THE OPERATING ENVIRONMENT FOR SMALL AND MEDIUM ENTERPRISES IN RURAL AFGHANISTAN: ENABLING OR DISABLING?

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Government's investment programs in agriculture and rural development reflect the priority needs of the majority of Afghans, who reside in the provinces. Agricultural reform will help to diversify and restructure the agricultural economy, creating high value production… Government's goal is to achieve pro-poor growth in rural areas by enhancing licit agricultural productivity, creating incentives for non-farm investment, developing rural infrastructure, and supporting access to skills development and financial services that will allow individuals, households and communities to participate licitly and productively in the economy.

Interim Afghanistan National Development Strategy,
Pages 131 and 145

I. INTRODUCTION

Agriculture and rural development are emphasised in the Afghanistan National Development Strategy (ANDS) as key in effecting the much needed transition from a largely informal economy to a formal and prosperous one geared toward improving Afghan livelihoods and strengthening the revenue base for the national government. The data on rural employment and the extent of the dependence on agriculture are based on estimates and thus not always reliable. According to the Afghanistan Millennium Development Goal Report (2005), agriculture accounts for over 50 percent of the licit economy and provides employment to almost two-thirds of the workforce. In 2003, the National Risk and Vulnerability Assessment (NRVA) estimated that agricultural activities contributed to the income of 63 percent of Afghan households, with significant diversity on a provincial, district and even village level. Given these statistics, economic development initiatives in rural areas will need to be focused significantly, since in many cases, the manufacturing and service sectors will also be heavily dependent on agriculture.[1] This focus needs to be contextualised in the broader national economy whose constituent parts must include non-farm activities such as construction, trade, manufacturing, transport, mining and other services which have significant bearing on rural employment.[2]

This paper provides an overview of the **key challenges faced by rural SMEs in Afghanistan**. The evidence is drawn from secondary sources as well as primary data collected during fieldtrips to the two provinces of Bamyan and Balkh. The secondary data are from widely available government and non-government sources such as reports and briefings, while the primary data are from interviews with SMEs involved in commercial agricultural production, food processing, marketing and trading in the two provinces. The case studies in this paper combine the data from secondary and primary sources (interviews with key informants in Kabul and in the field). The case studies are analysed to formulate a series of recommendations aimed at improving the operating environment for rural SMEs. We begin with a general description of the regulatory context and some of the formal institutions with key roles in rural enterprise development.

II. REGULATORY AND INSTITUTIONAL BACKGROUND

This section provides a brief overview of the regulatory context and some of the key formal institutions with major roles in rural enterprise development. It must be noted that these roles are far from settled and, like most other arrangements in the Afghan political economy**, are undergoing continual change and evolution**. Periodic name changes of key government Ministries are accompanied with redefinition of roles and responsibilities which continue to change in size and importance and which overlap. This renders attempts to map formal institutional arrangements difficult and perhaps not very useful at the present time because of the constant state of flux.

In the Interim Afghanistan National Development Strategy (IANDS), **the Government has committed to develop** by the end of 2010, a policy and regulatory framework to support the establishment of small- and medium-sized rural enterprises in the 34 provinces. IANDS commits to investments in both agricultural and non-farm enterprises in rural areas as part of its growth and employment generating rural economic development.[3] The document also emphasises the facilitation of light industry in rural areas to add value to agricultural production. A number of ministries and agencies have been charged with the responsibility of implementing measures likely to add value to agricultural products and foster the growth of agri-businesses.

The Ministry of Agriculture, Animal Husbandry and Food (MAAHF), recently renamed as the **Ministry of Agriculture and Irrigation** (MAI), is responsible for the commercialisation of agriculture, encouraging greater agricultural productivity through use of improved seeds, and the cultivation of crops with good market opportunities. The five-year Agriculture Master Plan contains provisions and budgeted funds for assisting entrepreneurs' and farmers' associations in gaining access to credit and government land, as well as cooperation with other ministries in finding regional and international markets for agri-business products. Donors such as the World Bank have been very supportive of the Ministry's attempts in this regard, committing significant funds for the next five years. Other key donors have been the Asian Development Bank (ADB) and USAID. ADB is currently preparing a commercial agriculture project that will focus on value addition and support of the private sector in exploiting domestic and regional markets for agri-business products. Over the last few years, USAID's Rebuilding Agricultural Markets Program (RAMP) has focused on elevating Afghan agricultural products along the value chain by encouraging local processing, improving irrigation, enhancing storage capacity, improving road access, identifying foreign markets for Afghan agricultural products and facilitating links between local producers and foreign markets.

Because of the emphasis on the role of the private sector in rural development, the Ministry of Commerce, recently renamed as the **Ministry of Commerce and Industry** (MoCI), has also been deemed as having a role, though at the present time it is unclear exactly what this role entails. The MoCI could provide advice based on its current endeavours to streamline the regulatory environment to promote and nurture national and international private sector activity in the Afghan economy as a whole.

The **Ministry of Rehabilitation and Rural Development** (MRRD) has had, and will continue to have, a key role in advancing the agenda for further development of agricultural production systems. In the period immediately following the fall of the Taliban regime, the MRRD was at the forefront of emergency aid provision and food security programmes in rural areas. The MRRD's most important role to date in rural business development has been linked with the National Solidarity Program (NSP) and the National Area Based Development Programme (NABDP) under which the Ministry is currently undertaking a significant research project on rural economic development with the aim of producing a detailed policy strategy.[4] Under the Master Plan, MRRD is charged with leading the efforts in creating an enabling environment for the rural private sector – a task inconsistent with MRRD's functions to date, requiring a substantial shift in the Ministry's approach and the "mental model" of providing for people rather than arm's length facilitation for private sector development. However, carried through with diligence, there are grounds for optimism that the implementation of the Master

Plan objectives will provide the impetus and support for the MRRD to assume its new role.

Reconstruction efforts are generally frustrated by a tension between cooperative-oriented approaches promoted and practiced by successive regimes prior to and during the Soviet era, and a private sector-centred approach promoted and practiced by development aid donors (notably USAID, Asian Development Bank, the World Bank and the Government of Afghanistan). One significant result of this tension has been the shifting of the boundaries for government and private sector roles in reconstruction efforts. As one interviewee pointed out, "the discourse should not be about the choice between cooperative or private sector approaches. Rather, policymakers and international donors need to agree on what type of private sector development is suited for Afghanistan, given the badly damaged infrastructure, weak government, diminished trust, and the cooperative institutional tradition."[5]

Adopting this middle approach, as suggested by the interviewee, is likely to maximise the synergy from having a multiplicity of actors on board with varying and/or competing agendas. Efforts in coordinating actions by overlapping or competing agencies and entities could turn the many contenders into *de facto* stakeholders.

A pragmatic and inclusive approach based on this line of reasoning is also likely to lay the foundation for setting attainable objectives and defining evaluation criteria to assess policy effectiveness. Common rules and the introduction of a clear and transparent division of labour could also ensure that policy objectives are met and set the precedents for the formation of learned communities and social networks that last beyond the lifetime of reconstruction programmes.

A shift is nevertheless **discernible from emergency aid provision to the development** of a market-based economy. The 2005 Master Plan, for example, is committed to measurable economic growth in agricultural activity with local participation and ownership also being emphasised. The two sectors targeted are horticulture and livestock. A key feature of this strategy is to create an enabling environment for rural SMEs to thrive in areas and regions with the potential to yield the highest productivity and return on initial investment. This focus raises numerous issues in relation to transport infrastructure, production technologies in use in agriculture and rural well-being. In the next section these issues are investigated in case studies drawn from the Balkh and Bamyan provinces.

III. CASE STUDIES

This section presents some of the **key issues** related to the commercialisation of agriculture and related rural SME development through seven sub-sectoral case studies conducted in the provinces of Bamyan and Balkh. These provinces were selected for the following three reasons: (i) the two provinces were isolated geographically and economically, (ii) the two provinces had reasonably stable economies and agricultural production systems, and (iii) Kabul City served as the largest potentially accessible external market for the agricultural goods from these two provinces.

Based on the analysis of the case studies, the **picture that emerges for the SME operating environment is mixed**. Like most rural and other enterprises, productive activity suffered significantly during the years of conflict which translated into scarce or unreliable supply lines, the erosion or disappearance of existing markets and supporting institutions, and outright hostility toward the farming communities from those in positions of power creating an operating environment best described as "disabling". Although the operating environment has improved significantly since 2001, certain aspects of business activity continue to demonstrate need for much improvement.

The next section reports on the findings from the seven case studies undertaken for this research. These findings are presented in summary form with the key descriptions highlighted.

Case Study 1: Potato production and marketing in Bamyan

Mostly people produce potato and wheat. Wheat they produce for themselves to survive. Potatoes they produce for [the] market but because we do not have good facilities like roads ... the people do not have easy access to the markets. This is why Bamyan people are poor.

Bamyan Governor Habiba Surobi[6]

Potatoes are the most important cash crop produced in the Bamyan province. Key issues related to the commercialisation of potato production are summarised below.

- **Pressure to sell at low prices directly after harvest:** Potatoes are harvested from August to September. Farmers needing to sell their harvest to traders directly after **harvesting** in September receive around 50 Afghanis per seer (7kg), but at other times of the year they can sell for up to 80 Afghanis per seer. This is particularly a problem for the poorer farmers.

- **Ineffective traditional storage methods:** The traditional storage method which involves storing potatoes in the ground leaves the stored potatoes vulnerable to frost damage and dehydration, reducing tonnage and quality.

- **No direct access to the market:** Most farmers in Bamyan City sell their potatoes to traders and truckers, as they are unable to arrange transport to the market in Kabul themselves. Traders selling the potatoes in Kabul can make a profit as high as 30 to 40 Afghanis per seer.

- **High costs due to poor road conditions and inadequate road infrastructure:** The lack of adequate infrastructure within the Bamyan province and between the province and Kabul and Mazar-e-Sharif was **pointed** to by many interviewees as the largest obstacle to development of potatoes as a commercial crop. Poor road conditions result in increased costs for the producers as shipments take longer and the produce is likely to be damaged. As a result, Bamyan farmers cannot effectively compete with potatoes imported from Pakistan and Iran, served by better transportation routes than those leaving Bamyan for Kabul. Pakistani suppliers also have access to cold storage for fruit and vegetables in Peshawar and Jalalabad, putting the Bamyan traders at a significant disadvantage.

- **Lack of a market for processed potato products:** The potential for further value addition in potato farming is **limited** not only due to the poor infrastructure but also to a very weak market in Afghanistan for processed potato products. Setting up a commercially viable potato drying project, for example, would need to take place on a larger scale than is currently feasible in Bamyan.

- **Lack of knowledge on markets for processed products:** There is currently a lack of market research, which makes it difficult to establish whether there is in fact a large enough market in Kabul for potato-based products to justify large-scale investment in potato processing.

  Initiatives to overcome some of the above listed impediments include the following:

- **The use of genetically modified potato seeds:** There has been some assistance to Afghan farmers, including some in Bamyan, in using improved and "virus-free" potato seeds. The International Potato Centre, based in Peru, increased the supply of virus-free potato seeds in Afghanistan for local needs as well as future export to neighbouring countries. The successful training of farmers and the testing of new varieties expanded from Jalalabad to Kabul and Bamyan districts. Some farmers in Bamyan have used virus-free seed produced in Jalalabad since 2003.

- **Building modern storage facilities:** A number of organisations have been involved in building modern potato storage facilities in Bamyan. The modern storage facilities have helped farmers plan the marketing of their products so as to get a better price. Two organisations are currently involved in building storage sites, the French NGO, Solidarité, and the Citizens Network for Foreign Affairs (CNFA). CNFA has built 22 potato storage facilities in the Bamyan province with funding from the US Department of Agriculture. CNFA provides the wood and stone and oversees the building process, whilst the farmers themselves provide the labour. The farmers involved are not in the poorest categories, as only farmers able to produce beyond subsistence levels require storage facilities.

  The size of storage facilities varies, but farmers interviewed in this study reported that the sites had an average storage capacity of around 8,000 seers (1.1 tons) of potatoes. The full impact of these initiatives on the scale of production for the Bamyan province could not be determined. However, it is certain that increased access to storage facilities is likely to lead to increases in the capacity of some farmers to produce a higher volume of potatoes while maximising returns on the sale of their crops.

- **Trader-initiated market intelligence system:** Digital connection through the Roshan mobile phone network has been very useful as a channel for farmers and **traders** in Kabul to communicate market information so that farmers can plan their shipments to Kabul more effectively.

Case Study 2: Apricot production, processing and marketing in Bamyan

The marketing of processed fruits, mainly apricots, has a long tradition in Kahmard and Saighan districts, as well as in some districts of Yakawlang. Traditional fruit drying methods are very small-scale and rudimentary. Apricots are dried in the sun on the roofs of houses. Currently, processing fruit is the only effective way to market Bamyan fruit in Kabul, as the poor road infrastructure and lack of refrigerated trucks make transport of fresh fruit to markets outside Bamyan very difficult. There are a number of small-scale, pilot initiatives aimed at increasing the profit margins of producers and traders through improved processing methods and better access to markets. These are implemented through the local NGO, Spring of Construction, Rehabilitation Cultural and Social Organisation (SCRCSO) under the Community Empowerment Programme for Women (CEPW) of the MoWA and the Aga Khan Development Network.

Some of the key issues are as follows:

- **Insufficient supplies:** Acquiring sufficient fruit for drying has been difficult as many fruit trees in Kahmard have been damaged by drought and part of the first crop destroyed by frost.

- **Lack of electricity and poor road infrastructure:** A number of respondents reported that small-scale processing such as the production of juices and jams would be a viable commercial proposition in Bamyan, were it not for the lack of electricity, the prohibitive added cost of running diesel generators and inadequate road infrastructure to transport finished products to various markets. While some villages are gaining access to electricity through small-scale hydroelectric generators constructed as part of the NSP, the electricity produced through these schemes is not sufficient to support small-scale industrial production. The NSP is intended to ensure that households benefit from very basic utilities such as having at least a light bulb per household.

Initiatives to overcome some of the impediments include the following:

- **Introduction of new processing technologies:** There has been some success in introducing new drying methods using sulphur to improve the appearance of the product and increase the appeal to the consumers in Kabul. Apricots dried without sulphur are sold to traders at around 100 Afghanis per seer (7 kg) whereas sulphur dried apricots are sold for up to 500 Afghanis per seer.

- **Improving access to markets:** The SCRCSO project has organised marketing expeditions to take the apricots to the bazaar in Kabul in an attempt to bypass intermediaries between the producers in Bamyan and the retailers in Kabul.

- **Product diversification:** SCRCSO is aiming to extend the apricot project to more beneficiaries and has submitted a proposal for a small fruit processing plant to produce juice from grapes, apples and cherries.

Despite some of the major issues such as poor road transportation and absence of reliable energy supply, the picture that emerges from the two case studies in the Bamyan province is positive. Government and donor assistance seem to be directed at areas of rural production which have the potential of increasing productivity and/or moving up the value chain, given the opportunity and facilitation. It is too early to state definitively and in precise terms the impact of assistance initiatives in Bamyan. Future research will be needed to assess this impact after sufficient time has elapsed and production patterns have become better established. However, it is doubtful that the situation would improve significantly over time if the infrastructure issues were to remain unresolved.

Case Study 3: Cotton production and marketing in Balkh Province

The Balkh province produces a significant quantity of cotton. Two plants were visited to get a sense of the operating environment for cotton processing. One was the formerly state-owned factory called “Jenopress”, and the other was a locally owned and operated plant. Since 2005, Jenopress has been operating under the auspices of the Northern Afghanistan Project for Cotton and Oil Development (NAPCOD), a joint venture between DAGRIS, the Agence Française de Développement and the Government of Afghanistan. It is hoped that the consortium now managing the plant will create over 300 permanent and around 150 seasonal jobs when in full operation.

The personnel interviewed had a list of concerns about perceived barriers to business activity:

- **Outdated machinery:** Most of the machinery at the factory is of German or Russian origin, dating back to the 1940s and 1960s.

- **Lack of adequately trained staff:** The plant does not have a sufficient number of trained technical operating staff. Most of the existing technical staff are Russian-trained and spend most of their time fixing old and dilapidated machinery.

- **Unreliable electricity supply:** To deal with constant power outages, the plant has recently purchased two large generators to maintain continuous production. The use of generators is more costly than supplied electricity.

- **Unreliable supply of cotton through contract farmers:** Agreements have been reached with the local cotton growers to sell their crop to the plant at a pre-set price in return for receiving genetically modified cotton seeds and fertilisers. However, the black market for harvested cotton offers a higher price than the pre-set price and many of the farmers sell their crops on the black market, depriving the plant of a reliable source of raw material. According to one interviewee the only way the black market could be eliminated would be by raising the pre-set price, something that the plant cannot afford to do financially. Without some degree of assistance from the government to discourage farmers from selling on the black market (through subsidies to the farmers, for example), a senior management official at the plant expressed pessimism about the long-term sustainability of the business.

A more optimistic picture emerged during the interview with the second cotton producer. In the past, this producer used to ship everything to Mazar for processing. In order to increase revenues, the proprietor decided to purchase processing machinery and to do some of the processing on-site. During the past eight years the plant has acquired a number of machines for ginning and seed oil extraction. Steadily, the plant has established itself in the local market and its oils are sold in markets of nearby provinces.

However, a number of issues were raised as main concerns:

- **Lack of quality control systems:** In response to a question regarding the quality and the grading of the oil products, the interviewees said that to date they had not felt having a quality control system was necessary. No laboratory tests have been conducted to determine the quality (or the safety) of the products. Testing of the finished product (oil) is particularly necessary since many locals collect their own seeds, bring them to the SME for processing and are allowed to feed the extraction machines with their collected seeds. This represents a potentially serious threat to the reputation of the SME as the consumption of contaminated cooking oil can be fatal. The safety issue is particularly important since some processes involve the use of toxic and corrosive chemicals such as caustic soda.

- **Inadequate energy supply:** As with all other SMEs interviewed, concerns were raised at this plant about the higher cost of generator-supplied electricity as compared to power supplied through the grid.

- **Fear of demands by government officials to pay taxes, fees and other charges:** The plant was not willing to share detailed financial and operational information with the interviewers because of a fear of being forced, by officials, into paying taxes and other charges on the account of owning production machinery and other equipment. This fear of revealing information acts as a major barrier to formalising economic activity.

No information was available on attempts by government or non-government organisations to address these concerns.

Case Study 4: Raisin production and marketing in Balkh

Despite the over two decades of strife and a long period of drought, agricultural and rural production-related business activity has continued in the Balkh province albeit with significant fluctuations in the volume of production, productivity and deterioration in the operating environment for SMEs. While traders of agricultural products have continued to operate during and after the years of conflict, the conditions have not been conducive to emergence and sustenance of other, more productive enterprises involved in value-adding activities. Agro-processing has suffered from a lack of capital investment, which has resulted in outmoded production machinery, reduced product quality and a loss of markets. Of the 30 or so raisin processing factories that once operated in Afghanistan only a few remain[7]. There are five raisin processing operations in or around Mazar-e-Sharif with only two working at full capacity when fieldwork was conducted.

At the time of our visit, one of the two raisin processing plants was operating at full capacity. In addition to processing raisins, the plant also processes cotton and extracts oil from cotton seeds. Fruit is dried and the nuts processed include almonds, pistachios and walnuts. The plant builds its own packaging cartons using cardboard and polythene and employs about 70 people. The supply of unprocessed products is from numerous local sources as well as suppliers from outside the province. The second raisin processing plant visited has been in operation for only a short while. It employs 30 men and 20 women. The raisins are packaged for export and to reach foreign markets, the plant has an agreement with a Russian trade company which markets the raisins along with many other products from Russia. No specific difficulties were expressed during the interviews and a general air of optimism about future prospects was noted during the visit.

A dried fruits trader in the bazaar underlined the key issues faced by raisin producers in the province:

- **Lack of processing capacity:** Much of the raisin on sale in the bazaar is of Afghan origin but processed in Uzbekistan. This points to inadequate or uncompetitive processing facilities within the province for adding value to primary farm produce.

- **Loss of local market for local producers:** During the height of the conflict and the drought, many traders had to look for new suppliers from the surrounding countries. While this practice has sustained retail trade, it has adversely affected the demand for locally grown produce.

No specific government or non-government initiatives to improve the operating environment for local producers and processors were identified during the visit. Regaining the lost market share by local fruit growers is likely to be a function of time, given sustained socio-political stability, normal annual rainfall and external impetus to re-establish a local production system capable of value addition.

Case Study 5: Fertiliser production in Balkh province

Production at the fertiliser plant near Mazar-e-Sharif has continued during and after the war.

However, production today faces a number of serious challenges:

- **Reduced production volume:** Under Soviet occupation, the plant operated 24 hours a day producing 320 tons of fertiliser per year. The plant also produced a number of industrial gases. Currently, the plant still operates 24 hours a day but produces only 100 to 120 tons of fertiliser per year.

- **Outdated machinery and lack of technical expertise:** The machinery is antiquated and the engineering expertise provided by Russian engineers is no longer available as before.

- **Threatened or costly fuel supply:** The pipeline from Sheberghan gas fields supplying the plant with natural gas is tapped into illegally by local strongmen. This threatens the supply line and adds to fuel costs for the plant.
- **Reduced product diversity:** The plant no longer produces industrial gases in order to streamline its production.

- **Loss of markets and unfavourable marketing arrangements:** The Soviet-backed government had a purchasing agreement with the plant under which all the fertiliser produced would be purchased and distributed by a government agency (Afghan Koud) to the farmers. This agency no longer exists. Currently a private dealer purchases the entire production and sells it on the free market to the highest bidder.

The fate of this fertiliser plant is symptomatic of other state-owned or previously state-owned industrial operations. Because of the years of conflict and changing government priorities, in the post-Taliban period state-owned operations in general have suffered from being under-resourced in many respects, particularly in terms of raw material, energy source and market access or selling arrangements for the products or services produced. The move from centrally planned and controlled industrial management to market-based industrial management has meant that during the transition, state-owned operations have been largely neglected. De-prioritisation of support for these operations by the State has meant uncompetitive salary structure, which has resulted in a flight of experienced personnel and expertise, diminished market share and outmoded production machinery. Given the current moves toward corporatisation and privatisation of state-owned operations, it will be sometime before socio-economic stability can act as an impetus for sustained, economically competitive production.

Case Study 6: Carpet and galeem weaving in Balkh

Carpet and galeem weaving has been and continues to be an important economic sector in Afghanistan as a whole. Interviews were conducted with two carpet/galeem weaving and cleaning workshops.

Key issues that emerged during the research include the following:

- **Domestic supplies:** Wool supplies have been chronically unreliable. To meet demand, the carpet weaving and cleaning workshop imports wool from Pakistan, Saudi Arabia and Iran. The dyes are almost entirely imported from abroad with German dyes being of the best quality.

- **Market access:** Afghan traders work on commission purchase carpets and galeems at wholesale prices on behalf of larger and more established Pakistani traders. The interviewees reported that much of this trade is illicit and the purchased carpets are smuggled out for wholesalers and exporters based (mainly) in Pakistan. In Pakistan, the carpets are cleaned and if necessary, repaired, and labelled as “Manufactured in Pakistan” for sale in domestic and foreign markets. Most Afghan producers and traders have little or no direct access to the markets in Pakistan and beyond.

- **Institutional support:** The main problem was described as a lack of a well-coordinated and institutionally supported marketing offensive to capture sizable segments of the very lucrative export market for handmade carpets. This problem has been recognised by government and development aid officials who have paid numerous visits to the carpet workshops in the area and have made commitments about increased efforts to increase access to markets. According to the interviewees, however, to date nothing has been done by the officials to remedy this situation.

- **Access to credit and corruption:** A second problem is the difficulty in obtaining credit from major national banks which, according to the interviewees, have "extremely difficult" qualifying requirements. Some loans intended for business development are reportedly widely misused by the recipients and spent to serve personal purposes.

- **Access to import/export licences and corruption:** Licences are very difficult to obtain and those who manage to obtain them for importing cleaning materials or certain types of wool, for example, have a *de facto* monopoly on the supply and thus the prices. The interviewees expressed a wish to have the right to import their own production inputs so as to have more of a say on the quality and the price. There were also remarks about corruption and how the monopolists were being protected by officials so as to maintain the status quo.

- **Pressure from imports of finished products from neighbouring countries:** A relatively new feature in the business of carpet traders is the import of finished products from neighbouring countries such as Tajikistan, Uzbekistan and Iran. There is also an increase in the importation of raw materials such as dyes and wool from these countries. Nevertheless, much of the value-adding activities reportedly continue unabated in the province.

Despite these difficulties, some carpet weaving workshops have experimented with more innovative ways of organising production. One of the workshops set up a work area for women who had traditionally worked from home. The purpose was to increase productivity and a more structured and controlled work environment. However, this experiment proved impractical: The women found it more convenient to work in their home environment because they could simultaneously attend to carpet weaving and (unpaid) domestic work. Based on a mutual agreement with the employers, the women reverted back to working from home and being paid on the basis of the amount woven.

According to the traders interviewed in the bazaar, rural businesses such as carpet making remained fully intact despite the many years of war: the supplier-producer arrangements continued during the war.

Case Study 7: Animal skin production in Balkh

The first one of the two animal products SMEs interviewed provided a similar view of trading arrangements and market access as those of the carpet makers:

- **Availability of skins:** The animal products sector was severely affected by the persistent recent drought, which resulted in wiping out 70 percent of the sheep population in the area. In the post-drought period there has been a rebound in the sheep population.

- **Low profits due to lack of direct access to markets and lack of processing capacity:** The SME interviewed reported that it collects raw animal skins and intestines, carries out very minimal preparation and ships the packaged products to Kabul and Peshawar for further processing. After grading, sorting and repackaging, the products are taken to Pakistan for distribution and sale. The total value of the trade in animal products was estimated at EUR 10 million, of which a small fraction accrues to the Afghan producers while the rest goes to the larger, technologically better equipped and more established and organised Pakistani traders.

- **Lack of security:** During the interview a request for taking photographs of the operations was turned down on the account of "unnecessary exposure" which might be used against the SME by ill-wishers and extortionists.

- **Corruption:** According to the second animal products producer, SMEs face insurmountable problems with widespread corruption of officials at all levels and a general failure by the Government to create an enabling environment for business activity:

  They [the Government] keep telling us about free trade and competition. What does all of this really mean when we have corrupt and unhelpful officials, no title to the land we operate on, no access to finance, insufficient fodder to feed the sheep from which we get our skins, and no basic services such as electricity?

Despite these difficulties, this SME has been exporting prepared sheepskins to a number of foreign markets for the last 20 or so years. The production volume has varied depending on the availability of fresh skins. The situation is likely to improve further in the post-drought period. However, many of the fundamental issues regarding security, lack of access to markets and inadequate energy and transportation infrastructure will continue to undermine initiatives by local producers to expand and grow.

IV. DISCUSSION AND CONCLUSIONS

Rural business development in the Bamyan and Balkh provinces will continue to be challenging, given the poor infrastructure and lack of liquid assets. There may not be a sufficient surplus in either of the two provinces to support large-scale agri-business development. However, there is clearly room for significant measures to promote the marketing and quality of agricultural commodities in these two poorer provinces to support small businesses. The most obvious measures with a potential to bring tangible and widely distributed benefits are improvements in **infrastructure (specifically roads) and the availability of basic services** such as electricity and storage facilities.

Efforts toward **facilitating more post-farm rural production activity** are likely to pay off economically, given the size of the world market for raisins, pistachios, dried fruits and nuts. This market is estimated at US$ 2.2 billion, only two percent of which is captured by Afghan producers. Many of these products were being produced at much higher volume and quality in the past. Afghan produced raisins used to account for around 60 percent of the world market. The dried fruits and nuts industry has suffered from serious setbacks due to outdated production methods and machinery; and is likely to benefit from modern techniques for sorting, drying, packaging and storage.

A modernised dried fruits and nuts industry is likely to go beyond recapturing its traditional markets in Russia, Pakistan and India by extending its reach to markets in Europe and North America. There are also positive residual effects associated with production modernisation. Traditional raisin production is labour-intensive and capable of providing numerous local jobs. **Designed carefully to take full advantage of available production inputs** such as abundant unskilled local labour, modernisation programmes could create jobs, and increase production volume and productivity.

To be successful, programmes and projects to revive or expand rural business activity need to be knowledge-based. Projects need to be geared toward the production of commodities suited to the local factors of production and for which there is market demand. Support and representation for existing businesses are important in raising the profile of the rural private sector. The **provincial Chambers of Commerce need to have the capacity** to provide representation for their business constituents and to support them. In the two provinces, the Chambers of Commerce are particularly weak compared to Chambers in other provinces. If the commitment to *broad-based* private sector-driven growth at the heart of the Afghanistan National Development Strategy is to be realised, support to the private sector from institutions such as the Ministry of Commerce and Industry, the Afghanistan Investment Support Agency and the Afghan International Chamber of Commerce also needs to be extended into areas where private sector development is more challenging. This could help to mitigate the currently uneven trajectory of economic development in Afghanistan.

There needs to be recognition by government, non-government and international donors that the situation in Afghanistan has evolved from one of emergency aid provision by international donors to one where the parameters for the emergence of a functioning political economy need to be set. The various government ministries and agencies lack experience and suffer from not being fully embedded in Afghan society. A continuing challenge in efforts to rebuild Afghanistan is the common perception of people and their enterprises as “the needy”, rather than as a valuable resource for the **reconstruction of a civil society**. However, recognition alone is not sufficient for changing the mode of development in Afghanistan.

Reconstruction efforts are generally frustrated by a tension between cooperative-oriented approaches promoted and practiced under the Soviet era governments, and a private sector-centred approach promoted and practiced by development aid donors, notably USAID, Asian Development Bank and the World Bank. One significant result of this tension has been the inability to set the boundaries for government and private sector roles in reconstruction efforts. As one interviewee pointed out, “the discourse should not be about the choice between cooperative or private sector approaches. Rather, **policymakers and international donors need to agree** on what type of private sector development is suited for Afghanistan, given the badly damaged infrastructure, weak government, diminished trust, and the cooperative institutional tradition.”[8]

Adopting this middle approach to development **maximises the synergy from having a multiplicity of actors** with varying or competing agendas on board. Efforts in coordinating actions by overlapping or competing agencies and entities would more likely pay dividends simply by making the many contenders *de facto* stakeholders. A pragmatic and inclusive approach based on this line of reasoning is also likely to lay the foundation for setting attainable objectives and defining evaluation criteria to assess policy effectiveness. Common rules and the introduction of a clear and transparent division of labour could also ensure that policy objectives are met and set the precedents for the formation of learned communities and social networks that last beyond the lifetime of reconstruction programmes.

In Afghanistan a shift is discernible from **emergency aid provision to the development of a market-based economy**. The 2005 Master Plan, for example, is committed to measurable economic growth in agricultural activity while local participation and ownership are emphasised. The two sectors targeted are horticulture and livestock. A key feature of the strategy, as outlined in the Master Plan, is to focus on areas with the potential to yield the highest productivity and return on initial investment. Central to this strategy is creating an enabling environment for small and medium rural enterprises to thrive. This focus raises numerous issues in relation to transport and energy infrastructure, production technologies in use in agriculture and rural well-being.

A necessary feature of a pragmatic and, by default, inclusive approach to policymaking in rural development is a **demonstrated capacity to coordinate between economic and social needs**. Put differently, reconstruction efforts must be designed or selected for their potential to increase economic as well as social well-being. A recent study commissioned by the MRRD, the Rural Economic Regeneration Strategies (RRERS), is a potentially important step toward a socio-economic policymaking environment. RRERS calls for the establishment of a framework for *integrated* rural development planning in Afghanistan. RRERS is intended to provide in-depth understanding of local and regional contexts and issues. It will also look at broader social and economic trends, opportunities and barriers faced by rural communities, the potential for growth based on local specificities, and potential regional development scenarios and their long-term viability. A key promise of this study is to identify pathways for scaling out (replicating local success elsewhere) and scaling up (building on local success as the foundation for national development). The recommendations in Section V are formulated in the same spirit as the RRERS study.[9]

V. RECOMMENDATIONS

The many improvements needed to overcome the disabling factors in the operating environment for rural SMEs can be grouped as follows: immediate, medium to long-term and general.

Immediate Measures

1. **Strengthen and expand transportation networks:** Lack of access to transportation routes and poor road conditions have been raised as a major reason for the sub-optimal performance of rural SMEs. While efforts are being made to address these shortcomings, attention must be paid to whether the proposed plans would give rural SMEs access to markets outside their immediate surroundings.

2. **Increase energy production capacity:** Energy continues to present major challenges for rural value-adding production. This is particularly the case for smaller rural producers who often lack the financial resources to afford generator power for production purposes. Innovative solutions based on micro-power generation from solar, wind and hydro sources should be considered by agencies in charge of improving the operating environment for rural producers.

3. **Strengthen existing markets:** Local institutions such as local government offices, chambers of commerce and development aid agencies need to collaborate on developing monitoring mechanisms to gauge how certain businesses succeed and maintain their markets, while others fail. Such collaboration is also needed to provide assistance when necessary, and to diffuse learning.

4. **Increase exports by exporting directly to markets, rather than to agents of traders elsewhere in Afghanistan and in neighbouring countries:** This task requires leadership and assistance from different levels of government. In line with the Ministry of Commerce and Industry’s recent attempt to simplify the process for obtaining licences and permits for foreign investors, similar attempts need to be made to enable rural SMEs to obtain the necessary licenses and permits to continue and expand. Various levels of government could also help by organising trade missions to other countries.

Medium and Long-term Measures

5. **Micro-credit facilities for post-farm production:** Easier access to credit will need to be provided for small producers. This calls for an increase in the current number of micro-credit providers in rural areas with preferential terms for rural SMEs.

6. **Establishing new markets and regaining traditional markets:** Historically, dried fruits from Afghanistan have had market shares in India, Russia, Iran and the Middle East. Many of these markets have been lost due to unreliable supply sources from Afghanistan during the years of conflict. Concerted attempts need to be made to reclaim these markets.

7. **Increase accountability:** A number of interviewees from donor and government agencies had serious concerns about the lack of accountability in how funds earmarked for infrastructure development were being deployed. The example given by one interviewee was the manner in which infrastructure contracts are implemented. Often, because there are so many sub-contractors contracted by other subcontractors, by the time the work commences only a fraction of the initial funds remain to do the actual construction. Awarding infrastructure contracts needs to be re-examined and streamlined through instituting a system of accountability, formalised through legislative (and other) measures.

8. **Formalise rural business activity of SMEs:** There is no system of registration for businesses in rural areas. Many rural SMEs opt not to expand formally because they fear being “noticed” and coerced by various corrupt elements. Little or no tax revenues are generated from rural business activity, particularly by SMEs. Moving toward a more enabling environment requires formalisation of business activity based on trust, which cannot be established overnight and requires continuous attempts by national and local governments to earn the trust from rural SMEs.

General Measures

9. **Quality Control:** A key issue with manufacturing and processing in less developed economies is quality and hygiene in foodstuffs production. Rural SMEs in Afghanistan are not exempt from this problem. To attend to this potentially serious problem, the following measures need to be carried out with the guidance and assistance from government and business communities:

a) Providing incentives for rural SMEs to recognise the link between quality and hygiene standards, and maintaining and increasing market share

b) Developing hygiene and quality protocols based on consultations with the rural producers and their representatives (if any)

c) Establishing a monitoring system

d) Establishing a system of certification

e) Creating incentives for meeting hygiene and quality standards

10. **Coordination of scientific research:** Research and development work carried out by government agencies, donors, the private sector and universities need to be coordinated to eliminate duplication in R&D and to utilise synergy.

11. **Increased collaboration:** Linkages between provincial educational institutions and rural SME representative bodies need to be strengthened to increase access by the SMEs to local technical and other areas of expertise.

12. **Strengthen rural business representation:** Establish local producer associations by reaching out to the informal local networks that have traditionally governed business activity in rural areas.

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[1] English Summary of the Afghanistan Agriculture Master Plan, Ministry of Agriculture, Animal Husbandry and Food (MAAAHF), recently renamed the Ministry of Agriculture and Irrigation (MAI).
[2] Widely reported in research from AREU's rural livelihoods work to NRVA. Cited in IANDS Vol. I.
[3] Existing rural enterprises include the cotton and leather industries, manufacturing and agro-processing including the processing of plant oils, vegetable and fruit conservation, flour milling and dairy production. Additional farm-based enterprises include milk and meat processing. Non-farm rural enterprises include carpet weaving, sewing and tailoring, fertiliser production and collecting and selling of wild plants.
[4] Of key importance in these developments is how Community Development Councils (CDCs) for community-based development will evolve in the local governance structures and the role they will play in rural economic development.
[5] Interview with an FAO / MRRD official on October 25, 2006. For a discussion of this tension and its implications for the privatisation efforts, see *Putting the Cart before the Horse? Privatisation and Economic Reform in Afghanistan*, by Anna Paterson and James Blewett, AREU Briefing Paper Series, November 2006 (Kabul: AREU).
[6] Selim Saheb Ettaba, AFP, 12 October 2006, In *Afghanistan, Bayyan suffers for being calm*, http://www.metimes.com/storyview.php?StoryID=20061012-062048-3480r
[7] Lister and Brown 2004
[8] Interview with an FAO / MRRD official on October 25, 2006.
[9] See also: http://www.undp.org.af/jobs/projects/nabdp/EOI-RRERS-FesibilityAnalysis-BusinessPlans.pdf.