavor to co-opt various actors in the reform process. Initially, the government sought to include Tajik and Uzbek warlords in the democratic process by giving them cabinet posts. However, in response to

Anti-democratic veto actors

increasing criticism for having co-opted leaders responsible for massive human rights violations and engaged in drug trade and criminal activities, the government attempted in 2006 to exclude them (with the exception of Ismail Khan, the former governor of Herat).

The Taliban's resurgence and the increasing violence in the southern and eastern regions reflect the government's failure to manage political cleavages. In January 2007, Taliban commander Mullah Dadullah announced an increase in attacks on foreign troops and those who negotiate with the government. The recent re-emergence of the Taliban challenges the government and pro-democratic social forces in over 140 districts.

Cleavage / conflict management

The role of civil society in the political process is limited, but the government has made attempts to include it. The government involved a wide array of stakeholders, including community and provincial representatives, religious leaders, the private sector, civil society and NGOs, in the twelve-month-long consultation over the I-ANDS, which was announced in January 2006.

Civil society participation

The leadership recognizes the need to deal with past injustices but has failed to bring reconciliation between victims and perpetrators. Many Afghans want to see justice done with respect not only to present and future abuses, but also to the countless murders and other war crimes committed by previous regimes and warlords. Afghanistan's Independent Human Rights Commission (AIHRC) has stressed the need to address past war crimes to bring peace and stability. Continued impunity has given perpetrators the opportunity to commit further abuses with no fear of persecution.

Reconciliation

17 | International Cooperation

It is the backing of international partners that has enabled the Afghan leadership to set up democratic institutions. International partners have also supported attempts to develop the Afghan National Army, the Afghan National Police, disband illegal armed groups, and implement reforms as suggested in ANDS and the Afghanistan Compact.

Effective use of support

Due to the support of the international donor community, President Karzai's government is considered credible, though his inability to curtail the insurgency and build stable relationships with neighboring countries has undermined the government's credibility in the region.

Credibility

Afghanistan, as a member of the Economic Cooperation Organization headquartered in Tehran, is cooperating with most of the countries of immediate economic interest to it, including all of its neighbors (excepting China), as well as Turkey, Azerbaijan, Kazakhstan, and Kyrgyzstan. As a member of the

Regional cooperation

Organization of the Islamic Countries, it is utilizing its Islamic identity to improve its ties with Islamic countries. However, years of conflict and the role of neighboring countries in the war have made the government cautious in dealing with them. Right now, Afghanistan holds Pakistan responsible for the ongoing insurgency in the country.

Strategic Outlook

Although the period under review offered some positive developments (a presidential election, warlords' decreasing power), Afghanistan still faces many problems threatening its political and economic reconstruction. Various local conflict constellations could influence elections, which could become a forum for unsolved conflicts. In addition, there are immense logistical problems; the size and boundaries of many districts are controversial, and there is to date no census of the provincial population. Furthermore, the state does not have a monopoly on the use of violence and the warlords constitute a genuine threat. The new cabinet must prove its ability to carry out necessary reforms against the will of the warlords. Propelling economic development might be one of the most serious hurdles to overcome as the Afghan economy continues to suffer from the legacies of war and remains underdeveloped. Achieving minimum socioeconomic standards remain far off and it will take a long time to reduce the opium economy in a sustainable way. At the moment, it appears that Afghanistan is about to become a narco-state. Whereas opium production is considered the number one obstacle to reconstructing the Afghan state, opium forms the mainstay of the Afghan farming sector and dominates national exports. Strategies for fighting the drug economies of other countries seem insufficient in the complex situation of Afghanistan. Much depends on the approach the international community decides to take. A strong emphasis on eradication would negatively affect rural poverty and could breed strong anti-government sentiment. Sustainable and equally distributed economic growth, along with the development of strong institutions, could create the political and social security necessary to eliminate opium cultivation. But this will take decades.