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# AFGHANISTAN'S FISCAL FUTURE AND CHALLENGES

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P R O C E E D I N G S

AMB. PASCUAL: Good morning. My name is Carlos Pascual. I'm the Vice President and Director of the Foreign Policy Studies here at the Brookings Institution. I'd like to welcome you today to Brookings.

We have an opportunity today to focus on the issues of Afghanistan's fiscal future and its challenges, some of the opportunities that Afghanistan faces and some of the difficulties it faces in getting there, and we are very pleased to be able to host the Minister of Finance, Ahadi, to lead us in this discussion.

The Minister, I am sure, will talk through some of the elements of progress in Afghanistan's economic performance including the 8 percent growth that it's scheduled to achieve in 2006 and 2007. He comes here at a time when he's just received the endorsement from the IMF and the World Bank, in particular from the World Bank executive directors who positively reviewed performance under the Poverty for Reduction and Growth Facility. On that, Mr. Minister, I congratulate you and your government.

We will want to use this time as well to explore the complexity of some of the issues that are facing Afghanistan, some of the underlying security, political and economic challenges confronting the country in the international community and its neighbors -- on the security front, particularly the issues in the south and the southeast, the incursion of the Taliban from neighboring states, the impact that that has on the security situation, the difficulty that that creates in the capacity to generate economic activity and some of the complexities that this creates in the

interlinkages between the Taliban and the drug lords and how the government is confronting those issues.

We'll want to talk about questions of poverty in a country where the per capita income is about $300 per person. There's a particular crying need to address these issues of the poor and what is the government strategy to do that and what does the government in the international community have to take into account to be effective.

It's impossible, in fact, to talk about Afghanistan's economy today without also thinking about the issue of narcotics where by some estimates the narcotics trade is at a level of about $2.8 billion and the legitimate GDP is perhaps $6 billion. And so, what are the implications for, in fact, getting control of this narcotics trade?

Finally, we'll want to talk about issues such as jobs and alternative livelihoods. The unemployment rates, of course, are extremely difficult to measure, but if unemployment might be on the order of 25 or 30 or some even estimate 40 percent, what are the kinds of alternatives that exist to be able to create alternative livelihoods, a major challenge again for Afghanistan, the international donors, its neighbors.

So to lead us in the discussion today, we have the benefit of Finance Minister Ahadi. The Minister is an expert in both the politics and academics and analysis of policy issues in the West and in Afghanistan itself. He earned his Bachelor's and Master's degrees from the American University of Beirut and a

second Master's and a Doctorate from Northwestern University.

Before working as a banking director at the Continental Elona Bank of Chicago, he's had a number of prestigious academic appointments including as professor of political science at Providence University until 2002 when he returned to Afghanistan as the Governor of the Central Bank and in December of 2004, he was appointed Minister of Finance.

We are very pleased to host you today, Mr. Minister, and I'd like to offer you the podium. Thank you.

MR. AHADI: Thank you, Ambassador, and good morning to all of you.

It was kind of difficult for me to decide on what issues to talk about today. Normally, I talk about financial matters and economic matters, but I thought that this audience would be interested in a more general picture of Afghanistan. So I asked myself if I were one of the audience, what are the kind of issues that I would like to know about, and I came up with what are the achievements of the government and what are the challenges ahead for this government.

Let me begin by saying that the undertaking that this regime started in the end of 2001 was a very comprehensive social, political and economic change in Afghanistan. I think one could very easily call this really a comprehensive revolution. Our political institutions, our economic institutions and our social institutions were diametrically opposed to what we had not only under the Taliban but even before that. We had a very static political economy, we had a very authoritarian regime, and we had a very intolerant society. The objective of the

new regime was to have a democratic society, to have a market-based economy and to have a pluralist society, and that is diametrically opposed to what we had in the past.

Let me also put this in perspective from an historical point of view. If you look at the development of nations, there are usually stages in the development of nations. First, most nations, when they achieve statehood, there is the era of state-building, and that takes a number of years, a number of decades at least until the authority of the central government is well established. Then they move into the era of nation-building where equality before the law becomes more important and that all citizens become equal before the law and they have the opportunity. Then they move into the era of democratization where freedom is emphasized.

On economic matters, first there is the accumulation of capital. The accumulation can be done by the private sector or at times it can be done by the public sector. Nevertheless, accumulation of capital proceeds, and then you have the issue of redistribution.

Each one of these phases in historical development, they have different requirements. What is required under state-building is very different from what is required under democratization. As a matter of fact, they are diametrically opposed to each other. In the era of state-building, this is the era of forcefulness, the era of subjugation, and the era of, at times, really resorting to very harsh measures while in the era of democratization, you emphasize freedom and perhaps tolerate to some extent even the loss of law and order. If you do all of

them together, it is extremely difficult to handle such a situation.

Well, let me tell you that this is exactly what Afghanistan had to do. When the Karzai Administration began, we had to build the state. We had to build the nation. We had to democratize. We had to change our polity, our society, our economy. We had to accumulate capital and, at the same time, take care of distribution.

This is almost an impossible task. I'm not so sure that any country could do it on its own. The only reason we're hopeful that we will be successful is because we have strong international support, and that matters a lot because the international support is giving us resources, and that's why we have made substantial progress in this regard.

I think we have made substantial progress with regards to state-building. Before the Karzai Administration, there was hardly a state. It was a failed state. I mean, yes, the Taliban had some sort of control in various areas, but it would be hard to call it a state. There was no security. There were no revenues. There were no services. During the Taliban era, the total number of students who attended school were probably not more than 500,000 students. Even the first year of Karzai our total revenues were $180 million. So the state had really collapsed.

There was no army and there was no police force. Now we do have in the Afghan National Army, last year it was 34,000 strong. This year, it's 48,000 strong, and by the end of this fiscal year -- that's March of 2008 -- we will have a

64,000 national army. The equipments are coming. The training is there. All of this was done with international assistance. It would have been hard for us to do it on our resources with our own resources, but it's possible, it's doable because we do have international effort. I think this will be the kind of army that should be able to face any challenge from domestic opposition.

The same goes with the police. We hardly had any police force, and now we have over 70,000, close to a 73,000 strong police force. It's not well equipped. It's not well trained. But this year, there will be a lot of equipments coming for the police force, and there will be additional training.

I can say that while the first few years were characterized by the rule of warlords, I don't think there are any warlords anymore in Afghanistan. I mean there are powerful people, and there are probably people who are not in line with the law, but the kind or warlords, the people who would have control over certain territory and they can defy the wishes of the central government, I don't think that's the case anymore. So that has been ended.

Tax collection has begun. Now for the past year and a half or two years, we have been collecting taxes. This is something new and it's not very pleasant for a lot of people. Our revenues this year, we just finished at almost $550 million revenues when we started four or five years ago with $118 million.

Justice institutions are throughout the country. There are now courts throughout the country. Mind you, the functioning of these courts is not that great. I mean sometimes it's very, very primitive and at times the outcome is not

really justice. Nevertheless, the institutions are being rebuilt, and what we need is the quality of the people that work in those institutions.

Except for this recent upsurge of the insurgency in the past few months, for the first years, there was relative quiet in the country. I'll talk more about the insurgency as part of the challenges that face this government, but otherwise it was rather quiet.

There has been return of services. Now we have almost six million students in schools. Afghanistan never had this many students in schools. Afghanistan never had this many teachers. Now we have 181,000 teachers that the central government is paying for every month. Mind you, still 45 percent of our school age kids do not go to school, and we do need additional support to be able to send those kids to school and to train people so that they can function as teachers. Nevertheless, we have never had this number of teachers or this number of students.

Basic health is now provided to more than 80 percent of the population, and recently the World Bank report indicated there is a substantial decline in infant mortality and also in the mortality of pregnant women, and that has happened in the past five years.

As far as nation-building, i.e, equality before the law, I think that there has been serious effort in this regard, and I can really honestly say that I don't think there is systematic discrimination against anyone. I think there is more participation now than there has ever been. I think that the various ethnic groups,

they demand participation and they demand their quotas in a way. I mean there are no formal quotas but a rough correspondence with that.

The constitution has admitted to that, that there will not be any discrimination, that all citizens of Afghanistan will be treated equally, and I think in practice we are moving in that direction. I think we have achieved quite a bit in this regard. I think there is a strong emphasis on national integration, and nation-building, in my opinion, is going rather well.

On democratization, we had presidential elections. We had parliamentary elections. We have political parties. Relations between Parliament and the executive branch are quite stormy, and I wish it were a little bit more cooperative, but nevertheless that reflects the reality that is we are trying to build a democratic institution and we are trying to learn how democracy works. I think we're making significant progress in that. I think the elections have been quite competitive, and I think they are becoming more and more competitive and the institutions are being in place.

There are certain ambiguities in this rather new democracy. It is rather new and there are certain ambiguities with regard to the role of the executive and the legislative as well as the judiciary, but we will be figuring out that. I think democracy, in practice, it is working there for now, and I'm quite hopeful.

On societal matters, I think women's rights have been advanced considerably. Twenty-seven percent of the members of Parliament are women. I think they are quite vocal. I think in the cities they are being heard. The other

day I was presenting the budgets to Parliament, and I made a note that 12 percent of the government employees are women, and I think that is great progress there.

I think human rights, even though there are still probably lots of people who do not abide by human rights or do not accept them, but I think they are on the defensive. A few years ago, I think they were on the defensive. I think they were proudly opposed to such things as human rights and women's rights. I think they are very much on the defensive now, and I think that if we continue this, hopefully, they will become pretty much part of the culture.

I think civil society is beginning and quite vibrant. I should say it's mostly in the cities, but gradually it will expand to other areas. I think we have a very free press. I think at times it's way too critical. Perhaps maybe I think they should balance and be a little bit more responsible, but it is a free press, and I think that people do recognize that.

The economy is market-based. We are establishing the institutions. There is an independent central bank. Government is a regulator. For instance, in the past, the government used to provide telecommunications services. Now the government is simply a regulator. It is private companies, telephone companies that offer services. We have begun privatization of state-owned enterprises. So we have privatized or liquidated a lot of state-owned banks.

I think we have one of the most liberal trade regimes, certainly in the area but perhaps even beyond that. Our average custom rate is less than 5 percent, and that is less than any other country in the region.

We have a very liberal foreign exchange system. You can take out money as you please, and you can bring in money as you please as long as there is no money laundering involved in it and it's not illegal activity. It's really your decision as to whether you want to invest here and take the profit or not.

The banking sector has been almost 90 percent privatized, and there are 13 or 14 private banks that are operating, and most of the business is done by them. No restriction on currency transfer as I just talked about. I think we have one of the most liberal investment laws. There is no preference given to nationals, national capital, international capital. They are on the same footing, and we would like international investors to come here.

I think our macroeconomic indicators are very positive. We have doubled the national income in five years. This year, our growth rate is 8 percent. This is one of the lowest. We expected it to be 12 percent, but we had a drought this year and that's why it is a little bit less, but in previous years it was much higher. For this current fiscal year, we are expecting once again to be 11 to 12 percent.

Inflation is quite low. Last year it was only 4 percent. I'll talk more about the unemployment situation which is a challenge later on.

So to conclude this part in terms of the achievements, I think we are doing quite well, and I think this was recognized in the Spring of 2006, that Afghanistan was a success story. Unfortunately, since the Spring of 2006, the insurgency has been revived, and consequently there have been some questions in the minds of lots of people, whether Afghanistan is really a success story or not. I still believe

that it is a success story, and I think that these problems will be solved.

So let me talk about the problems. A major problem is really the insurgency. It's a very strongly motivated, ideologically motivated group. Without specifying the links, I think it does have international support. It benefits from drug money.

But it has not been able to control territory. Last year, it tried to control territory and resorted to more conventional warfare, and they were defeated very quickly. Just in a few days' time, they lost 700 fighters, and then they changed their tactics. Now they're going back to the guerilla warfare. Guerilla warfare, even if you have a small number of people fighting, it's very difficult to eliminate them completely, but I don't think they will be able to gain control.

One other thing that I want to mention, and that is that the insurgents, they do not have popular support. I think it would be a misnomer. I think sometimes it is reported that people are rather alienated from the government and consequently they support the insurgents. I think that that's farthest from the truth. These people, to the extent that occasionally they do cooperate with the insurgents, it is because they are threatened with their lives that something would happen to them. It's a reign of terror. The limited reign that they have, it's a reign of terror. People will have to cooperate with them because otherwise they'll be killed. But that is hurting their popularity, and they are not popular. It would be a misnomer or a misperception that the opposition, the insurgents are popular.

What do you do with the insurgency? I think it's a test of wills. I don't

think anybody will have a solution, I mean a formula that will solve this problem in a few months time. I don't think that can be done. They are aware of this, that it's a test of wills, and they're hoping that the government and our foreign supporters, that they will find the situation unmanageable and change their course and leave the country. Of course, that would be a great victory for them, and I hope that never does happen.

I think that perhaps in the long run what we need is really to Afghanise the security problem in Afghanistan. What do I mean by Afghanisation? I think the Afghans should be fighting for their own security. I think that the Afghan army should be expanded, should be better trained, that the Afghan police should be handling this, but we would need financing, and we would need equipment, and we would need advice. I think if our international supporters give us support in those areas, I think that the Afghan security forces, if they are strengthened, should be able to handle this. It's our country and whatever it takes, we should be able to fight to the very end and we don't expect our international supporters really to continuously fight for us.

However, the Afghanisation, the policy of Afghanisation should be gradual. It cannot be and should not be done at once. It will take some time, and there should be a gradual increase of the role of Afghans in these security matters, in fighting the war against the insurgents and a gradual decline on the level of participation of our international forces. But we do need the financial support, and I think it would be economical for the Western forces rather to provide

financial support to the Afghans instead of doing it themselves because it's a lot more costly if they were to do it than if we were to do this.

I think there should be increased pressure on other countries in the region that they should cooperate with Afghanistan and perceive the situation as a threat to all of those countries and cooperate in this regard.

I personally believe that in the long run that the insurgency will be defeated and the government will prevail with the help of the international community.

The second challenge is the one of economic development. On macroeconomic indicators, we are doing well, as I indicated, but unemployment is a problem. It's not that unemployment has increased. It's not that unemployment has not decreased to the level that we would like it to be. The problem is that we hardly have any figures. Very often, the government is blamed for not being able to do much about unemployment.

My response usually is do we have figures because I think we have created lots of jobs. But the unemployment was so pervasive, and millions of refugees are returning. It is difficult for the government to create millions of new jobs while millions of refugees are coming back, and of course each one of them would want to have a job.

But there has been a change in the economic philosophy of the government. The government considers the private sector to be responsible for employment. The government will provide a more opportune environment for the private sector to prosper. That's why we're spending a lot of money on improving

infrastructure, and in the future we will be spending more money on education so as to have a more conductive environment for the private sector to prosper.

However, the private sector has not created as many jobs as we would like it to be, and that is a problem and it needs to be addressed. New possibilities should be explored. I think that even though the government, philosophically, is not inclined to be involved in production, but perhaps we should identify some large projects, investment projects with huge employment opportunities, develop those sectors and then privatize it when the private sector is ready to do that. So we need to work on that.

There is somewhat dissatisfaction with regards to aid effectiveness. We have received a substantial amount of support, but the outcome is not commensurate with the amount of input. Let me give you brief information on this. The total amount of money that has been committed to Afghanistan -- I'm not sure I should say committed -- pledge to Afghanistan, thus far is about $30 billion. Of that, $19 billion is a firm commitment until the year 2009. Until March of 2007, the firm commitment was $15 billion. Of that $15 billion, $12.8 billion has been already disbursed, and of $12.8 billion, only $3.7 billion of aid has been channeled through the government budget.

The government's share in the allocation of aid has been quite small, and the government has been arguing that if this money were to go though the government budget, I think that the aid effectiveness would go up. It's not that it's automatic that necessarily anything that's handled by the national

government, the national government is necessarily better, but we do have some information that it's much more cost effective. Our procurement is much more cost effective than money that is being spent by external budgets. So we need to improve our aid effectiveness, and more resources will have to go through the government budget, and I think we do need to review the competitiveness of procurement that takes place outside of the government budget.

I should say that perhaps we need more aid to go to economic development. While security is our number one priority and without security the economic development would not matter that much, but this year, for instance, the supplemental, for two years, $8.6 billion was proposed for security while for economic development, only $2 billion was proposed for economic development from the U.S. I think economic development requires a lot more resources, and we hope that will be reconsidered.

I think that the government has been very busy with infrastructure projects. These infrastructure projects will come to fruition in the next two or three years. Once the infrastructure projects are completed, I think that the environment will somehow improve for the private sector to make more investment, and I think then that our liberal economic policies will really make a difference.

How much time do I have? Very little? Very little, okay.

The issue of governance is also a problem in the sense that, unfortunately, capacity is very low in Afghanistan, and the main reason is because our academic, our educational institutions were destroyed. Now we have academic institutions

with graduate students, but they really cannot do the job that they are required to, and consequently the capacity is very low. The modern administration is quite complex, and our situation that we want to really expedite development in Afghanistan, that makes it even more difficult.

When will capacity be improved? I think it will take a long time. We are sending some students to India. When they return every year, we send about a thousand students to India for education. I think in another four or five years, then we will have some students to work with. USAID has a large budget for capacity-building. I hope that that will train more of the high level of managerial personnel that we need.

But we do need a more coherent capacity-building strategy. I think that right now it's rather fragmented. It's mostly aid. It's mostly donor-driven instead of government-driven. So it's very fragmented. Various countries, they have their own capacity-building efforts that a lot of money is being spent on. The emphasis is not so much on outcome, and we would like the emphasis to become very much on outcome.

I would also emphasize that in the long run unless we strengthen our educational institutions, it will be very expensive to send students abroad and bring them back to work there.

The issue of corruption, it's an old phenomenon and, unfortunately, in most of the countries in that part of the world, corruption is there. I think even before the Karzai Administration, corruption was there. It has become somewhat

intensified largely due to two or three reasons. One is the amount of money that comes to Afghanistan is much larger. So, of course, the corruption that goes with it has also increased.

Second, that is that we have changed lots of laws, and we have been very much in a hurry to change things. I don't think we have put an adequate control system in a lot of instances, but that is being address. For instance, there was a complaint about contracts. Now it's been two years that we have passed a very advanced procurement law very much in line with World Bank practices. I think that is going to reduce it. We need regulations in all areas, but that's not going to come in one or two years. I think it will take a while.

At the same time, the Ministry of Finance has asked the World Bank to study this phenomenon, do a comprehensive study of this phenomenon and to make recommendations, recommendations in terms of what laws can be changed, what control system do we need to have in order to prevent corruption, and what other measures do we need to do that. They're halfway in their study and sent us their recommendations for the control of the public finance sector. We have implemented them, and as I said I think I'm not worried about the public finance part, any problem there.

But it's mostly in the services where the ordinary citizens to a government office and receive a service, and in return usually they're asked for money or they pay money. That is the area that we need a lot of advice on this, and we're waiting for the World Bank report on that.

Well, I'll skip on this. I'll go to narcotics. It's a very large problem, $2.8 billion. The good thing is the size is declining. It used to be about 35 to 40 percent of the total economy. Now it's about 27 percent of the total economy. Nevertheless, it's pretty large.

The disturbing fact is that almost two million people work in the poppy fields, and it does require a comprehensive strategy -- a comprehensive strategy in the sense of as much as we want to get rid of this product which is very harmful to us and to the international community, we would like the farmers who will be affected, their income will be affected, to have alternative livelihood programs. Thus far, our alternative livelihood programs are not that comprehensive or adequate, about $150 million to $200 million, and most of that goes into security expenditures. That is not adequate, but I think they're working on that.

Let me conclude because I think we are running out of time. That's the problem when you don't have a written speech and you just talk from notes. One doesn't know how long it's going to take.

Let me conclude that I think we have a very clear vision of what kind of society, what kind of economy and what kind of polity we want to have. I think we have made tremendous progress in the realization of that vision, and I think we will overcome the current problems. I believe the insurgency will eventually be defeated.

I think that the governance situation will improve, I think, both in terms of capacity and in terms of controlling corruption, but I don't think it's going to

happen in the next few months or the next year. The government, however, is very serious in this regard.

We want to get rid of the narcotics sector of our economy but removing that will create a hole in the macroeconomy, and we do hope with our donors to address that issue in a comprehensive manner, so that we do have adequate alternative livelihood programs, so that eradication or elimination of the narcotics sector does not mean the starvation of two million people that work in those fields.

As I began, the task in Afghanistan is so ambitious that it's very easy to get sort of discouraged. How can we possibly reach this? But as I said we are making significant progress, and that is with the help of the international community. As long as this support from the international community is with us, especially as long as American support is with us and we have a strategic partnership with the U.S., I think eventually we will overcome this. I emphasize the U.S. because more than 50 percent of our aid comes from the United States, so the U.S. role is particularly important.

But, overall, I am quite optimistic that I think that our economy and our society and our polity will turn out the way we would like it to be, and that is a democratic polity, a pluralist society and a market-based economy.

Thank you very much.

(Applause)

AMB. PASCUAL: Mr. Minister, thank you very much. It was an

extraordinarily comprehensive and very helpful overview of the situation in Afghanistan, as you said, not just its economy but the interrelationship between the economics and the political and the security issues as well.

No need to apologize for the amount of time. You were a professor, so we expect that if you get up and talk that you will speak in 50-minute segments because that's what you were trained to do. So it just happens. You did very well in using the time.

Before we turn to the audience, if I can take you back to one particular point that you raised about the interrelationship between the security situation and the economic situation. As you pointed out, the Taliban have not been able to hold territory, yet at the same time there's been an ongoing level of violence and insecurity, particularly in the south, southeastern provinces. If you could help us understand this dynamic a bit better, is there a capacity to maintain sufficient security to undertake economic activity? What kind of threat is experienced in those provinces?

I raise this issue in the following context as well. President Bush, as you know, recently gave a speech here, announcing an increased American security commitment to Afghanistan, indicating his support for the supplemental appropriation. As you indicate, most of that is on the security side.

Even then, if one puts together the level of Afghan police and Afghan military, say plus or minus 120,000, and all of the U.S. and NATO troops, say generously about 50,000, if one compares that with, say, the troop concentration

levels that NATO had in Bosnia or Kosovo which were about 19 or 20 to 1,000. The implications of if you have that same level of a security investment in Afghanistan, you would have about 400,000 troops. Between Afghanistan and the international community, right now there are maybe let's say 170,000.

So on the surface one could say, well, if you look at other international experiences, the gap here could be on the order of about 200,000. It's really in that context that we raise this question of how serious is the security situation. Have you been able to see that there has been any progress so that people can begin to have some level of normal economic activity, or is the disruption that the Taliban can pose sufficiently severe that it makes it difficult for anybody to get control over what's happening in those provinces?

MR. AHADI: Thank you.

Well, of course, the operations of the Taliban have had a negative impact on developmental efforts and on economic activities in general. As to what level of force would be sufficient, I don't think I'm in a position. That's mostly for the defense department to determine as to what is the force level that they would need.

I'm addressing that issue from a relatively layman's point of view, and that is fighting guerilla warfare or fighting against guerillas, it's very hard for me to determine what is the level of adequacy of force because as soon as you appear in certain local, they disappear. They go somewhere else, and it would be kind of difficult to have adequate force throughout the country. It might require a very,

very large number of people.

But I think that if you identify as to where they come from, where did they go, where their sanctuaries are and if you can deprive them of those sanctuaries, if you can deprive them of the means that they receive, financing, then I think it becomes more and more difficult for them to operate. I think it's a test of will in the sense that the other side will have to realize that we're not going to give up and it's a futile exercise on their part. They might harm a lot of innocent people, which they do, but harming innocent people is not going to mean that the government is going to give up its position.

As we know from other countries, from well established regimes, they have been fighting guerillas for a long time, and I don't want to give names in this regard. But even though guerillas have been active against them for years, it has not stopped the economy or the society. It has made it more difficult.

Every day, we see. We go to the airport, and we go through a lot of hardships now that we didn't used to do. That's because of terrorism. We have to take off our shoes, and we have to do that. In the past, we didn't have to do this. What it means is we're not going to surrender to the terrorists simply because they inflicted a great deal of harm on innocent people, but we as a society, we are going to resist that.

I think the same is going to happen in Afghanistan, and it should happen that way. We will resist it. In the process, some innocent people will be affected. The economy will be affected negatively. I wish there was a solution. That

shouldn't be the case. That's why I say they are not popular. That's why I say the insurgency is not related to the failure of government to deliver because what the government tries is to build a school, build a clinic, build a boat, what do the insurgents do? They destroy the school. They destroy the clinic. They kill the teacher and the engineers that work on it. If the objective was really to provide more services to the people, then they should be doing just the opposite.

I wish I had, I wish anybody had a solution that we could free those areas from these negative influences and we could focus on providing services to the people. Unfortunately, that does not exist. So what we have to do is confront them militarily and at the same time pursue economic development objectives to the best of our ability, to the extent that we can, and at the same time have an awareness campaign for the people to make the people realize that it's not the government that is making it difficult for them to have a little bit more comfortable life. But it is the opposition. It is the armed conflict, the insurgency that is depriving them of this.

I think over a very long term the people will turn against them. As a matter of fact, even now in Helmand a few months ago, under the British leadership, they reached an agreement with the local people that they would be self-administering their own territory and it would not be administered or controlled by the Taliban or by the government. It's the Taliban who violated that agreement. Now the local elders, they are turning against the Taliban.

The government in other areas can also take on the insurgents and probably

can defeat them. It's just that the collateral damage, the casualties in terms of the civilians will be high, and that is why the government is reluctant to do that. Otherwise, the government does have the capacity to do that, and eventually probably it has to do that.

So I guess to come back to your question, yes, it does have a negative impact, not just in the south but anywhere. Armed conflict has negative impact on the economy.

What are we going to do about it? Well, we'll do the best that we can to fight these people militarily and at the same time do the best that we can to provide some services and development projects and implement develop projects for people that live in those areas.

Will this be optimal? I don't think so. It will be less than optimal, considerably less than optimal, but there is no other alternative. If we can be shown that there is an optimal solution to this, of course, that would be very much welcome.

AMB. PASCUAL: No, there clearly is no optimal solution, and one of the difficulties is what can you do physically in an environment like this.

Let me turn to the audience, please.

MR. SITOV: Andre Sitov with TASS, the Russian News Agency.

Two things, if tomorrow there are no poppy fields, will the national --

MR. AHADI: If there are no what?

MR. SITOV: If there are no poppy fields tomorrow, will the national

economy collapse?

Secondly, the Russians keep saying that they are ready to write off Afghanistan's debt, yet the actual signing of the agreement keeps being delayed. What seems to be the problem? When can we expect the signing?

Thank you.

MR. AHADI: On the poppy fields, if they were taken off, what would happen to the economy? Well, there would be a serious decline in aggregate demand or aggregate production, but it will have positive impact as well. I mean we want to get rid of that segment of our economy.

I think that some people who work in the poppy fields, obviously, it will have a negative impact on their livelihood in the sense that they won't have a job or they won't have an income. That's what I had been emphasizing earlier, that as much as want, let's think of those people too and let's approach it a little bit more from a planned perspective in the sense that how many people do we expect to become unemployed and what exactly can we do instead of saying well, we're going to pour some money, maybe $100 million, and let's that the economy will take care of them because it may not.

I don't think the economy will collapse. I mean collapse meaning in the sense that it will not function or that everyone will be leaving the country. No, of course not, but obviously, by definition, there will be a decline in the aggregate production or aggregate demand. I mean both the licit and illicit economy. It will not have a negative impact on the licit economy but on the total economy, it will

have a negative impact.

MR. SITOV: And the debt?

MR. AHADI: The debt, pretty much we have reached an agreement. We wanted to sign that agreement here this week. The Finance Minister Kudrin, I think, is ill, and he didn't come. There's also just one paragraph that we had added and the language, one or two sentences need to be changed, but it's not really a major issue. I think we expect that to be signed soon, hopefully in the month of May because the deadline is the end of May.

AMB. PASCUAL: This side.

MR. GALLAGHER: Yes, my name is Mark Gallagher. I implement a worldwide fiscal reform program for USAID.

Before your tenure in Afghanistan, government revenues came to about $3.50 per Afghan. You've done a great job, but they are now about $15 per Afghan.

You've laid out a number of challenges to your economy. You pointed out the low tariff rates. What are you going to do to get those up to more internationally normal standards?

That's not a criticism of what you've done. You've quintupled the revenues. Nonetheless, they're still at very, very low rates, and you have a lot of government challenges ahead of you, and foreign assistance is not the best long-term partner.

Thank you.

AMB. PASCUAL: You might want to just comment on the levels of per capita income as well just to put in context.

MR. AHADI: Yes, sure.

Well, as you indicated, we started at a very low level of revenues. Actually, per capita, it's probably more than $20 now, more than $15, $20. Now next year, it will be probably $30. This year, the total amount was about $546 million, and next year we're expecting $715 million, a 30 percent increase in revenues.

When we started, our revenue was about 3.2 percent of the GDP. Now it's over 6 percent of the GDP. So we almost doubled it in terms of percentage. Mind you, the GDP has also doubled. So our revenues have increased significantly.

Our objective is that in the next three years we will push that up to over 8 percent of the GDP. I think once we reach 10 percent, that's pretty much then the normal range, at the lower end of less developed countries' normal range. But I think achieving that in six or seven, seven or eight years, that's quite an achievement. Actually we have been commended by the World Bank, by the IMF for our efforts to increase revenues. We're doing well in that regard.

I think it's going to increasingly become more difficult because the potential has been realized and now there is marginal potential that is left, but we'll do the best that we can to raise our revenues to the normal level that a less developed country would have.

I'm sorry, what was the rest?

AMB. PASCUAL: I was just mentioning that if you also indicate the per capita income levels, it gives some context of what you can realistically expect as well.

MR. AHADI: Per capita income in the licit economy is about $360 per capita now in income, but with the narcotics sector, it's over $450 per capita. So I guess if the poppy fields were to be destroyed completely tomorrow, then there wouldn't be a licit and illicit economy. There would be just a licit economy, and per capita income would be $360, and there would be some loss there.

The growth rate in the first year, 2002, I think was about 2 percent, and then 2003 was about 18 percent and 2004, about 8 percent or so, and then 2005, back to 12 percent, and this year it's about 8 percent. This current fiscal year, we're expecting 10 to 12 percent. Again, our projections are for the next three years we will keep it at that level, and that helps us to catch up with other countries. But this is based on the assumption that we will continue to receive the amount of aid that we have been receiving thus far.

AMB. PASCUAL: Over here in the second row.

MS. SHANNON: Hi, Elaine Shannon from Time Magazine.

We've heard a lot from visiting Afghan leaders here as well as Americans who have posted in Afghanistan about the problem of developing a rural economy because of the lack of roads for transportation of perishable goods to market and also the lack of power, electric power for fabrication of anything from processed food to I don't know what else.

What sort of projects are you thinking of that would begin to provide a rural economy that would substitute for the opium trade which, of course, is fairly imperishable and easy to transport and what kind of government projects were you speaking of that might be started up to generate considerable employment?

MR. AHADI: Well, I think your observation is correct, that it is a problem that we don't have access to remote, rural areas. We have a program called NRAP, National Road Access or something program. We are spending this year, this fiscal year, $110 million on that to connect various districts with each other and the provincial capital. These are not national roads. These are not paved highways but at least to enhance the access of the rural areas, the access to market by the rural areas. It's $110 million we're spending this year, and we'll continue the relatively popular program that we're doing.

Unfortunately, the development need of Afghanistan is a lot larger than we can possibly do. Even with the amount of aid that we have been receiving, it's still a lot less than the development need of the country. So even though we're spending $110 million, I think probably the need is for over $500 million to do those kinds of roads.

With regards to power, that's a major bottleneck. Unfortunately, power generation is a long-term process. We thought that it would be faster and cheaper to import power. So we built transmission lines from Uzbekistan to Afghanistan from Tajikistan, and that will be completed next year, the transmission lines. But, still, we have not signed a contract with Uzbekistan on how much power they can

supply.

Initially, we were told they would probably provide about 300 megawatts of power. Now they're saying about 150 megawatts of power. Then we thought that we would buy some power from Tajikistan, but then that's not reliable in the sense that it's available in winter but not in summer. Now we're thinking of Uzbekistan, getting something from Uzbekistan.

To have our own hydropower, that will take five, six years. So it's a difficult situation. We're trying to achieve results a little bit faster, but a lot of these projects, they take years to design and to do a feasibility study and then to implement them. I don't think the government has that.

Recently, USAID offered us. I mean we agreed to it, but I think Congress would need to approve this, to buy generators to generate 100 megawatts for Kabul, and that's a very small amount.

In the cities, in the provinces and in the rural areas, it's even more difficult. There are some micro hydropowers that they are thinking about, the Rural Development Ministry and others. But it's a very serious problem.

There's also a conflict in the sense that based on our MDGs, Millennium Development Goals, we are supposed to provide power to more than 60 percent of the cities and, I don't know, 35 or so of rural areas, but that would require a lot of resources. While we would like that to be the case, unless donors help us to generate the power and then to transmit that power, it is going to be difficult to achieve that objective.

I wish I had a more promising answer in this regard, but we are doing the best that we can with the minimum resources that we have. I think that our NRAP program will help farmers at least to have increased access to the market.

AMB. PASCUAL: Mr. Minister, I am mindful of your time, so I will just take one more question. Up here in front, please.

MR. WARNER: Gregory Warner with NPR.

My question is about salaries. Anywhere you go in Afghanistan, people talk about low government salaries, I'm wondering, and their link to corruption. How much are you spending on salaries, and if you get more percentage of international aid, would that be your first priority? How much more do you need to actually boost them in a sizeable way?

AMB. PASCUAL: Maybe if I could interject just to give a context, if you can give people a sense of the size of your recurrent budget so that they have a sense of the envelope you're working with.

MR. AHADI: Actually, I was just going to do that.

For this fiscal year, 2007-2008 -- our fiscal year starts March 21st -- the total size of our recurrent budget is $1,072,000,000. Of that amount, over $600 million, about $650 million go to salaries. We have proposed to the government a new pay and grade scheme, and that has been with the government for the past few months. It's been discussed in the cabinet.

We link increase in salaries to reform, that people will have to be hired based on merit, and the positions that are in the government will have to be

reviewed as to what is needed and what's not needed, a restructuring of the old bureaucracy. Based on that, a new position and term of art for each position will have to be developed, and based on that you will hire them. The least salary would be $80 per month, and the highest salary for civil servants would be $800 per month which we think is a pretty good salary in the region.

It has not yet been approved by the President. He has some reservation. I think we have satisfactorily explained some of his reservation. He's still concerned about the fiscal sustainability, that when we implement it, it will take us four years to implement this program. We will be helped by the international financial institutions somewhat. He is concerned that after that whether we will have enough financial resources to pay this kind of salary.

Our forecasts indicate that in four years time our revenue will be such that we will be able to pay for this, and perhaps even beyond four years we hope that we'll get a little bit of help from the international community. But we think it's important to have realistic or at least subsistence level salaries for people, and that's the assumption on which this proposal has been presented.

I think the people, the government employees, they're anxiously awaiting a government decision on this. My impression is that perhaps within the next month or so, I hope that the President will make a decision on this and then we'll go into implementation

AMB. PASCUAL: So, in effect, a recurrent budget of a little over $1,000,000,000, about $650,000,000 of that is in salaries, and your revenues are

about $550,000,000 million.

MR. AHADI: For next year, it will be $700 million.

AMB. PASCUAL: So, in effect, just on the recurrent budget, a need for donors to finance over $300 million.

MR. AHADI: Yes.

AMB. PASCUAL: And on top of that, any kind of investment budget that you might have as well as additional investments in equipping your military.

MR. AHADI: Right, exactly.

AMB. PASCUAL: What it does underscore is there is still a massive need for external assistance and engagement from the international community.

MR. AHADI: Exactly, exactly, I mean I think we have a good start. There has been a lot of investment on the part of the international community, but any premature disengagement would lead to that previous investment done to be wasted. Therefore, we do need the continuation of assistance for some time to come until we can stand on our own feet.

AMB. PASCUAL: Mr. Minister, you've been very generous with your time. As you said, you're building from what was a failed state to try to create a new entity, and that is an extraordinarily complex task when you're contending not only with the economic and the political issues but the security ones as well.

We wish you and your country, your leadership and the people of Afghanistan, success, and we thank you for your time.

MR. AHADI: Thank you very much. Thanks for coming.

(Applause)

AMB. PASCUAL: Let me ask that you stay seated for a minute. I need to take the Minister out, and then you'll be free to go. Thank you.

MR. AHADI: Thank you.

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