

Barriers to boosting private sector development in Afghanistan- A case study of Khost Province

Gul Shah Sabary (M.Sc.) and Mohammad Sediq Nawabzada (M. Sc.)

Senior Lecturers at the Faculty of Economics, Shaikh Zayed University, Khost, Afghanistan

Abstract

This paper investigates the obstacles that lie against the development of the private sector in Afghanistan which is a new phenomenon in the country. The private sector remains the basic principle of the free market economy. However, many people are not familiar with this principle of the free market economy. The application of the free market economic system in the country, has had positive and negative consequences on the ground. The most remarkable consequence is that 80 percent of the investors would like to invest in the private sector and are satisfied from the ongoing investment process in the province. Also, Security is one of the factors with which 80 percent of the investors are satisfied. However, the satisfaction of most of the investors from the investment process does not mean that there are zero problems in the private sector. There are some factors which hinder the investment activities and the investors are unsatisfied with. The electricity- essential for investment/production activities- lacks and 82 per cent of investors are unsatisfied with that. Moreover, the lack of government monitoring and control and the deficiency of the resource market are other problems the investors encounter. The results of the research show that nearly 64 per cent investors have difficulties in access to raw material, but labor market is relatively more sufficient hence only 36 per cent investors are unsatisfied from the existence labor market situation. Besides this, corruption is another obstacle in the ground where 72 per cent investors have complained of. All of these and many other unnoticed difficulties result in the underdevelopment of the private sector in Afghanistan.

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I. Introduction

Private sector plays a tremendous role in the economic development of Afghanistan. The total value of the private sector output is around 13 per cent greater than the public sector. The total value of private production is US\$97.027 million while the value of the public sector production is nearly US\$12.573. In addition to, Afghanistan faces a tremendous trade imbalance: \$ 7407 million imports and \$875 million exports in 2018. The total trade deficit was 11.2 per cent in 2018. Afghanistan has trade deficit with its six largest trading partners such as Iran, China, India, Pakistan, Japan and the Central Asia (NSIA, 2018-19). From 2003 to 2015, there is remarkable increase in private investment, both domestic and foreign, valued nearly US\$ 10.2 billion in (Halimi, 2017). Among other variables, evidence shows that small and medium enterprises have important role in economic growth and development of a country especially in the developing world. With Afghanistan's turn to the market economy, the private sector is considered the engine for growth. At the heart of the private sector are small and medium enterprises (SMEs). SMEs make up about 80 per cent of Afghan business, half the country GDP, and employ more than 1/3 of the labor force (REU, p.5). However, the story of the SMEs in Afghanistan is quite different because of the decades-long civil wars and conflicts which have destroyed much of the infrastructure including the business sector. Fortunately, with intervention of the international community and inflow of millions of dollars in aids, thousands of SMEs were established in the country. As many as 65000 enterprises were formally registered with relevant government authorities; however, this figure may not accurately represent the myriad business that may have been registered with local authorities and municipalities (SIRI report, 2015). Due to the fact that SMEs play key role in providing jobs as well as poverty elimination in Afghanistan, yet the government has not prioritized the support and development of the SMEs (Sorosh, 2016).

In Afghanistan, incentives for formalization by licit actors remain low: A survey conducted by SIRI in 2011 revealed that registration brings few benefits in terms of government service delivery, contract and law enforcement, government protection (including for labor), or access to affordable finance. Formal businesses instead often face costs in terms of entry requirements; taxes, extortion and corruption by officials, as well as neighbors often disadvantage Afghanistan – that is, when they are enforced. Beyond the competitive advantages they have over Afghan businesses, a number of foreign producers are also backed by government subsidies and higher tariffs -which further disadvantage Afghan exports (SIRI report, 2015). In addition, challenges facing SMEs raise questions about their competitiveness, ingenuity and ability to survive the transition. Among the

issues they face are the uncertainty of the business environment and decreasing market confidence; dependence on donor organizations for start-up support; limited access to credit; lack of industrial-level energy, quality control and creativity, limited product diversity and access to markets. Lack of awareness of the workings of the new economic and trade system remain significant impediments to the growth of SMEs. Insufficient human and technological capacity exists, which is exacerbated by a disconnect between market needs and the education system (AREU, 2014). In addition to this, some of the researches indicate that SMEs suffer from not only corruption but also insecurity therefore; they cannot operate without support either from government or other organization (Habib, 2017).

II. Literature Review

The private sector plays an enormous role as an important stakeholder in economic development, generates income, creates jobs, and produces goods and services.

There have been various studies on the development of private sector and its role in boosting the economic growth in developing countries; few have also looked at the factors and barriers that restrict the development of the private sector in these economies including in Afghanistan. According to Nikzad (2015), the Afghanistan Investment Support Agency (AISA) has identified some of the challenges to the development of private sector. A Sigar report relates the development of the private sector as a key factor for economic growth which, subsequently, results in security (Sigar 2018).

Jake Cusack and Erik Malmstrom have examined the challenges for private sector development in Afghanistan. They have found that insecurity, corruption, lack of access to capital, lack of physical and human infrastructure, and lack of conducive policies, rules and regulations are the key factors that adversely affect the development of the private sector. In addition to the challenges, Cusack and Malmstrom have also proposed remedies to overcome the aforementioned challenges and problem (Jake Cusack and Erik Malmstrom, 2010).

In a study of the challenges of financing SMEs in Afghanistan, Habibi (2016) states that lack of access to finance leaves the SMEs in financial trouble which, in turns, restrict the sustainability and growth of the private sector. Hakimzai (2017) has investigated the effect of bank loans on fostering individual business/small businesses in Afghanistan and has found that sufficient funds, skilled workers, access to land and up-to-date machinery have a significant impact on the development of small businesses and, as a result, the entire economy.

For this study, SIRI is reviewed that is focused on the private sector of Afghanistan. Moreover, a research conducted by AREU on SMEs in 2014 has been studied. The AREU research points out the SMEs challenges which is a key contribution for the Afghanistan's GDP. In addition to these reviews, the National Statistics Information of Afghanistan (NSIA) is considered.

Objective of the Study

The main objectives for this study are defined as bellow:

- To understand the role of private sector in Afghanistan's economic development.
- To specify the main obstacles against the private sector development in Afghanistan.

III. Research Methodology

This research is a qualitative and descriptive study that examines the barriers to boosting private sector development in Afghanistan using the case study of Khost City. For convincing results, only the most accurate and reliable sources of data were used.

The data used in this study is drawn from both primary and secondary sources. The secondary data was collected from reliable and valid sources, including books, academic papers, reports, working papers, websites, laws and national statistical reports published by government agencies.

The primary data for this research project was collected from 85 private businesses that operate in Khost City, using pre-designed questionnaires. A total of 110 questionnaires were prepared and distributed. However, only 85 questionnaires were

correctly filled out and usable. Since there are no official statistics or figures available on businesses, it is impossible to collect data through random sampling. Therefore, the participants were selected based upon opportunity sampling. Opportunity sampling is a method of sampling through which the researcher collects data from those participants of the target population who are available and willing to take part in the survey at the time of data collection.

After the field work was completed and the required data from businesses had been collected, it was then organized and categorized according to the logical order of the research objectives and the questions in the questionnaires. The data was analyzed and interpreted using descriptive statistics to draw out the expected results.

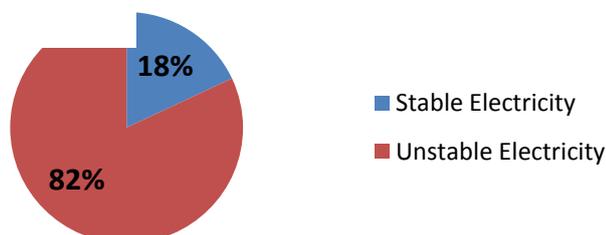
The main obstacles of the private sector development in the Khost province

After analyzing the primary data, several factors that basically deter the development of the private sector, were found. Each of these factors are discussed with the concerning figures explaining the factor.

1. Electricity

The research finds show that the private sector is faced with lack of stable electricity. It indicates that 82 percent private businesses do not have access to stable electricity. These businesses use their own generators to produce electricity and run their business.

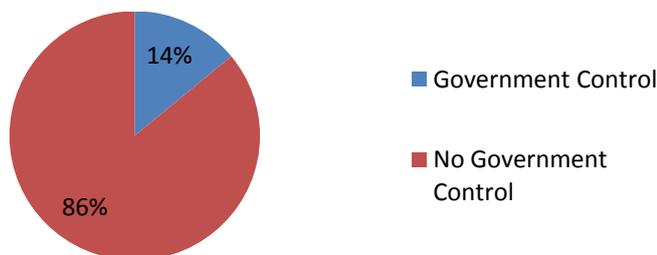
Fig 1: Electricity



2. Weak government control

In the open market economic system, government facilitates the opportunity for the private sector to invest in various sectors in the economy. In addition, the government assesses production processes either on the local or national level in order to find weaknesses and strengths of the investors. According to the survey from private businesses, there is weak government control in Khost Province. The research indicates that 86 percent of the investors complain from the weak government control.

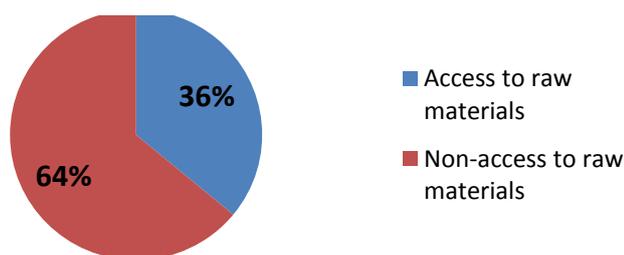
Fig2: Government Control



3. Access to raw material

From the economic point of view, raw materials are the basic need for economic activities especially in the production process. It means that any change in the nature of raw materials can change the nature of the investment i.e. higher prices of raw materials can cause to decrease demand for a specific product in the product market. Moreover, problems in resource market directly affect investment in the production sector. In the Khost province 64 per cent of the investors have difficulties in accessing raw materials. For instance, import tariffs, closures of the borders and high prices are the main factors that prevent the investors from access to raw material and smooth production process.

Fig3: Access to raw materials

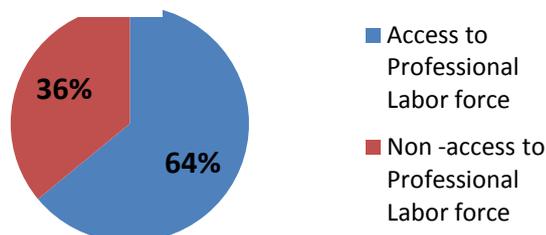


4. Lack of professional labor force

In Afghanistan, lack of skilled labor force is a national problem therefore, thousands of skilled laborers are invited and employed from foreign countries, whereas, millions of Afghans are unemployed due since they

do not have the skills that meet the current demand of the employers. Therefore most of the investors have difficulties in finding and employing skilled labor force, which, in turn, results in ups and downs in the production process the research findings indicate that 64 per cent investors have problem in finding professional labor force from the national labor market.

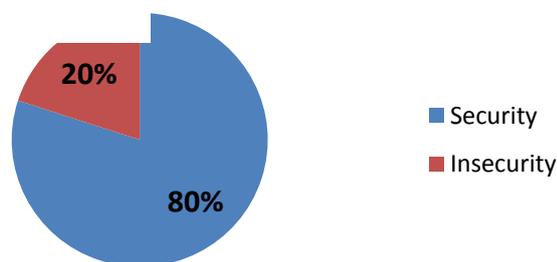
Fig4: Skilled Labor



5. Security

Stable and peaceful environment is a fundamental factor for economic activities especially for the private sector development. However, in the Khost province, security is an attractive element for the investors to invest in the private sector therefore, research findings show that only 20 percent investors suffer from the security issues and the remaining 80 per cent do not have any fear of insecurity.

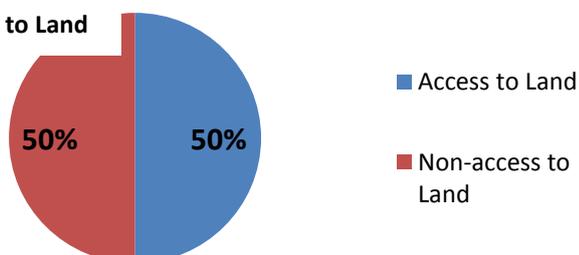
Fig5: Security



6. Land

Along with labor and capital, land is one of the main factors of production and the availability and accessibility of secured land can help production extension. In many countries, there are industrial parks which provide required land for investors to invest in production sector. Unfortunately, in Khost province, manufacturing companies operate in residential area. That means, investors rent residential houses and install machineries and equipment. A good point is that it has balance of satisfaction. There are 50 per cent investors having access to land and the remaining 50 per cent have problem in access to required land.

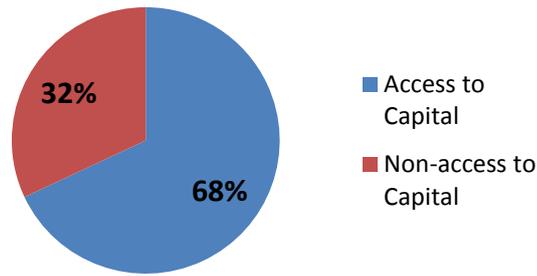
Fig6: Access to Land



7. Access to capital

Capital is another main factor of production so, access to capital is one of the major problems of developing and least developed economies. Problems in capital market can negative effect on production process. Fortunately in Khost province, investors do not have remarkable problems regarding required capital. The research findings show that only 32 per cent investors have problem in access to required capital and the large numbers of investor (68 per cent) do not have any difficulty in this regard.

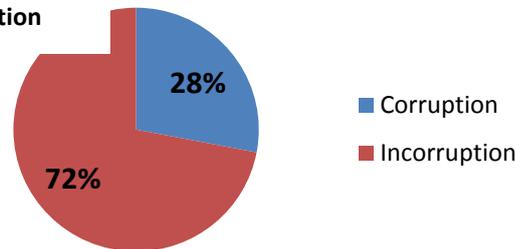
Fig 7: Access to Capital



8. Corruption

In fact, corruption can slow down the development process in each sector therefore; government should struggle to prevent them. Due to the fact that Afghanistan is one of the corrupted countries in the world, however, in the local level most of the investors are satisfied from the current administrative process. The survey shows that only 28 per cent investors have problems, but the remaining 72 per cent investors do not have problems in administrative process.

Fig 8: Corruption



IV. Conclusion

The concept of private sector is totally new in Afghanistan especially in the Khost province. However, the investment process in the province has positive and negative consequences ahead. From one hand, Secured environment, weak level of corruption, access to required capital and access to enough land are the strength points in the private sector that encourage investors to invest in different sectors. The other hand, instable electricity, weak government control from the investment process, access to raw material, access to skilled labor force, and non-activation of industrial parks are the negative aspects of the investment process that cause discouragement of the investors in the Khost province.

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