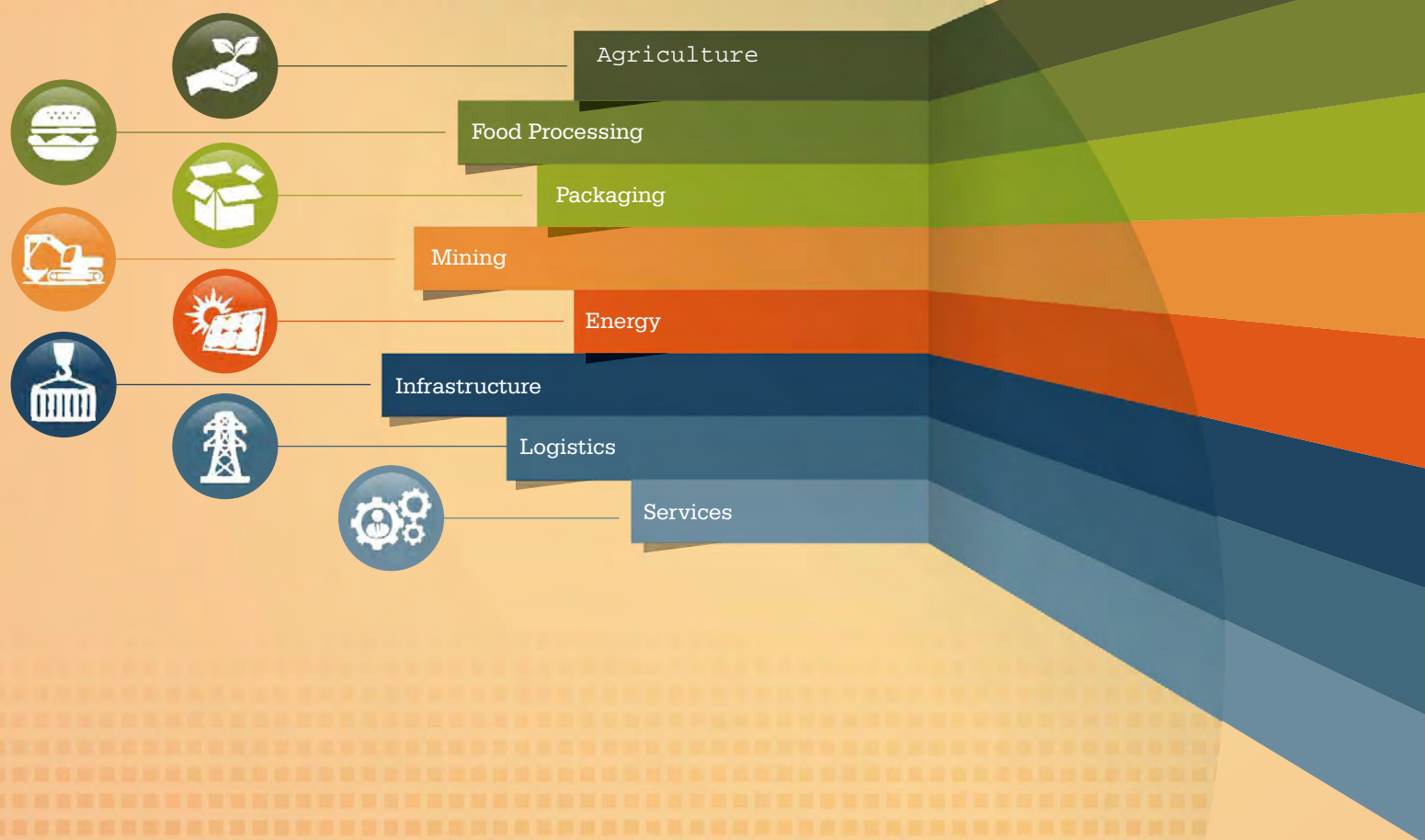


Doing Business with AFGHANISTAN

Harnessing Afghanistan's Economic Potential



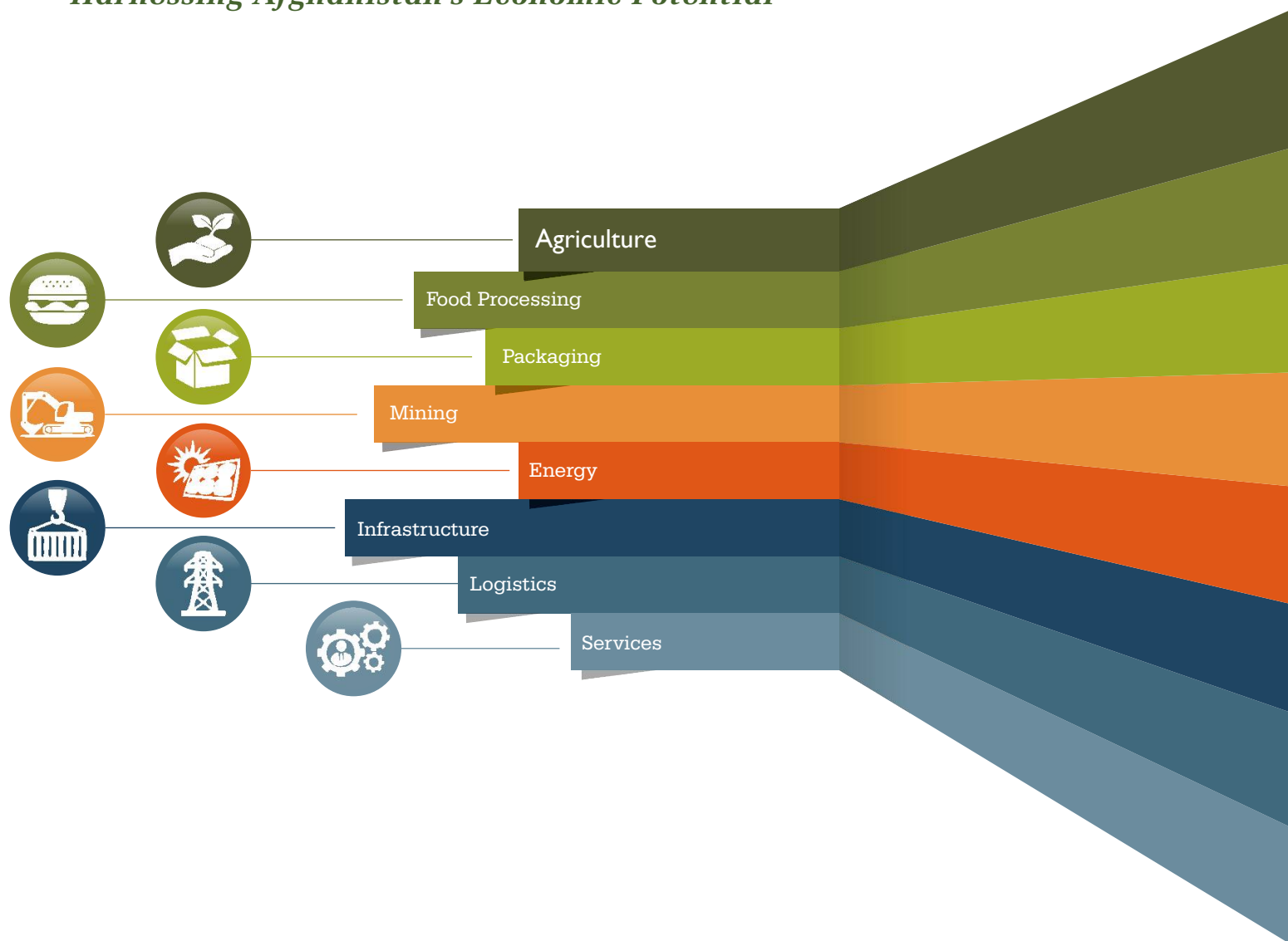
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Doing Business with AFGHANISTAN

Harnessing Afghanistan's Economic Potential



Foreword

Doing Business in Afghanistan presents an overview of the business environment available for foreign investors in Afghanistan and identifies the types of sectors and products that have a potential for growth.

The publication is an update of an earlier one prepared by the South and South-West Asia Office of UNESCAP to serve as a background document for the International Conference on Doing Business in Afghanistan hosted by the Federation of Indian Chambers of Commerce and Industry (FICCI) in New Delhi, India on 18-19 November 2013. This edition updates information on Afghanistan's potential to inform the discussions at the Sixth Regional Economic Cooperation Conference on Afghanistan (RECCA VI) to be held in Kabul, on 3-4 September 2015.

As a development partner of Afghanistan, UNESCAP strives to support efforts of the Government of Afghanistan and its allies and stands ready to assist the country as it evolves as an important "land-bridge" between Central and South Asia.

I hope that this brief publication will help to stimulate discussions on the productive potential of Afghanistan and attract investors to this land of opportunity!

Nagesh Kumar

Head, UNESCAP South and South West Asia Office

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Doing business in Afghanistan

1. Macro-economic setting

Afghanistan's economy has shown considerable resilience and strength in weathering political and economic transition. The year 2014 was marked by severe challenges with presidential elections and withdrawal of international security forces, and an end of protracted political deadlock. The newly formed government has taken a strong stand in pursuing peace, economic development, building infrastructure and strengthening regional cooperation.

The economy was hit hard with growth rate falling from 3.6 percent in 2013 to 3.2 percent in the transitory year of 2014, but signs of recovery are already visible. With expected pick up of industry and services sector in the second half of 2015, the growth rate for the year has been projected by UNESCAP at 4.5 in 2015 rising further to 5.0 in 2016.¹ World Bank's projections are in line with the UNESCAP's, forecasting an average yearly growth of 5 percent in the medium-term to 2018.

In pre-2014 period, Afghanistan emerged from 25 years of conflict with some of the highest levels of poverty. Landlocked and vulnerable to natural disasters, Afghanistan's economy had performed better than the comparator countries in terms of broad macro-economic indicators (Table 1). The economic growth was robust, inflation was low and public finance management made healthy progress (Table 2).² Between 2002 and 2009, average per capita GDP increased by more than 75 percent in real terms.³ Debt-to-GDP ratio declined from 19.8 percent in 2008/09 to 8.1 percent in 2010/11 and debt service was 1.8 percent of exports of goods and services.⁴ The real GDP growth in 2012 was 10.9 percent supported by a good agricultural harvest, which helped to moderate inflation down to 7.6 percent. The year 2014 marked the third consecutive year of a maximum potential in agriculture. Structurally, years of good growth have also been years of good harvest. Substantial donor-support and international military spending over the years have been crucial in Afghanistan's progress. Evolving gradually, the policy development during this period was laying foundations for private sector development.

¹ UNESCAP, *Economic and Social Survey of Asia and the Pacific 2015, Making Growth more Inclusive for Sustainable Development*, 2015, p. 4

² The growth of budget from US\$ 346 million in 2002/03 to US\$ 3.3 billion in 2010/11 demonstrated the rising absorptive capacity of the economy for the funds channelized through the budget. Over the same period, domestic revenue grew from 3 percent of the GDP to 11 percent due to the reforms in tax and customs administration. See, The World Bank, *Afghanistan in Transition: Looking Beyond 2014*, Volume 2: Main Report, May 2012. p.35.

³ *Ibid.*, pp. 5-8. Strong performing comparator countries include Cambodia, Lao (People's Democratic Republic), Liberia, Mali, Mozambique, Nicaragua, Rwanda, Tajikistan, Uganda and Viet nam.

⁴ *Ibid.*, p.35.

Table 1: Afghanistan's performance relative to the strong performers cluster (prior 2014)

Variable/indicator	Afghanistan trend	Trend of strong performers	Comments
Real average per capita GDP growth	Very rapid	Rapid	Growth in Afghanistan has been faster than in virtually all comparators; needs to maintain robust growth even if at somewhat lower rates
Average per capita GDP level	Rising sharply	Rising	Avoiding recession and continuing growth, especially employment growth, will be key
Inflation (GDP deflator)	Very low	Not so low	Needs to maintain good performance in controlling inflation during difficult transition
Structure of the economy	Rapid change	Rapid change	Afghan structural change appears to a considerable extent aid driven; needs new growth drivers
Government consumption	Flat	Flat	Government consumption for Afghanistan substantially higher due to external budget

Source: The World Bank, *Afghanistan in Transition: Looking Beyond 2014*, Volume 2: Main Report, May 2012. Table 1.1, p.5.

Global trends in food and non-food products have had a strong pass through on inflation in 2014. The falling global oil prices since September 2014 were translated into lowered transport costs in January 2015 with transport price inflation falling from 19.5 percent to 2.5 percent in January 2015.⁵ Similarly, the fall in food prices globally as well as the exceptionally good years of harvest in the domestic agricultural sector had a positive effect on consumer price index.

Exports also increased for a second consecutive year as a result of strong performance of the agriculture sector. Another positive impact on export growth was the depreciation of the real exchange rate by 3.5 percent in 2014.⁶

Slow global demand, supply surplus, major breakthroughs in lifting embargo of the Islamic Republic of Iran and discovery of United States of America's shale oil, among other developments led to sharp decline in oil prices. The prices are expected to remain under \$70

⁵ World Bank, Afghanistan Economic Update, April 2015, available at: www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2015/05/15/090224b082e8582d/2_0/Rendere d/PDF/Afghanistan0economic0update.pdf

⁶ Ibid. p15

until the end of 2015, and under \$100 in the upcoming five years. As an oil-importing country, Afghanistan is set to reap large savings on its oil import bill. The transport sector will further benefit from lower oil prices, creating demand for internal and regional trade by local producers. The immediate impact will be translated into lower food prices, which will highly benefit the poorest segments of the population. The consumption of more diversified diet is expected due to a stronger purchasing power with positive spillovers on the health of the population.

Table 2: Economic profile of Afghanistan

Annual Indicators	2008	2009	2010	2011	2012	2013
GDP (millions US\$ in constant prices 2005)	8588	10067	10393	11295	12529	13336
GDP growth rate (constant prices 2005)	2.3	17.2	3.2	8.7	10.9	6.4
Population size (in millions)	27032	27708	28398	29105	29825	30552
Inflation (% change per annum)	30.6	-8.3	0.9	10.2	7.2	7.6
Government Expenditure (% of GDP)	21.1	20.8	20.6	22.3	17.4	22.8
Debt (% of GDP)	19.8	19.6	15.1	13.7	12.7	11.9
Current account balance (% of GDP)	5.2	1.9	3.1	3.1	3.9	2.8
Merchandise trade balance (% of GDP)	-23	-23.3	-29.6	-31.7	-42.4	-39.1
FDI inflows (% of GDP)	0.9	0.6	1.3	0.4	0.4	0.3
Average exchange rate: national currency per US dollar	50.2	50.3	46.5	46.7	50.9	55.4

Source: UNESCAP database, various sources, available at:

www.unescap.org/stat/data/statdb/DataExplorer.aspx, accessed August 16, 2015.

During the last decade, services sector has been a strong growth driver with significant boost

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