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AFGHANISTAN'S AGENDA FOR ACTION

Developing The Trade & Business Environment



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INTRODUCTION

Afghanistan: A Search for Self-Sufficiency

Afghanistan is a land-locked Islamic Republic of about 30 million inhabitants located in the mountainous region of Central Asia between Iran, Turkmenistan, Uzbekistan, Tajikistan, China, and Pakistan. It has long been a more-or-less loose confederation of disparate peoples separated by harsh terrain, language, local politics, and tribal affiliations. It is predominantly an agrarian economy. Over the past thirty years, a series of civil wars and external invasions have wrought significant civic and physical destruction. In late 2001 the U.S.-led ouster of the ultra-Islamic Taliban from Kabul led to significant changes. Although the current Constitution of Afghanistan is three years old, a violent insurgency has yet to be rooted out from the Southern portion of the country, mostly along its border with Pakistan.¹

Billions of dollars of international aid have been spent on Afghanistan and billions more are promised. Afghanistan has joined a number of significant international conventions on trade and finance, has constitutionally committed itself to a market economy, and has laid out aggressive and progressive goals in its Afghanistan National Development Strategy. Most agree that the goal of outside aid is to support the development of a free, prosperous, friendly and self-sustaining Afghan-Afghanistan. The question is, "When will that happen?"

Short-term economic prosperity can lead to growth – a man given a fish to eat gets stronger. Self-supported sustainability, however, is the key to productive long-term economic and national evolution. An Afghan economy with the ability to provide for most of the needs of its people will enjoy stability and respect, and will be able to deal with its neighbors and the international marketplace on fair terms. An elected government that serves Afghans with the basics of human necessity – while enabling a necessary degree of

personal and economic self-determination – will enjoy legitimacy, stability, and international clout. This type of government and economy will be mutually reinforcing and will ultimately be responsible for rebuilding a strong and self-sustaining Afghanistan.



The instant Diagnostic of the current state Afghanistan's environment for Commercial Legal and Institutional Reform (CLIR) and Trade (referred to as "ACLIR Trade" or "Diagnostic") cannot directly answer the question of "when." If one accepts, however, that the rule of law is a critical foundation for legitimate business and honest government, the findings herein can be of enormous value. This Diagnostic not only covers the "nuts and bolts" of Afghanistan's commercial law framework, but it also discusses general mechanisms, specific peculiarities, and some of the otherwise unique features of Afghanistan that impact the underpinnings of a strong economy. These include, among many examples: Afghanistan's comparative advantages in agriculture and regional trade; how a post-authoritarian mindset contributes to the exclusion of a free press and consequently greater public ignorance; and the impact of Islamic banking on the development of domestic investment.

¹ Photo credit: CIA World Factbook 2007.

Such analyses are useful not only as a snapshot of where Afghanistan is today with respect to its commercial institutions and legal framework, but also as a tool for deciding how, where, and when help should be applied. This Diagnostic recognizes that there are few easy answers and that important decisions will require a balancing of competing interests and overlapping dynamics. With that in mind, this Report provides recommendations for improvement.

The ACLIR-Trade Diagnostic: At the Heart of Central Asia

This Diagnostic is the first of its type to take place in nearly five years in the heart of Central Asia.² Afghanistan is bordered by a number of economic and geopolitical actors – Iran, Pakistan, and Tajikistan, among others – who represent emergent interests and dynamics in the spheres of global development, energy security, and international trade.

Through the comprehensive methodology established through USAID's Seldon Project for Global Trade Law Assessment and Assistance,³ this Diagnostic examines the following topics:

1. Islamic Law (*Shari'ah*)
2. Company Law and Corporate Governance
3. Contract Law and Enforcement
4. Real Property Law
5. Secured Transactions Law
6. Bankruptcy
7. Commercial Dispute Resolution
8. Court Administration
9. Competition Law and Policy
10. Opium Poppy
11. Foreign Direct Investment
12. International Trade Law
13. Flows of Goods and Services across Borders
14. Trade-Related Financial Flows
15. Trade-Related Flows of People
16. Financial Crimes
17. Intellectual Property

² Previous Diagnostics in the region include Armenia (2001); Azerbaijan (2002); and Kazakhstan (1999).

³ Detailed information about the Seldon Project can be found at www.bizlawreform.com.

The purpose of focusing on these topics is to identify in specific and substantive terms the various ways in which a country may not capitalize on opportunities for economic growth because of its law, policies, institutional characteristics, or social dynamics, and how specifically it might capture and realize those opportunities. Sustained efforts to address these topics can increase a country's prospects for economic growth and prosperity. Raising prosperity over time requires legal and institutional changes that allow economic actors to establish themselves, grow, compete, resolve conflict, access markets, and engage in free trade with relative ease. Although every country has specific needs and priorities, research has brought to light a number of "best practices" in the successful implementation of economic reform.

Taking data from a broad spectrum of stakeholders, and looking through the following lenses, this Diagnostic builds a "360° picture" of Afghanistan's commercial law and trade-related institutions:

Legal Framework. The Diagnostic first examines the laws and regulations that Afghanistan has in place that serve as the basis for their ability to achieve and sustain market-based development. The Diagnostic poses the following questions: *How closely do existing laws reflect emerging global standards? How well do they respond to commercial realities that end-users face? What inconsistencies or gaps are present in the legal framework?* Often discovered through this review are opportunities to make relatively small changes that may result in significant openings for business development and expansion.

Implementing Institutions. Next, the Diagnostic examines those institutions that hold primary responsibility for implementation and enforcement of the laws, regulations, and policies governing one or more of the areas addressed in this Report. For example, courts are usually a crucial institution in the examination of commercial law. Problems uncovered often relate to bureaucratic inefficiency, lack of resources and training, and, of paramount concern, real or perceived corruption.

Supporting Institutions. The Diagnostic then considers the environment of organizations, individuals,

or activities without which the legal framework or policy agenda cannot be fully developed, implemented, or enforced. Examples include notaries, lawyers, banks, business support organizations, professional associations, universities, and other ancillary service providers. Of particular interest with respect to supporting institutions is whether they have any meaningful involvement in *what the law says*. Where there has been “buy-in” from affected constituencies, a law and its commensurate system for implementation are more likely to be understood and used properly, and to achieve their overall purpose.

Social Dynamics. Finally, social dynamics are studied to determine whether the affected constituencies of a law or policy perceive a need for change, and, if so, how they are demonstrating this need. Are they effectively lobbying those institutions that can make a change? Is the media seizing the issue as a topic of public concern? Are individuals speaking out? Or, have social dynamics taken a less positive approach – for example, is the “gray economy” growing as a response to overly burdensome conditions for market entry? Analysis of social dynamics may affect how an assistance project is ultimately designed. Where outside participation is strong and inclusive, and public understanding high, a reform program may simply involve a relatively small number of government officials who are capable of meeting the demands. In contrast, where mistrust and misunderstanding are abundant, an approach that involves significant engagement of “end-users” will likely be necessary.

The ACLIR-Trade Diagnostic took place from February 1–15, 2007, when a team of commercial law and trade professionals, including a representative from USAID/Washington, DC, traveled to Afghanistan to conduct a comprehensive inquiry into the country's laws, public and private sector institutions, and social dynamics relating to commercial law and trade. The team consisted of the following members:

- Peter J. Baish (Flows of Goods and Services across Borders, Trade-Related Flows of People)
- Michael F. Cardoza (Competition Law and Policy, Foreign Direct Investment)
- Wade Channell (USAID) (Commercial Dispute Resolution, Court Administration)
- J. D. Crouch (Administration, Logistics, Security, and Introduction)
- Bikramaditya Ghosh (Team Leader)
- Thomas N. Jersild (Company Law, Real Property Law)
- Kenneth G. Swanberg (Opium Poppy, Trade-Related Financial Flows, and Financial Crimes)
- Andrew White (Islamic Law, International Trade Law)
- Louise D. Williams (Contract Law and Enforcement, Intellectual Property)
- The Honorable Michael G. Williamson (Secured Transactions Law, Bankruptcy).

Cross-Cutting Themes in Legal and Institutional Reform

Certain themes and dynamics are so prevalent across the analytical framework that they bear special mention. They can be thought of as layers. For example: this Diagnostic is organized so that the typical components of a healthy civic society and a prosperous economy are discussed discretely and then related to each other where appropriate. This structural format forms much of the Western mental construct about civil society and an individual's relationship to the state and other organizations. Concepts such as “church and state,” “public and private,” and “principle and agent” are so ingrained in the West that they are often deemed to be actually distinct entities and concepts. In Afghanistan, this is not the case. There, different relationships, authorities, sources of law, duties, and responsibilities are often conceptualized as a seamless whole – as “society.”

Thus, in order to appreciate the true impact of the unique themes that permeate the findings and recommendations in this Diagnostic, it is important to keep in mind that they not only overlap and affect all of the separate analytical areas, but each other as well. For example, a lack of literacy creates a dependence on oral transmission for information, usually from a

trusted source who has some familial and, quite likely, religious stature. In this case, information about something as mundane as a market price may come blended with a religious and micro-community component that would not otherwise be available to everyone reading the same secular newspaper.

Against this backdrop, a number of cross-cutting themes emerged during the course of this Diagnostic. They may be characterized as follows, and are discussed in turn: (a) the tension between the urgency of creating a legal framework that will support a genuine market economy, and the legitimacy of laws that are enacted without a broad-based effort to build consensus and educate stakeholders; (b) the grave challenge of rebuilding implementing institutions; (c) the scarcity of knowledge and understanding underlying key supporting institutions; and (d) the clear opportunities that currently exist in Afghanistan's business environment.

A. "Urgency vs. Legitimacy"

Many development professionals take the view that Afghanistan needs **modern civic institutions** in order to build a vibrant and self-promoting middle class, and that development aid should be used to build those institutions. A second vision of long-term, sustainable development holds that successful civil societies emerge from knowing and participatory consent between the governed and the system of government.⁴ It contends that legitimacy of law, and ultimately the long-term prosperity and stability of a nation, depend on the degree to which its citizens have committed to the program by either creating it in their own vision or by being an assenting partner to the compromises that resulted in its ultimate form.⁵

⁴ See, e.g., William Easterly, *Planners vs. Searchers in Foreign Aid* (Paper prepared for ADB Distinguished Speakers Program, January 18, 2006), at 23.

⁵ It is argued that a program of legal reform should be a dynamic activity that "includes research, debate, negotiation, public education, outreach, institutional capacity building in parliament, revisions of drafts based on local political compromises and a host of other steps." Wade Channell, *Lessons Not Learned: Problems with Western Aid for Law Reform in Postcommunist Countries* (Carnegie Paper No. 57, March 2005) at 9.

At the time of this Diagnostic, ten commercial laws had been prioritized for enactment over the next calendar year through the Afghanistan National Development Strategy, an effort subscribed to by the government but largely led by the donor community.⁶ These laws are supposed to undergo a process of review by the Afghan Ministry of Commerce and the Taqin (the legislative drafting unit of the Ministry of Justice) and to be reviewed by the U.S. Embassy in Afghanistan and other U.S.-sponsored advisors. Revisions are to incorporate comments from each of those reviews, when necessary. In January 2007, four of these laws (the Company Law, the Partnership Law, the Arbitration Law, and the Mediation Law) were signed into effect by the President during the Parliamentary recess – an act not without its controversies. The Contracts Law, according to most observers, is next in line. The remaining five laws slated for near-term enactment include three intellectual property laws (Copyright, Trademarks, and Patents), a Law on Agency, and a Law on Standards.

The urgency with which this agenda is being pursued contributes to the following observations about the ultimate ability of the emerging legal framework to be considered legitimate by the Afghan people. As detailed over the course of this Report:

- The **Company Law**, signed by the President in January 2007, was written by foreign lawyers who did not spend substantial time in Afghanistan and received little (or no evident) review or input from Afghan companies, businesspeople, or professional persons such as lawyers, accountants, and judges. Local actors, including a ministry senior lawyer and lawyers who represent a major Afghan company, reported that they are unaware of the new law or its contents, that they have not seen a draft of it, and that they would like to have had – and would now like to have – substantive input.

⁶ See Ministry of Justice and National Assembly, *Prioritized Legislative Agenda for 1386 and Legislative Capacity Needs of Ministry of Justice and National Assembly* (January 30-31, 2007), found at: <http://www.ands.gov.af/lands/jcmb/src/jcmb4/eng/05%20-%20Maj%20%20P L%20Agenda%20&%20Annual%20Legislative%20Plan%20-%20JCMB-IV%20Folder%20-%20024%20Jan%20-%20Eng ish.pdf>.

- The **Contracts Law** was drafted chiefly by outside advisors in 2003 and 2004. Since that time, local lawyers, judges, businesses, law professors, and other critical constituencies have not been consulted about its contents – or even informed about it – to any significant degree. The new law reflects this lack of consultation insofar as it does not yet provide any guidance about the process for contract enforcement. Furthermore, the law was not constructed in conjunction with a meaningful plan for implementation, including how law students and existing lawyers will learn to write and enforce contracts. In the Afghan marketplace, there continues to be only nominal use of contracts, and those companies that do use them have little appetite for taking disputes to court. How the new law will integrate with this reality has not been planned for in formal terms.

- A review of the **three draft intellectual property laws** reveals that, three years after they were prepared by outside experts, there is no local consensus concerning how they are to be implemented or enforced. In fact, the draft laws at once suggest the establishment of a single office to handle all types of intellectual property, while simultaneously indicating such possible sources of discrete administrative authority as a new Trademark Office, a copyright office within the Ministry of Information and Culture, and, for registration of international patents, an office to be named later.

- Although certain of Afghanistan's newer laws or draft laws exhibit strong **compliance with the traditions and expectations embodied in Sharīah**, a common theme during the course of this Diagnostic was that many legal drafters – foreigners in particular – appear to either disregard *Sharīah* entirely or regard it as irrelevant in their drafting efforts. In discussions with members of the Afghan academic, legal, and business communities, and with various international consultants, voiced the following concerns:

- Most outside consultants consider the Constitutional requirement of *Sharīah* compliance as merely political and not a substantive legal requirement;
- The typical international advisor is not an expert on Afghan culture, law, or *Sharīah* compliance;
- Even those laws that mention *Sharīah* compliance do so in a merely perfunctory manner and not as a substantive consideration;

- *Sharīah* is a factor in a number of commercial areas and, if it is not considered adequately, the implementation and long-term use of the commercial laws is jeopardized; and,
- As one business leader in Kabul put it, “Afghanistan is not America, Pakistan or Europe.” *Sharīah* and other Afghan moral, religious, and sociological factors need to be taken more into account in drafting new laws.

A contrasting example of how outreach and consensus-building can lead to a greater sense of legitimacy can be found in the process used in the development of the land policy, which will ultimately incorporate land-related law, regulations, and practices. The policy was developed with the participation of relevant government representatives, including officials at the Ministries of Urban Development, Agriculture, and Justice, mayors and other local government officials, private investors, and community members. It proceeds with assistance and coordinating help from the USAID-sponsored Land Titling project. A draft of the policy was approved in February 2007 by the three ministries identified above and the Economic Committee of the Cabinet, whence it is expected to go to Parliament for approval. The various constituencies have been working together in this process for more than a year with multiple meetings and workshops at which there was “plain talk and argument” (quoting one interviewee). According to interviewees, consensus and compromise views have emerged on many issues. Thus, to a far greater extent than the ANDS-prioritized commercial laws, Afghanistan's land policy offers significant potential for public understanding, support and compliance.

In short, and in light of these observations, critical questions arise: *Is Afghanistan in such a state of emergency that what are essentially “foreign” concepts and institutions should be substituted for home-grown ones that might sprout later? Will these institutions and concepts last? Are they appropriate (e.g., compliant with Islamic Law)? Will they emasculate the legislature? Will they alienate the people? Is some kind of foundation – wherever it comes from – a necessary predicate to the ultimate creation of indigenous Afghan institutions?* Thus the argument unfolds in terms of **urgency versus legitimacy**, and these questions form the core of the debate running every

day through every level and facet of the Afghan development effort. Do we give them what they need, or help them build what they want, or both?

B. Implementing Institutions: The Challenge of Rebuilding

Afghanistan's suffering in recent years places its implementing institutions – including ministries, courts, and other major agencies – at a stage that is almost worse than having nothing at all. Observations of the state of various institutions include the following:

- Afghanistan is currently rebuilding its **courts**. Though once respected for efficiency and general trustworthiness, years of Russian interference, civil war, and Taliban domination took a severe toll on the judiciary. At present, there is widespread perception of corruption in the formal court system, along with indications that the perception is not unfounded. Starting judges earn \$50 per month – far below basic needs – yet over 700 candidates applied recently for 170 judicial vacancies. Anecdotal evidence suggests that the positions are highly desired because of their potential for earning rents, and some judges have indicated that positions are for sale.
- Various **ministries** discussed in this Report are responsible for drafting and implementing new laws. Many of these ministries simply lack the human capital and resources to realize their nearly overwhelming agenda. Due to habit, personal agendas, and lack of resources, information-sharing among the ministries is said to place grave constraints on progress.
- With respect specifically to trade, the **Ministry of Commerce** and **Ministry of Foreign Affairs** take the lead in matters of international trade. At the time of this Diagnostic, however, the respective roles of each and the lines and parameters of authority were unclear. While the Ministry of Foreign Affairs, for example, initially took the lead in implementing the WTO accession process in 2003, that responsibility shifted to the Ministry of Commerce in July 2005 because literally no action had been taken (not even meetings). Of course, the bi-cameral **National Assembly** (the *Wolesi Jirga*, or House of People, and the *Meshrano Jirga*, or House of Elders) will have a legislative role in international trade matters, but this power has not yet been exercised has yet to be seen. Similarly, the role of the

President in international trade and treaties, as executive, is anticipated to be considerable, but specifics are still unknown. Often repeated during the course of the Diagnostic was the suggestion that accession to the World Trade Organization will have to wait until more of the institutions that will necessarily be involved – from the Ministry of Commerce to the Customs agency and others – are more able to comprehend, integrate, and implement a program of WTO compliance.

- The **Afghanistan Customs Department (ACD)** is the principal government agency for border control and is part of the **Ministry of Finance (MOF)**. In general, these institutions are weak, lacking in coordination, inadequately resourced, and marked by corruption. Although Afghanistan has made some progress toward stability, these agencies lack competent staff to provide even basic services and functions.

On the other hand, certain institutions set a promising stage for the future:

- The **Afghan Investment Support Agency (AISA)** arranges the registration of most companies with the commercial court, issues investment licenses, and maintains a license database. AISA is the primary and best investment-information and investment-support body in Afghanistan. Its staff is knowledgeable and helpful, and it is a good resource for significant-sized potential investors, both for company registration and for navigating the system generally. It has an attractive website. In the future, it could serve as the “one-stop shop” that oversees a company's application for specific industry and sectoral licenses. It would undoubtedly also be a good source for comment on the text of the new Company Law.
- Afghanistan has a long cultural tradition of dispute resolution through local councils known as *shuras* (Dari) and *jirgas* (Pashto). While there are some historical differences between the two, both are traditional councils of elders that can be convened by parties to resolve conflicts. The types of cases brought before these councils tend to deal primarily with family law (particularly marriage), inheritance, and local property disputes, but commercial claims also appear on occasion. The *shura* is the only adjudicatory system in Afghanistan that enjoys the respect of the general population. It is used by Afghans because it works better than the courts: *shuras* are perceived to be cheaper,

faster, more just, and more trustworthy. As a consequence, for commercial purposes, most Afghans prefer the *shura* system to the judicial system. Even upper-level members of the business community in Kabul reported the use of *shuras* to resolve commercial disputes.

In general, for most practical purposes, Afghanistan **lacks the basic institutions** upon which a middle class depends. Laws, courts, schools, credit, electricity, information, security, transportation, and other institutions are impaired. Commerce mostly occurs at either end of the spectrum – informal micro-enterprise (survival trading and subsistence farming) or large international investment – at the expense of the middle. This gap is not unrecognized, and progress is being made; however, the importance of building the Afghan middle class cannot be overstated. It is axiomatic that a **middle class** is critical to the stability and prosperity of a modern nation. The middle class are the managers, producers, regulators, traders, teachers, voters, and consumers that make a market economy function. However, as a result of the fundamental weaknesses in implementing institutions, the middle class currently have nowhere to thrive in Afghanistan.

C. Supporting Institutions: A Scarcity of Knowledge

Returning to the theme of “layers,” almost three decades of authoritarian (Communist and Islamist) rule and war have shaped and informed the values, beliefs, and practices of the Afghans who survived it. The **post-authoritarian “hangover”** has left the average citizen, and the supporting institutions usually constructed by a society to help economies grow, deficient in personal and economic initiative. Years of having to ask permission and of harsh punishment for unauthorized actions, however insignificant, have given rise to a **“decree” mindset** in which people will normally not act unless explicitly or implicitly told that they may do so. Authoritarian rule is also partly responsible for the **primacy of personal authority over positional authority** – a handicap in trying to build effective institutions governed by the rule of law. Another legacy of authoritarian rule is the seemingly intractable **combination of business and**

government, both in reality and in the minds of Afghans. The control levied on information by the authoritarian regimes in the recent past and the danger presented by standing out from one’s peers are also partly to blame for the **general lack of information** present in Afghan society at large. For example, the media is typically feared and shunned by businesses and government alike – there is little to no appreciation of their potentially positive contribution. Another common paradigm is that – whether from family, tribe, government, religious sources, international or donor inputs, or a combination thereof – **rules and laws come from “somewhere else.”** There is consequently little sense of individual participation in civic society. The notion that people could decide for themselves, via representative government, what rules to follow, does not exist.

There is a marked **lack of information** in Afghan society generally. Some of that deficiency is attributable to the authoritarian experience described above, while some of it is attributable to the lack of literacy and education discussed below. Much of it is likely attributable to the lack of information itself. Afghanistan is not a culture of widespread information. There is no commonly held expectation of knowledge or feeling of entitlement to know things beyond the information incident to daily life and religion. From that lack of expectation seems to have followed a stunting of curiosity. There are few available statistics or even raw data relating to business, government, or the economy. Rumors are rampant, but they have not fueled the market for “ground-truth.” Television and radio are dominated by entertainment programming and there is little clamor for the government to produce information as a public good – or even to disseminate it incident to its daily operations. There is, moreover, no credit information bureau, despite the fact that bad-credit risks are known to many in the banking industry and that they represent a threat to the profits of all bankers.

There is a significant **lack of human capital** in Afghan society today. Educational institutions fell victim to the civil wars following the Soviet withdrawal in the late 1980’s and were then systematically savaged by the Taliban in the late 1990’s. (What remains of the

educational infrastructure is largely colored by Communist doctrine held over from the 1970's and 1980's.) The national **literacy rate is less than 40%**.



This means that, aside from radio and television (which both depend on technology and electricity), there are no media for sharing a common understanding. There is little appreciation for an objectively neutral authoritative text – such as a law or tax regulation, because most must have it read to them. There is also painfully little quantification in a society where **numerical literacy** is not any more widespread than written literacy. This lack of numeracy has major implications for the growth and government of a complex society, from management and promotion of a market economy to the collection, recordation, and expenditure of tax revenue, to even the simplest of business decisions. There is also a lack of understanding about the **role of public servants**. Government was long a place to accumulate wealth and power at the expense of attention to fiduciary responsibilities.

The lack of human capital is pervasive and its **effects are multi-fold**. For example, a dearth of professors who can teach market economics results in a concomitant lack of businessmen, government functionaries, intermediaries, and price-wise consumers who make up the functioning market economy that is so critical to national self-sustainment. The lack of domestic human capital also fuels imports of human

capital from neighboring countries for critical functions, thereby decreasing the “Afghan-ness” of the economy and marginalizing what would otherwise be an indigenous middle class (with perhaps predictably negative consequences to government stability).

Women comprise almost 50% of Afghanistan's population – and they **work**. While businesswomen in the formal sector do exist, most women work in the home without remuneration. Barriers to their entry into the mainstream of the economy are numerous and include the following: social constructs, traditional gender roles, domestic chores that remain labor intensive due to lack of modern appliances, lack of higher education, and a literacy that is less than half that of males.⁷ Pioneering female entrepreneurs are mostly widows who are thus able to negotiate and otherwise speak for themselves in the business context. Banks, government offices, and other institutions critical to business are getting used to dealing with women professionally. The greatest hope for bringing this underutilized part of the workforce to greater capacity may lie in the reinvigoration of the carpet industry and agricultural processing.⁸

D. Opportunities for the Future

Although much of the information pertaining to Afghanistan's business environment does not paint a positive picture, the Diagnostic team found many promising areas of change, growth, and opportunity. These include the following:

- **Sharī'ah-based lending** may represent a powerful force behind economic growth in the future. Loans are structured to assure compliance with restrictions imposed by *Sharī'ah* prohibiting the collection of conventional interest. Lenders have been able to obtain *fatwas*⁹ assuring borrowers that a type of transaction is in compliance with *Sharī'ah*. A typical *Sharī'ah*-compliant loan is a *murabaha* loan, that is, a “buy/sell” arrangement. Under such an arrangement, the lender buys the item to be financed directly from the vendor. The lender then resells it to the borrower at a mark-up. Because

⁷ CIA World Factbook 2007.

⁸ Photo credit: Michael F. Cardoza, personal collection.

⁹ A *fatwa* is a legal pronouncement made by an Islamic scholar on matters involving the *Sharī'ah*.

the lender only derives a profit from the mark-up on resale and is paid that amount without interest, there is no “*riba*” or interest involved in the transaction, and it does not run afoul of the *Sharīah* prohibition from the collection of *riba*.

- Another area that has seen immediate acceptance and growth is the **leasing of equipment**. This has obvious advantages. First, this simplifies repossession rights because the title stays in the name of the lessor-finance company. Second, there is no interest involved (at least not outwardly) and therefore, the transaction does not violate the *Sharīah* principle against charging interest. Even though in substance these transactions are economically identical to secured financing, their being classified as leases gives them advantages in marketing and enforceability.
- The new **Law on Contracts** is clear, well written, and consistent with both *Sharīah* and international best practices. When the process of implementation begins in earnest, it has the potential to serve as an excellent tool for teaching the fundamental principles of modern contract law.
- A significant opportunity relating to Afghanistan's Counter-Narcotics Strategy is the development of **large-scale agri-business**. Given the products produced in Afghanistan before the conflict and since, the potential for such enterprise certainly exists. Of course, it is difficult to suggest this opportunity against a backdrop of constant droughts, harsh winters, wars with the Taliban and Al Qaeda, religious conflicts, lawlessness, and underdeveloped transportation, electric, and sewage infrastructures. Yet agri-businesses are beginning to flourish, the rule of law is improving, finance systems are evolving, and goods are beginning to move.

Indeed, there is, within these examples and in many others set forth in this Report, hope in Afghanistan.

Summary of Subject-Specific Findings

The findings of the 17 subject-matter areas examined in this Diagnostic are summarized as follows:

Islamic Law (*Sharīah*). Afghanistan is by Constitutional definition an Islamic Republic, one whose laws and government are legitimate only to the

extent that they do not conflict with *Sharīah*. Laws currently in force exhibit a significant degree of secular “assistance,” as do draft laws currently pending enactment. While it is likely that outside help will not be overtly rebuffed by Afghanistan, it is also quite predictable that laws that are not *Sharīah*-compliant will not be enforced, thereby eroding respect for and universal application of the rule of law. Afghanistan, and other countries in the region, are finding that *Sharīah*-compliant banking and business are enormously compatible with realizing profit and the growth of economy generally. On the other hand, to be viewed in the long-term as a destination where outsiders feel comfortable doing business, Afghanistan is challenged with incorporating Islamic law in a way that is not perceived as unduly complicated, biased against foreigners, or unpredictable.

Company Law and Corporate Governance. A simple yet effective Company Law is one of Afghanistan's best bids for bringing informal business into the formal sector where it can enjoy state promotion, protection, and recognition (and the payment of taxes). Afghanistan's new Company Law brings modern international best-practices to what was an unwieldy and often impenetrable legal regime. Due to foreign assistance in drafting, some of its idiosyncrasies are not entirely appropriate for Afghanistan's circumstances, but are none that significantly detrimental. The Company Law holds room for further improvement, particularly in the areas of continued reduction of the impact of state bureaucracy on business.

Contract Law and Enforcement. From a Western perspective, Afghanistan's existing Contract Law is biased in favor of releasing parties from their contractual obligations. Much of this dynamic is derived from tradition and custom, some is derived from *Sharīah* compliance. In many cases, the law codifies an “at-will” contract where performance is conditioned on continued mutual assent. Not unsurprisingly, mechanisms for enforcement or damages in the event of breach are stunted. A draft Contract Law represents a major step into formalizing and mainstreaming the informal economy by taking business arrangements out of the minds of the dealmakers and putting them onto

paper. Yet the absence of overall policy or specific plans for implementation – in the business community, among lawyers, in the law schools, and elsewhere – threatens to create a law without context and that is destined to disappoint.

Real Property Law. Real Property Law is the underpinning of a modern, middle class, credit-based consumer society. An unambiguous, officially recognized, and transferable title to real property provides the basis for borrowing money secured by that property – money that then in turn fuels the economy. Afghanistan's land laws and practices are extremely complex and often unclear. Moreover, Afghanistan has never had a reliable, standardized system of land titling. The consequence is that, today, commercial land use and investment present obstacles to future economic development.

Secured Transactions Law. The presence of a working legal system for the enforcement of a lender's rights to its collateral upon the borrower's default is central to a mature economy with a strong commercial lending sector. A well understood and efficient Secured Transactions Law – combined with a judiciary that is well versed in commercial law and is perceived to be fair, speedy, and transparent in the enforcement of commercial rights – is an essential component of such a system. Unfortunately, at this stage of its development, Afghanistan has neither a statutory framework nor a judiciary that can be relied upon for the enforcement of a lender's collateral rights.

Bankruptcy. While there are provisions of existing law in Afghanistan that deal with insolvency and the winding up of business enterprises, they are generally unknown even among lenders. In practice, bankruptcy is nonexistent as a viable method of dealing with insolvency in Afghanistan. Inefficient or nonexistent bankruptcy systems prevent the redistribution of income-producing assets and employees, with an overall negative impact on the local communities in which previously solvent businesses once operated.

Commercial Dispute Resolution and Court Administration. For the formal systems of adjudication, the overall legal framework is reasonably sufficient to support the needs of the developing

economy, when it is applied. There are some gaps, but the basic system of commercial procedure – on paper – will not need substantial amendment for some years. Arbitration and mediation have formally been introduced through the recent adoption of new laws, and these should also be adequate for this stage of development. The institutional structures are not so robust. Not only did government institutions and civil society organizations retreat or disintegrate during the war years, the underlying educational system was badly damaged as well. As a result, many of those responsible for the administration of justice have minimal educational and practical qualifications to fulfill their roles. As the schools are re-established, new and better qualified judges and lawyers will be available.

Competition Law and Policy. Competition Law, known commonly as "Anti-Monopoly Law," is the body of rules designed to promote business competition by preventing domination of any one market by any one enterprise. Afghanistan does not currently have a Competition Law, nor does it have many of the developed markets or market players that might give rise to the need for a Competition Law. There are a number of unique social dynamics that constrain business competition. Work in these areas could ultimately help build a vibrant domestic economy that might one day benefit from such a body of law.

Opium Poppy. Afghanistan's opium poppy narco-economy constituted 36% of the licit GDP in 2004/2005. It permeates the entire economy and the culture of the country, contributing to massive corruption, undermining public institutions, and hindering the development of the rule of law. The licit economy is growing, however, and some of the legal instruments needed to combat the narco-economy are nearly in place. The goal of eliminating opium poppy production, or at least of making the impact of the narco-economy negligible, is near at hand and fully achievable, assuming that the right development instruments are supported and the political will to sustain them is manifest.

Foreign Direct Investment. Foreign direct investment has grown dramatically in Afghanistan over the past four years but it has thus far failed to deliver

on its promise to grow the business infrastructure of a self-sufficient Afghan economy. Afghanistan remains largely a nation of raw exports and re-exports of goods made elsewhere in Central Asia and beyond. Although the legal framework appears to support predictability in investment and return, a lack of supporting institutions and underlying social factors conspire to make Afghanistan's climate for foreign investment less attractive than those of the comparable alternatives.

International Trade Law. There is no specific "trade law" in Afghanistan. Many of the trade laws and regulations typical in developed countries are non-existent in Afghanistan. Tremendous impediments to international trade must first be overcome. For example, the deplorable security situation discourages investment in the critical infrastructure of international trade and discourages travel and transit overall. The absence of commercial laws drafted and implemented to the standards of the international marketplace will severely hamper Afghanistan's progress toward becoming a meaningful international trading partner.

Flows of Goods and Services across Borders. In April 2005, a new Customs Law came into effect in Afghanistan. The law reflects effective modern Customs practices, such as organizational structure, seizure and penalty authority for Customs violations, collection of foreign trade statistics, joint facilities with neighboring countries, and the acceptance and the use of electronic data for Customs documentation. However, conditions at border ports remain chaotic, with poor security, thefts, and many unauthorized individuals offering both legitimate and illegitimate services. Import processes, despite improvements, continue to be complex and burdensome, leading to delays and increased costs. WTO accession is a new topic to both the government and private sector of Afghanistan; as a result, accession is often treated with apprehension fueled by a lack of basic understanding and misconceptions about its potential impact upon Afghanistan's foreign trade regime and Customs collections. Enactment of a GATT-compliant statute and the issuing of the defining and implementing decrees are important steps in WTO accession that remain to be accomplished.

Trade-Related Financial Flows. Access to money is unconstrained, and transferring money in and out of the country is relatively easy and uncontrolled. The Central Bank is mandated to carry out the basic operations of a central bank, including foreign exchange controls and regulating the flow of money, although the monitoring of exchange practices has been limited to date. Laws are being prepared, and in the process of being enacted, for regulating trade financing, documentary credits, and various forms of financial instruments. However, the laws do not reach as far as regulating international trade financing or providing for insurance for financing transactions. Foreign investors are allowed to operate in Afghanistan and trade and investment financing is not considered to be unduly complicated or cumbersome.

Trade-Related Flows of People. Trade-related flows of people to Afghanistan are very limited at this time because the security environment remains volatile and unpredictable. Tourism (except so-called "extreme tourism") is out of the question. The ability of Afghan authorities to maintain public safety and order while ensuring the security of citizens and visitors is limited. Even though the capital of Kabul is considered fairly safe, extreme caution is advised in U.S. State Department and other foreign government travel advisories. Elsewhere in Afghanistan, a significant increase in attacks in the south and southwestern areas of the country has occurred, and a seasonal surge in insurgent activity is expected. Violence and the threat of violence are restricting trade development in many parts of the country, cutting off work opportunities for Afghans and those wishing to invest in Afghanistan. Despite low trade-related people flow in Afghanistan, key infrastructure improvements have been made and more are planned. Over \$8 billion in aid and investment from the international community has greatly improved Afghanistan's prospects for the future. As needed stability is achieved, these improvements will allow for larger numbers of cross-border, trade-related travel.

Financial Crimes. Financial Crimes – namely, money laundering and terrorist financing – seem to run unabated throughout Afghanistan. Opium poppy is a \$2.7 billion illicit industry. Some of the warlords and

local militia have now become “traffickers,” “protectionist groups,” or “terrorists,” receiving some or all of their financing from the opium trade. Given this situation, the government is attempting to introduce anti-money laundering legislation and combat terrorist financing through improved law enforcement. An Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework and corresponding laws are in place; however, the system of financial crimes detection and prosecution is just beginning – no apprehensions or prosecutions have been made to date.

Intellectual Property. In Afghanistan, the IPR tradition is wafer-thin, existing almost exclusively in the arena of trademarks. Works that may be subject to IPR

protection in other economies – such as books, CDs, computer software, and visual designs – tend to be freely accessed and copied without payment or attribution. The fact that Afghanistan's economy is so small, however, means that this issue presents far less of a threat to international commerce and foreign investment than it does in many other countries. Whether now is the time to drive for a comprehensive system of IPR registration and enforcement in Afghanistan is a threshold question that has not yet been fully examined by the Afghan government or the donor community. Afghanistan faces the challenge of “selling” an IPR regime to a general public that has an unusually high rate of illiteracy and an enormous urgency to simply avoid the daily perils of poverty.

ISLAMIC LAW (*Sharī'ah*)

Introduction

A recurrent theme is announced repeatedly by virtually every non-governmental organization (NGO) and government-sponsored donor organization operating in Afghanistan: "This is not merely a post-war economy, this is a post-devastation economy." Yet, out of the ashes of nearly three decades of severe devastation wrought by the combined hardship of wars and droughts and international isolation, a new commercial legal system is resolutely rising. Its Father is the Islamic law (*Sharī'ah*) that governs all aspects of life in this unequivocally Islamic country,¹⁰ and its Mother is the centuries-old traditional or customary law that continues to guide personal and business relationships, especially in the outlying provinces distant from the more progressive urban environment of Kabul. But its Nursemaid is clearly the modern legal system of civil codes (*Qanūn*) first adopted in the early to mid-20th century and currently being rewritten with the assistance of myriad NGOs and other donors. It is this complex intertwining of *Sharī'ah*, customary law, and *Qanūn* that weaves together a unique, complex, and colorful fabric of commercial law and institutions.

It is difficult to separate out which of these three facets of the commercial legal system – *Sharī'ah*, customary law, or *Qanūn* – has primacy. The answer depends largely on who is answering the question. NGOs and the international donor community tend to promote *Qanūn* through modern law reform and seek to incorporate broader international standards. For them, and for many Afghans in the Afghan business community, this is seen as the means to accomplishing the quick and effective economic jump-start so desperately needed. Yet, there are also those voices in Afghanistan, including many in the business community

¹⁰ Afghanistan's population is 99% Muslim, approximately 85% of whom are Sunni and 15% of whom are Shi'ā. The differences between Sunni and Shi'ā, while especially significant from a historical and current political perspective, are beyond the scope of this commercial law assessment.

and government, who are quick to respond that *Sharī'ah* is paramount. After all, this is an Islamic Republic, they point out, one whose laws and government are legitimate only to the extent that they are not in conflict with *Sharī'ah*. Finally, although not as prominent perhaps in the urbanized and more modern environment of Kabul, one also is easily reminded of the importance of pre-modern customary law, especially the Pashtunwali code of the Pashto culture (the largest ethnic/tribal group in Afghanistan, variously estimated to encompass somewhere between 38% and 50% of Afghans), that often blends almost indistinguishably in many ways with *Sharī'ah*.¹¹

In contemplating the interplay and overlay of *Sharī'ah*, customary law, and *Qanūn*, the recent cautionary observation of a prominent business leader in Kabul resonates: *Sharī'ah*, ultimately, "is the standard against which all laws are measured."¹² Indeed, a report on the Afghan legal system prepared in 2002 under the auspices of the International Commission of Jurists went so far as to predict ("with some confidence") that "past experience would suggest that any attempt to implement and enforce secular statutory laws which depart from customary and/or particular interpretations of Islamic law is liable to be met with protests and perhaps even civil unrest."¹³ These past

¹¹ "The notional ancestor of all Pashtuns is Qays, who, it is said, received Islam directly from the Prophet Muhammad. Essentially, Pashtuns deny having any pre-Islamic past or experience of conversion. Being Muslim is thus inextricable from their tribal heritage." Kristin Mendoza, "Islam and Islamism in Afghanistan," paper published as part of Harvard Islamic Legal Studies Program, Afghan Legal History Project at <<http://www.law.harvard.edu/programs/ilsp/research/mendoza.pdf>>, last accessed 27 February 2007 (citing Jon Anderson, "How Afghans Define Themselves in Relation to Islam," in *Revolutions and Rebellions in Afghanistan*, eds. M. Nazif Shahrani and Robert L. Canfield (Berkeley: University of California Press, 1984), 274).

¹² Interview in Kabul conducted on 10 February 2007.

¹³ Martin Lau, "Afghanistan's Legal System and its Compatibility with International Human Rights Standards: FINAL REPORT", available at <<http://www.icj.org/IMG/pdf/doc-51.pdf>>, last accessed on 27 February 2007.

experiences, notably, include the unsuccessful attempts by more than one Afghan ruler to perhaps too rapidly or too aggressively modernize Afghanistan's legal system during the 19th and 20th centuries. As another prominent Afghan business leader pointed out recently during a discussion in Kabul, "history reminds us to be careful: there was a popular uprising in Afghan history when the King tried to modernize the laws too fast by bringing in Western laws."¹⁴ That particular ruler (Amanullah), the author of Afghanistan's first modern Constitution in 1923 and the ill-fated innovator of significant social and legal reforms through a series of codes and decrees (largely influenced by Atatürk's reforms in Turkey), found his reforms rejected by the 'ulamā'¹⁵ and tribal leaders that feared losing their power. These groups formed an alliance against Amanullah and quite easily incited the largely rural and traditional Afghan population into a popular uprising that overthrew his rule.¹⁶ Indeed, it is perhaps quite instructive that subsequent rulers, such as Zahir Shah in the 1960's, successfully undertook more moderate legal reforms that not only avoided any direct conflict with the 'ulamā' and their realm of authority, but also carefully included them and considerations of Islamic jurisprudence in the drafting processes and ultimate reforms. Even today, President Hamid Karzai is careful to consult with the Afghan Council of 'Ulamā' on various matters, and recently ordered the funding of 500 new posts for Islamic scholars within the Ministry of Hajj and Religious Endowments.¹⁷

¹⁴ Interview in Kabul conducted on 10 February 2007.

¹⁵ Plural of 'alim, Islamic religious/legal scholars greatly respected for their knowledge ('ilm).

¹⁶ See Bruce Etling, "Legal Authorities in the Afghan Legal System (1964-1979)", paper published as part of Harvard Islamic Legal Studies Program, Afghan Legal History Project at <http://www.law.harvard.edu/programs/ilsp/research/etling.pdf>

¹⁷ These moves by the president are seen by some Afghans as politically quite savvy: not only is the president careful to demonstrate to the Afghan people that their religious interests are protected in the reform process – countering accusations by the Taliban and other dissidents that the Government is not taking notice of Sharī'ah – but along with greater input from Islamic leaders and scholars formally brought within the fold of the Government, there is also the increased ability of the Government to co-opt them and control their potential dissidence.

It is important to note that, even among learned 'ulamā' and higher-level *mujtahidun*,¹⁸ *Sharī'ah* itself has always been difficult to fully define and circumscribe. *Sharī'ah* is the final divine law established by Allah (God), governing all aspects of human life – including religious practices, morality, criminal matters, family matters, and commerce. Because it arguably is impossible to fully comprehend all of that which Allah intends for His followers and commands them to do, Islamic scholars have, more than a millennium, struggled to determine *Sharī'ah*. Briefly, *Sharī'ah* firstly is determined by reading the *Qur'ān*, the textual word of Allah as received by the Prophet Mohammad. Secondly, *Sharī'ah* is determined by studying the example of the Prophet Mohammad – his words and behavior, as recorded by his Companions and followers and transmitted from generation to generation through narrative reports. Finally, *Sharī'ah* is determined by utilizing a rigorous methodology that employs, for example, analogical reasoning, seeking equity, advancing the public good, inferential reasoning, and consensus. By rigorously applying these methods of reasoning and interpretation, qualified Islamic religious/legal scholars can formulate an opinion on a difficult point of *Sharī'ah*.

Because Qur'anic hermeneutics and the applicable methodologies require such rigorous and advanced scholarship, defining *Sharī'ah* has generally been the province of a handful of well-respected and renowned scholars over the centuries. Gradually, these scholars differentiated into distinct *fiqh* (jurisprudence) *madhahib* or schools of legal thought – estimated at anywhere from nineteen to possibly hundreds over the first few centuries of Islam. Each *madhab* employed a slightly different methodology to interpret *Sharī'ah* and deduce divine law. Today, the dominant surviving four *Sunni madhahib* and the predominant *Shi'ā fiqh madhab* agree as to the fundamentals of this methodology, although they still disagree with each other as to the precise rules of interpretation to be employed.¹⁹ Early on, the

¹⁸ A *mujtahidun* generally is a scholar distinguished by the 'ulamā' as being capable of rigorously applying certain methods of reasoning and interpretation to formulate an opinion on a difficult point of *Sharī'ah*.

¹⁹ The four major *Sunni madhahib* are the *Hanafi*, *Maliki*, *Shāfi'i*, and *Hanbali*. The *Jafari* school is the major *Shi'ā madhab*.

scholars within each *madhab* also reached some consensus as to specific rulings on significant issues, and the agreed-upon rulings became identified as the position of the *madhab* on those issues.

In Afghanistan (and among an estimated majority of Muslims world-wide), the dominant *Sunni madhab* is the *Hanafī*, which is based on the scholarship of its founder, Imaam Abu Hanifa (d. 767 AD). The predominant *Shi'ā madhab* in Afghanistan is the *Ja'fari madhab*, based in turn on the scholarship of the *Shi'ā* Imaam Ja'far al-Sadiq (d. 765). While the jurisprudential, theological and historical distinctions between these two *madhab* are of relatively minor importance for the purposes of this Diagnostic, it is important to note that various laws (including the Constitution, as discussed below, and especially the criminal and family laws) do take into account their differences, largely for political reasons.²⁰ On the other hand, it is also noteworthy that political expediency has led to some selective adoption of *fiqh* (*Sharī'ah*-based jurisprudence) principles from among the several dominant *Sunni* and *Shi'ā madhab* – a practice which some Islamic scholars both within and outside Afghanistan criticize as quite wrongly fitting the law to suit one's personal interests, verging on apostasy.²¹

Legal Framework

Formal commercial law in Afghanistan currently is a system of *Qanūn*, which are approximately 20% *Sharī'ah*-based and 80% derived from secular law (heavily influenced by the laws of Turkey, Germany, France, and Switzerland). Underpinning the formal commercial laws, the Afghan Constitution of 2004 (as well as all previous incarnations since 1931 and especially since 1964) dispels any doubt that the legal framework in Afghanistan must fundamentally be

²⁰ This may be particularly important to a national healing, as the *Shi'ā* generally were persecuted under the Taliban rule.

²¹ An interesting example which is frequently mentioned in Afghanistan as justifying this selective jurisprudence occurs in the case of divorce upon disappearance of a husband: under classical Hanafī jurisprudence, it is said, a wife would need to wait 90 years after his disappearance before she could be granted a divorce; ostensibly borrowing from other Islamic jurisprudence, however, Afghan law now recognizes a waiting period of only three years.

consistent with Islam and *Sharī'ah*. The *Preamble* to the Constitution begins, “With firm faith in God Almighty and relying on His mercy, and Believing in the Sacred religion of Islam ...” Moreover, the first three articles emphasize further that “Afghanistan is an Islamic Republic, independent, unitary and indivisible state” (*Article 1*), “[t]he religion of Afghanistan is the sacred religion of Islam” (*Article 2*), and “[i]n Afghanistan, no law can be contrary to the sacred religion of Islam and the values of this Constitution” (*Article 3*). As required by the Constitution, even the flag includes within its insignia “the sacred phrase of ‘There is no God but Allah and Mohammad is his prophet, and Allah is Great’” (*Article 19*). And the courts, in the absence of express positive law on an issue, are Constitutionally bound to render decisions “within the limits of this Constitution” in accord with specified Islamic jurisprudence (*Article 130 and Article 131*). Indeed, these requirements that Islamic law will ultimately prevail are firmly and permanently planted by the Constitutional prohibition that “The provisions of adherence to the fundamentals of the sacred religion of Islam ... cannot be amended” (*Article 149*).

In addition, *Hanafī* jurisprudence clearly dominates the commercial laws, with *Ja'fari* jurisprudence only being clearly applied in personal (i.e., non-commercial) matters between *Shi'ā* Muslims. Indeed, the



Constitution expressly provides that “[w]hen there is no provision in the Constitution or other laws regarding ruling on an issue, the courts’ decisions shall be within the limits of this Constitution in accord with Hanafi jurisprudence and in a way to serve justice in the best possible manner” (*Article 130*). The only possible exception is in cases where “no clarification by this constitution and other laws exist and both sides of the case are followers of the Shia Sect,” in which case the “courts will resolve the matter according to the laws of this Sect” (*Article 131*).

The existing commercial laws recognized (and effectively reinstated) by the Bonn Agreement in December 2001 include the Commercial Code of 1955 and various provisions of the Civil Code of 1975 that address commercial matters (such as the laws on contracts scattered throughout myriad provisions of the Civil Code). Those specific laws, and revisions to them, are discussed in detail elsewhere in this Report. With respect to the role of *Shari'ah* in the commercial law framework of Afghanistan, however, it is important to make two observations: (1) the “existing laws” were heavily influenced by *Shari'ah*, especially *Hanafi* jurisprudence;²² and (2) a common complaint about the redrafting efforts of many foreign NGOs and the international donor community is that *Shari'ah* compliance is not being given sufficient attention.

Cited as a good example of *Shari'ah*-compliant drafting by largely international actors is the Contracts Law, recently drafted by consultants assembled through an American Bar Association initiative. This effort is notable, apparently, because a team of *Shari'ah* and Western-law scholars carefully considered *Shari'ah* issues in their draft, and also relied heavily on existing laws that were known to be *Shari'ah*-compliant, rather than completely reinventing the law from a purely Western model. The result is a new draft Contract Law that has been well received, at least by the international advisor community, and which is predicted to pass without substantive changes by the Taqin (the legislative drafting and review branch of the Afghan Ministry of Justice charged with ensuring that draft laws comply with the “principles of the Islamic Republic of Afghanistan”).²³ This draft legislation successfully addresses *Shari'ah* concerns by, among other points, expressly providing for *khiyar al-majlis* (by which each party may revoke their contract at any time until they have gone their separate ways) and

recognizing *mudaraba* contracts (in which one party brings capital and the other brings labor and both share the profit according to a pre-agreed ratio).

Together with the draft Contracts Law, the Law on Agency is also viewed as well drafted from the perspective of *Shari'ah* compliance, borrowing heavily from the United Arab Emirates (UAE) Civil Code and Kuwaiti Commercial Code, as well as Egyptian laws and the American Uniform Commercial Code. It is generally regarded that this draft legislation successfully addresses *Shari'ah* concerns by, among other points, expressly providing for *khiyar al-majlis* and recognizing *mudaraba* contracts. Likewise, the recently-enacted Partnership Law, which was based on existing Afghan law, was reviewed in draft form by at least one Afghan government ministry and, following revisions which specifically resolved *Shari'ah* concerns, is regarded as *Shari'ah*-compliant.

In contrast, other international NGOs and donor-sponsored organizations appear to either disregard *Shari'ah* entirely or regard it as irrelevant in their drafting efforts. Anecdotal evidence exists of concerns in this regard being voiced by some consultants within the international NGO/donor community, as well as by Afghans – such as the Taqin, which is charged with, among other responsibilities, the “strengthening of Islamic *Hanafi* jurisprudence, *Shari'ah* and the rule of law by drafting and scrutinizing proposed laws.”²⁴ In discussions with members of the Afghan academic, legal, and business communities, and with various international consultants, significant concerns expressed include the following:

- Most outside consultants consider the Constitutional requirement of *Shari'ah* compliance as merely political and not a substantive legal requirement;
- The typical international advisor is neither an expert on Afghan culture, law, nor *Shari'ah* compliance;
- Even those laws that mention *Shari'ah* compliance do so in a merely perfunctory manner and not as a substantive consideration;

²² Reportedly, a review of the Civil Codes “found that they were essentially a codification of the scholar’s law (*Hanafi fiqh*).” Etling, *supra* note 7, at 11.

²³ As discussed in this Report’s chapter on Contract Law, while this law may be a good example of sensitivity to *Shari'ah*, since the law was drafted, local lawyers, judges, businesses, law professors, and other critical constituencies have not been consulted about its contents – or even informed about it – to any significant degree; this is a cause for concern as to its ultimate implementation.

²⁴ The Islamic Republic of Afghanistan Ministry of Justice website <<http://www.moj.gov.af/taqin.html>>, last accessed on 28 February 2007.

- *Sharī'ah* is a factor in a number of commercial areas and, if it is not considered adequately, the implementation and long-term use of the commercial laws is jeopardized; and,
- As one business leader in Kabul put it, "Afghanistan is not America, Pakistan or Europe." *Sharī'ah* and other Afghan moral, religious, and sociological factors need to be taken into account more explicitly and often in drafting new laws.²⁵

It should also be noted that there is almost universal agreement that the implementation of a new commercial law framework is an urgent priority. While some Afghan advisors advocate slowing down and giving more attention to a number of concerns, including *Sharī'ah* compliance, the Afghan business community is quite eager to get on its feet and secure a prominent place in international commerce. One business leader expressed the view that the highest priority should be toward drafting and passing laws that are consistent with international standards and commercial best practices, rather than worrying about *Sharī'ah* compliance, at this point. As he pragmatically explained, "If the economy is strong and people have jobs and money, then *Sharī'ah* issues are less important; only if the economy suffers and people are struggling and have no food or money, then they will turn more to religion and to the *Mullahs*. Look at other Islamic countries for examples of both: UAE, and Iran." In fact, as noted in the discussion of Contract Law in this Report, there are definitely those within the Afghan commercial community (especially among repatriated Afghans) who feel that compliance with principles of *Sharī'ah*, particularly when trying to enforce contractual obligations, is not necessarily an attractive legal attribute for merchants: "Here, they come at you with the *Sharī'ah*, which kills you." It is no wonder that, balanced against concerns that the new laws are being pushed through too quickly in the interests of elevating Afghanistan to the international market place without paying sufficient attention to *Sharī'ah* compliance, many Afghan business leaders and international consultants view this as an emergency situation, and believe that "it

is more important to get new commercial laws on the books now and worry about *Sharī'ah* issues later."²⁶

Implementing Institutions

As indicated above in this Report, the **Ministry of Justice** plays a key role in the process of drafting and scrutinizing legislation through its legislative drafting unit, the **Taqnin**. The Taqnin is charged with not only ensuring that proposed laws are consistent with and in furtherance of *Sharī'ah* and, in particular, *Hanafī* jurisprudence, but it is also responsible for the overall "development of legislative affairs in accordance with the principles of the Islamic Republic of Afghanistan."²⁷ The Taqnin has seven professional departments that are divided according to specialized areas of law, including a Department of Civil and Commercial Laws. There is no department specifically tasked with considering *Sharī'ah* issues -- that is left to each department's own review. On occasion, members of the Taqnin will consult with the Afghan Council of 'Ulamā' on issues of *Sharī'ah* compliance.

In addition, it is reported that President Karzai has recently created and begun appointing members to a nine-member commission which will also review draft legislation specifically for *Sharī'ah* compliance. No further information regarding such a commission was found, and it is unclear whether this is an executive commission or within another branch of government, such as the judiciary.

Other sections of this Report (especially those addressing Commercial Dispute Resolution and Court Administration) describe the lack of capacity in the **courts** to handle commercial disputes, as well as the significant lack of confidence by Afghans in their **judiciary**. One of the problems perceived by Afghans (and the international community alike) is that the courts are not reliable and are susceptible to corruption. As was succinctly reiterated by several Afghan academics on different occasions, the Afghan

²⁵ Interview in Kabul conducted on 10 February 2007.

²⁶ View expressed by an international consultant during an interview in Kabul, 03 February 2007.

²⁷ The Islamic Republic of Afghanistan Ministry of Justice website <<http://www.moj.gov.af/taqnin.html>>, last accessed on 28 February 2007.

people do not believe in the legal authority of the courts.²⁸

Another perceived problem beyond that of fundamental legitimacy, however, is that the formal *Qanūn* that ought to be applied by the courts are not well-known to or understood by litigants, lawyers, and judges. In other words, formal law itself may hold little relevance and little meaning in the resolution of disputes. Instead, the courts and other dispute resolution bodies (such as the tribal elder councils known as *jirgas* and *shuras*) appear to fall back on principles of *Sharīah* and customary or traditional law – especially, of course, in those situations where it is perceived that the *Qanūn* are silent on an issue and in questions of legislative interpretation. As pointed out repeatedly during various interviews, the popular Afghan view is that the *Qanūn* are “against *Sharīah* and customary law,” “people have more faith in a blend of *Sharīah* and customary law,” and “the spirit of the law [*Sharīah*] is more important than the letter of the law [*Qanūn*].”²⁹

During interviews with judicial personnel in the **commercial courts** and other judicial offices, it was difficult to unequivocally determine whether they tend toward application of *Sharīah* over *Qanūn* or vice versa. On the one hand, judicial officers are eager to point out (to Americans, at least) that their commercial laws are secular, “modern,” and “just like those in the West”.³⁰ On the other hand, one commercial court judge stated that “the rules (*Qanūn*) and *Sharīah* belong to each other,” without distinction; that the judges are trained to review *Sharīah* authorities; and that the judges will consult with each other on *Sharīah* issues that arise.³¹ In fact, in the appellate courtroom (where certain commercial cases are heard as a matter of first instance, as well as commercial appeals) there is a *Sharīah* law clerk as well as a secular law clerk, although the respective roles of these law clerks are unclear.

Interestingly, at least two-thirds of the current judiciary and at least half of the public prosecutors in Kabul are graduates of the **Faculty of *Sharīah* at Kabul University**. Traditionally and still today, graduates from the secular **Faculty of Law and Political Science at Kabul University** become administrators in the courts, lawyers, or members of diplomatic service. And it appears that this proportionate breakdown of career paths from the two faculties is typical of other universities in the country that have *Sharīah* and law faculties.

Moreover, within the **Afghanistan Supreme Court** itself, there is also a **Fatwā Department**, whose jurisdiction is the issuance of *fatāwā*³² upon request by the various judges, including the issuance of *fatāwā* in commercial cases. An example given by the head of the *Fatwā* Department during an interview was the issuance of a *fatwā* regarding whether a company engaged in manufacturing and distributing a tobacco product should be issued a license and permitted to do business in Afghanistan, according to *Sharīah* and, particularly, *Hanafī* jurisprudence.³³ Interestingly, it is estimated that the two Afghan commercial courts currently might hear an average of 150 cases per year and that *fatāwā* are requested and issued in 10-20% of those cases.

Supporting Institutions

As discussed above, the study of *Sharīah* and its application in the laws (including commercial laws) of Afghanistan is within the province of the various faculties of *Sharīah* in Afghanistan's reportedly eight or nine public universities. A criticism of the *Sharīah* curriculum by some legal scholars is that it is geared entirely toward Islamic studies in a very general sense, rather than toward law and jurisprudence (be that *Hanafī* or otherwise). In **Kabul University**, for example, from among 48 listed subjects taught by the *Sharīah* faculty, fewer than half even arguably relate

²⁸ Interviews with academics from Kabul University in Kabul during 04 February - 07 February 2007.

²⁹ Id.

³⁰ Interviews in Kabul on 05 February 2007.

³¹ Id.

³² Plural of *fatwā*, a non-binding Islamic legal opinion issued by a well-respected high-level Islamic scholar, based upon the rigorous methodology described previously in the Introduction, above.

³³ Interview in Kabul on 12 February 2007.

directly to law, with the remainder addressing such topics as “Commentary of Islamic Perception,” “Arabic Grammar,” “History of Islamic Civilization,” “Islamic Philosophy,” and “Mysticism.” Many in the legal community express concern that the judges and lawyers being trained in this faculty are not being taught Afghan law – whether that is viewed as *Sharīah*-based or otherwise – and they are especially not being taught subjects relating directly to the *Qanūn* and commercial laws that Afghans are likely to encounter in modern and international trade. Similarly, it appears that students enrolled in faculties of law and political science are not being taught enough law, either, and especially are lacking in any meaningful training regarding *Sharīah* and the *Hanafī* or other jurisprudence which informs the Afghan legal framework.

It is interesting that, despite an apparent lack of consistent attention to *Sharīah*-based commercial law reforms, a strong and growing institutional support for *Sharīah* principles in commercial law is rising out of **the banking and finance sector**. In particular, there has been a considerable increase in so-called Islamic banking and Islamic finance, with such banks as the Abu Dhabi-based Bank Alfalah and the Afghan Azizi Bank, as well as FINCA Afghanistan, experiencing enormous growth in offering *Sharīah*-compliant products and services. These services and products avoid, among other things, the earning or payment of interest (*riba*), uncertainty (*gharar*), and speculation (*qimar*), and they seek to promote ethical commercial practices. While some Afghan businessmen interviewed did argue that conventional commercial practices such as the charging of interest in commercial (as opposed to consumer) credit transactions is not in conflict with *Sharīah*,³⁴ the sharp upward growth of Islamic banking in Afghanistan – including Islamic commercial banking – is an indication that *Sharīah* compliance is a prominent concern. In

³⁴ This is an issue which is debated widely, with some Afghan businessmen arguing that only excessive interest or consumer interest is forbidden in Islam, while others see that argument as fallacious and self-serving, relying on specific Qur’anic passages to the contrary, such as verses 278 and 279 of Surah Al-Baqarah. Indeed, those in favor of such practices as charging interest in credit transactions argue that “it is not only allowed [under *Sharīah*] but necessary in a modern context in order to make capital available.”

fact, a significant number of Afghan businessmen interviewed also indicated that – although the Afghan marketplace still operates almost entirely on a cash basis – in credit and banking matters, they will only utilize Islamic banking and finance.

Social Dynamics

As explained during an interview with the head of Islamic banking in the largest foreign bank in Afghanistan, a “very fundamentalist population” exists in Afghanistan, and it was necessary to introduce Islamic banking and finance because no one will take out loans and engage in banking transactions unless these transactions are *Sharīah* compliant. Even in the case of conventional banking, that particular bank reports that 80% of its deposit accounts are non-interest bearing, because its customers do not want to receive interest in violation of *Sharīah*. And although the move from a purely cash economy to a more modern credit and finance economy is slow – even in the context of large commercial transactions (one businessman, for example, explained that he buys heavy road construction equipment and materials with cash only) – *Sharīah* compliance appears to be a growing concern among at least the middle tier of businesses and the overall Afghan population.

In a country where the judges are trained in *Sharīah*, where the government leaders are careful to pay at least lip-service to *Sharīah*, and where the various legal and financial institutions significantly consider *Sharīah* in various contexts, it appears that the overall social dynamic is one in which *Sharīah* is an important factor. This is true especially if, as predicted in the International Commission of Jurists Report referred to above, “any attempt to implement and enforce secular statutory laws which depart from customary and/or particular interpretations of Islamic law is liable to be met with protests and perhaps even civil unrest.”³⁵

³⁵ Martin Lau, “Afghanistan’s Legal System and its Compatibility with International Human Rights Standards: FINAL REPORT,” available at <<http://www.icj.org/IMG/pdf/doc-51.pdf>>, last accessed on 27 February 2007.

Recommendations

- International donor organizations and other NGOs involved in commercial law reform must take account of the strong traditions in *Sharī'ah* and customary law in order to give commercial laws and supporting institutions clear legitimacy, especially outside Kabul.
- International donor organizations and other NGOs involved in commercial law reform should engage in consultation with Afghan *Sharī'ah* scholars and clerics, respected Islamic scholars, and clerics from other Islamic countries, especially as a counter-balance to extremist Islamic interests in Afghanistan and in the region.
- International donor organizations and other NGOs involved in commercial law reform should engage in consultation with Afghan *shuras* and *jirgas* to determine whether there are any commonalities in regional/provincial laws that should be taken into account in commercial law reform.
- The court system should be structured to ensure the appointment and meaningful training of judges who are familiar with and sensitive to issues of *Sharī'ah* (including both *Sunni* and *Shi'ā madhahib*) and – especially – customary law, and who have reputations for integrity. Consider a judicial nominating commission that makes recommendations to the President, with greater transparency and an opportunity for input by the public, legal community, and '*ulamā*'.
- A special judicial training program should focus on the prominent *Sunni* and *Shi'ā madhahib*, as well as Constitutional law, civil law, judicial ethics, and legal issues specifically involving women (i.e., unlawful gender inequality and the status of women in Islam). This should supplement, not replace, better cross-curricular studies among the faculties of *Sharī'ah* and faculties of law at Afghanistan's nine relevant universities.
- The customary laws of the Afghanistan should be better studied and compiled, where possible, perhaps in coordination with or input from Provincial Reconstruction Teams and NGOs working at the local level. Those laws should be taken into account in the drafting of commercial legislation in order to ensure greater implementation and support in areas outside of Kabul.
- Closer/better coordination among various donor organizations and NGOs in addressing the priorities set forth in these recommendations, especially in ensuring *Sharī'ah*-compliant and customary law-sensitive legal drafting and institutional reforms.
- Better coordination among the Ministries and others involved in legal reforms within the Afghan government, including a greater sensitivity to ensuring *Sharī'ah*-compliant and customary law-sensitive legal drafting and institutional reforms.
- A special judicial training program offered to the *shuras* and *jirgas* in order to acquaint them with the *Qanūn*.
- The *shuras* and *jirgas* should be incorporated into the formal legal system, as courts of first instance (similar to magistrates or small-claims courts), with clearly defined jurisdiction and a right of appeal to the national court system. This step will:
 - Add greater legitimacy to the national courts;
 - Create more clearly defined equal access to justice and human rights for all Afghans – especially women and children,
 - Provide some uniformity and state control over these provincial "courts," and in turn a more predictable and stable legal environment for rural economic rehabilitation and growth;
 - Serve in a role that is similar to the *Sharī'ah* courts of many other countries with Muslim-majority populations.

COMPANY LAW AND CORPORATE GOVERNANCE

Introduction

Company Law is crucial in market economies; it sets the legal environment for the creation and continuing operation of privately-owned businesses. *Good* Company Law is especially critical in transition-economy countries. It can encourage entrepreneurship by making it easy to start up and register a company; it can encourage businesses to come out of the underground economy into the publicly-registered taxpaying economy; and it can encourage new investment – and provide investor protection – by setting forth clear and objective rules for a company's ongoing internal governance.

Afghanistan is expected to have a new Company Law as of March, 2007. The new law contains some corporate governance principles for corporations that, on paper, follow some international best practices for investor protection and encouragement of investment. Those provisions were taken from current U.S. corporation laws. The new law's provisions for limited liability companies – which represent the vast majority of Afghan companies – are not available at this time. They should be made flexible to fit the needs of small companies and closely-held companies large or small. Local Afghan consultation and input into the new law can make it stronger, better known, and more widely accepted.

Afghanistan's procedures for new company startups have been somewhat inconsistent and sometimes costly; the new law does not address these problems. Among other things, starting a significant new business in Afghanistan often requires approvals other than company registration, and getting these approvals is often a lengthy, difficult, costly, and unpredictable process. This Report recommends that the company registration process be taken out of the courts and other bodies and given exclusively to an independent

and streamlined central registry agency that has “one-stop-shop” authority with respect to all regulatory licenses. That agency could reside within the Afghan Investment Support Agency (AISA) or exist as an entirely new governmental body. Other transitioning countries provide successful models. Afghanistan also suffers from a lack of disclosure and public recordkeeping of information on companies. The new central registry also offers an opportunity to address these problems.

Legal Framework

A. A New 2007 Company Law

Until now, Afghanistan's company law has been part of its 1955 Commercial Code (Articles 116-470). That old law has been adequate for business conditions to date, but it must be updated. Recognizing this, in August 2002 the Ministry of Justice authorized an American Bar Association (ABA) -affiliated group to review and suggest revisions to the old company law along with several other commercial laws. That process resulted in an August 2003 draft replacement company law prepared by U.S. lawyers working as unpaid volunteers. A version of that draft was signed by President Karzai on January 28, 2007 and, at the time of the in-country portion of this Diagnostic, presented to Parliament for acceptance or rejection. If Parliament accepts, it will become law. Acceptance is expected, although last-minute changes are still being made to the text and an important part of the law was not available for review for this Report.

I. Overview of the New Law. The new law pulls the Company Law out of the Commercial Code and breaks it into two new freestanding statutes: (1) a “Corporations and Limited Liability Companies Law,” which governs those two company forms, and (2) a “Partnership Law,” which governs the partnership

form. The new law generally follows the pattern of the old law but it adds new provisions for the corporation form, including new detail for corporation board and shareholder meeting procedures and dissolution of corporations, and new corporate governance provisions for corporations. The new law, like the old, provides three basic company forms: corporations, limited liability companies (LLCs; these are called “limited companies” in the English translation of the old law), and partnerships.

Worldwide, the LLC form is usually considered best for small and closely-held businesses, which is what Afghan companies overwhelmingly are. As in a corporation, the owners of an LLC are not personally liable for the company's debts, but an LLC has more flexibility and fewer formal constraints than does a corporation. This is largely because the corporation form is designed to accommodate large companies with an unlimited number of shareholders, including passive investors who need more formal protections. In many countries, including the U.S., LLCs are close to partnerships in their governance flexibility. The difference between LLCs and partnerships rests in liability: in partnerships, the owners (partners) are personally liable for the company's debts, whereas in LLCs they are not.³⁶

2. Corporate Governance Provisions in the New Law. The corporations section of the new Company Law introduces U.S.-style corporate governance provisions as found in U.S. Delaware law and the ABA Model Business Corporation Act.³⁷ These replace corporate governance provisions in the old Afghan company law that had covered much of the same ground but were simpler (and were themselves fairly strong). The new provisions include a requirement that conflict-of-interest dealings between a corporation and a director must receive prior approval of non-

³⁶ To be complete in this description, there are also *limited partnerships*, in which one or more partners do and one or more partners do not, have personal liability for the company's debts. Both the old and the new Afghan company laws permit limited partnerships, but limited partnerships are perhaps not needed at all in Afghanistan.

³⁷ That is a model law drafted and continually updated by an ABA committee of experts. Its text has been largely adopted by about half of the 50 U.S. states.

conflicted directors or shareholders or be “established to have been fair to the corporation” (Articles 66-69); that directors have duties of care and loyalty which are worded in U.S.-style language that has been extensively interpreted in U.S. courts particularly Delaware courts (63); and that a corporation may indemnify a director, officer, employee, or agent (including for the person's legal fees) when the person is sued by shareholders for wrongdoing (74). The new provisions contain more detailed requirements than the old law for shareholder derivative suits, i.e., court lawsuits brought by shareholders in the name of the corporation against misbehaving directors (64). In addition, the new law states that directors of a corporation can be held personally liable if their decision to pay shareholders dividends renders a corporation insolvent (65). The old law does not have such a provision.

At the same time, the new law contains provisions that are not generally harmonious with international corporate governance best practice and that may discourage new investment (particularly foreign and institutional investment). Some of these provisions, identified in this Report's section on “Suggestions for Revision of the New Company Law,,” include: permitting a corporation to restrict free transfer of its shares (this is not appropriate in widely held companies); permitting a corporation to limit the votes which a shareholder may exercise at shareholder meetings (this is counter to the “one share one vote” principle); allowing directors to set their own pay and length of term in office terms without shareholder approval; permitting a corporation to require shareholders to show “cause” when replacing a director; and permitting a board of directors to delegate its powers to a committee.

3. Issues in Drafting and Enacting the New Company Law. A draft of the new law has been in progress for more than three years. Two features of that process are notable: the general lack of local Afghan consultation and input, and the on-and-off review and drafting process within the government itself.

Regarding the first of these, the draft was written by foreign lawyers who did not spend substantial time in

Afghanistan and received little (or no evident) review or input from Afghan companies, businesspeople, or professional persons such as lawyers, accountants and judges. Local actors, including a ministry senior lawyer and lawyers who represent a major Afghan company, reported that they are unaware of the new law or its contents, that they have not seen a draft of it, and that they would like to have had – and would now like to have – substantive input.

Local consultation over time could have obviated the need for the last-minute changes that must now be made. Also, it is probable that Afghans themselves would have advanced some of the “Suggestions for Revision” if they had been consulted in the drafting stage. As a general point, local consultation, input, and “buy in” produce laws that are both more practical and better accepted.

Based on interviews for this Report, the process in the government might be described as “hurry up – wait – hurry up again.” The original draft was submitted in 2003; it was largely untouched until 2007; and it was then signed in haste without a final text. Waiting time could have been used for local consultation, while hasty enactment left insufficient opportunity for the two ministries involved – Commerce and Justice – to communicate and coordinate their work carefully.³⁸

As stated in the Recommendations below, a process of user consultation would seem advisable now, before the new law is finalized and made effective. There may be no loss in doing that since the old law – while indeed needing an update – functions adequately under today's circumstances.

³⁸ There is a regulation of the Ministry of Justice stating the process under which the text of a new draft law is to be prepared by a primarily-responsible ministry (in this case the Ministry of Commerce), and then submitted to the Ministry of Justice for final scrutiny. This scrutiny is done by a legislative review body in the Ministry of Justice called the Taqin. As indicated above, with the new company law the Taqin process involved back-and forth last minute changes in haste. The Ministry of Justice regulation is entitled “Regulation Governing the Procedure for Preparing and Proposing Legislative Documents.”

B. Profile of Afghan Companies

All or almost all Afghan companies are family – or otherwise closely – owned. Most of the smallest Afghan businesses are not companies but sole or family proprietorships. These businesses have little or no reason to register as companies: limited liability has little meaning for a small-scale business when their business is conducted on a personal basis and court lawsuits are virtually unknown. Interviewees stated that the municipalities are the main regulatory body for these businesses and that they live in fear of local municipal authorities “hitting” them for alleged infractions of local rules and bribes.

The largest company that was interviewed, a major provider of telecommunications, has three shareholders. There is no stock exchange or other mechanism with an open or liquid market in share trading, although there should be a future need for this, as several interviewees pointed out. Persons who wish to buy or sell shares in a company do so privately.

Many important Afghan companies are owned or controlled by the state, which adds a political tone to doing business. State-owned companies are not organized under the Company Law and thus are not subject to its rules and protective provisions. The government has an active and commendable program supported by USAID and implemented by Emerging Markets Group for privatizing state-owned companies. In most cases, this is being done through liquidation and asset sale because most of the companies are not salable as going concerns with existing liabilities. The few companies that are salable as going concerns will be “corporatized” (reorganized as corporations under the old or new company law), and their shares sold as equity interests to private investors. This has already been done with three companies.

C. Company Registration, Startup and Licensing

In Afghanistan, a company is created and begins its existence by registration with the commercial court, which takes one or only a few days. On this particular step, the “creation” step, the World Bank 2007 Doing Business survey placed Afghanistan near the top (at 17th) of the 175 economies it surveyed. Formal

company creation, however, is only one step in starting a business, and investors rarely accomplish this directly with the commercial court. Most companies require a “facilitator,” an investment license, and industry-specific licenses. A significant-sized investor first acquires a facilitator, depending on the business type. If the business is trading, the facilitator will be the Ministry of Commerce and Industry (MoCI). If the business is “other than” trading, the facilitator will be AISA. There is no logical reason for this split jurisdiction and the definitional boundary between trading and non-trading is not clear in the law.³⁹ Nonetheless, both the MoCI and AISA abide by this split.

The MoCI and AISA are “facilitators” – they provide services typically rendered in other countries by lawyers, paralegals, or accounting firms. Each agency handles forms and other formal requirements for registration with the commercial court and gets the new company registered there. (Indeed, the commercial court requires a letter from the MoCI or AISA to register a company.) The formal requirements for registration include getting a clean police record clearance, acquiring a tax identification number, and posting for publication in the official gazette, with documents certified by providing a photograph or a thumbprint (no notarization is required). The MoCI and AISA also require the investor to obtain an investment license, which those organizations themselves can grant. AISA’s service fees, which vary according to company size, can reach several thousand dollars.

All interviewees stated that both the MoCI and AISA are prompt and efficient with these services. Each is an effective “one-stop shop” for handling a company’s initial registration and investment license. There is no evident reason, however, why a separate investment license should be required (with a significant fee in AISA’s case) in addition to the company registration, and no reason why the registration itself should be in a third body, the commercial court.

³⁹ The MoCI’s regulation on this subject states that the type of business covered “includes, but is not limited to, trade,” but interviewees stated that in practice the Ministry has interpreted this to cover only import and export trade.

This system leaves – between the cracks – many small companies whose registration and emergence from the underground economy are desirable. They can only register by trying to go themselves to the commercial court, and they have little motivation to do this.⁴⁰

D. Further Permits and Licenses

Company registration and investment licensing are only a first step; they do not reduce the need or time for separate approvals that are mandatory in Afghanistan for an overly-long list of specific activities. These include banking, freight-forwarding, security guard, insurance, insurance agency, private university, travel agency, tourist accommodation, animal clinic, film producing, printing, pharmacy, hotel and restaurant, construction, electricity connection, medicine import, animal medicine import, land transfer, building, mining, health care, construction, tourism and commercial agriculture.

Every interviewee on this subject remarked that the processes for getting these permits and licenses are lengthy, arbitrary, unpredictable, and/or very expensive. One commented that he acquired his investment license from AISA in a few hours but has been dealing with a ministry for a sectoral license for over a year “and it is still not resolved.” Another stated that that he also got his investment license immediately, but has since spent \$5,000 and four months dealing with sectoral agencies “and now they want to shut me down.” Some sectoral licenses are clearly justified for health or public safety purposes, but many or most of those which are required have no evident public purpose. There is no standard form or uniform procedure for these approvals; each ministry and other agency has its own rules and approach, often unpublished and opaque; and the ministries and other agencies do not always communicate with each other. Some of these approvals are required as a precondition

⁴⁰ To be precise, the MoCI will handle registration of a company of any size but – as pointed out above – it will handle only companies in import-export trade. On the other hand AISA will handle companies only over a certain size, which leaves small companies which are not in import-export trade with no way to come out of the underground economy, since the court requires a letter from the MoCI or ASIA before it will register a company.

for a company's initial registration with the MoCI or AISA, which means that a startup business cannot even take normal organizational steps until it has received these approvals. This is not a newly noted problem. Details and other very negative features of this system were described in a 2006 independent consultancy report to the MoCI to which reference can be made for more detail.⁴¹

E. Information on Companies

There is a shortage of statistical and other information on Afghan companies, and what does exist is not easily available publicly. Efforts were made to obtain, for example, breakdowns of companies by type of business (such as by industrial classifications as used in the U.S.), size (by any rough measure such as capital, total sales, or number of employees), number of shareholders, number of companies which are foreign-owned vs. domestically-owned, number and names of companies which are linked in common ownership, names of company directors, addresses and contact information for companies, etc. Information of that kind is sought by potential investors and it can be essential for assessing corporate governance needs of Afghan companies.

The best source for information of that kind was AISA, which retains much of such data for the companies which it has arranged to register (which, as stated below, is not all Afghan companies but does include most companies of significant size). AISA's data is not publicly filed or website-available (as such information should be), but on request it was provided for this Report on a CD after a day's preparation time. AISA clearly does not keep such data confidential and it was offered without hesitation when requested, but it should be noted that is not easily available publicly. AISA's data shows that the overwhelming majority of companies are "limited companies" (which would be LLCs under the new company law); perhaps 5-10% at

most are corporations or partnerships. This makes it all the more important for the LLC provisions in the new law to be clear, modern and flexible.

The MoCI also maintains a database on the trading companies which it has arranged to register, but an apparently force majeure event forestalled viewing it for this Report and interviewing the MoCI officials who administer it. Other interviewees stated that it maintains the records in regional offices throughout Afghanistan and transfers them periodically to Kabul. The commercial court also has records of the companies it has registered, but these are reportedly not kept separately from its records and decisions on other matters.

Implementing Institutions

As described above, the **Ministry of Commerce and Industry** (MoCI) arranges the registration of trading companies with the commercial court, issues an investment license to trading companies, and maintains a database of information on the companies which it has helped register.

There is no ongoing company regulation or monitoring such as is provided in other countries by bodies such as securities commissions, stock exchanges and similar agencies, or by shareholder groups.

The **Afghan Investment Support Agency** (AISA) arranges the registration of most registered companies other than trading companies with the commercial court, issues an investment license to those companies, and maintains a database of information on them. AISA is the primary and best investment-information and investment-support body in Afghanistan. Its staff is knowledgeable and user-friendly, and it is a good helper for significant-sized potential investors, not only for company registration but for navigating the system generally. It has an attractive website. It would also be a likely vehicle for a future "one-stop shop" overseeing the process of a company's getting specific industry and sectoral licenses. It would undoubtedly also be a good source for comment on the text of the new company law.

⁴¹ *Initiative for Regulatory Reform to Enhance Private Sector Development in Afghanistan: An Investor Roadmap* (October 2006), addressed to the MoCI and prepared by Adam Smith International (funded by the British Department for International Development (DFID)). The report was based on information provided by the MoCI, AISA and other concerned Afghan institutions and persons.

The **commercial court** is the institution that registers (creates) new companies. It maintains records of its registrations, mixed in with other case and court-decisions records.

Supporting Institutions

The **Afghan International Chamber of Commerce (AICC)** is an active and useful information source and advocate for private companies and investors. It should also be a good source for comment on the new company law.

Donors, particularly USAID and DFID, have been active in supporting and helping with company law, registration and licensing reform. Particularly active are the USAID Economic Governance and Private Sector Strengthening project implemented by BearingPoint, which directly assists the MoCI and has been of great help in connection with the text of the new company law and company license reform; and the Afghanistan Rule of Law project which tracks the legislative status of pending laws. As stated above, DFID funded the Investor Roadmap which analyzed the problems of the licensing process. The German GTZ assists AISA, but time constraints did not allow for interviews with GTZ.

The **Ministry of Justice** has responsibility for reviewing new draft laws which come from other ministries and it has participated in drafting the text of the new company law.

In most countries including transition countries, **independent lawyers** and other professionals are necessary and helpful for advice on company registration, corporate governance, and investor disputes. Interviewees reported that, in Afghanistan, there is not an active **independent bar** or **accounting profession representing** private clients in such matters. One interviewee said that “there is not an environment for that here.” The input of such professionals would, however, be helpful to support and comment on the new company law, and on improving registration and company licensing procedures.

The **courts** are the ultimate legal recourse for resolution of company disputes. In general, however, the courts are viewed as slow to decide and lacking in company and business expertise and in independence and thus, as a practical matter, not very useful.

Social Dynamics

There is a demand (market) for a more modern company law, which was recognized in 2003 by the Ministry of Justice assisted by American Bar Association volunteers, and which has also been recognized by the MoCI and donors. There is a great demand for efficiency and transparency in the granting of approvals needed for a company's full operation and for disclosure and information about Afghan companies; and there will be a future now-unmet demand for advice, training and education with regard to investor rights and corporate governance.

Thus far the drafting of the new company law has come largely from the outside, but local actors have expressed a desire for input and that would be helpful. On other matters, AISA is particularly helpful and eager to help more. Overall, there is great local awareness and demand for participation in the process. The need is for organization of local resources to meet that demand.

Recommendations

- Revisit and revise the text of the draft company law using input from:
 - an expert who has time to dedicate to the task and has practical experience in both drafting company laws and using and advising businesses on them, and
 - selected Afghan users of the company law including lawyers (both independent and in-company), businesspeople (including both entrepreneurs and company directors), other professionals including accounting firms, and judges, and organizations such as AISA and the Afghan international Chamber of Commerce,

taking account of, among other things, the suggestions in the Annex below.

Adequate time should be taken for this; undue haste can frustrate the process.

- After the law becomes effective with a final text, hold meetings and workshops throughout the country with regional, business, professional and other concerned persons covering:
 - training and education in the law and company procedures and corporate governance best practices in general, and
 - soliciting suggestions for continuing amendment and revision of the law.
- Consider establishing a committee of government and private practitioners with the stated task of regular review and updating of the company law and corporate governance practices. This can be donor-supported but should not be donor-run or controlled.
- Establish a single central company registry (although with regional branches) which combines, consolidates and fills the gaps in the current three-institution system of the MoCI, AISA and the commercial court. That registry could be established in AISA or the MoCI, or it could be a new government body. If it is in AISA, it should be separate from AISA's advisory and investment promotion function. It should not be in the commercial court; the court should be removed entirely from the company registration process.⁴² The new central registry should among other things:
 - make registration quick and cheap with fees which are publicly posted and the same for all companies; provide simple printed forms that any small

business can use without a lawyer or facilitator; and register (create) a new company without regard to whether the company needs later licenses for specific activities;

- maintain all the data and information about companies referred to above and make it available to anyone free; and
 - have an attractive website with its governing laws, procedures, fees and forms, and company data of the types described above, all clearly displayed.
- Establish a single, central, "one-stop shop" for all business permits and licenses. This could be established in AISA, which already has a "one-stop shop" for company registration and investment licensing steps (but not for sectoral licenses). It should have the power to coordinate the process of obtaining all licenses from each ministry or other agency, and all such bodies should be required to provide it in writing with their procedures, forms, fees, contact persons and contact data, and time frames and deadlines, all of which it will publish and make personally available to any person requesting it. To the extent possible the procedures and time frames for all licenses should be the same. In this connection:
 - Consider eliminating the requirement of a separate investment license as now issued by the MoCI and AISA; and
 - Eliminate sectoral licenses which have no good purpose. Clearly some licenses have a good purpose such health and safety. Reconsider, however, the license requirements for most of the activities listed above which now require licenses.
 - Establish procedures for greater collection and dissemination of data on companies such as the data listed in "Information on Companies" above. Some of this data can be collected when a company registers (for example, identifying its business sector using a standard industrial code system). The information could then be posted on the appropriate agency website.

⁴² It is recognized that reorganization can involve practical issues of inertia, turf and politics. It is also recognized that it would require reducing AISA's current (sizable) fee for registration which is now actually used to fund not only registration but also other AISA activities such as investment promotion. Other countries have accomplished similar reorganizations and can be used as examples. Two recent ones are Serbia and Macedonia, in both of which company registration was removed from the courts (who resisted the move) and a new independent agency such as described above was created. Their experiences and laws on the subject can be borrowed from and, to some extent, copied.

Annex: Specific Suggested Revisions of the New Company Law

The following suggestions are made with regard to the text of the new company law:

General Provisions (Articles 1-16)

- Clarify the status of companies already organized under the 1955 law -- for example, whether they continue under the old law, whether they must re-register and by what date, and whether they must reorganize if that is necessary to comply with the new law.
- 3(c): Eliminate the concept of legal capital from the law. It is undefined, confusing, outdated and not meaningfully used elsewhere in the law (see e.g. 17, 20(b), 88, 98, 109 and 112). Many countries have eliminated capital for those reasons, and because it does not protect either creditors or shareholders in any event.
- Regarding the Central Registry provisions of the new law: State the duties, jurisdiction, governance, responsibilities, fee-setting and collection, certificate-issuing, public-record-keeping and other powers and obligations of the Central Registry (see Arts. 3(f), 4, 15, 16, 31). See Recommendation 4 above.
- State clearly that a company can begin its existence (and with limited liability) before it obtains all necessary industry permits or pays later-assessed fees (see Art. 14). This is important for getting a company started and organized pending the long delays in getting sectoral licenses.
- To improve financial reporting and transparency and facilitate companies' obtaining of credit in general, require in the new company law that all companies over a certain size, regardless of form, must have independently-audited financial statements prepared at least annually. (The size itself should be determined with local advice.)

Corporations (17-129)

- 29: Do not permit widely-held corporations to issue shares for future services that a person might or might perform.
- 34(b): State that directors may be elected at any properly-called shareholder meeting, not only the annual meeting.

- 34-35 and 61(2): The number of directors and their terms should be stated in the shareholder-approved Articles of Incorporation (not set by the directors themselves) and should expire at each annual shareholder meeting, although with no restriction on a director being reelected.
- 37: Revise. The shareholders must always be entitled to remove a director when they believe it is in the company's best interest without having to prove "cause" (which is undefined in the new law anyway).
- 62: Revise to state that the board may not delegate all of its authority to a committee. Decisions of a committee should be subject to approval by the whole board, who were elected as a whole by the shareholders.
- 63(d): Correct this statement of the business judgment rule to state that it applies only to business judgments, not to any action or failure to act whatever.
- 67: Revise this broad exculpation to state that covers only liability for breach of the duty of loyalty, *not* all liability whatever. Also delete 67(b)(2) since it is subjective and, realistically, would not be decided in Afghanistan by U.S.-type independent courts in response to a shareholder challenge. It is better to keep the standards simple and objective.
- 66-69, which cover directors' duties: Look again at Articles 311-13, 320-24, and 326-27 and 329 of the old law and keep some of those. Many of them are simpler and more objective and do not depend on U.S. case law to be understood. They also cover some ground that the new law does not.
- 70: Require independently audited financial statements in widely-held companies; see above.
- 71: Revise to state that the compensation of directors is always subject to shareholder approval (except perhaps in rare cases where that is not feasible).
- 74: It is suggested that this U.S.-style indemnification is not appropriate in a transition country such as Afghanistan. See comments on 67 and 66-69 above.
- 98(a): This would allow a company to disenfranchise or restrict voting rights of selected shareholders. Revise it to state that a company may have only one

class of common stock and that every share has one vote.

- 101(b)(3) and 102(b): For shareholder protection (particularly in a transition country such as this) directors should be elected by a majority, not a plurality of shareholder votes.
- 111: Also for shareholder protection, expand these special shareholder vote procedures to cover other major actions such as merger, sale (stripping) of major assets, dissolution, etc.
- 115: Revise to state that a widely-held company may not restrict a shareholder's right to sell his shares. Restrictions should be permitted only in closely-held corporations, LLCs and partnerships.
- Consider adding provisions for items found in other corporation laws such as for right to information, preferred stock, merger, and treatment of foreign corporations.

Limited Liability Companies

The text of the LLC part of the new law was not available. However, the LLC form should be the best form for almost all Afghan businesses. It should be easily usable by the smallest businesses with no need for a lawyer, or – at the other end of the scale -- by large closely-held businesses including international joint ventures whose owners can custom-negotiate an LLC agreement among themselves. To serve this need and to conform to LLC laws in other countries, include the following:

- Make clear that an LLC's members – unlike in a corporation -- may structure its governance as they wish – e.g., the LLC could give all members equal management authority, or it could name certain persons as managers, or it could have a formal elected body like a corporation's board of directors. However, there should also be a “default” provision that specifies the structure if the members do not agree otherwise (it could state, as in the old company law, that they have equal authority).
- Allow an LLC's members – again, unlike in a corporation -- to share votes and share profits as they wish – e.g., equally, on a family basis, in proportion to their capital contributions, or on some other agreed basis. Again, the law should state how such things are shared if the members do not agree otherwise (it could state that they share equally in that case).

- Allow an LLC – by agreement of the members -- to impose whatever restrictions on sale of shares they wish – e.g., free transferability (no restrictions), transferability only to family members or other company members, requirement of a first offer to the company or to existing members, etc. However, the law should state how transfer is restricted if the members do not agree otherwise (e.g., it would restrict transfer to inheritance or transfer with 75% member approval as is stated in the current law), and
- Provide that decisions in an LLC are made by majority voting power except that certain very major decisions require unanimous consent – such as admitting a new member, amending the charter, sale of the company's assets, merger with another company, etc. However, the law should also allow the members to vary even those requirements.

Partnerships

The new partnership law is similar to the old one, and it can also be a good form for closely-held businesses because it has many flexible provisions worded as “default” provisions that apply unless the partners agree otherwise (see 68). These include the provisions for sharing of profit and loss (13, 18 and 36), appointment of managers (40), partners' control of management (70-71), voting by partners in making decisions for the partnership (43), transfer by a partner of his interest to third parties (73), admission of a new partner (74), and amending the partnership agreement (77).

- Make it clear that partners may be LLCs or corporations, not only individuals.
- 10, 44-45: Extend to partnerships the same fiduciary duties and protections (care, loyalty, conflict of interest, etc.) as are in the new corporation provisions.
- Clarify whether registration is required or a partnership exists automatically by agreement (19, 21, 63 and 82).

Generally, clean up and clarify the drafting of the new partnership law. Among other things the references to “credit partnerships” and “work partnerships” should be made clear or removed.

CONTRACT LAW AND ENFORCEMENT

Introduction

The ability to create and enforce contracts under a clear, consistent legal framework is a critical component of economic growth. Where there is widely held expectation that agreements freely entered into between businesses or individuals will be subject to enforcement by a court or other tribunal, a marketplace can be transformed. Namely, what was once mere hope for performance based on a personal relationship or vague insinuation becomes a legitimate expectation of delivery. When business partners are in fact required to do what they have said that they will do – pay money, deliver goods, provide services, and so forth – risk diminishes and the recipients of a promise can better plan for the future. With decreased risk, the cost of doing business goes down, thereby elevating the private sector's prospects for profit.⁴³

At the time of this Diagnostic, Afghanistan was presumed to be nearing the passage of a new Law on Contracts, the fifth in line among the ten commercial laws prioritized for enactment through the Afghanistan National Development Strategy (ANDS) -initiated system of benchmarks.⁴⁴ Although the draft law is strong and comprehensive – as well as reportedly compliant with the requirements of *Sharī'ah* – there can be no mistake that it remains far from being a truly Afghan law. That is, the development of the new law appears to have involved only minimal engagement of the Afghan legal community.

Thus, once enacted, the impact of the new Law on Contracts is destined to be weak. This will be the case until significant effort is made to educate the legal and business communities in the concepts, obligations, and opportunities the new law presents, as well as to clarify the process for redress when disputes arise. The contrast between the relative simplicity of the new contract law and the old one's complexity, opacity, and unmistakable bias *against* enforcing contracts is stark. Accordingly, the process of teaching lawyers, judges and others to view contracts differently will not be easy.

Fortunately, the draft law itself constitutes a very strong teaching document, with clearly defined terms and principles drawn somewhat from Afghan legal tradition and, to a greater extent, from international best practices. If and when the new law does become integrated into the legal culture and business environment, it will set a vastly improved stage for the creation and enforcement of contracts in Afghanistan.

In addition to a system of private sector contracts, economies benefit from sound and transparent contracting practices by the state. Strong law and enforcement in the area of government procurement can result in increased public confidence in the work performed on behalf of the government and in diminished public risk arising from malfeasance and cronyism. In Afghanistan, a new Law on Procurement was enacted in 2005. Plans for its implementation are more clearly defined than those pertaining to the Law on Contracts. On the other hand, commitment to genuine reform in government contracting is, at this time, underwhelming.

⁴³ See World Bank, *Doing Business 2007, How to Reform* (2006) at 49 (discussing economic benefits that arise from improved systems of contract enforcement).

⁴⁴ Ministry of Justice and National Assembly, *Prioritized Legislative Agenda for 1386 and Legislative Capacity Needs of Ministry of Justice and National Assembly* (January 30-31, 2007), found at <http://www.ands.gov.af/ands/jcmb/src/jcmb4/eng/05%20-%20Moj%20-%20PL%20Agenda%20&%20Annual%20Legislative%20Plan%20-%20JCMB-IV%20Folder%20-%2024%20Jan%20-%20English.pdf>.

Legal Framework

Although contract law in Afghanistan will soon be transformed, an understanding of its current status will assist the process of integrating the new legislation into the business and legal environment. In addition to reviewing the old contract law and its anticipated replacement, this section briefly discusses the role of contracts in customary institutions, as well as the Law on Procurement, another central aspect of contract law in any thriving economy.

A. The Civil Code of 1975

Afghanistan's current law of contracts is scattered throughout the Civil Code of 1975, and embedded chiefly in Chapter Two, Legal Transactions; Part One, Contracts. The Civil Code itself is a long and cumbersome document that speaks to some of the most intimate details of daily life – the home, the family, the marketplace, and beyond. The extent to which the Civil Code's provisions on commercial contracts are actually relied upon in the everyday practice of the courts is not clear. Moreover, the tumult of recent history, coupled with wide illiteracy beyond the capital, has meant that, even after more than three decades, the Civil Code has not had the opportunity to influence the interactions of Afghan society as much as it likely was intended to do.

A close read of the Civil Code suggests that strict adherence to its text, in practice, would likely prove impossible: the existing law of contracts is vast and ethereal, and, as such, hardly conducive to a low-risk marketplace. In its totality, the Civil Code presents an underlying theme that contracts are instruments to be guarded against, rather than enforced according to their terms. More charitably, the Civil Code reflects Afghanistan's tradition of "apology and forgiveness" that can be found throughout its customary law.⁴⁵

The Civil Code's language pertaining to contracts begins with terms familiar to a Western practitioner of contract law. Basic principles such as offer, acceptance, validity, voidability, and others can be found (see, e.g., Arts. 505-533). But, the similarities between Afghanistan's existing law of contracts and conditions familiar to free-market economies are sharply limited. The Civil Code encompasses many principles that are unique, complicated, or contradictory. These include "aversion" to consent to a contract (Arts. 551-561); the "procurator" as an ambiguous, relatively undefined participant in the contracting process (Arts. 534-541); and the belabored notion that some contracts are "naturally non-binding" (Art. 738). In excruciating detail, the Code offers a myriad of paths to forgiveness for those parties who do not meet their obligations. Excuses for non-performance include an "ignorant or neglectful" mindset in the process of contract formation (Art. 546-550); "vitiation" (Arts. 620-636); "suspension" for a variety of reasons (Arts. 637-649); and "options that defer the binding of the contract" (Arts. 652-681). The Civil Code wavers at other instances on the enforceability of the clear terms of certain contracts, stating, for example, that "credence shall be given to objectives and meaning" of the contract, rather than to its "words and letters" (Art. 706).⁴⁶ At points, the contract law wanders into the existential: "Reality," the Civil Code states at Article 724, "can be dispensed by virtue of habit."

The tone and priorities of the Civil Code lean much more heavily to the side of parties that find themselves unable to meet their contractual obligations, rather than to the side of those who would seek to enforce those obligations through the formal court system. Ultimately, Afghanistan's contract law in its current form does exactly the *opposite* of what market-oriented law seeks to do: it institutionalizes a very high risk involved with entering into a contract.

⁴⁵ Amy Senier, "Rebuilding the Judicial Sector in Afghanistan: The Role of Customary Law," *al Nahkalah* (online journal of the Fletcher School, Tufts University) (Spring 2006) at 2. See also Ali Wardak, "Building a post-war justice system in Afghanistan," 41 *Crime Law and Social Change* 319, 327 (2004) (discussing the Pashtun tradition of *nanawate*, which means seeking forgiveness or pardon and the obligatory acceptance of a truce offer).

⁴⁶ As just one example of how implementation of the new Contract Law will require a transformed mindset, this provision conflicts with the incoming provision that "If the wording of a Contract is clear it may not be departed from by way of interpretation to ascertain the intentions of the Parties." Contract Law (in draft form, December 19, 2006) at Article 60(1).

B. The Draft Law on Contracts

Clearly, Afghanistan's old law on contracts is not suitable for the modern economy that the country's government now aspires to cultivate. In 2003 and 2004, U.S.-based lawyers drafted a new law, one of several prepared through the Afghanistan Transitional Commercial Law Project (ATCLP), a joint effort of the Center for International Management Education and the American Bar Association-Asia Law Initiative. In the process, drafters consulted officials within the Ministries of Commerce, Finance, and Justice, and the Judicial Reform Commission. Consultations reportedly included some dialogue over the incorporation of *Shari'ah* principles, although impending Taqin (the legislative drafting and review branch of the Ministry of Justice charged with ensuring that draft laws comply with the "principles of the Islamic Republic of Afghanistan") review will reveal whether its *Shari'ah* compliance is sufficient.⁴⁷

Significantly, since the law was drafted, local lawyers, judges, businesses, law professors, and other critical constituencies have not been consulted about its contents – or even informed about it -- to any significant degree. The new law reflects this lack of consultation insofar as it does not yet provide clear guidance about the process for contract enforcement. Furthermore, the law was not constructed, apparently, in conjunction with a meaningful plan for implementation. In the Afghan marketplace, there continues to be only nominal use of contracts, and those companies that do use them have little appetite for taking disputes to court. How the new law will integrate with this reality has not, evidently, been thought through.

Nonetheless, as of February 2007, the draft Contract Law was reportedly headed for Taqin review and Parliamentary approval, likely to take place in the

⁴⁷ Compliance with principles of *Shari'ah* – for example, the likely inability to charge interest when payment is late – is not necessarily an attractive legal attribute for merchants. "Here, they come at you with the *Shari'ah*, which kills you," asserted one Afghan businessman (formerly based abroad) who is concerned about his ability to enforce contracts.

spring.⁴⁸ It is widely agreed to be a sound law, one that rises to the expectations of international best practices.⁴⁹ The new law is laid out in a series of "Books":

Book One: General Provisions

Chapter 1.	Scope and Purpose
Chapter 2.	Essential Elements & Formation of Contracts
Chapter 3.	Validity and Effect of Contracts
Chapter 4.	Formalities; Conditions; Rights of Rescission
Chapter 5.	Performance of Contracts
Chapter 6.	Rules of Contract Interpretation
Chapter 7.	Modification & Assignment of Contracts
Chapter 8.	Contract Term; Discharge; Premature Termination
Chapter 9.	Breach of Contracts
Chapter 10.	Special Provisions

Book One provides clear definitions of terms (Art. 2) and clearly states that men and women have equal capacity to enter into contract (Art. 9). It states that there are four elements essential to the formation of a valid contract – offer, acceptance, a lawful object, and a lawful cause – and clearly defines these elements (Arts. 11-15). Book One further lists the various other terms that may be found in a contract, including quantity, quality, price, and others, but unequivocally states that these elements are *not* essential for a contract to be enforced (Art. 11). With admirable clarity and brevity, Book One covers a thorough list of circumstances that may arise over the course of a contracting relationship, including conditions for voidability (Arts. 29-36); the meaning and impact of performance (Arts. 47-54); and general principles of interpretation (Art. 60). Book One defines and explains the consequences of breach of

⁴⁸ The draft law provided to the assessment team, dated December 19, 2006, still contains a chapter on Agency, a topic that has reportedly been isolated to become a stand-alone law, the 10th of those required by the ANDS benchmarks.

⁴⁹ Among the law's strengths is the conspicuous absence of reliance on notaries to create or validate a contract. In so many developing economies, notaries create an expensive bottleneck to the creation of contracts and/or represent a state-sanctioned monopoly that serves a function that could otherwise be handled by lawyers and lay-people, or, quite simply, eliminated.

contract, including remedies, damages, specific performance, and liquidated damages, as well as the aggrieved party's duty to mitigate (Arts. 79-90). In general, the statute of limitations for contract enforcement is four years (Art. 94).

Book One speaks briefly to the issue of Dispute Resolution (Art. 92), commending contract disputes to the courts unless the terms of the contract call for alternative dispute resolution, such as settlement, mediation, or arbitration. If any section within Book One needs strengthening, it is this one: the new Law on Contracts should provide far more clarity about what set of civil or commercial law procedures a contracting party may access in order to enforce an agreement.

Book Two: Sales Contracts

- Chapter 1. General Provisions
- Chapter 2. Warranties and Related Rights
- Chapter 3. Transfer of Ownership; Scope of Certain Sales
- Chapter 4. Risk of Loss.
- Chapter 5. Performance, Breach & Remedies
- Chapter 6. Certain Types of Sales Contracts

Book Two introduces to Afghanistan the conventional treatment of sales of goods that is found in many of the world's free-market economies. Critical to this area is the issue of warranty, including implied guarantees that items sold are "merchantable," and the fact that Afghan traders under the new law will face new expectations that they may have avoided in the past (Arts. 104-110). The new law gives buyers the right to inspect goods they have contracted for (Art. 104) and the right to reject defective goods, so long as they meet a clear list of criteria (Art. 107). In addition, the new law clearly allocates the risk of loss, stating that, unless otherwise provided, "the risk of damage to, or loss of, the sold item is borne by the Seller prior to delivery and by the Buyer after delivery" (Art. 118).

Book Two further sets forth the rights of the Seller upon discovery of the Buyer's insolvency (Art. 122), providing the right to reclaim the goods if they have been received on credit while insolvent, as well as certain additional remedies where the Seller has borne costs in stopping delivery. Commensurate rights of the buyer are also set forth (Arts. 128-133).

Finally, Book Two defines a number of sales contracts that may arise in the Afghan marketplace, including sales contracts requiring delivery in separate lots (Art. 134); installment purchases and repossession (Art. 135); sales between merchants (Art. 136); sale by trial (Art. 137); "Free Carrier" (FCA) sales contracts (Art. 138); and "Carriage and Insurance Paid" (CIP) contracts (Art. 139). Several of these concepts are "aspirational" – that is, the Afghan economy may not be sufficiently dynamic to support them now, but they may arise in the future.

The major defect of Book Two is its failure to specify the process for redress when one contracting party is allegedly in breach. Although it is not the responsibility of the contract law to detail civil procedure, the guiding law and regulations pertaining to accessing the courts should be referenced.

Book Three: Agency – to be placed in a separate law

As defined in Book One, Agency is a relationship whereby the Principal authorizes another person in the place of himself in an "ascertained, permitted transaction" (Art. 2(x)). For reasons that appear related to the call for ten new laws to meet the ANDS benchmarks – that is, the need for a tenth law and the lack of seaworthiness of any other commercial legislation in draft form -- the topic of Agency will reportedly be removed from the draft Law on Contracts and established as its own law. Like the rest of the draft law, the Book on Agency is clear and thorough, except that, also like the other Books, it fails to provide any indication of the civil procedure that can be accessed in the event of breach.

Book Four: Certain Other Contracts

- Chapter 1. Barter
- Chapter 2. Gifts
- Chapter 3. Carriage Contracts
- Chapter 4. Warehousing Contracts

This Book describes certain situations in contracts that may come up in the Afghan marketplace. The inclusion of warehouse contracts – the type in which a warehouse stores the goods delivered by a depositor and the depositor pays the warehousing fee – is significant in its responsiveness to the agrarian nature

of the Afghan economy as well as its reduction of risks for parties involved in such a relationship.

Book Five: Miscellaneous Provisions

The last Book is short but includes the critical details of the new law's applicability, date of effect, and implementation. It also clearly states that upon the effective date of the new contract law, all existing contract laws, decrees, and regulations will be terminated and have no further effect.

C. Customary Law

As noted, the integration of the new contract law into the marketplace and legal arena will present enormous challenges in fundamentally dismantling, and then re-building, how people think about commercial agreements and obligations. The tortured language of the existing Civil Code represents a national consensus in favor of forgiveness over enforcement, a sentiment that is essentially rejected by the new contract law that presumes to hold people to their obligations. The initial users of the new law will likely be larger businesses that wish to grow according to free-market terms – that is, they will abide by written contracts and use the courts as a means of documenting their credit-worthiness. In the meantime, individuals and micro-businesses will likely continue to rely on local or tribal institutions – *jirga* and *shura* – that traditionally handle dispute settlement. Although these informal institutions work against a backdrop of high illiteracy and do not typically resolve cases according to written guidance, they will be part of Afghanistan's legal framework for dispute resolution for the foreseeable future.

D. Law on Procurement

While the new Law on Contracts will speak mainly to agreements in the private sector, critical issues pertaining to contract law and enforcement arise in the context of government procurement. Afghanistan enacted its new Law on Procurement in October 2005. The purpose of the new law is to “establish an open, transparent, competitive procurement system, based on effective budgetary and expenditure controls and reporting requirements designed to achieve efficiency, economy, the prevention of abuses and a fair opportunity for participation by all potential

contractors, including private enterprises and other persons” (Procurement Law, Art. 2).

The challenge of bringing Afghanistan's system of government contracts under control is daunting. At this time, throughout the 26 line ministries, there is a lack of accounting controls, consistency of rules, disclosure requirements, and tracking of the vast government funds used to procure services. The Ministry of Economy operates a donor-funded unit that oversees most high-value contracts – mainly those valued over \$200,000 USD and involving donor funds – but the flow of lower value amounts throughout the line ministries is essentially un-discernable. Among the Ministry of Economy's initiatives is to establish a web site in which procurement solicitations and decisions will be published, thereby adding some gravely needed transparency to the process.

Concerned over the damage that can be caused by millions of dollars of un-checked spending, the World Bank has put into place an agenda for reform. The new law established a Procurement Policy Unit (PPU) within the Ministry of Finance, which is charged with: (a) drafting implementing regulations, including a mechanism for appeal of contracting decisions; and (b) engaging in procurement capacity-building, including training of procurement officers throughout the line ministries. The regulations have been drafted and are now in the process of Cabinet review, with an anticipated implementation date of the end of this fiscal year. In addition, the PPU is drafting standard bidding documents, an effort intended to bring some consistency and transparency to the process.

The significance of a sound government procurement system, among other vital points, is that it establishes standards of contract performance that public sector agencies and private sector contractors will benefit from achieving. Where there is widely held expectation that government contracts will be subject to scrutiny and enforcement, the overall marketplace for goods and services is improved. Again, when parties to a contract are in fact required to do what they have said that they will do – adhere to a competitive bidding process, deliver goods, provide services, and so forth – risk diminishes and the recipients of a promise can

better plan for the future. With decreased risk, the cost of doing business goes down, thereby elevating the private sector's prospects for profit and the government's chances of meeting its obligations.

Implementing Institutions

The drafting and implementation of the new Law on Contracts is the responsibility of the **Ministry of Commerce and Industry**. To an extent, and with the assistance of a variety of donors, the Ministry understands its role to “facilitate and promote the development of a dynamic, competitive private sector.”⁵⁰ The Ministry engages in regular forums and consultations involving the private sector, inclusive of merchants, traders and investors within and beyond Kabul. It also maintains a website and, with the technical assistance of the United Kingdom's Department for International Development, publishes a useful, informative newsletter.

With respect to the new laws the Ministry has been charged with drafting, however, “legislation has preceded policy,” according to various observers. Specifically, there is not yet a broad and meaningful scheme for integrating the very unfamiliar but important principles of the new Law on Contracts into Afghanistan's legal and business environment, let alone for soliciting broad-based public input on the mechanics of the new law prior to its enactment. Ideally, such a scheme would be multi-faceted and long-term, and include introducing the most basic principles of contracts through accessible media (such as newspapers and radio); training law professors who in turn would teach law students; reaching out to the economy's small cadre of commercial lawyers for continuing legal education; developing a library of forms for simple contracts; and accessing existing business and trade organizations to share not merely the principles, but also the details of the anticipated new law. A strong policy of implementation would recognize the importance of consensus, and be prepared to hear out and respond to concerns raised by the community of stakeholders.

⁵⁰ Website of the Ministry of Commerce, found at <http://www.commerce.gov.af/p-s-development.asp>.

In the more than two years since the draft Law on Contracts was prepared, however, it was essentially kept confidential. Moreover, although casually discussed, there remains no clear plan for drafting the regulations that will be critical to judicial interpretation and enforcement of contracts. To date, many opportunities to realize the lessons of good development practice have simply been missed – chiefly, that “passage of legislation is not the same thing as implementation of policy.”⁵¹ The process of implementation *following* the enactment of the law will necessarily involve catching up to efforts that should have already been made.

On a more promising note, the new Law on Contracts itself, though not short, is clear, well written, and consistent with international best practices. When the process of implementation begins in earnest, it will serve as an excellent tool for teaching the fundamental principles of modern contract law.

There is much to be said about the capacity of Afghanistan's **commercial courts** to rule on disputes over contracts, and thereafter to enforce their own judgments. In short, judges and commercial courts remain utterly unprepared to do so. This Diagnostic's sections on Commercial Dispute Resolution and Court Administration detail the challenges underlying judicial implementation of the new commercial laws, contracts being principal among them.

Alternative Dispute Resolution (ADR). In what is widely regarded as a controversial move, President Karzai recently signed two pieces of legislation pertaining to the resolution of disputes – including contractual disputes – outside of the formal court system. (The controversy concerns the enactment of these laws while Parliament was out of session.) The laws on arbitration and mediation represent benchmarks in the process of building a “legal framework for commerce [that] will provide improved support for Afghan business and commercial

⁵¹ Wade Channell, *Lessons Not Learned: Problems with Western Aid for Law Reform in Postcommunist Countries* (Carnegie Paper No. 57, March 2005) at 8.

investments.”⁵² Yet, again, there appears to be no formal plan for integrating these new laws into the legal and business environment that will be charged with using them. (Until their enactment, the draft laws were actually marked “confidential”!) Nor is there evidence of close coordination between the substance of the new Law on Contracts and the new laws on ADR in a way that benefits the community of stakeholders. That said, the relative sophistication of certain trade associations (discussed below) indicates that arbitration tribunals may be created in the future that provide a more promising forum for dispute resolution than that which is currently found in the courts.

With respect to government procurement of contracts, implementation of reform begins with the **Procurement Policy Unit** of the **Ministry of Finance**. But authority dissipates, and opportunity for graft and mismanagement proliferates, within the individual contracting offices in each of the 26 line ministries. Although only briefly touched upon here, the topic of government contracts warrants extended cooperation and consultation among ministries and donors alike.

Supporting Institutions

Among the challenges of implementing the new Law on Contracts is the fact that Afghanistan's community of supporting institutions in the legal arena is unusually weak, even for a so-called Least Developed Country. In particular, there seems to be no viable **bar association** or **organization of lawyers** that could assume the role of providing continuing legal education for commercial lawyers, not only in contracts, but in all commercial subjects. Indeed, particularly with respect to domestic contracts and disputes, there seems to be nothing more than what one donor representative calls “rumors of lawyers.” A few Afghan attorneys who previously lived abroad assist international actors in navigating the perilous business environment, and a handful of locally educated lawyers are receiving excellent training from foreign investors. Otherwise,

the field is nearly barren, and the challenge to create a community of commercial lawyers is enormous.

The state of **legal education** and **higher education in economics** is similarly woeful. Legal education is a key component in any program to establish the rule of law in the public psyche.⁵³ Those who provide the legal service in a working democratic society have immense influence on attitudes toward the law. Those who train lawyers are critical to the attitudes and approaches taken by those lawyers and their effect on society.

In the opinion of some local observers, there is virtually no contemporary legal training in Afghanistan at all. In Kabul, the **Faculty of Law and Political Science** (consisting of about 1000 students) teaches primarily to its latter discipline, and the **Faculty of Islamic Law** (500 students) is narrowly focused on a legal tradition that has not begun to integrate the changes emerging from Afghanistan's new system of government. There are reportedly eight additional public universities with faculties of law and Islamic law scattered throughout the country, but, as one law professor explained, they have “no faculty and no textbooks.” Neither the law nor the economics faculties are in a position to integrate free-market principles into their curricula; after all, they are rarely taught or consulted themselves about the content of new laws. Moreover, assuming the existing Civil Code does get taught in law school, its extravagant nuances and minutia that have little to do with the modern practice of contracting suggest that, even if well delivered, the substance of the education is virtually useless.

One area in Afghanistan's supporting environment that shows significant promise is that of **business and trade organizations**. Though it battles against perceptions of elitism, the **Afghan International Chamber of Commerce (AICC)** consists of a sophisticated membership that is well positioned to take the lead in educating the community of stakeholders about the risk-diminishing benefits found

⁵² Website of the Ministry of Commerce, found at <http://www.commerce.gov.af/p-s-development.asp>.

⁵³ See Mark K. Deitrich and Nicholas Mansfield, Lessons Spurned: Legal Education in the Age of Democracy Promotion (East-West Management Institute Occasional Paper Series, 2006).

in the new Law on Contracts, as well as in other new laws. The AICC is accustomed to hosting roundtables and training sessions and will no doubt be available to participate actively in public dialogue about the content, viability and implementation of new commercial laws. It will even set a strong example for the work of the “other” chamber in Afghanistan, the state-affiliated **Afghan Chamber of Commerce and Industry**. Established in the 1930's, the ACCI is clearly less inclined to march into new, free-market territory, but the example set by its independently established peer organization will provide a competitive force for its internal reform and activity.

Other business and organizations hold similar promise as outlets for implementation of the new Law on Contracts. These include an active **Banker's Association**, a **Builder's Association**, and a **Dried Fruit Association**. Membership in each of these groups will likely be enormously interested in learning about the content and implications of the new law.

In addition, the **Afghan Women's Business Federation** (AWBF) is a group that, like the AICC, has proven worthy of the support it has received from outsiders. The AWBF is a USAID-supported institution that consists of 43 individual, dues-paying women's business associations, representing about 10,000 small businesses owned by women throughout Afghanistan. The AWBF provides an extensive and well received training for women business owners. Among the subjects taught at this time are company start-up and business-plan drafting. Certainly the new Law of Contracts will be an excellent topic for further training.

One supporting institution that will be critical in the implementation of the new Law on Contracts are **the media** generally, including newspapers, television, and, perhaps most promising, radio. In general, the opportunities for public education available through the media are not yet being exploited. In particular, government ministries and other change agents – including donors – do not provide sufficient access to the media so that they can thoroughly and accurately carry the news of change to the public.

At this time, due to low literacy rates and near-impossible conditions for distribution, the circulation of

the major **newspapers** in Afghanistan is limited – that is, fewer than about 5000 papers. Nonetheless, a good opportunity exists within the print media to reach the Afghan constituency that *can* read; very basic information about the new laws would be enthusiastically received by papers that are seeking to fill their pages. To a certain extent already, **television** has been chosen as a medium for public education about private sector issues. Sporadic electricity and the public's preference for entertainment shows, however, render television a low-impact option at this time.

Business information geared to the general public will necessarily have the most impact on **radio**. In just three years, over 30 radio stations have opened throughout Afghanistan, and, according to one observer, “they are all making money.” With USAID support, civic education content is being provided from Kabul, including 14 hours daily of news and current affairs and programs on health, agriculture, and women's issues. Internews, a USAID-funded initiative to provide programming on business issues will be launched in the near future. Although the content must be geared toward a very rudimentary preexisting context, the service to be provided by such programming is enormous. Implementation of the new Law on Contracts, as well as other new commercial laws, should certainly include the use of radio in educating the public.

Social Dynamics

The reform of Afghan contract law is very much a “donor-driven” issue. Donors have pushed for the enactment of a new law and have themselves actually written the law. But the fact that the push comes from the outside is not a reason to dismiss the critical importance of a fully implemented and reformed system of contracts. Without such a system, the risk of doing business with anyone other than either a large corporation or close family friend will remain too high for most people. Indeed, mid-sized companies have voiced their desire for a system with more predictability and accountability, two features of a modern system of contracts. “I long for crisis management,” commented one business owner about

the Afghan business environment. “This is chaos management.” A new system of contracts will assist in stemming the chaos.

Moreover, unless there is a fully implemented, modern system of contracts, the high rate of informality within the economy will persist – the *legal* portion of which amounts to 80% of all businesses, according to most estimates. Entering into a binding contract represents a first step for many companies toward joining the formal (taxpaying) economy. When a small business establishes a track-record for meeting its contractual obligations, it becomes in turn a desirable outlet for lending or investment. Typically, formal lending and investment is available only to those companies that have joined the formal sector. Under the current system, there is little incentive to convert casual agreements into enforceable contracts. With a new, fully implemented law, incentives can change.

Recommendations

- The Ministry of Commerce and its donor supporters should develop a comprehensive, long-range plan for implementation of the new Law on Contracts, which should be just one part of a comprehensive, long-range plan for implementation of all of the new commercial laws. Implementation should include engaging constituencies from all corners of the Afghan economy, including lawyers, judges, small and mid-sized businesses, business and trade associations, state and provincial authorities, and women-owned enterprises. The long-range plan should include an agenda for using the media to help inform the public about the opportunities inherent in the new system of contracts.
 - Clarity must be reached within the new Law on Contracts about the formal processes for handling contract disputes and enforcement. Although the new laws on arbitration and mediation seek to remove such disputes from the courts, the judicial process shouldn't be forsaken completely. A plan for drafting court rules and regulations pertaining to contract disputes must be devised and that plan must include collecting input from the likely community of stakeholders. Ultimately, there should be no doubt in the mind of anyone who reads the new law about where his or her formal avenues for redress exist.
- Afghanistan needs a bar association that, at the very least, can provide a forum for continuing legal education for commercial lawyers. Donors engaged in training lawyers should work to develop one or more such organizations. Training for lawyers should, for the most part, take place through the new associations, so that sustainability in training will prevail over the ad hoc.
 - In cooperation with the central government, the donor community should examine Afghanistan's crisis in higher education, and, for the purpose of implementing its new system of commercial laws, in the law faculties in particular. The following approaches should be considered:
 - Establish faculty training programs. Teaching the teachers is, of course, a tried and true method for reaching exponentially larger groups of people, yet no training programs have been established at Kabul University. These can be as simple as inviting expatriate lawyers working in Kabul to conduct short workshops with faculty in their specialized areas.
 - Engage in curriculum development. With the advent of a new system of commercial law, much work needs to be done with the existing curriculum in both the Faculty of Law and Political Science and the Faculty of Islamic Law. It is time for those actors who are drafting and enacting the new law to reach out more effectively to those who must teach it.
 - Set up clinical legal education programs. As U.S.-based law schools have discovered, no programming provides more impact upon both students and the community than clinical legal education. Given the country's special interest in agriculture as a source of economic development, clinical legal education may properly be directed, at least in part, to this arena. The use of contracts would necessarily be part of a commercial law clinic, whatever its focus.
 - Use the law faculty. Law faculties can provide a resource for information within the community of practicing lawyers by developing continuing legal education programs. They also would be an obvious source of content for media programs seeking to educate the public about changes in the commercial law.

In the area of government contracts, the legal and business communities and general public should be kept informed about changes in policy and increased expectations of transparency that will lead to sounder

procurement practices. The topic of government contracts should be included within both continuing legal education programs and law school curricula.

REAL PROPERTY LAW

Introduction

Real property law is crucial in market economies; it provides the legal environment for a business to own, use and sell land and buildings as well as to use them as collateral to obtain credit. Good property law is especially critical in transition-economy countries; a good law enables entrepreneurs to acquire land freely to produce goods and services in a secure ownership environment, which is a necessity for planning for the long term. A good property law must also be accompanied by an objective, standardized titling system.

Afghanistan's land laws and practices and laws are extremely complex and often unclear. Moreover, Afghanistan has never had a reliable, standardized system of land titling. These circumstances are a natural result of the physical destruction and governmental discontinuity which characterized the conflict years going back to the 1970's. The consequence is that, today, commercial land use and investment are much more difficult than they should be for future economic development.

At the same time, there is an understanding of the problems at many levels in and outside the government, and some important positive steps are being taken. A new national land policy is being developed which can lead to reform and replacement of the present inadequate and largely outdated laws. A comprehensive titling and survey project is currently in process which in several more years could cover much of the significant residential and commercially-usable urban land in Afghanistan.

Legal Framework

A. Present laws

The legal framework is a patchwork of laws enacted at different times over past decades.⁵⁴ They are often

⁵⁴ More than 15 land laws and regulations were reviewed for this Report and there are more. The laws reviewed include

unclear and overlapping and they are silent on many subjects that land law should cover. Separate customary, traditional and Islamic laws and practices are often as important – or more important -- than the enacted land laws in understanding how land is held and transferred and how things work. Thus, a summary of the laws themselves will not give an accurate or even useful description of the situation as it actually exists.

B. How Land is Held

A 2006 consultant's report states that "Afghanistan's land tenure situation might best be described as chaotic."⁵⁵ A foreign private investor interviewed for this Diagnostic called it a "nightmare" (although, notably, he still does business there). Similar statements were made even by government officials who were interviewed. They are all essentially correct.

The picture can be seen by listing some of the principal ways in which land ownership is held and evidenced. The picture is very complex (and the list below does not describe it fully), but it must be understood in its full detail for proper legal reform.

I. State Land

Much Afghan land, urban and rural, is state-owned. This takes many different forms. It includes ownership by municipalities, ministries, regional and administrative units and any number of other governmental bodies. (Indeed, disputes between state bodies over which one owns a particular piece of land were cited in interviews.) State land also includes all cultivable land

the Afghan Land Management Law, Law on Land Expropriation, Law on Private Investment, various laws relating to the Kabul Master Plan and its implementation, Kabul Regulation on Distribution and Sales of State Owned Land, National Law on Municipalities, National law on Distribution and sale of Residential Properties, Law on Pasture and Grazing Land, and Law on Property Agents.

⁵⁵ *Legal Issues Pertaining to Land Titling and Registration in Afghanistan*, prepared for the USAID LTERA project. Another useful consultant's report is a 2006 DFID-sponsored document entitled *Initiative for Regulatory Reform to Enhance Private Sector Development in Afghanistan: An Investor Roadmap*.

which has no owner, and a recent Presidential Decree states that all land in which ownership by individuals is not established legally is property of the state.

Much state land is not occupied by any state body, but rather by private persons and families who have built homes, shops and other buildings on it. Those persons have no legally recognized rights and are subject to eviction without notice or compensation – which does happen, sometimes on an area-wide basis. Those landholders know they are vulnerable and as a result they do not invest in or improve the property beyond a minimum.

A considerable part of the residential and commercial land in Kabul falls into this category. The vulnerable status of these properties has led to a social problem which should be addressed in any land law reform.⁵⁶

2. Private (Non-State) Land

The near-incomprehensible complexity of private landholding can be seen in the following list of types and issues.

a. Formal vs. Informal Landholding. Roughly, “formal” landholding means land ownership as known in the West – ownership traceable back to proper prior owners, properly recorded, and held exclusively by the recorded owner with the right to sell, lease, mortgage, pass by inheritance, etc. Under Afghan law, formal ownership requires that all formal legal requirements be met and, in the case of urban land, that the land conforms with the Master Plan of the municipality. In Kabul, however, the Master Plan is more than 30 years old; it was issued during the Russian period when Kabul had about a fourth of its present population; and it often has little relation to the facts on the ground today. Interviewees stated that, because of this and other problems, about 70% of the land in Kabul is now informally owned.

⁵⁶ Afghanistan has a Law on Land Expropriation which provides in considerable detail for setting compensation and giving substitute land when private land is taken by the state for public purposes. Interviewees reported, however, that that law is often not followed in practice, and it would not apply in any event to the persons described above.

b. Types of Informal Landholding. Informal holding comes in many varieties, each with its own rules, themselves not always clear. They include:

- **Customary ownership.** This includes land in villages that were later incorporated into municipalities. Ownership of this land is generally respected but not deeded or recorded. Much of the land on the outskirts of present-day Kabul is in this category.
- **Grabbed land.** This is extensive nationwide. Much of it was taken by powerful persons during the Mujahedin period after the Russian departure. Some of that was then distributed to, or bought from the grabbers by, bona fide purchasers who now occupy it.
- **Share-crop land.** In rural areas, much land is held by farmers under arrangements requiring them to remit their production (or sometimes its arbitrarily-set cash value) to “owners” of the land which in many cases is grabbed land. These arrangements vary but the farmers are often under the threat of eviction and without opportunity to buy or otherwise obtain secure tenure. Much of the land now under Poppy cultivation falls into this category.
- **Squatter settlements.** This includes land settled by individuals on state land but without following the onerous (often impossible – see below) bureaucratic formalities which are required to acquire land from the state legally. The highly visible hillside communities around Kabul are in this category.
- **Traditional ownership.** Ownership by persons who inherited land long held by their ancestors is generally recognized. One person interviewed for this Report who inherited a farm that was owned by his father and grandfather stated that he feels secure in his ownership. Land in this category was often granted generations ago by then-rulers of Afghanistan.
- **Land bought from formal legal owners but without following the requirements for formal ownership such as a deed and recordation.** This is a relatively secure form of informal ownership. Much of the land in the LTERA titling project (described below) is in this category.

C. Acquiring and Transferring Land Including Leasing and Mortgaging

Here the greatest problem is in **acquiring state land**; this can be so bureaucratically difficult as to be near-impossible as a practical matter. One interviewee stated that he initiated paperwork four years ago to acquire a vacant parcel from the Municipality of Kabul that is adjacent to land he already owns and that he sees at least another year or more for completion. When this example was mentioned in interviews with government officials, they showed no surprise and went on to point out that each Ministry or other state owner has its own separate procedures, often unpublished and subject to change in mid-transaction. Needless to say, that also invites corruption and discourages acquisition of State land through the legal process.

Selling or buying privately-owned land can be easier but not necessarily much easier, according to interviewees. It is inhibited by costs and procedural requirements that make a free and active land market impossible. Agreement between seller and buyer on price is only a tiny part of the process. The remainder was described by interviewees as lengthy, costly, opaque and – again – inviting of corruption. For that reason many persons circumvent the legal process altogether which, in turn, exacerbates the above-described problems of establishing ownership and title. Separate taxes on land transfer are payable to the Ministry of Finance, the district court (which also certifies ownership – a task it is not fitted for, as interviewees commented), and the municipality, and can add up to eight percent of the assessed value of the land being sold (and that value itself is assessed separately, using different criteria, by the municipality and then the Ministry of Finance). Several more governmental offices are part of the process, all taking their time and some not performing a function which appears to be useful.

The previously cited “Investor Roadmap” describes more than 50 procedures that a business startup might need (almost all *not* relating to land) and concluded that land acquisition and transfer is one of the four “most difficult, time-consuming and expensive processes in

the investment and start-up of a project in Afghanistan.”⁵⁷

Leasing of land is common and is not subject to the complexities of ownership transfer – although it carries no assurance that the lessor’s underlying ownership is valid. There are real estate brokers in Kabul and a somewhat active market in commercial and residential properties. A broker who was interviewed has an attractive brochure of available properties for lease or sale and reported that the market is strong and demand and prices are high compared to other countries (partly due to limited availability and land transfer difficulty in general). One month’s rent is a typical commission for bringing a lessor and lessee together; they normally split it equally but (as in other countries) that and the rent amount are always negotiable. The broker also stated that some persons use leases rather than the alternative of a purchase with a purchase-money mortgage, in order to avoid paying interest in violation of Islamic principles. Generally, state land is for rent but rarely for sale and interviewees stated that leases of state land sometimes require side payments to avoid taxes on the transaction.

One person interviewed owns commercial agricultural property outside Kabul and leases adjoining property from neighbors on a long term basis. One large Telecommunications company that was interviewed leases its transmission stations and other operating properties under lease agreements negotiated with private owners and governmental units. The leases also sometimes include appurtenant interests such as easements and rights of way. (It leases rather than owns because, as a company owned by foreign shareholders, it is prohibited from owning land in Afghanistan – see below).

⁵⁷ The other three cited are obtaining building permits, obtaining licenses from certain ministries such as mining and telecommunications, and customs. The Investor Roadmap states: All-in-all, the land transfer process in Afghanistan requires the seller to accomplish 34 steps; it takes about six months; the legal fees are almost 10% of the sales price and the bribes needed to accomplish the process range between 10% and 20% of the sale price of the land for small transactions.”

From interviews it became clear that a businessperson (including a foreign one) can fairly easily find office space and a good apartment or house in Kabul for a price, and there is definitely money to be made in real estate by persons who understand the market and its risks.

Mortgages are being granted although a mortgage-finance market as known in the West is not possible because there is no mortgage law and no established legal means for enforcement and foreclosure. Interviewees cited instances of short-term (one or two year) mortgages at interest rates of up to 20-25% per year. Also cited was a history of mortgages in the Russian period on apartments in the many Soviet-style apartment buildings seen in Kabul; those were subsidized and did not lead to ownership with clear title.

Today mortgage enforcement is largely by informal means including *shura* ruling or persuasion which, in fact, can be quite effective. Mortgages are registered in the land ownership records; many examples of recorded mortgages were seen in random searches that were made for this Report at the Kabul land registry (*Makzhan*).

D. Registering Ownership of Land

Registration (recording) and proof of good title can present huge problems, closely related to the land transfer problems. Interviewees uniformly stated that title registration in Afghanistan has been “a mess” and the reasons are obvious. They include; the physical destruction of land registries and records (and theft of records) during the conflict years, land grabbing and awards of titles to political supporters by successive governments also during those years, forging of deeds and issuance of false deeds for bribes (many of which have been recorded), high turnover and lack of expertise or training in land courts and judges, an inevitable degree of corruption, and – not least – the fact that deeds themselves are often inaccurate in describing the boundaries of the land they are supposed to cover. On the subject of registering land title *World Bank Doing Business 2007* survey rated

Afghanistan 169th of the 175 countries which were surveyed.⁵⁸

E. Landholding by Foreigners

The Afghan Constitution prohibits land ownership by foreigners and all interviewees on this point agreed that this will not be changed in the foreseeable future. The prohibition applies both to foreign individuals and companies and to domestic companies which are owned by foreign individuals or legal entities. The usual way around this is for foreigners to lease land or land rights from a state body or a private owner. The Afghan Private Investment Law (Article 21) specifically authorizes this, for a maximum lease term of up to 50 years.

Leasing from state bodies can involve uncertainties. An example was cited by a foreign company which leased business properties for the “official” 49 years but a ministry later challenged the lease on the ground that its own governing rules provide only for lease terms up to three years. Another issue is that the Land Reform Law (Article 77) requires bidding for leases of state land, with rules that are both detailed and unclear. In reality, bidding is often not practicable, especially for small transactions and cases where there is only one possible lessee or use for the land. It was reported that it is often not really helpful to seek advice on such matters from government personnel themselves, because they are often not conversant with the laws and, in any event, cannot give binding interpretations. It was reported that challenges and ambiguities (or inconsistencies) in the law, such as those described above, can lead to demands for extra payments, lease renegotiations and other problems which simply should not happen.

F. Other Land Issues

For completeness, three other real property-related issues should be mentioned. The law commits **dispute resolution** involving land issues (including title disputes) to the courts, but the courts are not often used and generally considered not useful for this

⁵⁸ The six countries ranked worse were Nigeria, Guinea-Bissau, Maldives, Marshall Islands, Micronesia and Timor-Leste.

purpose. This is the result of many things, not least the fact that the courts suffered greatly during the conflict periods and there is high turnover, limited expertise and lack of training in the courts and among judges. Several interviewees made the point that *shuras* are quicker to decide, not corrupt, and more respected than courts. From interviews, it appears that land disputes are not as prevalent in Afghanistan as in many other countries. This may be attributable to several factors including the availability and wide acceptance of *shura* and other informal means for dispute resolution, the high degree of personal knowledge by neighbors of each others' affairs including their past land occupancy and use, and – not least – the fact that in Afghanistan so many land boundaries are marked by long-recognized physical walls.

Zoning and land use regulation are a separate issue to be added to those of land transfer and titling. Even if an investor locates a land parcel and can deal with the transfer problems there may remain regulatory uncertainty over its uses. Related to this is the issue of obtaining **building permits** to construct the facilities the investor needs. In Kabul, these issues are exacerbated by the fact (noted above) that the city Master Plan is more than 30 years old and is now largely unrelated to the facts on the ground. The result for an investor can be delays and extra payments required informal “rezoning” by the municipality to accommodate the investor’s actual needs.⁵⁹

G. Positive Points

The above leaves a very negative impression, but there is a positive side. Indeed, one positive fact is that the problems described above are generally known and understood within the government, and many of them are receiving attention.

I. The Land Titling and Economic Reconstruction (LTERA) Project

The multiple shortcomings in the land titling and registration systems are being addressed by a major project – Land Titling and Economic Reconstruction in Afghanistan (LTERA and pronounced “el-terra) –

⁵⁹ Note footnote above listing building permits as one of the four worst regulatory hurdles for a business startup.

managed by USAID and implemented by the Emerging Markets Group with the support and active participation of several Afghan governmental bodies.

The scope of the LTERA project is comprehensive and it is a success story. Its components include:

- Revamping Afghan land registration offices including physical upgrading of the facilities, sorting, cleaning and restoring documents, and placing them in secure storage. Thus far millions of documents have been thus protected.
- Digitizing (scanning) and indexing of deeds, mortgages and other land instruments and linking them to the surveyed land plots they relate to, so that such information can be found in minutes and read by any member of the public on computer screen. This was seen in sample searches conducted for this Report at the Kabul registry (*Makhzan*). Formerly such information retrieval could take months when it was possible at all.
- Mapping land using aerial photography and satellite surveying on a large scale. This has proven more cost-effective and more accurate than methods formerly used. Scores of thousands of land parcels have been thus far surveyed, replacing old outdated maps and in many cases mapping property for the first time.

The LTERA project is also conducting pilot programs in two specific districts in Kabul which are proving highly successful. Those projects have included boundary marking, formalization of deeds and records, incorporation of the districts into municipal maps and plans, compilation of a database of property claims, and assisting in the organization of community-based associations and *shura* councils for governance, clarification of tenure rights and adjudication of disputes. The results are striking; hundreds of informal claims (some based on customary deeds, some with no documentation at all) have been formalized in these pilot districts, and – it can be truthfully said – the resulting security of tenure has increased local pride in ownership and investment by owners in their land.

2. New National Land Policy and Land Law

Clearly a comprehensive new national land law (or set of laws) is needed. Ideally this should result from a

carefully thought-out land policy which has consensus support within the government and of relevant private constituencies.

That appears to be happening. A new land policy is now being prepared with the participation of relevant government persons including officials at the Ministries of Urban Development, Agriculture and Justice, and also mayors and other local government officials, private investors and community members. It is proceeding with assistance and coordinating help from the LTERA project. The forthcoming policy is seen as groundwork for a new land law. A draft of the policy was approved in February 2007 by the three ministries identified above and the Economic Committee of the Cabinet, from which it is expected to go to Parliament for approval. The various constituencies have been working together in this process for more than a year with multiple meetings and workshops at which there was “plain talk and argument” (quoting one interviewee) and, interviewees stated, consensus and compromise views have emerged on many issues.

A text was not yet available at the time of this Report, but it was reported to cover all land in Afghanistan, rural, urban and mixed, and it is suggested that it should deal with the following matters:

- Steps to encourage foreign investment, looking toward ultimately allowing foreign ownership of land;
- Improving security of land tenure covering all the types of landholding described above;
- Clarification of types of land rights including ownership, lease, mortgage, easements and rights of way;
- Fair compensation for expropriation, objectively and independently determined, with expropriation permitted only for clearly defined public use;
- Transparent and simple procedures for acquisition and transfer of land, both from state bodies and private owners;
- Clear rules for zoning and determining and changing zoning;

- Recognition of existing customary, traditional and communal rights including those of pastoralists in various parts of the country;
- Legitimization of informal developments, including an “adverse possession” rule that good title can be established and eviction prevented by proving long-term dwelling or productive use;
- Clear titling and registration rules; and
- Clear rules for land dispute resolution including title and boundary disputes, taking account of customary, traditional and Islamic traditions and the fact that *shura* and other informal bodies are now more effective and accepted than courts.

3. Other Positive Indicators

Interviewees, including government officials, described three proposed housing developments outside Kabul that are being planned jointly by foreign investors working with the Ministry of Urban Development. The land is government-owned and is to be sold directly to Afghan residential and commercial buyers at controlled prices with long-term mortgages available, while construction, furnishings and much of the planning is undertaken by private investors. Indirect financial support would be provided by multilateral agencies. A project of this kind exemplifies government-private collaboration and attention to the details of legal structuring with a view to enable foreign property investment without running afoul of the legal prohibition of foreign ownership of land.

The Afghan Investment Support Agency (AISA), with USAID assistance, has created an industrial park (Bagrami) on the Kabul outskirts and is in process of developing three more, with one in Jalalabad. The finished park is full. When it was opened for bidding the number of investors bidding exceeded the number of plots available.

Persons within the Ministry of Urban Development have prepared a draft of a new – much needed – mortgage law.

Coca-Cola established a large bottling plant in the Bagrami Business Park in late 2006 and interviewees mentioned that Nestle and other foreign companies are

planning new facilities near Kabul. Time did not permit interviewing the persons involved in those projects, but it seemed evident that further time and interviews would have led to more significant instances of new (and encouraging) investment involving land in Afghanistan, together with details of how they are negotiated and structured.

Implementing Institutions

The **Ministries of Agriculture and Urban Development and Justice** are prominent in both land ownership and land use regulation and, as stated above, these three ministries have been active in developing a new national land policy.

Municipalities have widely varying and not always clearly-delineated responsibilities relating to land, including in many cases power over zoning and land-use rules. Also, as described above, any particular body may own land and impose its own policies respecting its use, sale, leasing, or expropriation when it is occupied by others.

Land Registries (Makzhans) are the offices for registering and maintaining records of land ownership as well as other governmental records. As pointed out, they and their records suffered greatly during the conflict periods and their rebuilding is one of the practical components of the LTERA project.

Under the law, the **courts** have ultimate authority for adjudicating disputes concerning land matters. As noted above, they too suffered during the conflict years. They are generally viewed as slow to decide and sometimes lacking in independence and expertise.

Shuras are found throughout Afghan society and, as stated in more detail above, are considered quicker to decide than courts, more respected and accepted, and free of corruption as adjudication bodies in land and land tenure matters.

Supporting Institutions

As noted above, the **Afghan Investment Support Agency (AISA)** has been active in developing industrial

parks in the vicinity of Kabul. AISA is a governmental agency with a mandate to facilitate and support investment of all kinds throughout Afghanistan. Based on interviews of AISA staff and private businesspersons, it is clear that AISA is a helpful and user-friendly resource on land (as well as other) aspects of investment. AISA also has an attractive website in English displaying useful data and information including information on current investment deals and a copy of the Foreign Investment Law.

The **Afghan International Chamber of Commerce (AICC)** is a non-governmental association of businesspersons and investors which is also active in assisting its members and others on land-related issues and as an advocacy group for reform.

Donors have been very important resources and helpers on land and land reform matters. Activities of the USAID-supported LTERA project are detailed above. The British DFID supported the Investor Roadmap which contains a highly useful analysis of land and other legal and regulatory issues for investors. The German GTZ (Federal Ministry for Economic Cooperation and Development) has given extensive support to AISA.

Social Dynamics

The instant discussion should make it clear that there is an immense demand (market) in Afghanistan for change and reform of the land practices and governing laws. Much of the present difficulty is a result of the destruction and absence of development that characterized the conflict years. Now, however, there is opportunity which should be pursued in every area.

It is a positive factor that the problems are generally understood and acknowledged, including at high levels within the government. The fact that there is impetus and active work inside the government on a new national land policy, with the support and participation of several ministries, is a major plus. Indeed, such a “ground up” process is the best route to a new system of laws because it is the most likely to produce consensus and necessary compromise in advance. This can be contrasted with what is sometimes found in

transition countries, a process in which donors or experts – often outsiders – produce new laws which have not been debated and understood by the relevant local constituencies.

Recommendations

1. Extend and expand the LTERA titling project.

Consider expanding it to include a pilot project involving more “difficult” categories of land ownership (i.e., categories in which title is not traceable back to previously-titled and recorded land), and to focus also on land transfer issues as distinct from titling and registration issues.

2. Encourage and assist the “ground-up” consensus process described above for development of a comprehensive national land policy. That process should continue essentially as it is.

3. Draft and enact a new comprehensive land law or set of laws dealing with the problems described above. This is obviously a task of months or years, but it should not drag. It should follow and be consistent with the national land policy. The land policy should be considered a precursor to such new laws, certainly not as an end in itself.

4. Meanwhile, in the short term, several legal steps should be encouraged and pursued including:

- Enact a mortgage law, using the draft of the Ministry of Urban Development and soliciting input from investors and businesses dealing in land,
- Encourage foreign investment by making the rules and procedures for land use by foreign persons simpler and more transparent and thus more secure. While not eliminating the basic prohibition of foreign ownership (which would be impracticable), do or consider the following:

- Amend the Private Investment Law to allow longer term leases to foreigners (for example for 99 years), and consider laws to allow certain foreign persons (such as long-term residents and persons or companies making investments over a stated amount) to have land use rights the same as or similar to those of Afghan citizens;

- Issue a formal regulation or law clarifying matters about which there may now be uncertainty such as the rules for leasing of state property (see above), foreign ownership of buildings and other attachments on land; companies or joint ventures which are partly foreign-owned; and the holding of land by Afghan citizens for the benefit of foreign persons, as another possible way of facilitating de facto landholding by foreigners;

- Reform the building permit process and the zoning permit process; simplify and streamline the rules and requirements for these.

5. Create a single independent governmental body for property and title registration, combining the divided functions of the local registries (*Makzhans*) and courts. This is another project of months or years. It can build on the work of the LTERA titling project.

6. The non-transparent practices surrounding state land should be reformed. To the extent possible there should be a single governmental body which owns or coordinates ownership of all state land. Also, a long-term program should be adopted to privatize state land, particularly the large areas which are not actually used for public purposes.

7. Establish training programs for governmental officials and judges at all levels on all of the above.

SECURED TRANSACTIONS LAW

Introduction

The presence of a working legal system for the enforcement of a lender's rights to its collateral upon the borrower's default is central to a mature economy with a strong commercial lending sector.⁶⁰ A well understood and efficient Secured Transactions Law – combined with a judiciary that is well versed in commercial law and is perceived to be fair, speedy, and transparent in the enforcement of commercial rights – are essential components of such a system. Unfortunately, at this stage of its development, Afghanistan has neither the statutory framework nor a judiciary that can be relied upon for the enforcement of a lender's collateral rights.

Notwithstanding these shortcomings, Afghanistan has an active and emerging commercial financing sector willing and capable of lending to borrowers that include small and medium business enterprises (SMEs). Currently, contractual collateral-based lending to SMEs is succeeding, albeit on a limited basis, despite the absence of an effective court system and a statutory framework for obtaining, recording, and enforcing security interests in personal property. While this may seem surprising in a society with a notoriously corrupt and unreliable legal system, the presence of community-based relationship banking has resulted in overall excellent loan performance of SME loans.

While there is no short-term solution to the ineffectiveness of the court system, there is currently legislation addressing secured transactions in personal property that will provide a statutory basis for such

lending, and which is supported by the lending community. This effort should continue to be supported. Further work on the implementation of the new legislation, to include drafting and training in the new laws and applicable forms, and evaluating and making loan credit decisions, is important to the continued viability and expansion of secured lending to commercial borrowers.

In addition, Afghanistan lacks a collateral registry system by which creditors can establish a non-possessory interest in collateral. Afghanistan's establishment of such a collateral registry system is necessary to support the extension of secured credit. The absence of reliable credit information is also an impediment to rational commercial lending. Work should commence on the appropriate mechanisms and implementing institutions for such a registry.

With the potential for increased urbanization and the possible marginalization of the tribal *Shura*-based system for enforcement of collection rights, Afghanistan's need for a functioning judicial system in the commercial area will increase. Work must be done to improve the judiciary in terms of its transparency. The training of judges on the terms of the new legislation and the general economics of commercial lending is also an essential part of the process.

Legal Framework

A. Overview

There is a general perception that there is currently no law dealing with the creation and enforcement of security interests on movable property.⁶¹ While this is accurate in practice, Afghanistan does have provisions in existing laws dealing with the creation and

⁶⁰ This section, "Collateral Law," will deal with consensual liens on personal property, which includes both personal property such as equipment and intangible personal property such as accounts receivable. Issues relating to the status of the laws where the collateral for a loan is a mortgage on real estate will be dealt with under the "Property" section of this Report.

⁶¹ The term "movable property" as used herein means tangible and intangible personal property.

enforcement of liens on movable property. These provisions are found in subchapters D, E, and F of Chapter IV of The Law of Commerce of December 15, 1955 (“1955 Commercial Code”), Chapters 3 and 4 of the Civil Code of 1976, and Article 38 of the Law of Banking of Afghanistan of 2003 (“Banking Law”).



Pakistan Supreme Court in Islamabad.

Under sections 697-710 of the 1955 Commercial Code, a commercial mortgage may be given in connection with a commercial loan. The collateral for such a loan may include negotiable instruments and other commercial documents.⁶² If such a loan exceeds a relatively small amount, the loan must be registered and “certified by the commercial registration office.”⁶³ The creditor holding the mortgage has priority in payment from the collateral over other creditors but only when the collateral is in the hands of the secured creditor or the third person with the consent of the debtor and creditor.⁶⁴ Thus, it appears that a secured creditor’s rights are limited to that of holding possessory pledges of tangible personal property. There is no provision for the attachment of a security interest with priority over general creditors for property held and used by the debtor in its business, nor are there any provisions for priorities over conflicting security interests in the same collateral.⁶⁵

Chapter 3 of the Civil Code of 1975 deals with possessory mortgages on either movable or immovable property.⁶⁶ In order for such a mortgage to be valid,

“the mortgagee should totally take hold of the property mortgaged.”⁶⁷ Chapter 4 deals with “Official Mortgages,” which are formal mortgages contracted on “official paper completed in presence of concerned officials.”⁶⁸ An official mortgage may only be taken with respect to immovable property.⁶⁹

Neither of these laws provides a straightforward method to create and perfect a security interest in personal property. These existing laws also do not establish priorities among security interests on the same property. While there is nothing in the laws to prevent parties from entering into contractual collateral assignments of rights in personal property, neither provides a mechanism for creation and enforcement of non-possessory security interests. While there is reference to the recording of such security interests in the official records, the laws do not create an independent collateral registry for security interests in personal property. Rather, any such recording must be done within the court system—an extremely cumbersome process.

Another law governing the rights of creditors holding security interests in personal property is a banking law that went into effect in 2003 (“Banking Law”). A bank’s rights in the event of payment default under a note secured by an interest in collateral are specifically delineated under Article 38 of the Banking Law. In the event of a payment default on debt to a bank secured by a lien on movable goods, the goods may be sold by public auction or through a broker on a public exchange in accordance with the law. The bank may bid for the goods. In the event that the goods cannot readily be sold by public auction or on a public exchange for a price that is at least equal to the amount of the debt together with sales costs, the interested parties may agree or the court may order that the goods be sold otherwise.⁷⁰ *It is important that any new legislation dealing with this same topic be harmonized with this provision of the Banking Law, or this provision should simply be deleted from the Banking Law so that*

⁶² Afg. Law of Commerce of Dec. 15, 1955, § 700.

⁶³ Id. at § 699.

⁶⁴ Id. at § 701.

⁶⁵ Photo Credit: Michael F. Cardoza, Personal Collection

⁶⁶ Afg. Civil Code of 1976, arts. 1770-1831.

⁶⁷ Id. at art. 1773.

⁶⁸ Id. at art. 1833.

⁶⁹ Id. at art. 1839.

⁷⁰ Afghanistan Banking Law of 2003, art. 38.

inconsistencies will not result in two laws with overlapping coverage.

It is clear that these laws provide an insufficient framework for modern secured lending to develop in Afghanistan. Just as important, these laws are simply not relied upon by the lending community in documenting loan relationships. This may be attributable in substantial part to the laws' inadequacies in dealing with the subject of secured lending. It is also a product of the general problem of the lack of availability of printed texts of laws -- even among the judges who are responsible for their enforcement.⁷¹

B. Current Draft Legislation

I. Process of Enactment

There are a number of laws that are in various stages of consideration for Afghanistan. One of these is a draft law on secured transactions. The process for consideration and review of this law in its various draft forms has been extensive.

The process began in late 2002, with the initial work done by a team of lawyers working with the American Bar Association/Center for International Management Education-sponsored Afghanistan Transitional Commercial Law Project (ATCLP). The ATCLP members completed a review of loan and mortgage law in early 2003, and a draft law based on existing Afghanistan law and Kyrgyzstan's Pledge Law was circulated for review. A meeting was held to review the law in May of 2003, which was attended by ATCLP lawyers; the Ministries of Finance, Foreign Affairs, Justice and Commerce; the Afghanistan Judicial Reform Commission; and other foreign advisors in Kabul.

USAID's Economic Governance Project was involved in the process in the spring of 2004. Also, in the summer of 2004, the Asian Development Bank expressed concern that this subject should be addressed as a matter of priority. The following summer, Da Afghanistan Bank (DAB)/BearingPoint made this a priority and has taken a lead role in coordinating the

process of enactment. The Ministry of Commerce determined that this was a priority for year 1384 (which ended on March 20, 2006). Along with the ATCLP draft, a European Bank for Reconstruction and Development (EBRD) model secured transactions law was also considered at the Ministry of Commerce.

During 2006 and into the first two months of 2007, the legislative drafting team at Da Afghanistan Bank (DAB) circulated the various drafts of the law to the members of the Afghanistan Banks Association and to the 3,600 members of the Afghanistan International Chamber of Commerce. Suggestions for improvement were actively sought, considered, and in many cases, included.

As of late January 2007, the draft of the law that was under consideration was a combination of drafts derived from the Bosnia and Albanian laws, and the EBRD draft. Due to the complexity and inconsistencies that had resulted from attempting to combine provisions from separate cohesive laws into one draft, however, the decision was made in February 2007 to simplify the law by using the Albanian law as the basis for a final Afghan version.

2. Current Draft

a. General Comments. The choice of the Albanian law as a model from which to derive the Afghanistan law is a good one for several reasons:

First, the Albanian law is modern in its approach, covering the basic elements of laws in advanced economies. Just as important, it is also simple. It is important in implementing new concepts into an economy and legal system such as those that exist in Afghanistan that there be a balance between necessary implementable legal constructs and irrelevant ones. New laws that are unduly comprehensive and complex may not be practical, and consequently may have a low acceptance rate by those for whose benefit the laws are being enacted. In the words of one of the Albanian law's principal architects, Yair Baranes, "simplicity is progress."⁷²

⁷¹ See, e.g., J. Alexander Their, *Reestablishing the Judicial System in Afghanistan*, Center on Democracy, Development and the Rule of Law (Stanford Institute For Int'l Studies 2004) at 9-10.

⁷² E-mail from Yair Baranes (March 2, 2007) (*on file with author*).

Second, the law, while simple, accomplishes the principal objectives of a modern secured transaction law. In this regard, the law facilitates asset-based lending. Asset-based lending is the lending of money and taking a security interest in the personal property assets of the borrower to offset the risk of loss due to default. As part of this process, the ability of the secured lender to seize and sell the collateral must be commensurate with the amount of the loan in terms of the amount of time needed to liquidate the collateral and the legal and other costs associated with such liquidation.

In simple fashion the law addresses the need of a lender to have flexibility to reach both existing and after-acquired collateral, both through possessory and non-possessory types of lien attachment. This is particularly important in the area of intangible collateral, such as accounts and intellectual property. The law also recognizes that such arrangements must contemplate the borrower's continued possession and use of the collateral in order to generate the funds necessary to repay the loan.

The law also includes leases of goods having a term of one year or more. This is an important part of Afghanistan's emerging commercial lending sector and provides a *Shari'ah*-compliant method of financing well-suited to the financing needs of SMEs.

Importantly, a key area in which the law differs from the Albanian law is in the right of a secured lender to enforce its security agreement on the borrower's default without the necessity of court involvement. This is an important modification necessary to deal with the current ineffectiveness of the Afghanistan court system in resolving commercial disputes.

b. Key Elements of Draft Law.

Chapters 1 & 2-General Principles & General Provisions

Collateral is defined as movable property.⁷³ By definition, movable property includes "tangible things such as Goods and intangible things such as Documents of title, Accounts, Securities, Instruments, copyrights,

⁷³ Afghanistan Draft Law as derived from the Albania Law on Security Charges ("Aft. Draft Law") ch. 2, art. 4 (2007).

trademarks and patents."⁷⁴ Importantly, it includes collateral in existence at the time of execution of the security agreement,⁷⁵ as well as collateral that the borrower may obtain in the future, that is, after-acquired property. In addition to after-acquired property, collateral includes proceeds collateral -- that is, collateral that derives directly or indirectly from dealing with the collateral and extending to "second-generation and later-generation collateral as well as insurance payments."⁷⁶

The law also defines separately a purchase-money security interest as a security interest in goods taken or retained by a seller of the goods to secure all or part of their purchase price. A purchase-money security interest may also be taken by a person who loans the borrower the money necessary to acquire the collateral, even if not the seller.⁷⁷

Chapter 3-Scope, Rules and Securing Charge

The law governs any transaction, whatever its form and however it is denominated, that creates, whether by transfer of ownership, by possession such as in the case of a pledge or otherwise, a security interest in personal property.⁷⁸ This includes a contract for the sale of goods which provides for reservation of title of the sold goods until payment of the purchase price.⁷⁹ Importantly, it also includes the lease of goods having a term of more than one year.⁸⁰ Thus the law includes true leases rather than just security agreements that are disguised as leases but in substance are security financing arrangements. This is important as Afghanistan's emerging lending sector has begun to use

⁷⁴ *Id.*

⁷⁵ The statutory terms used in this Report are those that have common usage in the United States as contained in Article 9 (secured transactions) of the Uniform Commercial Code adopted by all 50 states. These terms and the corresponding term used in the draft law are: secured lender (chargee), borrower (chargor), perfection (completion), security interest (securing charge), purchase money security interest (purchase money-securing charge), and security agreement (securing agreement).

⁷⁶ Afg. Draft Law at ch. 2, art. 4 ("Definitions").

⁷⁷ *Id.*

⁷⁸ Afg. Draft Law at ch. 3, art. 1 ("Scope").

⁷⁹ Afg. Draft Law at ch. 3, § 2.2(b).

⁸⁰ *Id.* at § 2.2(e).

leases as *Shari'ah*-compliant financing devices for which legal framework laws are much in need.

The law is specific in not allowing even a consensual security interest in property of the debtor or the spouse of the debtor that is exempt from seizure under other law.⁸¹ This provision appears to be consistent with existing Afghan practice, which, in the analogous area of real estate financing, prohibits mortgage foreclosure if the collateral is the sole residence of the borrower. Lenders typically require that any real estate collateral be a second non-residence before they will take a building as collateral.

Chapter 4-Effects of a Securing Charge on Parties to the Agreement

The law follows the conventional approach of distinguishing between the attachment of a security interest as between the borrower and the secured lender, and perfection of the security interest which governs the rights of third parties. Attachment or creation of the security interest occurs when the borrower signs a written security agreement granting a security interest in the property described in the agreement, obtains rights in the collateral by becoming owner or otherwise, and the secured lender has given value in the form of credit or an advance to the borrower.⁸² Thus, once the security interest has attached, the security interest becomes effective as between the secured lender and the borrower. Perfection, dealt with in chapter 5 of the draft law, only determines the rights of the secured lender with respect to third parties.

Chapter 5-Effect of a Securing Charge against Third Parties

As discussed, while the security interest arises when it attaches to the collateral, the effectiveness of the security interest in terms of priority over creditors generally and with respect to competing security interests is determined by whether and when the security interest is perfected. As a general proposition, a security interest becomes perfected when it has both

⁸¹ *Id.* at § 3.1.

⁸² Afg. Draft Law at ch. 4, art. 1 (“Creation of a Securing Charge on Collateral”).

attached under Chapter 4 and been registered in the collateral registry or, in the case of a possessory pledge, the secured lender has taken possession of the collateral.⁸³

The priority system is based on a first-in-time rule. A security interest that is perfected has priority over a security interest that is not perfected.⁸⁴ Priority between two or more perfected security interests is determined on the basis of the order in which the security interests are registered, or if perfection is accomplished by possession, the date of possession by the secured lender.⁸⁵ Knowledge of the existence of a prior security interest is irrelevant. While this may seem harsh, it is necessary in order to provide certainty to a system that depends on the objective and easily verified fact of registration, and not on competing views on when a party had knowledge of a prior security interest.⁸⁶ Where there are competing unperfected security interests, priority is determined on the basis of the date of attachment under Chapter 4.⁸⁷

Importantly, purchase-money security interests, that is, security interests given in connection with funding the purchase price of the particular item of collateral, receive priority over a “floating” security interest in the same type of collateral.⁸⁸ In order for the purchase-money security interest to be given this priority, in cases of inventory, the purchase-money security interest must be perfected at the time that the borrower receives the collateral, and the purchase-money lender must notify the lender with the floating security interest in the same collateral.⁸⁹ In cases involving collateral other than inventory, the purchase-money secured lender will have priority if its security

⁸³ Afg. Draft Law at ch. 5, § 1.2.

⁸⁴ *Id.* at § 4.3.

⁸⁵ *Id.* at § 4.5.

⁸⁶ Yair Baranes & Ronald C.C. Cuming, *Handbook on the Albanian Collateral Law* 51 (International Bank for Reconstruction and Development and International Finance Corporation, Wash., D.C. 2001).

⁸⁷ Afg. Draft Law at ch. 5, § 4.4.

⁸⁸ *Id.* at §§ 4.8, 4.9.

⁸⁹ *Id.* at § 4.8.

interest is perfected within 20 days of the date the borrower obtains the collateral.⁹⁰

An unsecured creditor may obtain priority over unperfected security interests by becoming an “execution creditor” before perfection of the security interest or before the secured lender has knowledge of the existence of the execution creditor.⁹¹ An execution creditor is an unsecured creditor who has taken the necessary steps to have the collateral seized pursuant to an order of the court.⁹²

Chapter 8-The Central Charge Registry

Chapter 8 of the law creates the central charge registry, known as the “Registry,” for the purpose of registration of security interests.⁹³ This will operate under the control of the Ministry of Commerce and Industry.⁹⁴ Work will need to commence immediately on the preparation of the necessary regulations governing maintenance and operations of the Registry to include the duties of the Chief Registrar; the fees payable for registry services and the manner of payment of the fees; prescribing the form, content, and manner of use of registration notices to be used to register security interests; and the form, content, and the manner of use of any other notice mentioned in the law.⁹⁵

Chapter 9-Default, Enforcement, Execution and Legal Means

One of the remedies found in secured transaction laws in effect in various countries is the right to proceed without judicial process if it can be done without breach of the peace. This remedy was not considered appropriate in Albania because of the need to maintain public order and peace in a country that had endured various crises in the decade that led up to enactment of the secured transaction law in that country in 1999. Therefore, the Albanian law does not contain any such self help provisions.

⁹⁰ Id. at § 4.9.

⁹¹ Id. at § 5.1.

⁹² Id. at ch. 2, art. 4 (“Definitions”).

⁹³ Id. at ch. 8, § 1.1.

⁹⁴ Id. at ch. 8, § 1.2.

⁹⁵ Id. at ch. 8 art. 2 (“Regulations of Securing Charges”).

Current circumstances are different in Afghanistan. The circumstances make it appropriate to provide for enforcement of security agreements without court involvement. As discussed below, the business community, including both commercial lenders and borrowers, does not presently consider the courts to be of any use in resolving commercial disputes. Accordingly, the Afghanistan draft provides for self help by allowing the secured lender, after default and a 30-day notice, to enforce its rights without court involvement.⁹⁶

Where the collateral is an account, after default, the secured lender may notify the account debtor (which is the person who owes the borrower money giving rise to the account receivable) to pay the secured lender directly the amount of the account owed to the borrower.⁹⁷

When the collateral is of a kind that cannot readily be moved from the borrower’s premises or is of a kind for which adequate storage facilities are not readily available, the collateral may be seized without removing it from the borrower’s premises and may be disposed of on the borrower’s premises.⁹⁸ Any surplus after applying the proceeds from the sale must be paid to any other holder of a subordinate security interest who has notified the secured lender of its interest prior to distribution, with any balance to be paid to the borrower.⁹⁹

The collateral may be disposed of by public auction or private sale so long as the sale is conducted in a commercially reasonable manner.¹⁰⁰ The secured lender may purchase the collateral only at a public sale and only then for a price that is close to the commercial value of the collateral.¹⁰¹ In addition to the process of sale of the collateral, matters may be resolved by the secured lender proposing to take the collateral in satisfaction of the debt. The borrower and

⁹⁶ Id. at ch. 9, § 2.2.

⁹⁷ Id. at ch. 9 at § 3.1 (“Collection of Accounts, Instruments and Security”).

⁹⁸ Id. at ch. 9, § 9.1 (“Seizure and Sale of Collateral on Premises”).

⁹⁹ Id. at § 9.4.

¹⁰⁰ Id. at ch. 9, art. 6 (“Method of Disposal”).

¹⁰¹ Id.

any subordinate holder of a security interest has 15 days to object to such a proposal. Absent objection, the collateral may be taken in satisfaction of the debt.¹⁰² In addition, at any time before the secured lender has disposed of the collateral or retained it in satisfaction of the debt, the borrower has the right to redeem the collateral by paying all amounts owed which are secured by the collateral.¹⁰³

Implementing Institutions

There are two institutions that can be viewed as being necessary implementing institutions in the area of collateral. The first is a **collateral registry**, which provides a mechanism by which security interests on personal property can be recorded for the protection of those lending in reliance on an effective collateral system. The second institution is a **court system** that, in most countries, is the key to the interpretation and enforcement of security agreements. At this point in Afghanistan's development as a modern economy, neither institution is effectively in place for the purposes of collateral-based lending.

A. Collateral Registry

While there is a system in place for the recording of mortgages on real property, lenders in the country making loans secured by personal property collateral currently do so without any reliance on a collateral registry system. Obviously, a reliable registry for personal property collateral will necessarily be part of any new law on secured transactions.

As discussed above, while the new law will create the collateral registry, it will be up to the Ministry of Commerce and Industry to work with the lending community to develop regulations that will result in implementation of an effective collateral registry. Various issues will need to be resolved dealing with everything from the structure of the system, its accessibility, and the forms needed by the users.

¹⁰² Id. at ch. 9, art. 13 ("Payment of the Debt and Retaining Collateral").

¹⁰³ Id. at ch. 9, art. 14 ("The Right of the Chargor to Redeem the Collateral").

Ideally, such a system would be accessible both remotely, by Internet or facsimile, and locally where lenders can physically deliver registration notices. A simple method must be provided for obtaining information as to existing registration statements on file for a particular borrower. Such a system should be both Internet-based and regionally accessible to service lenders who have Kabul offices and lenders outside of Kabul.

The fees to be charged for recording of registration notices and obtaining of recorded information should be nominal with respect to the size of the loan transactions. To the extent that fees charged are disproportionate to the amount of the loans, they will be an impediment to an active commercial lending sector.

B. Courts

Afghanistan's lending and business communities do not perceive that the court system provides a viable method to resolve commercial disputes. Of the many lenders and business owners consulted with respect to this Report, not a single one could cite an example of an instance where a court had resolved a commercial dispute. In summary, the courts are considered to be corrupt, ineffective, unprofessional, and primitive.

Currently, Afghanistan's economy operates at three levels. At the top are the large companies who include in contracts, choice of law provisions requiring the application of the laws of other countries and arbitration provisions requiring the submission of any commercial disputes to foreign arbitration panels. At the bottom, are the "micro" businesses whose disputes are settled through the local *Shuras*, or tribal councils and "village based" peer pressures. In the middle are the small and medium enterprises (SMEs). As discussed below, there is an emerging and promising lending market involving SMEs. Even in this area, however, lenders rely on relationships with borrowers, peer pressure, and careful monitoring of loan relationships to avoid defaults. In summary, at all levels of the economy stakeholders conduct their affairs without any expectation that the courts will be available to assist in providing a resolution of their commercial disputes.

As a result, not only are the courts considered generally not viable in the context of resolution of commercial disputes, but the other participants in a typical system of secured lending are also not available. For example, court personnel such as bailiffs who could assist in enforcing a secured lender's rights do not exist because they are dependent on court orders for authority to act. Similarly, other participants in the typical process of enforcing security interests are currently not organized or needed. These include appraisers, used equipment dealers, and auctioneers. Until the lending market matures to the point where there is a sufficient volume of repossessed collateral to provide a market for these types of professionals, lenders will need to deal with the mechanics of liquidating collateral on an ad hoc basis.

Thus, in Afghanistan, the ability of a lender to enforce rights under any collateral-based relationship is dependent more upon the appearance of rights than upon actual effective rights to seize collateral under court process and have that collateral liquidated to pay the debt. However, when it comes to a loan default secured by collateral perceived to be in jeopardy of repossession from a defaulting borrower, even the appearance of rights can be effective in providing psychological leverage.

Supporting Institutions

The most visible and effective supporting institution in the area of collateral law is the **Afghanistan Banks Association** (Banks Association). The Banks Association is a non-governmental and non-profit association formed by the local and foreign commercial banks in the country in September of 2004. While its formation was relatively recent, it was only at the end of 2003 that Afghanistan's central bank, Da Afghanistan Bank, resumed the licensing process for the formation and establishment of new local and foreign commercial bank branches in the country.

The Banks Association initially started with eight member banks. There are currently 15 commercial banks who are members of the Banks Association: Afghanistan International Bank, Azizi Bank, Arian Bank, Alfalah Bank Ltd, Bank-E-Millie Afghan, BRAC

Afghanistan Bank, Development Bank of Afghanistan, Export Promotion Bank, Habib Bank of Pakistan, Kabul Bank, National Bank of Pakistan, Pashtany Tejaraty Bank, Punjab National Bank – India, Standard Chartered Bank, and The First Microfinance Bank.

Members of the Banks Association have been active with respect to the draft secured transaction law. They have also formed a subcommittee which has worked for a number of months to draft forms that will complement the new secured transaction law. Copies of these forms have been widely circulated among the members of the association.

Afghanistan does not have an active or effective **bar association**, nor an **association of judges**. As a result, there is currently no group of legal professionals who monitor the need for legislative reform and amendment or who can be relied upon to lobby for change. In addition to the absence of any established organization of legal professionals, there is a general absence of Afghanistan **lawyers** who specialize in or focus on commercial law.

Social Dynamics

The recent growth of commercial lending in the bottom two sectors of Afghanistan's economy -- that is in the microfinancing and SME areas -- has been remarkable. This has occurred in the absence of a collateral registry and otherwise working secured transaction law and without any assistance from a formal court system, making this achievement all the more remarkable.

Microfinancing is growing steadily. Depending on the institution, microfinance loans are in the \$100 to \$3,000 range, with most loans being in the \$200 to \$500 range. While the loans are relatively small, in the context of Afghan society, these loans may provide the basis for a small family farm or trading business to operate. Return on these loans is relatively high, typically in 20-30 percent range. The volume of these loans is also quite high, with lenders forecasting a loan demand in excess of 100,000 loans by the end of 2007.

The SME market is also growing quite rapidly. There is currently a very high demand for loans in this market, which ranges from \$3,000 to \$300,000 or higher. Returns here are again quite high with ranges of 20-30 percent being mentioned by lenders. Borrowers in this area run the range of the entire middle class economy of Afghanistan—flour mills, oil traders, meat traders, electronics importers, and similar enterprises.

There is also emerging *Sharīah*-based lending. Loans are structured to assure compliance with restrictions imposed by *Sharīah* prohibiting the collection of conventional interest. Lenders have been able to obtain *fatāwā*¹⁰⁴ assuring borrowers a type of transaction is in compliance with *Sharīah*. A typical *Sharīah* compliant loan is a *murabaha* loan, that is, a “buy/sell” arrangement. Under such an arrangement, the lender buys the item to be financed directly from the vendor. The lender then resells it to the borrower at a mark-up. Because the lender only derives a profit from the mark-up on resale and is paid that amount without interest, there is no “*riba*” or interest involved in the transaction, and it does not run afoul of the *Sharīah* prohibition from the collection of *riba*.

Another area that has seen immediate acceptance and growth is the leasing of equipment. This has obvious advantages. First, this simplifies repossession rights because the title stays in the name of the lessor-finance company. Second, there is no interest involved (at least not outwardly) and therefore, the transaction does not violate the *Sharīah* principle against charging interest. Even though in substance these transactions are economically identical to secured financing,¹⁰⁵ their being classified as leases gives them advantages both in marketing and enforceability.

The progress that has occurred in the area of SME lending particularly in the agricultural area has been greatly aided by current programs such as that

provided by the Microfinance Investment Support Facility for Afghanistan (MISFA) and its programs directed at supporting SME lending. This not only involves the provision of loan capital at fair market rates and the establishment of a loan guarantee facility to reduce the risk of SME lending, but also the provision of technical advice to upgrade the lenders' capabilities to make SME loans. Some of the lenders that were originally started by USAID funding appear, according to their management, to be approaching self-sustaining operations.

The most remarkable occurrence in microfinance and SME lending is the relatively low default rates. Lenders indicated default rates for such loans in the zero to three percent range. This is done without any court involvement and without a working secured transaction law. Even without the legal framework, the loans are structured under terms in which the borrower provides collateral in the form of whatever asset is being financed together with a mortgage on any real estate owned by the borrower. Some of these loans are recorded, some are not. This depends on the personal policy of the particular lender. The cost is significant for those wishing to record such a mortgage - six percent of the amount loaned. Whatever collateral is taken, it appears to be only for psychological purposes. That is, lenders seldom have any realistic expectation of ever taking a defaulting borrower to court and foreclosing on their collateral as a source of repayment.

Rather, lenders depend on local peer pressure, pressure on the community to ensure community sources of financing, involvement of the local *shura*, and the threat that loan documents may create in the minds of borrowers. In addition, the loans are managed very closely. Even a one-day default in payment will be followed by a visit from the loan officer and possibly the credit officer.

A recurring request from SME lenders is the need to establish a central credit bureau. Currently, there is no way that a lender can find out if a potential borrower has other lender relationships with other SME lenders.

¹⁰⁴ Plural of *fatwa*, a legal pronouncement made by an Islamic scholar on matters involving the *Sharīah*.

¹⁰⁵ In a typical transaction, at the end of the lease term, the lessee (borrower), having paid an amount equal to what interest and principal would have been on a loan for the purchase, will be given title to the collateral. Thus, the resulting ownership and costs are the same to the borrower and the lender.

Recommendations

- Work needs to be completed to achieve a consensus among the relevant stakeholders about the form of a new secured transaction law. Modifications to the straightforward and simple approach contained in the current draft should be kept to a minimum. Priority should be given to passage of the new law in the near term.
- Work should begin immediately on the structure of a collateral registry. This should commence with a review of similar systems utilized in both newly emerging and more established economies, with a view of implementing a system that is easy to use by those seeking to file registration notices and to obtain information about previously recorded notices. The system should be computer/Internet based, with accessibility provided to those who do not have computers or the Internet available. Simple forms for filing registration notices should be created and promulgated by regulation. Fees, while required, should be minimal.
- The Banks Association's ongoing efforts to develop forms to assist in the implementation of the new legislation should continue to be supported. These forms should not, however, become part of the law as enacted or the regulations that are subsequently promulgated. This could create the unintended result that changes to the forms to suit a particular situation could lead a court to refuse to enforce the borrower's obligations. Rather, the forms should be "living documents" in that they may be subject to constant updating and improvements as well as being capable of adaptation to the particular circumstances of a transaction.
- The ongoing efforts to support the growing microfinance and SME lending sectors should continue with particular emphasis on technical assistance to upgrade the lenders' capabilities to make loans to SMEs.
- A credit registry should be established under the auspices of the central bank (DAB)—either as a department within the bank or in conjunction with an independent vendor operating under contract with the central bank. As part of this process, similar systems utilized in both newly emerging and more established economies should be reviewed.
- Educational activities should be planned in conjunction with passage and implementation of the new secured transaction law to include the Afghanistan legal, banking, business, academic, and judicial communities. This could include:
 - A separate workshop for the banking community to include (1) a presentation to familiarize bankers with the requirements of the new law, (2) instruction on credit determinations and cash flow analysis for purposes of extending credit in real estate and asset-based lending transactions, (3) a loan documentation class to include a review of the forms developed by the Banks Association, and (4) a workshop on *Sharīah*-based lending to include basic principles of allowed lending practices, loan documentation, and community involvement in the process of *Sharīah* banking.
 - An outreach program to the universities to assist in the training of professors in commercial concepts and laws with a view of developing curricula designed to educate law students on modern commercial concepts.
 - Establishment of formalized and regular judicial training on basic economic and business principles to include study of the new laws and how they relate to everyday commercial transactions.

BANKRUPTCY LAW

Introduction

When a borrower becomes insolvent and is unable to pay its debts as they become due, most legal systems provide a procedure that has as one of its primary purposes the expeditious and orderly liquidation of assets to pay the claims of creditors. Such systems are essential in countries with active economies in which credit is generally available. Without such systems, assets and the conflicting claims of creditors become hopelessly embroiled in prolonged and inefficient legal proceedings, which produce relatively small distributions in terms of recoveries to creditors. Inefficient or nonexistent bankruptcy systems also prevent the redistribution of income-producing assets and employees, with an overall negative impact on the local communities in which previously solvent businesses once operated.

While there are provisions of existing law in Afghanistan that deal with insolvency and the winding up of business enterprises, they are generally unknown even among lenders. In practice, bankruptcy is nonexistent as a viable method of dealing with insolvency in Afghanistan. In a recent survey, Afghanistan shared the lowest ranking in the world -- "No practice" -- in the bankruptcy category with Bhutan, Cambodia, Cape Verde, Comoros, Dominica, Equatorial Guinea, Grenada, Guinea-Bissau, Iraq, Kiribati, Madagascar, Rwanda, Sao Tome and Principe, Seychelles, St. Kitts and Nevis., St. Vincent and the Grenadines, Timor-Leste, Trinidad and Tobago, and West Bank and Gaza.¹⁰⁶

There is presently no active, broad-based effort to enact legislation dealing with insolvency and bankruptcy in Afghanistan. The absence of commercial credit, combined with more pressing legislative needs, has made bankruptcy legislation a low priority among the

stakeholders in the commercial arena. This will change at some point, however, as the country's economy continues to grow and bankruptcy legislation becomes necessary to deal with the defaults and insolvencies that will necessarily follow an active commercial credit industry.

Moreover, the potential possibility of increasing urbanization of Afghanistan's tribal-based society may result in a breakdown of the traditional culture of family, tribal, and honor-based systems of debt repayment. While this may occur only gradually, it does provide time for a corresponding design and implementation of an effective statutory and judicial framework for the enforcement of commercial lending laws and provision for the inevitable bankruptcies of enterprises that fail in an emerging middle sector economy.

However, further work in the area of bankruptcy legislation should be a deliberative process that involves the various stakeholders and takes into account international standards for the drafting and implementation of insolvency laws in emerging countries.¹⁰⁷ This work should involve all of the various stakeholders to include representatives of the lending and business communities through their respective representative organizations, the relevant governmental ministries, lawyers, and members of the judiciary.

Legal Framework

A. Overview

There is currently no viable working bankruptcy system available in Afghanistan to deal with an insolvent private enterprise.¹⁰⁸ There is also the general perception that

¹⁰⁶ Doing Business 2007, "Closing a Business" (*World Bank, 2006, available at <http://www.doingbusiness.org/ExploreTopics/ClosingBusiness/>*).

¹⁰⁷ See Legislative Guide On Insolvency Law (United Nations Commission on International Trade Law, adopted June 25, 2004)("UNCITRAL Guide") at 10.

¹⁰⁸ The scope of this discussion is limited to insolvencies and bankruptcies of private enterprises. The liquidation of state-owned enterprises is governed by Procedures for the Liquidation of State-Owned Enterprises in Afghanistan which have promulgated pursuant to Article

there are no statutory framework laws under which a bankruptcy case can be filed. However, there appears to have been at one time a law dealing expressly with bankruptcy--the Law of Insolvency and Bankruptcy in Afghanistan enacted on 15 Qaus 1321 (1942). Not surprisingly, this law is no longer available in any form readily accessible to the judiciary or public.¹⁰⁹ The bankruptcy laws are not unique in being unavailable to the public in general and the judiciary in particular. This is a recurring theme among those who have reviewed the legal system of the country.¹¹⁰

The Civil Code of 1975 is available, however, and it does contain provisions dealing with the rights of creditors when the debtor is insolvent. Under these provisions, all property of the debtor is subject to the claims of creditors.¹¹¹ However, the procedures contained in the brief, 28 sections dealing with the liquidation of the debtor's assets do not deal with such concepts as who is eligible for relief, appointment of a trustee, the stay of actions of creditors, the rights of secured creditors, the concept of a discharge, and reorganization as an alternative to liquidation.

B. Proposed Legislation

Bankruptcy legislation has been under consideration in the country in concept since 2004. However, in light of more pressing priorities with respect to other framework laws as well as the general perception that bankruptcy laws are generally not needed until credit

becomes available, there is currently no widespread active effort underway to pass a bankruptcy law in the near future.

The last draft of such legislation was circulated in 2005. It is taken from the U.S. Bankruptcy Code.¹¹² While simplified, it nevertheless contains many of the complex concepts central to the U.S. system to including automatic stay, provisions dealing with property of the estate, executory contracts, discharge of debts of individual debtors, appointment of a trustee, avoidance powers, and reorganization.

This proposed legislation has not been the subject of widespread discussion and input from various stakeholders such as the lending community. This is not surprising given that the lending community is currently dealing with the complexities of much more pressing new legislation in the areas of secured transactions, negotiable instruments, and mortgage law. At this point, bankruptcy legislation appropriately is a secondary concern in the context of an otherwise very full legislative agenda. There also does not appear to be any active support for continuing with the current draft as a model for a new Afghanistan law.

At some point, however, work must begin in earnest in a deliberative, inclusive process to review the options available for an insolvency law suited to Afghanistan's needs. In order for an effective and efficient insolvency regime to achieve acceptance in a country where bankruptcy has historically been relatively nonexistent, the process should include observance of several objectives. These objectives recognize that bankruptcy laws must not produce results that are fundamentally in conflict with the premise upon which the general law is based. These objectives include:¹¹³

- The laws should provide certainty in application and predictability of results in the context of a mature credit industry. That is, the laws should promote reorganization of viable businesses and the closure of nonviable ones with the speedy liquidation of assets for the benefit of secured and unsecured creditors. This provides certainty to the credit markets about the consequences of a borrower's default.

73 and 79 of the Afghanistan Law on State-Owned Enterprises.

¹⁰⁹ For example, while a reference to this law was found in an "unofficial and incomplete" draft list of laws obtained in the preparation of this Report, there is no reference to the law in the most comprehensive public collection of Afghanistan's laws available, which is maintained by the International Development Law Organization ("IDLO") (<http://www.idlo.int/Afghanlaws/>). The IDLO was founded in 1983 to give technical assistance, research and publications to governments, non-governmental organizations, local communities and professional associations in developing countries, countries in economic transition and countries emerging from armed conflict. It has 18 member states including the United States and is headquartered in Italy.

¹¹⁰ See, e.g., J. Alexander Their, *Reestablishing the Judicial System in Afghanistan*, Center on Democracy, Development and the Rule of Law (Stanford Institute for Int'l Studies 2004) at 9-10.

¹¹¹ Afghanistan Civil Code of 1975 ("1975 Code"), Art. 831.

¹¹² 11 U.S.C. § 101 et seq.

¹¹³ UNCITRAL Guide, at 11.

- The law should aim to maximize on the value of the borrower's assets. There is an inherent tension between the speedy liquidation of collateral to pay a secured creditor and the need to preserve asset value for the benefit of not only the secured creditor but other secured creditors and unsecured creditors.
- The laws should provide equality among similar creditors. One of the purposes of a centralized bankruptcy proceeding is to prevent the race to the courthouse that would otherwise result if creditors were left to pursue the assets of the debtor independently. In this regard, the laws should address preferences and fraudulent conveyances made to benefit favored creditors or to shield assets from the reach of creditors generally.
- The laws should provide a timely and efficient resolution and wind up of the debtor's affairs. Procedures should be simple with the rights and duties of the participants -- the debtor, creditors, and trustee -- clearly delineated.
- The process needs to be conducted transparently to ensure complete access to information by all participants. The debtor's obligations to provide information about its financial affairs to the trustee and other interested parties needs to be clearly delineated, with participants able to obtain the debtor's compliance with those duties.
- Priorities of certain creditors need to be established. This is a matter of local policy and will be in large part culturally based.
- The type of entity for which bankruptcy relief should be provided should be defined. For example, while consumer credit is generally not available in Afghanistan, personal liability based on a guarantee of a business obligation does exist. A decision needs to be made as to the extent of the discharge of debts to be granted to individuals and the conditions for obtaining such a discharge.

As part of the process of enacting legislation, laws that have been used in other emerging countries should be reviewed both in terms of content and in terms of their achievement of the objectives set forth above. A final draft should be the product of a deliberative effort by all stakeholders.

Implementing Institutions

The primary implementing institution in the area of bankruptcy is the **court system**. It is up to the courts to administer, interpret, and enforce the rights and duties of the respective parties in a bankruptcy case. Unfortunately, Afghanistan's court system is not perceived as capable of providing an efficient method to resolve commercial disputes generally. Rather, the courts are considered to be corrupt, ineffective, unprofessional, and primitive.

The **judges** are also not trained with respect to commercial concepts and laws. Under these conditions, the legal system plays little or no role in adjudicating commercial disputes. Instead, businesses and lenders use informal mechanisms to resolve disputes and enforce property rights. Consequently, the judicial system is not ready to administer the inherently complex process of overseeing a bankruptcy case.

There is a general view among the law reform community that nations need bankruptcy laws to enforce creditor rights. However, providing debtors with a set of bankruptcy laws that invoke an automatic stay against any creditor action – a necessary and typical feature of any bankruptcy law - and that initiate a lengthy legal proceeding, may only make the commercial lending system worse due to the legal uncertainties and delays which will inevitably occur in a country without a legal system able to deal effectively with a bankruptcy case. This conclusion is consistent with a view shared by many development professionals that countries with ill-functioning judiciaries are better off without sophisticated bankruptcy systems.¹¹⁴

For example, Albania adopted a bankruptcy law in 1994 that was generally perceived to be well drafted and consistent with international standards. Soon after the law's enactment, much of the population's savings was lost in a massive Ponzi scheme. However, only one bankruptcy case was prosecuted in the years following these losses. In the Albanian case, the bankruptcy law was essentially irrelevant to the situation because it

¹¹⁴ *Doing Business in 2006 – South Asia Region* (The International Bank for Reconstruction and Development/The World Bank, 2005) at 33.

addressed commercial debt at a time when Albania had almost no commercial lending.¹¹⁵

Although bankruptcy law is certainly important to the long-term economic development of a country, it may have very little importance in early legal reform efforts. The Albanian case is an example of the law reform community wrongly prioritizing. In a country without a mature lending law and practice and without a legal system capable of enforcing it, the focus on less important areas of law reform, such as bankruptcy, may distract efforts from other legislative initiatives. It may also result in disrespect among stakeholders concerning the process employed for other more important and more pressing legal reforms.¹¹⁶

Not only are the courts not ready at this point to deal with bankruptcy cases, but the other participants in a typical bankruptcy system are also not available. Specifically, court personnel specially trained in the administration of bankruptcy cases which typically involve the processing of many, in some cases thousands, of claims, do not exist. Also importantly, individuals with experience as bankruptcy trustees do not exist in the country. Any functioning bankruptcy system will necessarily require the training of individuals in the administration of a bankruptcy case in both of these important areas.

As part of the process of developing a working bankruptcy system to include drafting the necessary laws and training court personnel and other participants necessary to the system, consideration should be given to placing the jurisdiction over bankruptcy cases in the hands of specialized judges. Specialization of courts in the commercial area has been found to be an effective approach in dealing with the complex nature of commercial disputes in a number of countries. This can be done either by the creation of a specialized court or by assigning bankruptcy cases to a small cadre of judges who have been given the training necessary to deal with such cases.

¹¹⁵ Wade Channell, *Making Law Reform Work*, Carnegie Foundation (presentation to Carnegie Endowment Rule of Law Roundtable, November 16, 2001).

¹¹⁶ *Id.*

Supporting Institutions

Because of the absence of a bankruptcy law system in practice, there is also a general absence of supporting institutions typically present in countries with efficient bankruptcy law systems. Such supporting institutions include individuals who regularly serve as **bankruptcy attorneys, accountants specializing in the insolvency area, and workout consultants**. None of these institutions currently exist in Afghanistan.

In addition, there are no **associations of attorneys** and other professionals dedicated to the promotion and enhancement of the insolvency profession. There are also no **judges' organizations** dealing specifically with bankruptcy. As a result, there currently is no group of legal professionals who monitor the need for legislative reform and amendment or who can be relied upon to lobby for change. In addition to the absence of any established organization of legal professionals, there is a general absence of lawyers in Afghanistan who specialize in or focus on bankruptcy law.

While development of these organizations will not occur until a bankruptcy system is started and professionals and judges begin work on actual cases, they are essential to a maturing bankruptcy system over the long term in the input they provide to the improvement of the system, both from a legislative perspective as well as in providing continuing legal education in bankruptcy-related topics.

In addition, there are no **appraisers, used equipment dealers, and auctioneers** experienced in the liquidation of bankruptcy estates. Until the bankruptcy system matures to the point where there is a sufficient volume of repossessed collateral to provide a market for these types of professionals, bankruptcy professionals will need to deal with the mechanics of liquidating collateral on a case-by-case basis.

An existing organization that may be able to play a role in supporting or facilitating the development of the bankruptcy system is the **Afghanistan Banks Association** (Banks Association), discussed in more detail in the Secured Transactions section of this Diagnostic. The Banks Association is a non-governmental and non-profit association formed by the

local and foreign commercial banks in the country in September 2004. Members of the Banks Association have been active with respect to the draft secured transaction law and could play a similar role in the process of drafting and enacting a bankruptcy system.

There is also an active chamber of commerce involved in commercial law issues. This is the 3,600-member **Afghanistan International Chamber of Commerce (AICC)**. The AICC has been involved in the current consideration of three commercial laws considered crucial to developing Afghanistan's economy -- negotiable instruments, mortgage law, and secured transactions.

Social Dynamics

An effective system for the liquidation of insolvent debtors does not currently exist in Afghanistan. And local stakeholders have not expressed any support for the immediate creation and implementation of such a system. The reasons are understandable.

Until current legislative initiatives dealing with such areas as negotiable instruments, mortgage law, and secured transactions are successfully completed with the passage and implementation of laws in these critical areas, there will be no demand for a bankruptcy system. While the commercial lending system is expanding even in the absence of statutory framework laws and an effective legal system, due to low default rates and the availability of informal and traditional non-judicial methods for dealing with defaults, there will be no need for a bankruptcy system. Consequently, there is no immediate impetus to pass a comprehensive bankruptcy law.

Certainly, there is a need to reform the legal system generally. This is an area that affects all aspects of Afghan commercial activity. Obviously, the practice of bankruptcy law when it commences will benefit from institutional judicial reform. However, demand in the area of effective enforcement of contractual rights completely overshadows any needs specific to the prosecution of a bankruptcy case. That is, while the manner in which creditors and debtors are treated under a given bankruptcy system influences the extent

to which lenders are willing to extend credit and to commence bankruptcy proceedings in the event the enterprise-debtor fails, Afghanistan's needs for institutional judicial reform exist at a much more fundamental level.

Recommendations

Until the environment for commercial and consumer lending matures to the point that commercial and consumer credit are widely available, bankruptcy laws will be little used. Accordingly, there is no immediate demand for institutional reform in the narrow area of insolvency and bankruptcy laws. Indeed, if there were any needs in this area, they would be insignificant when compared with the larger needs for judicial reform and the establishment of effective secured transaction laws and a collateral registry system.

Afghanistan's commercial lending sector is, however, experiencing significant growth. This growth can be expected to continue given current trends and projections. This expansion will be increased by the enactment of a comprehensive law on secured transactions (as discussed in more detail in the Secured Transactions section of this Report). An expanded commercial lending environment will inevitably lead to a greater incidence of defaults and the eventual occurrence of sufficient numbers of insolvent borrowers so as to make an efficient bankruptcy system necessary to the workings of the economy.

Accordingly, the following recommendations are made:

- While not a legislative priority given Afghanistan's other needs, work should begin in a deliberative process to review the options available for an insolvency law suited to Afghanistan's needs. This should include a review of bankruptcy laws enacted in other emerging economies and consideration of how those laws have performed in practice.
- A working draft of a new bankruptcy law should be produced giving consideration to: (1) certainty in application and predictability of results, (2) maximizing on the value of the assets available for payment of creditors' claims, (3) equality among treatment of similar creditors, (4) a timely and efficient resolution and wind up of the debtor's affairs, (5) transparency in application to ensure

complete access to information by all participants, (6) determination of priorities of certain creditors, and (7) the type of entity for which bankruptcy relief should be provided as well as the extent of such relief.

- While consumer credit is generally not available in Afghanistan, personal liability based on a guarantee of a business obligation does exist. At some point, consumer credit may also become available. A policy decision needs to be made as to the extent of the discharge of debts to be granted to individuals and the conditions for obtaining such a discharge.
- Once formulated in draft form, the proposed law needs to be circulated widely among the stakeholders to include the lending and business communities through their respective representative organizations, the relevant governmental ministries, lawyers, and members of the judiciary.
- Consideration should be given to conducting a study to assess the viability of commercial courts designated to deal exclusively with bankruptcy and

other issues involved in the commercial credit process.

- Once a draft of the new law has been widely circulated for review and comment, put into final form, and is in the process of passage, educational activities should be planned in conjunction with passage and implementation of the new bankruptcy law to include the Afghan legal, banking, business, academic, and judicial communities. This should include:
 - A workshop for the banking community to familiarize bankers with the new law and bankruptcy concepts generally.
 - An outreach program to the universities to assist in the training of professors in bankruptcy and insolvency concepts and laws with a view of developing curricula designed to educate law students on bankruptcy and other commercial concepts.
 - Establishment of formalized and regular judicial training on basic economics and business principles to include study of the new bankruptcy law.

COMPETITION LAW AND POLICY

Introduction

Competition Law, known commonly as “Anti-Monopoly Law,” is the body of rules designed to promote business competition by preventing domination of any one market by any one enterprise. Although their aim is to promote competition, and thus “consumer welfare,” the laws are generally prohibitive and regulatory in nature. These laws don’t give benefit or license to an enterprise wanting to compete; they enable competition by preventing those who already have a dominant place in the market from crowding the smaller guy out. Their ultimate aim is to promote consumer and national welfare by protecting the market forces that drive quality, fair pricing and the efficient use of resources in an economy.

Afghanistan does not currently have many of the developed markets or market players that might give rise to the need for a Competition Law. Complaints of anti-competitive behavior by rival enterprises are largely anecdotal and are not widespread. A macro view of the economic landscape shows Afghanistan importing roughly eight times as much as it exports and only very slowly building the beginnings of domestic production capacity. There are a number of unique Social Dynamics that are constraining business competition and work in these areas could ultimately help build a vibrant domestic economy that might one day benefit from a body of Competition Law.

Legal Framework

Article X of the **Afghan Constitution** commits the country to a “market” economy.¹¹⁷ The **Commercial Code** of 1955 includes a section on “Illegal Competition” that prohibits (with criminal penalty)

¹¹⁷ Constitution of Afghanistan, available at, <http://www.embassyofafghanistan.org/constitution.html>.

various acts such as using another’s trademark, making libelous statements about another’s business, and bribing the employees of another merchant for the purpose of attracting customers.¹¹⁸ The **Telecommunications Law** has a self-contained Competition apparatus with mechanisms for oversight, enforcement and appeal. Beyond these, Afghanistan has no other Competition Law framework.¹¹⁹

This does not, however, mean that there is an immediate deficiency in this area. For competition laws to positively affect an economy, there first must be dominant market actors that they can work to constrain. In Afghanistan, to a great extent, such actors do not exist. Currently, Afghanistan is notably poor in productive capital. As a result, significant portions of its GDP result not from moving materials internally through the various steps of the “value-add” chain, but from directly (and inefficiently) exporting raw materials and serving as a regional transit hub by importing and re-exporting finished goods between its neighbors. For example, Afghanistan only recently saw the creation of a domestic bottler of purified drinking water (albeit one heavily reliant on importing the bottles from Pakistan).

A common feature in Competition Law is the exception for certain desirable monopolies and what would otherwise be “anti-competitive” behavior. These exceptions are often properly used to allow an enterprise to build capacity in a market and to get an

¹¹⁸ Commercial Code of Afghanistan, available at, [http://www.idlo.org/AfghanLaws/Afghan%20Laws/CD%20Laws%201921%20-%20to%20date%20in%20English/Afghan%20Laws%20in%20English%20\(and%20other%20languages\)/The%20Commercial%20Code%20of%201955.pdf](http://www.idlo.org/AfghanLaws/Afghan%20Laws/CD%20Laws%201921%20-%20to%20date%20in%20English/Afghan%20Laws%20in%20English%20(and%20other%20languages)/The%20Commercial%20Code%20of%201955.pdf).

¹¹⁹ There is a Proposed Competition Code and a Revised Illegal Competition Code (changing the 1955 Commercial Code) that was drafted in late 2004 by lawyers in Washington, D.C. These texts are not on the legislative agenda according to sources in the Ministry of Commerce.

industry off the ground. In this context, the absence of an Afghan Competition Law can be seen to work much as an exception to Competition Law – but with the benefit that there is no ambiguity about the “exception” and no mechanism for Government actors to interfere by inserting themselves as an “implementing institution.” Without fail, everyone interviewed during this study prefers a healthy horse of Afghan industry walking before a cart of Competition Law working to constrain it.

As a result of the current state of Competition Law, there is no “implementing institution,” and few “supporting institutions” to discuss (those that do exist will be examined in the following section). There are, however, a number of social dynamics that are constraining competition in Afghanistan.

Social Dynamics

Afghanistan is a land of great diversity in geography, climate and custom but one whose people are, to a person, creative, industrious and determined. Afghanistan was long known for producing the finest fruits, nuts and carpets in the Central Asian region and also as a progressive center of art and culture. Most of the notable social dynamics that currently stymie business competition are a result of Afghanistan's recent history of communism, authoritarianism, and war.

A. Post-Authoritarian “Hangover”

Afghanistan was ruled by a Communist government for the 14 years between 1978 and 1992. The Communist state ostensibly controlled most aspects of the human experience. Speaking, reading, learning, travel, association, and commerce were all subject to the *diktat* of the State. The government sought to control by force and deterrent, such as punishment for unauthorized activity, but also by persuasion. Through its campaigns to educate citizens on the social values of Marxist-Leninism and to show the government as a benevolent and stabilizing economic force, it won many converts. While Soviet influence was the compelling factor in this form of government, its servants, implementers and rulers were Afghans. Afghans who were 20 years old during the peak of those years are

now in their 40's, those who were 40 are now in their 60's. Many of them serve in government; many of them teach or are otherwise influential in academia.

I. Decree Mindset

Partly as a result of custom and partly as a result of communism, official Afghanistan exhibits a permission-based or “decree” mindset. This is a paradigm in which acts are forbidden unless they are implicitly or explicitly authorized. This dynamic manifests in the commercial sphere on the small, medium and large scales. For example, workers typically need to be closely supervised and told exactly what to do and how to do it. Would-be small businesses are discouraged from starting up because multiple iterations of the dynamic mean that the licensing “authority” needs to be told by someone else that it's okay to issue a license. Another current example is the Ministry of Finance reportedly having concerns about a successful finance company being illegal because the Corporate Law does not specifically provide for “finance companies.” The decree mindset is a dynamic that at best creates exhaustive opportunity for consultation and consensus but at worst is the bane of that commercial initiative which is the cornerstone of a market economy.

2. Personal vs. Positional Authority

A closely related dynamic is that personal authority is universally recognized and positional authority isn't. Thus, the “who” in who authorized a particular activity is almost always more important than the statutory basis for that authority. (And written rules or laws without an authority figure to speak them are usually unpersuasive.) Often the two authorities coincide and make the distinction meaningless. However, sometimes they don't – resulting, for example, in a bureaucratic log-jam when a deputy cannot issue orders on behalf of a principle or a principle cannot bind the actions of his office beyond his personal tenure.

Taken together, the decree mindset and the primacy of personal over positional authority make for slow going in the commercial realm. Would-be businessmen and women are reluctant to behave creatively and competitively without the direct and express permission from an individual of superior authority. A

worthy challenge then is how to replace a decree-based regime of permissions and personal authorizations with an open playing field constrained only by a regulation-based regime of rules in order to promote commercial initiative.

3. “Goverbusiness” or “Busniment”

For many Afghans, the concepts of “business” and “government” are not separate – nor should they be. For commerce beyond that of informal micro-enterprise (subsistence farming and survival trading) the population is familiar with the paradigm of government providing essential goods and services and regulating the prices of those things it didn't provide - in essence, consumer protection. The idea of an economy independent of the government that could “grow the pie” or “raise the tide” economically to everyone's benefit is practically unknown. The dominant paradigm is generally one of fixed sums. The assumption is that whether it is donor money or minerals in the earth, there is one pot of riches for everyone to share and that good economics – from the personal perspective – means that everyone gets his or her fair share. The state was long the steward of that fair share. Municipalities had Offices of Price Control which would set, and then post in shops and markets, the authorized price for most goods and services. Afghanistan is now constitutionally bound to a market economy and the municipal Offices of Price Control have been renamed the Internal Trade Offices. The price lists still remain.

Years of government business have built relationships, attitudes, employee rolls and balance sheets that are difficult to undo. One ministry of the government is in the business of transporting and distributing diesel to other ministries simply because the customs tradition is to levy an in-kind tax on diesel from trucks crossing into Afghanistan. Another has been in the (largely unproductive) business of drying fruit because it holds the payroll of workers remaining from a long-ago obsolete State Owned Enterprise. Many surmise that the future of Afghanistan's chambers of commerce will be, in fact, one chamber. That chamber being the vestige of the Chamber of Commerce under Communist times which will be brought back under the government wing by fiat since it is rumored to have

vast land holdings that are reclaimable only if it again becomes a part of government. These conundrums are difficult to resolve – especially in an environment where authority is not effectively delegable. They will take time, but more importantly, they will require personal will and common vision.

A market economy has been declared but very few have a confident or optimistic idea of what that exactly means. Some believe it means total freedom from all laws, some believe it means freedom to produce for international markets - to the exclusion of domestic consumers - and most are rightly convinced that it means the end of government handouts. All of these dynamics militate against change. The businesspeople and bureaucrats most critical to the enactment of change are those who believe they have the most to lose from it. A challenge presented by this dynamic is to enable these people to believe that they have the most to gain from change and to get them to enact it.

B. Post-Conflict “Hangover”

Afghanistan is a country at war and has been for 28 years, more or less. Between the years 1978 and 1992 an estimated one million Afghans died and another five million fled for their lives. From 1992 to 1996, an estimated 70% of Kabul was destroyed by shelling. Just over five years ago, the capital was controlled almost completely by the Taliban. Afghans are not necessarily committed to the idea that there will be a tomorrow, or that if there is, it will be any better than today. History, for them, suggests that it may well turn out worse. It is essential to recognize that Afghanistan is a nation of individuals who have recently known personal loss of a magnitude unimaginable to the average modern Westerner. Against this backdrop, it is difficult to expect that there will be an appreciation in Afghanistan of, for example, the “time value of money” such as there is in the West. The lack of a Western perspective (a slightly optimistic view of a certain future) on time also shows itself in other situations. Businesses are valued as the sum total of their fixed, moveable and real estate assets – nothing more. There is little application for the concepts of “going concern” or “goodwill” in the valuation of an enterprise or a proposed venture. Thus, the concept of mortgaging the

future to get things started today doesn't provide the same leverage it does in the West. The future just simply isn't something to be counted on yet.

Those Afghans who remain continue, understandably, to practice the politics of personal survival. They have been told by successive governments that everything will be better after every new societal upheaval and, for the most part, those promises didn't materialize. The survivors are skeptical of today's new national order and the changes that are coming with it. They are concerned for the continued survival of their families and that there still isn't apparently enough to go around. They are reluctant to discard the beliefs and modalities which have gotten them to this point because those beliefs and modalities are apparently superior to those possessed by the Afghans who didn't make it – or they are, at least, good enough. Petty corruption, *baksheesh*, cash-first, keeping a low personal profile, and "it's all who you know," are not unusual manifestations of the survivor experience. They aren't necessarily signs of hopelessness, but they do indicate that Afghans may be, by Western standards of time, slow to modernize and slow to participate in and trust their system.

C. The "Middle"

A prosperous middle class is almost universally recognized as a critical factor in a country's economic growth and consequent political stability. Informal institutions serve informal businesses on the micro-enterprise or "survival economy" level and major market players often play by international rules and are able to negotiate special concessions from the government. The "Middle" – which represents Afghanistan's greatest potential for universal growth and global market connectivity – has inadequate supporting institutions for business.

In Afghanistan, informal institutions serve informal (unregistered) business at the micro-enterprise (survival trading and subsistence farming) level. The *hawalas*, the uniquely Islamic financial system of informal currency trading and money forwarding, provide an avenue to move money over great distances in a largely cash economy. The *shuras*, or councils of elders guided by Afghan custom and Islamic tradition,

regularly decide all matters of dispute from quarrels over land to commercial matters and even wrongful death or injury. Sanctions are often in the form of public approbation and a mandate from tribal elders that the victim be compensated by the wrongdoer.

Given a national literacy rate estimated at about 36%,¹²⁰ information about markets and business opportunity is most often passed by word-of-mouth at regular and informal gatherings. Financial assistance is usually provided by close or extended family – the idea of borrowing from a bank is relatively new and unknown in many areas outlying major cities. Ownership of property is often decided according to existing physical manifestations (such as walls or gates) and a community's best oral recollection. Spiritual direction comes from the mosque and community elders and, as is the Islamic tradition, provides guidance on a full range of matters crossing both the personal and professional spectrum.

The result is that informal businesses in Afghanistan have access to what Western eyes would consider to be basic services from other informal institutions. Since, however, membership in each of these informal institutions is often overlapping, (a *Shura* may have as a member a village elder who has some clerical standing and loans money or works with the *Hawala*) the perspective of the informal business is one of receiving aid and assistance from the community at large – as an integrated and seamless whole. This perhaps becomes significant at that point where formal, function-specific, institutions attempt to penetrate their markets and compete with the traditional informal regimes for patronage.

Thus far, major market players (e.g. beverage bottling, food processing, telecoms, etc.) have come to Afghanistan with their own support structure and rule books. They are typically financed exclusively from abroad and they enjoy corporate support from operations outside of Afghanistan. They bring such a promise of employment, tax revenue, infrastructure development, and general prosperity that the government can't help but to allow them favorable

¹²⁰ CIA World Factbook (2006).

concessions where permitted by law. Typically these large market players will negotiate dispute resolution provisions with the government that specify a foreign arbitration with a foreign choice of law (e.g. British or American) – thereby removing disputes entirely from Afghanistan's nascent judicial system. They also use foreign finance and finance institutions as a guard against the relative instability of the local currency (the Afghani) and as protection from local bank fees for basic services such as balance transfers that are perceived to be onerous. Currently, their relative prominence in Afghanistan's economic landscape enables them to make personal connections at high levels (ministerial) levels of government. These relationships are indisputable in providing a predictable business environment free of the often unannounced levies and re-negotiations by officials representing other levels and branches of the government.

Informal institutions that support business, being largely dependant on local geography and personal relationships are, for the most part, unsuited to formal business requirements. Formal businesses smaller than the major market players discussed above aren't able to avail themselves of extra-national supporting institutions, or to wield the negotiating power necessary to ensure that their interactions with government remain supportive and not deleterious to their enterprise.

Supporting institutions for businesses in the "middle" are largely in their infancy but are showing great promise. The success of micro-finance (unsecured loans of about \$90 to \$500) has led to the development of Small and Medium Enterprise (SME) financing in most major population centers in Afghanistan. A modern land registry is building data and general acceptance – allowing for the prospect of larger loans at more competitive rates that will be secured by real estate. Chambers of Commerce are offering critical services to SME businesses and promoting the idea generally of middle class businesses being run with the aid of reliable and helpful government institutions.

The common thread in these institutions (and those that remain yet to be built or implemented) is the necessity of government action. The government must

(especially in a decree based society) take affirmative actions to allow for institutions to be built (e.g. banks, credit information bureaus, land titling offices, finance companies) and to prevent their destruction or impairment by other actors (e.g. exclusive license and legitimacy to one land registration enterprise and enforcement of laws against forged currency).

Despite the early indicators of success, significant challenges remain. The lack of a professional civil service casts doubt on the government's ability to erect and sustain these institutions. That lack is largely a product of a need for greater human capital in both written and numeric literacy, education on modern economic theory and practice, and education on the values and roles of the public servant in society.

A vibrant and productive middle class is one in which citizens are engaged in business on every level – as producers, as employees and as consumers. While there will likely be a place for survival enterprises and major market players (and the economies of scale that each represent) for the near future, failure to build the institutions necessary to support the economic "Middle" will result in major portions of Afghanistan's economic potential, and its population, being left behind.

Recommendations

- Continued focus on building economic capacity prior to constraining it with Anti-Monopoly laws.
- The government must be enabled and encouraged to totally and rapidly complete the privatization of the State Owned Enterprises. While it may be uncomfortable in the short-run, privatization of these shell enterprises will produce incalculable benefit by teaching the government and the citizenry that the government is in the position of promoting business – not participating in it.
- Multi-modal education (radio, TV, civic action groups, employee training days, flyers, posters, etc.) across the spectrum of society focused on the following:
 - The benefits of a market economy,
 - Superior authority of laws over the authority of individuals,

- Celebration of creativity and initiative in all areas of life,
 - Celebration of business and industry heroes to a similar extent as war heroes, and
 - The proper role of the civil servant.
- Continued focus on enabling transparent, globally understood, functioning civil and commercial institutions and processes in Afghanistan that ultimately defeat competing informal institutions through superior service.
 - Close and quantified monitoring of industry sectors until such time as a Competition Law regime should be called for by a broad cross-section of businesses, academics, government officials, and would-be investors. At that point, Competition Law should be introduced only in the sectors where it can quantifiably be shown to be required, and then only to the extent necessary to correct palpable deficiencies in that market.

COMMERCIAL DISPUTE RESOLUTION AND COURT ADMINISTRATION

Introduction

Commercial dispute resolution, properly understood, describes a range of mechanisms that can be used by the private sector and government to avoid, manage, and resolve commercial conflicts. These include courts,

Dispute resolution is a system, not an event.

arbitration and mediation, but also informal institutions, traditional conflict resolution approaches, and various

private sector skills such as contract drafting and receivables management, as well as systems that match consequences to behavior – credit information bureaus, self-regulating bodies, ombudsmen, and even property registries.

Courts are normally the last resort for resolving commercial disputes, but when they come into play, they may be the only resort. Consequently, they are fundamental for ensuring the overall integrity of the conflict resolution systems. Afghanistan is currently rebuilding its courts. Though once respected for efficiency and general trustworthiness, the years of Russian interference, civil war and Taliban domination took a severe toll on the judiciary. Today, the country is essentially starting over.

Arbitration and mediation have recently been introduced on a formal basis. A hybrid version, however, has been around for centuries, if not millennia, in the form of the *shura* or *jirga*. These traditional councils of elders mediate disputes between parties, then issue a binding decision, as would an arbitration panel, which is enforceable through community pressure and even the courts. Unfortunately, the system is not always well suited for

“foreigners” – either investors from other countries or outsiders from other Afghan provinces. Consequently, formal systems are needed as an additional option in the commercial sphere.

Other pieces of the dispute resolution system are either missing or damaged. Afghanistan has no credit information bureau for assessing the likelihood of disputes over eventual non-payment of debts, nor is there sufficient public court data to determine past history of potential business partners as defendants or plaintiffs. Contract drafting skills are very limited. There are no collection agencies. Few self-governing bodies – such as business associations – have been structured or established to handle disputes among or against their members. Property registries are being rebuilt for immovable property, and have not yet been established for immovable and intangible property. Within this fractured framework, however, are opportunities for creating a better conflict resolution infrastructure than has previously been available.

This chapter primarily examines the formal systems for court adjudication, arbitration and mediation, including court administration, by separately examining the framework laws and implementing institutions, but combining the analysis of supporting institutions and social dynamics because of the many overlapping themes. Keeping in mind conflict resolution is a system and not simply an event, this chapter will also examine some of the other components of the system noted above that are frequently neglected in the more pinpointed analysis applied to formal commercial dispute resolution bodies such as courts and arbitrators.

For the formal systems of adjudication, the overall legal framework is reasonably sufficient to support the needs

of the developing economy, if applied. There are some gaps, but the basic system of commercial procedure – on paper – will not need substantial amendment for some years. Arbitration and mediation have formally been introduced through the recent adoption of new laws, and these should also be adequate for this stage of development. To the extent that amendments are currently needed, most changes can be accomplished through regulation and internal decree, without recourse to the more difficult process of amending the codes.

The institutional structures are not so robust. Not only did government institutions and civil society organizations retreat or disintegrate during the war years, the underlying educational system was badly damaged as well. As a result, many of those responsible for the administration of justice have minimal educational and practical qualifications to fulfill their roles. As the schools are re-established, new and better qualified judges and lawyers will be available, but it will take time.

The demand for reform is significant. A reliable, trustworthy court system is one of the principle pillars of economic growth. Courts underlie the capacity – or incapacity – of banks to make loans at affordable rates, because the costs and risks of enforcement are critical elements in the calculus of lending. Courts also determine a substantial portion of the stability and safety that investors need to initiate or increase investment. Without reliable “referees” to fairly apply the “rules of the game”, investors stay out of the investment game. Court reform must therefore be one of the highest priorities until the system has been restored.

The current level of instability in the formal system suggests that economic actors *must* primarily rely on informal and alternative systems of dispute resolution for the immediate future. The *shura* or *jirga* systems, while imperfect, enjoy popular legitimacy at many levels, and even hear conflicts between sophisticated investors. Reliance on these structures has risks, but ones that can be managed and reduced. Use of formal structures will increase only as users begin to perceive them as trustworthy, so that there is likely to be a

natural evolution toward use of formal courts, if the courts provide benefits greater than those currently provided by the *shuras* and *jirgas*.

The informal system, at heart, is significantly similar to formal mediation and arbitration systems. As such, it provides a cultural foundation for growth in these alternatives. While not suitable for some types of conflict, the average business conflict can be handled adequately through these approaches. Indeed, shifting reliance to alternative forms of resolution will help create a better long-term approach to commercial conflicts, in which the courts will more appropriately emerge as the last resort, instead of becoming the backlogged, unproductive first resort that they have become in so many transition countries that do not have effective CDR.

Framework Laws

Several laws define and govern the courts, providing them with jurisdiction over commercial disputes. Together, they lay out the structure, rules of procedure, and competencies of the judicial system. Separate, additional new laws establish a legal basis for arbitration and mediation. This analysis focuses on systemic strengths and weaknesses of the commercial dispute resolution system; other recent work on the courts provides highly detailed analyses that need not be repeated here.¹²¹

The Afghan Constitution

The Constitution of Afghanistan clearly sets forth the judiciary as a unitary system for civil, commercial,

¹²¹ **Armytage, Livingstone**, “Justice in Afghanistan: Rebuilding Judicial Competence after the Generation of War.” Draft prepared for the Heidelberg Journal of International Law, edited November 26, 2006. **U.S. Agency for International Development**, “Rule of Law Project: Field Study of Informal and Customary Justice in Afghanistan and Recommendations on Improving Access to Justice and Relations between Formal Courts and Informal Bodies.” April 30, 2005. **International Crisis Group**, “Afghanistan: Judicial Reform and Transitional Justice.” ICG Asia Report No. 45, January 28, 2003. **Wardak, Ali**, “Building a Post-war Justice System in Afghanistan” Kluwer Publishers, Crime, Law and Social change 41:319-341.

administrative and civil claims. The judiciary is an independent branch (Art. 116) with its own budget (Art. 125) prepared by the Supreme Court in consultation with the executive and legislature. The judiciary has exclusive jurisdiction over lawsuits between and among individuals, entities and the state (Art. 120), and Supreme Court has authority to review laws, regulations, and other legislative acts for compliance with the Constitution. (Art. 121) This constitutional authority, however, may only be exercised at the request of the government or other courts. In practice, private parties do not have standing to challenge the constitutionality of laws or state – unless they can convince a lower court to examine such issues, the issues cannot be raised with the Supreme Court.

The Supreme Court is responsible for regulating the performance and behavior of all judicial personnel (Art. 124) in accordance with general laws affecting government employees. Other than Supreme Court judges, who serve under a non-renewable appointment of 10 years, there is no express tenure security for the judiciary. They can serve until 65 years of age (with the possibility of extension beyond 65 based on judicial need). Presumably, they cannot be dismissed without cause, but this is not sufficiently defined or regulated at this time.

Law on Courts. The *Law of the Organization and Authority of the Courts of the Islamic Republic of Afghanistan*, dated Hamal 11, 1390 sets forth the structure and jurisdiction of the various bodies constituting the independent judicial system, including the fact of its independence from the executive and legislative branches of the state. (Art. 2) The structure includes separate specialized divisions (*dewans*) and courts to deal with commercial and civil matters. This structure should permit increased judicial specialization in commercial issues over time, but there is little specialized knowledge at present.

The *Law on Courts* sets up a system of primary courts throughout the country, with flexibility to increase the number of *dewans* (including “traveling courts”) (Arts. 2 and 50) as necessary to meet demand. For commercial matters, the law stipulates that each district capital shall have a commercial court. Currently, there are only four commercial divisions operating: in Kabul, Herat, Jalalabad and Mazur.¹²²

Appeals are heard by the Court of Appeals in each district. In some cases, it appears that these appellate courts are also acting as courts of first instance due to insufficient staffing of Primary Courts. At both the Primary and Appellate levels, cases are to be heard by a three-judge panel, meaning that each *dewan* of each court should in theory have at least three judges. In practice, this is not always the case at the primary stage due to insufficient staffing; the law, however, provides for fewer judges when three are not available. (Art 6(3)1)

The Supreme Court is the court of final appeal, staffed by nine judges who are appointed by the President, subject to approval of the Parliament (Constitution Art. 117). The Supreme Court has 4 *dewans*, and cases in each are heard by the two judges. Each judge currently

COURT STRUCTURE AND DIVISIONS (Dewans)

Supreme Court	Primary Courts	Court of Appeals
General Criminal	Central Provincial	General Criminal
Public Security	General Criminal	Public Security
Civil and Public Rights	Civil	Civil and Family
Commercial	Public Rights	Commercial
	Public Security	Public Rights
	Traffic Criminal	Juveniles
	Juveniles	
	Commercial	
	District	
	Family	

has four judicial advisors, who are professionals having at least ten years of judicial experience. (Arts. 20 and 21) As such, the Supreme Court is a magnet for the most highly qualified judges in the country. These

¹²² This number is in dispute. According to some respondents, only Kabul and Herat have functioning commercial primary courts.

advisors analyze and comment upon cases for the judges.

Judges are appointed by the Supreme Court, with approval of the President. The *Law on Courts* also sets forth the qualifications (Art. 58) as:

- 25 years of age
- Citizen of Afghanistan (for at least 10 years)
- Lack of criminal record or performance-impeding disability
- Graduation from a faculty of law, *Sharī'ah* faculty, or recognized *madrassah*¹²³
- Completion of a one year internship (*stage*)
- When there is significant competition for judicial appointments, the Supreme Court may add additional requirements. (Art. 58 (3)).

There are currently over approximately 1500 judges in Afghanistan staffing the various courts. As of 2006, approximately 44% of judges held degrees from the *Sharī'ah* faculty. Only 12% graduated from the law faculty, and the rest finished from other faculties (8%) or from *madrassas*, high schools or lower.¹²⁴ As noted elsewhere, none of these institutions currently provides an adequate educational base for handling commercial matters effectively.

The Code of Civil Procedure

Although the commercial courts have their own procedural code (discussed below), the Code of Civil Procedure (CCivP) establishes some important parameters within the judicial system.

First, the CCivP recognizes the use and legitimacy of the Rights Department of the Ministry of Justice, known as the *Hogooq*. The *Hogooq* is technically an optional body for use by citizens in bringing claims. (CCivP Art. 12). In practice, however, the *Hogooq* acts as only the intake department for all cases of first instance and is responsible for handling all judicial enforcement. The option of commencing a matter in court or in the *Hogooq* does not exist in practice: the

Hogooq handles *all* filings. As further explained in Implementing Institutions, below, this executive agency has become an important arbiter of what cases may appear in court, which can compromise the independence of the judiciary. At the same time, it serves as an effective dispute resolution filter that reduces backlog through mandating mediation.

The CCivP also attempts to put limitations on the legitimacy of customary dispute resolution through the *shuras*. According to Article 490, “the decisions and rulings of non-judicial gatherings in civil matters and public rights are not valid.” In practice, however, the *Hogooq* and the courts accept and confirm *shura* decisions on a regular basis. This limitation does not affect arbitration and mediation conducted in accordance with the laws regulating those forms of CDR.

The CCivP also reinforces the Code of Commercial Procedure (CComP, discussed below), which sets forth an essentially common law style of adjudication. Instead of a multiple hearing system common under civil law jurisdictions in which the judge drives the case and is responsible for establishing material truth, the two procedure codes set up a more limited role for the judge within limited hearings and a single-event trial. The CCivP expressly states that “the court is a venue and not a proving party.” (Art. 500). While an effective alternative in the universe of judicial options, many Afghan judges are trained in or more familiar with the inquisitorial style, in which they share with the parties the burden of requesting evidence, pleadings, and argument. In practice, many judges actually manage their cases in an inquisitorial manner.

Finally, the CCivP establishes the sources of law that should be used to settle claims. Legislation is primary, but in the absence of clear legislation, a judge is to use “fundamental principles of Islamic law.” (Art. 501) Although not stated, when there is no *Sharī'ah* principle to apply, judges may also turn to custom and practice.

The Code of Commercial Procedure

Practice before the commercial *dewan* is expressly regulated by the Code of Commercial Procedure (CComP). In theory, the procedures set forth should

¹²³ Madrassahs are religious schools that terminate at the high school level. Because of population displacements in the past 30 years, the courts recognize both Afghan and Pakistani madrassahs.

¹²⁴ Armytage, p. 5.

establish an efficient and flexible system for hearing cases in a timely manner. In practice, delays, exceptions, and failure to apply procedure have undermined the design, impact, and output of the courts.

The CComP sets up a limited series of pleadings by which parties can set forth and refine their claims and defenses. After provision of pleadings and evidence, the judge is to hold a hearing and set a trial date. According to the provisions of the law, most cases should take no more than six months, absent legitimate, approved delays. According to interviewees, most claims take years. Once an opinion is issued, additional delays accrue during generally ineffective enforcement proceedings.

Although generally sufficient for the needs of commercial claimants – if applied – the commercial procedures lack a system of scale. All claims – whether \$10 or \$10 million – are subject to the same courts, procedures and requirements. Claimants are not required to have counsel; consequently, very few do. This is neither surprising nor inappropriate for small claims in which the expense of lawyers is not justified by the size of the claim, but in more sophisticated cases, the lack of legal professionals undermines the quality of legal adjudication. Higher value cases should require the use of legal representation. Over time, it will be useful to regulate small and higher value claims with more appropriately tailored provisions. This is not, however, a high immediate priority given the more serious challenges facing the courts.

The fee structure for bringing claims is inappropriate and will need to be amended, sooner rather than later. There is no initial fee required for filing a lawsuit. Instead, fees are awarded upon judgment as a percentage of the award, and are levied against the losing party. The size of the fee (11% of the award for a successful plaintiff; 1% of the claim for an unsuccessful plaintiff) has no relationship to the costs or quantity of the judicial services rendered.

This fee structure is undesirable for a number of reasons. First, by assessing fees only at judgment, the judiciary subsidizes private parties in their use of the courts. Courts are essentially free of charge for the

months and years it takes to get to judgment. If the parties simply stop pursuing the case, judges can theoretically close the case and levy a fee, but this will take years, if it happens at all. For commercial claims among non-indigents, there is no sensible economic or revenue reason for giving away free services.

The award-based fee also distorts incentives. Neither plaintiffs nor defendants can reasonably estimate the final cost of litigation as part of their calculus of settlement or negotiations. For that matter, the courts cannot effectively predict budgetary needs based on this system of contingent fees assessed against unknown future awards. At the same time, the percentage based accounting creates inappropriate incentives for the courts to award higher fees to make up for shortfalls in budgetary resources. All of these factors serve to discourage legitimate use of the judiciary.

Another eventual change is needed to ensure effectiveness of enforcement. Experience elsewhere in transition countries shows that the post-judgment enforcement proceeding can be abused to create inappropriate and damaging delays. The current law does not expressly provide that enforcement should go forward during appeal or protest, unless the appealing party puts up security for the damage award or is exempted for limited other reasons of equity by the court. Otherwise, the plaintiff's validly adjudicated claim can become interminably thwarted through a long appellate process, with no negative consequences for the defendant. This amendment, however, should not be addressed in the next five years because of the almost universal distrust of the courts. As further discussed in the next section, the courts must re-establish their integrity before efforts are made to strengthen their general enforcement capacity.

Mediation and Arbitration Laws

Afghanistan recently adopted new laws regulating the use of mediation and arbitration. The Arbitration Law of is based on international models and local traditions. As such, it should be readily accepted by the international business community, providing provides a needed sense of security for foreign investors.

Attention in the drafting to local values should also appeal to the local business community.

The Arbitration Law sets forth standard provisions for the appointment of an arbitral body in which each party may choose one arbitrator and those arbitrators then choose another. (Art. 5.4) Unlike judicial litigation, the parties' arbitrators can act as advocates for the positions of those who have chosen them. Indeed, this is the strength of the system – each party chooses someone they trust (normally a technical or legal expert in the subject matter) to set forth and argue their claims effectively. The third arbitrator is a neutral party who can both mediate and guide the process, and cast the deciding vote should the arbitrators not be able to reach consensus. Final decisions can thus be made based on a majority vote.

Once an award is issued, it is enforceable according to its terms by a court if a party fails to comply with the decision. The law appropriately provides few avenues for appeal, because one of the reasons for arbitration is to establish finality. Consequently, the law provides for appeal primarily on the basis of procedure, not on substance. (Arts. 9.4, 10.2) That is, a dissatisfied party can claim that the arbitrators did not follow prescribed rules, or that they acted fraudulently, but cannot appeal the findings or substantive decisions of the arbitral panel.

The potential weakness in the system is practical rather than legal. Enforcement capacity of the courts, as exercised through the *Hoqooq*, is very limited at present. Attention should be given now to establishing a trustworthy system for enforcing arbitral awards (including foreign arbitral awards in accordance with the New York Convention on the Enforcement of Foreign Arbitral Awards (to which Afghanistan is a signatory)). Without effective enforcement, arbitration is a less effective option that can quickly become ensnared in the dysfunctions of the court system.

The Law on Commercial Mediation sets forth a framework by which parties can voluntarily seek to resolve disputes through outside assistance without concern that their discussions will be used against them should they eventually end up in litigation or arbitration. (Arts 21, 34) Indeed, that is one of the

principle purposes of the law, as parties may always seek to settle their disputes with outside help, with or without a mediation law.

According to Article 4:

“Mediation” means a process, whether referred to by the expression Mediation or an expression of similar import, whereby Parties request a third person or persons (the “Mediator”) to assist them in their attempt to reach an amicable settlement of their dispute arising out of, or relating to, a contractual or other legal relationship. The Mediator does not have the authority to impose upon the Parties a solution to the dispute.

This voluntary nature of mediation is what distinguishes the procedures from arbitration and litigation, where the third party imposes an enforceable solution to the dispute. Should the parties come to an agreement with the help of mediation, they can then elect to make the agreement enforceable as part of the contract (Art. 37).

Mediation is an important tool for helping parties overcome conflicts without resort to litigation or arbitration. It is best used when the parties have an interest in continuing their commercial relations by getting their understandings “back on track.” The importance of this law is that it permits parties to negotiate freely without fear that the negotiations can be used against them in court or in arbitration should the attempts fail. Although Afghan society has a long history of mediation and consensus-restoring mechanisms, foreign investors need assurance that their attempts at mediation will not be used against them. This law brings local custom within the ambit of international best practices.

Summary of Legal Framework

The numerous laws defining the commercial dispute resolution system of Afghanistan define a system on paper that could work effectively without major amendments in the short term. Numerous small changes identified in other surveys, as well as more substantial amendments identified above and in those surveys, will need to be addressed eventually. But the

legal framework itself is not the most important issue. The extensive failures of the existing court system to handle commercial claims in Afghanistan is not due to design, but capacity. As further explained below, lack of legal education and ethical standards, coupled with low salaries and inadequate oversight, have led to widespread, apparently deserved distrust of the courts. To the extent that other forms of resolution, such as mediation and arbitration, must rely on the courts for enforcement or appeal, they too are tainted by the judicial ineffectiveness.

Implementing Institutions

As with the laws, there have been extensive analyses of the courts as implementing institutions, and this chapter will not attempt to summarize or repeat that work. Much work is underway to correct, repair, and reestablish the judiciary, all of which needs to be continued and adjusted as necessary over an extended period. Successful judicial reform has proven to be a slow, methodical, deliberate and long-term process, even in stable countries that have experienced little or no social upheaval. In post-conflict, transitional states, almost no significant changes have been achieved in less than 5-7 years and those achievements have tended to take the form of re-designing the judiciary, with implementation beginning only after the re-design has been completed.

Afghanistan is rebuilding a judiciary that was virtually destroyed in the past 25 years. Buildings, processes, training, capacity and management have all suffered devastating impacts since the communist takeover in 1978. To expect substantial results for Afghanistan in less than 5-10 years from today is unrealistic. There are no quick fixes, but short-term solutions are needed and some are even available. These will be addressed below.

Judicial Oversight and Management

The Supreme Court is responsible for oversight and management of the judiciary, except for those functions falling to the *Hoqooq*. Recent changes in the Supreme Court have led to greater emphasis on judicial integrity, which will continue to be a high priority for the courts.

At present, there is widespread perception of corruption in the formal court system, and indications that the perception is not unfounded. Starting judges earn \$50 per month – far below basic needs – yet over 700 candidates applied recently for 170 judicial vacancies. Anecdotal evidence suggests that the positions are highly desired because of their potential for earning rents, and some judges have indicated that positions are for sale.

It is very difficult to prove actual corruption, but the conditions that give rise to rent-seeking opportunities can be attacked nonetheless. The Supreme Court will do well to build internal investigation functions and should consider the Bosnian system in which court users can bring complaints to a judicial disciplinary committee. At the same time, long term effort is needed to create a culture of integrity in the courts. Several areas deserve particular attention:

- **Judicial opinions.** Worldwide, perception and incidence of corruption are greater where opinion writing is weaker. When the basis of a judicial opinion is not transparent, the public frequently attributes decisions to bribery and influence. Afghan judges are legally required to issue written opinions that clearly set forth the relevant facts of the case, the law applied, and the reasoning used. In practice, many judges do not do this, and many are not currently capable of doing so. Without such opinions, there is no clear basis for appeal, which undermines the ability of the parties to ensure proper application of the law. Increased insistence on written opinions, coupled with training in this skill and disciplinary action for failure to comply will help establish a foundation of transparency and accountability that helps to diminish corruption.
- **Judicial remuneration.** Raising salaries alone has not been proven effective in reducing corruption, but it is certainly clear that judges cannot earn a living on the existing salary level. In the past, government employees were provided with low salaries, but also were given housing and transport, thus creating a respectable package of benefits. Today, judges receive only salaries – and paltry ones at that. Increased salaries will be necessary to attract and retain qualified judges and staff. Funding for increases is clearly a difficulty at present, which further emphasizes the need to reform the fee

structure for judicial services as noted above. Structured properly, the courts should pay for themselves.

- **Judicial staffing.** At present, there are approximately 1500 judges serving in the court system. This appears to be more than are actually needed to meet the demand for judicial services at this time. Because of the low repute of the judiciary, most potential litigants are actively avoiding the courts. Judges are reported to hold irregular and infrequent office hours throughout the country. Although there are significant exceptions, judges do not work full time, suggesting that continued hiring is premature. Rather than continue to hire judges who cannot be paid, the Supreme Court would do well to institute a hiring moratorium and concentrate on improving compensation, qualification and accountability of existing judges. If more hiring is to be done, it should probably concentrate on judicial assistants and court administrative staff.
- **Tenure.** The Supreme Court regulates and manages the judiciary within the framework of other relevant laws. There is no clear system of tenure below the Supreme Court level to undergird judicial independence through security in office. Unfortunately, very few judges sitting today are qualified to be there, so that this gap in tenure is actually a benefit. The Supreme Court should therefore set a long-term strategy for providing tenure to qualified judges as they indeed become qualified. This may include a system of testing all judges dismissing those who fail, or setting performance and education levels that judges must meet in a certain period to obtain tenure. Such replacement need not be done immediately (except for cause in cases of corruption or clear incompetence), but should be phased in to begin building a cadre of competent professionals.

The Supreme Court needs to continue and expand its work in carefully establishing internal strategies, goals, procedures and regulations for the ongoing, permanent professionalization of the courts, judges, clerks and administrators.

Court Administration

The courts are being rebuilt. Case tracking, case management, court administration and other standard tools and procedures of effective administration of justice were in complete disarray by the time the

Taliban were driven from power. Many of the court buildings, along with many of their files, were destroyed during the past generation of war. To a great extent, Afghanistan is starting over.

Extensive existing research and reporting on this topic need not be repeated here. It is sufficient to note that Afghanistan has a long way to go. Donors are providing long-term technical assistance to help introduce effective court management and case management, including computer-based case management systems based on improved manual procedures that comport with the recently redesigned civil and commercial procedures. Human resource capacity is the number one challenge to these efforts. Physical infrastructure (including lack of reliable supply of electricity) is also an impediment in many cases, but the low educational level of court staff make it particularly difficult to rebuild. On the other hand, most staff have not been trained in antiquated or inappropriate methods, so this time period does offer an opportunity to train without the impediment of bad habits.

In Eastern Europe, most court administration projects have taken 3-5 years to show significant results and efficiency gains. Afghanistan has an advantage because the court system was redesigned before case management was introduced, so that progress will not be set back by substantial revisions to the underlying codes and rules. Even so, the timeframe is likely to be as long or longer than in Eastern Europe, which started with a much higher level of education and experience. Substantial assistance will be needed for a number of years as the new systems are established, piloted, revised and rolled out on a national basis.

The human resource issue takes on an additional dimension in Afghanistan. Most parties to lawsuits are deeply undereducated, not just in legal matters, but in reading, writing and reasoning. Few of these claimants are represented by counsel, even in commercial disputes. As a result, court administration must take into account the need to handle defective filings, incomprehensible claims, and illiterate parties. The *Hoqooq* is addressing some of this problem but more work will be needed.

The *Hoqooq*

The existence and functions of the “Rights Department”, known as the *Hoqooq*, are controversial. On the one hand, the *Hoqooq* is an executive agency with power over the intake and enforcement of judicial matters, thus representing a potential challenge to judicial independence. On the other hand, the *Hoqooq* is providing valuable services in promoting alternative dispute resolution and providing services to an undereducated population.

The *Hoqooq* was established under the Ministry of Justice to receive and review complaints of a judicial nature. Although technically optional (CCivP Art. 12), in practice all complaints go through the *Hoqooq* before being sent onward to courts. Today, there are *Hoqooq* offices in 357 of Afghanistan's 365 districts, with a total staff of 950. Educational levels are quite low, with few officials trained in formal law or even *Sharī'ah*.

Hoqooq officials review complaints, help complainants fill out forms or write up their requests, and determine what court, if any, should handle the case. They frequently summon the defendants to discuss the case, and often require the parties to take their disputes to a *shura* or otherwise mediate them outside of court. If the cases cannot be settled through alternative means, or if they should otherwise determine that the cases should go to court, *Hoqooq* officials will then assign the claims to a court and send them forward.

On the positive side, the *Hoqooq* has been very effective at encouraging successful use of alternative dispute resolution and keeping unnecessary cases out of court. This is somewhat similar to mandatory court-annexed mediation used in some court systems, where once in litigation, parties are required to attempt mediation before moving forward for hearings and trial. However, the *Hoqooq* system is substantially different in that officials do not permit use of the courts at all until the parties attempt other means. In doing so they overstep the bounds of existing law and regulations that permit the parties to file in court and bypass the *Hoqooq*.

Once a case has gone to court and been adjudicated, any enforcement required is handled by the *Hoqooq* as

well. They can attach assets, conduct evictions, and otherwise ensure compliance with judicial decisions. In Kabul, the *Hoqooq* has actually performed very little commercial enforcement, and has yet to seize movable property, although such functions are foreseen. This is not altogether surprising: nationwide, approximately 5% of all cases are commercial in nature. There is not yet much demand for judicial involvement in commercial conflicts.

The *Hoqooq* is providing useful services, but the structure is problematic. First, by acting as an executive filter to claims – including claims against the state – the *Hoqooq* can intervene in the independent functions of the judiciary. In fact, such interventions have been reported in which the *Hoqooq* would not permit filing of claims. As the sole enforcement agent, the *Hoqooq* can again undermine judicial independence by failing to carry out its role for non-judicial reasons. The role, jurisdiction, and functions of the *Hoqooq* need to be more carefully established and limited by law and regulation and the responsibilities brought under the independent authority of the judiciary.

As noted, the *Hoqooq* regularly sends cases to local *shuras*; it also enforces *shura* decisions. It thereby validates the system of customary law that has essentially been ignored to date by linking the informal system to the formal judiciary. Unfortunately, this validation is outside of the legally recognized framework. Article 490 of the Code of Civil Procedure appears to invalidate *shura* decisions from a legal standpoint: “The decisions and rulings of non-judicial gatherings in civil matters and public rights are not valid.” By ignoring the law in favor of reality, the *Hoqooq* is improving the actual settlement of claims through a more trusted system, while forcefully highlighting the need for legal reform to delineate the legal authority and jurisdiction of *shuras*.

Shuras

Afghanistan has a long cultural tradition of dispute resolution through local councils known as *shuras* (Dari) and *jirgas* (Pashto). While there are some historical differences between the two, both are traditional councils of elders that can be convened by parties to resolve conflicts. The types of cases brought

before these councils tend to deal primarily with family law (particularly marriage), inheritance, and local property disputes, but commercial claims also appear on occasion.

The approach to resolution is a hybrid of negotiation and arbitration techniques. The convening individuals will present their arguments, answer questions, and otherwise discuss the situation, including options for resolution. The council – generally comprised of six to twenty men – will then deliberate, forge a consensus among themselves, and issue a binding decision. Failure to comply with the decision will trigger a range of sanctions, from traditional social shunning to monetary fines enforceable locally.

The *shura* is the only adjudicatory system in Afghanistan that enjoys the respect of the general population. It is used by Afghans because it works better than the courts: *shuras* are perceived to be cheaper, faster, more just, and more trustworthy than the courts. As a consequence, most Afghans prefer the *shura* system to the judicial system. Even upper level members of the business community in Kabul reported the use of *shuras* to resolve commercial disputes.

The court system is almost unanimously disdained by the general population at present, yet there are thousands of claims being brought annually. (Exact numbers are unknown due to inadequate record keeping and data collection.) When asked why people use the courts instead of going to *shuras*, respondents from the business and legal communities gave two reasons. First, courts are preferred when there is no recognized *shura* to convene, such as in larger cities where major demographic upheaval over the years has destroyed the traditional leadership structures. Second, most respondents felt that claimants use the courts when they know that they cannot win in accordance with law and custom, but believe that they can succeed in bribing the judiciary.

POPULAR PERCEPTIONS OF SHURA vs. COURT		
	Shura	Court
Expense	Low	High
Speed	Fast	Slow
Integrity (trust)	High	Low
Quality	High	Low

On a popular level, the *shura* system is widely accepted, so much so that courts and the *Hoqooq* accept decisions from *shuras* and even defer to them as arbiters of first instance. Yet the system is controversial for a number of reasons. First, this customary system incorporates numerous traditional values and practices that are at odds with generally accepted international standards of human rights, particularly with regard to the rights of women. A number of reformers are concerned that recognition and validation of the *shuras* will be perceived as acceptance of the standards they apply. Second, some officials disdain the system because it is outside the control of the government. It is not established, regulated or overseen by any government agency, but arises instead from widespread tradition based on customary values designed over centuries to ensure the survival of the community. Third, some *shuras* have been captured by influence of local warlords and are perceived to be undermining justice.

At present, most legal reform programs are simply ignoring the *shura* system while rebuilding the courts. There is some wisdom in this approach. The courts are in need of extensive reform and rebuilding, and until they offer competitive advantages over the *shura*, they will not be accepted or preferred by the general population, or even the commercial class. On the other hand, the *shuras* are an integral part of Afghanistan's dispute resolution system and failure to recognize this undermines the credibility of the reformers.

Reformers of the national dispute resolution system would do well to begin recognizing and regulating the relationship of the *shura* to the formal system of courts. Concerns about *shuras* can better be met through formal interaction than through eventual replacement (which is unlikely to happen any time soon). Given that

the *shura* system is here to stay, but that it may perpetuate undesirable practices or be subject to improper influence, Afghanistan should build an interface for recognizing and possibly even formalizing the system. At the initial stages, this should include several components:

1. **Jurisdiction.** The law should set forth exclusive and non-exclusive jurisdiction over subject matter that can be handled by *shuras*. Parties should be free to choose the forum they prefer, with the courts as the default forum when they cannot agree. (In fact, this is already the case.) Placing some matters (capital crimes or forced marriage, for example), within the exclusive jurisdiction of the courts will not necessarily stop *shuras* from handling them, but can be used to judicial enforcement of any decisions outside the subject matter jurisdiction of the *shuras*.¹²⁵
2. **Enforceability.** The strength of the *shura* system is that it is built upon agreement and consensus. Consensus leads to implementation; enforcement is needed only if one of the parties objects to the ultimate outcome. One of the weaknesses is that individuals can be subjected to the *shura* system without actual consent, especially in the case of forced marriages, or where there is no viable alternative in the jurisdiction. To limit such injustice, enforcement should be permitted only when the parties have formally signed agreements in which they accept the *shura* decision as binding. This requires increased formalization of the *shura* system, allowing for greater oversight and regulation.
3. **Appeals.** The various codes of civil and commercial procedure should expressly provide for appeal from *shura* decisions and set forth the basis of the appeal. This can be based upon appeal from arbitrations, which are similar, but should be expanded to include express permission to appeal based on violations of human rights or constitutional protections.

¹²⁵ For example, in attempting to enforce civil rights law in the United States, courts refused to enforce illegal agreements that forbade the sale of homes to minorities. When a community attempted to apply sanctions in the agreements or to stop the sale, the courts simply did not recognize the validity of the agreements and would not permit judicial enforcement. These traditional discriminatory agreements thus lost all force of law.

Clearly, designing an entire system for incorporation of the *shura* system into the formal judicial system is beyond the scope of this assessment. There are, however, numerous legal standards and models that can be used to capture the strengths of this widely accepted institution while addressing the weaknesses.

Appellate Practice

Appellate practice has an apparent inefficiency. Appeals can be conducted as a virtual *de novo* trial. In more established systems, this is not appropriate – appeals should be based only on those matters expressly at issue in the case and should focus on proper application of the law to the facts, or proper application of procedural rules. There should be no new evidence or new arguments on appeal. Otherwise, the system can become mired in interminable delays.

Afghanistan is not ready to reform this facet of appellate practice. Although the law appears to limit what can be presented on appeal, it is not practical to enforce this for a very simple reason: the trial record – if one exists at all – is so sparse as to provide no meaningful basis for review. Consequently, it makes sense that parties to a dispute would need to present arguments, evidence, research and other input constituting the better part of the original trial in order for the appellate courts to understand the nature of the appeal.

Eventually, appellate practice should be reformed to comply with the law. Part of that reform should include insistence on better records from the courts of first instance, with appropriate sanctions for failure to provide them. Until the courts of first instance can produce such records, however, it will be difficult to bring about meaningful change.

Administrative Claims

Claims by or against the state and its agencies are expressly handled by the court system, not by separate administrative bodies. In theory, Afghanistan has specialized judges who can handle such cases more effectively; in practice the specialization does not yet exist. Moreover, there are no separate regulations or court rules addressing the particularities of administrative law, such as exhaustion of administrative

remedies. Consequently, administrative claims are not moving forward effectively.

Given the importance of government contracts generally, and even more so during reconstruction of a country, Afghanistan should give high priority to systematic establishment of regulations, practices, and remedies for breach of government contracts. This should include training of judges, but such training must be within the context of overall reform. That overall system must also include establishment of better drafting capacity within the government. It is reported that few government agencies are currently adequate for drafting of contracts for goods and services, resulting in agreements that are difficult to understand, interpret or enforce. Consequently, the administrative contracting reforms should address the entire range of needs, from drafting to contract management to dispute resolution.

Mediation and Arbitration

Although the laws are in place for both mediation and arbitration, there are not yet any formal institutions handling these procedures. Informally, the *shuras* are conducting similar functions, but separate mechanisms are needed to handle the claims of international and intra-national investors who are not voluntarily within the local *shura* system.

Arbitration and mediation services should be offered on a competitive basis by any organizations or institutions that can provide them effectively. There is sometimes a tendency among donors to implant foreign models that give monopoly or preferential rights to only one institution, such as a national arbitration board, or a national chamber of commerce. In practice, this seldom works out because the lack of competition eliminates incentives for quality service. Consequently, donors would do well to promote the establishment of arbitration and mediation services through a variety of interested organizations, including chambers of commerce, professional associations, industry groups, and even in the courts.

Supporting Institutions

Judicial Education and Training

As noted elsewhere in this Report, there are very few well trained legal professionals, including judges, currently working in Afghanistan. The system is being rebuilt after years of destruction and degradation from an insufficient supply of qualified candidates. As a result, today's judges have virtually no background in commercial law. As of 2006, only 12% of judges had graduated from the law faculty, with the rest coming from the *Sharī'ah* faculty (43%), other faculties (8%), madrassas (16%), and high school or less (21%).¹²⁶

Judicial education must be re-established to ensure a sufficient baseline education for entry level and ongoing training in skills, administration, and application of new laws as they are introduced. Currently, there are a number of courses being provided by a variety of donor organizations in an attempt to raise the educational quality of existing judges. Over the past few years, many of these have been effectively revised based on field experience to adapt teaching style, content and class composition for greater results. (A number of courses now require pre-testing to place participants in classes appropriate to their level of understanding.) In addition, significant work is being done to improve the content and utility of the mandatory practical internship – the *stage*.

While each of these efforts is certainly needed, what is needed more is a systematic and systemic approach. The basic educational requirements should be redesigned to ensure consistent quality geared toward the needs of the courts. The current requirements for judicial education are producing three streams of graduates with markedly different capacities, but who are theoretically fungible. The *Sharī'ah* education is currently more suited to family law, inheritance and some property rights issues, while the faculty of law produces judges more geared toward commercial and civil disputes. Madrassah graduates are an interim measure of insufficient education that should eventually

¹²⁶ *Armytage, p. 5*

be eliminated in favor of professionally trained judges.¹²⁷

From a commercial dispute perspective, it is important to create a basic, mandatory level of proficiency in commercial legal matters as an entry requirement. This suggests the need for improving the commercial law curriculum for the *Sharī'ah* faculty, merging the two faculties (thus providing deeper *Sharī'ah* training for judges from the law faculty and better commercial and civil training for *Sharī'ah* students), or establishing separate qualification guidelines for judicial specialization.

With donor assistance, the Supreme Court is in the process of establishing a judicial training institution that will oversee continuing judicial education. The center will have to concentrate at first on immediate, short-term needs, but must also begin to determine and plan for the long-term needs of the judiciary. This institution should also act to coordinate the various efforts currently underway. By bringing various donor training programs within the ambit of the center, it should be possible to allocate resources more effectively.

In order to effectively re-build the major educational institutions, it is important to continue sending professors and future professors abroad to receive advanced degrees and certification. This approach is more expensive than bringing foreign trainers to Afghanistan who can actively train dozens of individuals, but the cost comparison belies misplaced assumptions. Study abroad brings about invaluable core transformations in understanding, analysis and teaching styles, thus creating a core cadre of professional educators who will return to Afghanistan with greater capacity to transform the overall system. Currently, advanced education programs are being conducted in the West; future programs should seek to utilize educational institutions in Islamic states as well – such as Malaysia and Indonesia.

¹²⁷ *In fact, this is already taking place: entry exams were recently made more difficult in a deliberate effort to improve judicial quality by eliminating the under-prepared madrassah graduates. To pass the exam, they will now need to engage in additional study and preparation.*

Bar Association

In countries with a significant supply of legal professionals, lawyers' organizations, such as voluntary or mandatory bar associations, often play an important role in overseeing the quality and integrity of the courts. In Afghanistan, there are few lawyers and no functioning association to take on this role. To make matters worse, very few litigants even use lawyers and when they do, judges have occasionally questioned why they were there instead of their clients. Clearly, much work is needed to rebuild the legal profession in general. As the rebuilding gets underway, careful attention should be given to creating appropriate mechanisms for interaction with the judiciary.

The lack of readily available commercial law expertise creates numerous problems, but one of particular concern for commercial dispute resolution is a lack of contracting skills. Failure to provide clear terms, clear obligations, and clear remedies within a cohesive contract undermines the ability of the courts to interpret and enforce the agreement. It would therefore be useful to identify high use, high impact specialized contracts, such as basic credit agreements and supply contracts, and provide training to a wider array of stakeholders to establish better skills in drafting, interpreting and enforcing such agreements.

Enforcement Agents

The Afghanistan court system enforces judgments through the *Hoqooq* and its supply of officials. There is no specialized body of enforcement agents such as bailiffs or private enforcement agents. Over time, the country will certainly need a more effective, specialized group of professionals who can seize and auction assets, but now is not yet the time.

Court decisions are all but universally distrusted at this moment in Afghanistan's judicial history. Businesses and the legal community expressed serious concerns about judicial competence and integrity. In short, they do not trust the courts and do not accept the credibility of court decisions, which are considered unjust. Efforts to improve enforcement, therefore, will undermine the stability and credibility of the system, because any such enforcement will be seen as a greater injustice. The

current lack of enforcement capacity is actually beneficial because it hinders imposition of disrespected judgments. All efforts to enhance the general enforcement powers of the court system should follow improvements in court integrity, so that enforcement begins in earnest only as the courts become more trustworthy.

Not all improvements in enforcement can await the long-term improvements in the overall legal system. Commercial activity depends on enforcement of commercial contracts, and the current atmosphere dramatically increases the risks that an investor may not be able to enforce a contract at all, much less in a timely and reasonably cost-efficient manner. Consequently, near-term programs should be instituted immediately.

Keeping in mind that investors do not trust the courts in general, it is important to provide other enforceable options and to assist in giving enforcement power where trust is present. This can be done in several ways. First, commercial arbitration is more favored in a system with under-developed courts, but only if the arbitration awards are enforceable. Projects aimed at building commercial arbitration capacity should also include enforcement components. Second, special attention should be given to leasing and secured transaction cases, which depend heavily on efficient enforcement mechanisms to increase access to affordable credit. This should include rights or self-help, such as repossession, private sale, or other rapid enforcement actions set forth in the underlying contract and supported by law. Third, upper level appeals are generally more trustworthy than lower level court decisions. Within the court system, improvements in enforcement should begin with enforcement of Supreme Court decisions and work their way down over time to the courts of first instance.

Credit Bureaus, Pledge Registries and Collection Agencies

An effective system of enforcement requires that there be consequences for commercial behavior. These can be delivered by courts, of course, but that is only one of the needed mechanisms. There should also be a

system for sharing information about commercial performance, so that those who perform well can establish their credibility, and those who do not cannot simply hide their past failures. At the same time, mechanisms are needed for collecting past due accounts.

Credit information bureaus – whether public or private – provide information on the past credit history of borrowers, including records of late payments, bankruptcy filings, litigation, and, more positively, timely repayment. This permits lenders and potential business partners to assess and manage their risks more effectively. In so doing, they system creates incentives for better performance and reduces the need for court enforcements. Afghanistan has no such system in place, not even a shared list of bad debtors (a “black list”) among banks.

Movable property registries provide a similar function: they list claims against a debtor’s property in a public venue. This transparency results in improved repayment behavior and reduces the possibility of fraud against creditors. It also establishes priority interests in the property, thus reducing conflicting claims and improving efficiency in enforcement. Afghanistan has no registry for pledges of movable property. A secured transaction law is being drafted, however, and will include a registry.

Collection agencies bring discipline to enforcement of contracts. First, they aggressively pursue delinquent debtors as an important step prior to pursuing a law suit. Second, they teach creditors the importance of timely account management because they normally refuse to pursue aged accounts that have languished too long to be readily collectible. Collection agencies are also a component of self-help, in which creditors can delegate their self-help rights to specialists. Afghanistan has no collection agencies.

All of these supporting institutions should be promoted and pursued within a strategic approach to enforcement as a system. Without these supports, the courts will eventually become overloaded with unnecessary claims that could have been avoided.

Social Dynamics

A well functioning system of reliable commercial dispute resolution is fundamental to the integrity of any economy. Investors – whether foreign or domestic, large or small – require certainty and transparency in the rules of the game in order to manage risks and set prices competitively. Without a well functioning dispute resolution system, economic growth is stunted.

There is high demand in Afghanistan for reliable courts and other mechanisms for dispute resolution, but meeting that demand is and will be a significant challenge. Formal systems were destroyed during the generation of war and will take years to rebuild effectively. In the best of circumstances, there is unlikely to be substantial systematic improvement in the court system for at least five years, based on experience in easier jurisdictions. Unfortunately, business cannot wait five years to start growing.

The informal *shura* system is widely accepted and utilized heavily throughout the country by all social classes, including the commercial sector of Kabul. For simple disputes, this system is generally sufficient. For complex commercial transactions, however, it is not appropriate, especially for outsiders – foreign investors and individuals from other provinces or minority ethnic groups. Because it is unregulated, the *shura* system cannot be readily reformed to improve its capacity or its record on rights of women and minorities.

Trust and respect are built over time. The *shura* system is widely trusted and respected; the court system is not. The goal of reformers must be to establish a system that is sufficiently accepted as it provides needed services that it will fill existing gaps in dispute resolution. Eventually, the formal system may even replace much of the work of the *shura*, at least on matters affecting commerce.

Because of the level of devastation in the courts, there are no short-term solutions to repairing them. Systemic, long-term assistance is needed. Yet the business community requires better options today. This can be accomplished, in part, through focusing short-term efforts on creation of new mechanisms built on trustworthy foundations. Arbitration provided by

private-sector organizations, such as the Afghan International Chamber of Commerce, should be encouraged in tandem with efforts to ensure enforceability of arbitral awards. Credit information gaps can be filled over the long term through creation of bureaus and registries, but over the short term it may be possible to insist on “good standing” certification from local *shuras* as a risk-management and enforcement tool.

Current funding for the formal court system is doomed to failure. The high cost, contingency fee structure will keep litigants out of court, or will distort incentives so that they find ways to avoid the fees. The system needs to be restructured on a cost recovery basis that will better ensure a source of funding. This, of course, will have to be balanced with general budgetary needs, but elsewhere it has been shown that revenue earners improve their likelihood of necessary funding lest their revenue potential be undermined.

Afghanistan's culture of consensus provides a strong foundation for building various dispute resolution mechanisms, whether 3-judge panels, 3-arbiter boards, or decision-making by associations. However, there is another context underlying consensus. Directly or indirectly, consensus assumes compliance with Islamic law – *Shar'ah* – and failure to recognize this important parameter can destabilize reform efforts.

In commercial matters, *Shar'ah* is only indirectly applicable. That is:

Nothing in the Qur'an or the *sunna* is directly applicable to such contemporary problems as industrial pollution and traffic control, so regulations for those matters must be set according to nonreligious criteria. To conform with Islamic law, the regulations must be just, equitable, and imposed after consultation with the community, but there is considerable leeway within those standards.¹²⁸

For new institutions and rules to be acceptable to the general population, they must be approved or certified

¹²⁸ Lippman, Thomas W., *Understanding Islam: An Introduction to the Muslim World*. Revised 2nd Edition; Meridian Books, New York, 1995, p. 88.

by an authorized body. Thus the laws of Afghanistan are reviewed for *Sharī'ah* compliance by the Taqin, and all judges are trained in *Sharī'ah*. Donors can enhance the acceptability of support by assisting Afghan counterparts in applying *Sharī'ah* analysis to reforms to demonstrate their compliance with the requisite standards of justice and equity. This can be further enhanced by greater use of experts and reform models from other Islamic countries, as appropriate, rather than rely solely or primarily on Western consultants and orientations, which are inherently suspect in the Muslim world.

In addition, this cultural proclivity requires greater input from the community, to ensure that their very appropriate need for inclusion is adequately addressed. Such inclusion builds legitimacy, but also builds better systems that can be implemented more effectively.

Finally, it should be noted that all reforms should be built as much as possible with national input. There is a danger of Kabul-based reforms being rejected in other regions, especially if people feel that the changes are being imposed, are foreign to the culture, or both. This suggests that commercial arbitration should be piloted – perhaps simultaneously – in all of the principle commercial centers of the country.

There is and will be substantial resistance to court reform. The current system has allowed a high level of rent-seeking behavior. This must be met with both positive and negative incentives. On the positive side, it is clear that current salary and benefits packages cannot meet the basic subsistence needs of an individual judge, much less those of a judge with a family. This must change. But salary increases alone do not stop corruption. Corruption flourishes in non-transparent settings, especially where there is ignorance of the role and obligations of the judiciary. Extensive public education is needed in Afghanistan to create new expectations for an accountable, professional judiciary. This must be coupled with mechanisms for reporting and sanctioning incompetence and corruption.

Recommendations

- The legal professional lacks an adequate supply of legally-educated practitioners, including attorneys and judges. Efforts to bolster legal education should be supported, including law schools, judicial training centers, etc. This education should include specific and targeted education on commercial law. Relatedly, a bar association is needed to support such efforts as well to more generally bolster the legal profession.
- There is a need to increase staffing at primary courts to alleviate the need for courts of appeals to also act as courts of first instance.
- Legal limitations on arbitration, while often not enforced, should be removed from the law to avoid future conflict between accepted practice and the law on the books.
- The length of legal proceedings are unreasonable and as a result do not provide fair protection of a parties economic interests. Delays exist throughout the system, from basic functions of court administration to execution of judgments, for reasons including rent-seeking behavior, administrative inefficiencies and lack of education. The Supreme Court needs to continue and expand its work in carefully establishing internal strategies, goals, procedures and regulations for the ongoing, permanent professionalization of the courts, judges, clerks and administrators. Ongoing reform efforts in this regard must be supported.
- The fee structure for bringing claims is inappropriate and will need to be amended, sooner rather than later. Fees are not based on the costs of the services rendered and are only assessed at judgment. If the parties withdraw a case before completion, fees will likely not be paid, or will only be so after a period of years. the courts cannot effectively predict budgetary needs based on this system of contingent fees assessed against unknown future awards. At the same time, the percentage based accounting creates inappropriate incentives for the courts to award higher fees to make up for shortfalls in budgetary resources. All of these factors serve to discourage legitimate use of the judiciary.
- Judge's salaries should be increased to attract well qualified judges and staff.

- Written judicial decisions should be required in all cases.
- The Supreme Court should therefore set a long-term strategy for providing tenure to qualified judges as they indeed become qualified. This may include a system of testing all judges dismissing those who fail, or setting performance and education levels that judges must meet in a certain period to obtain tenure.
- International donors are providing long-term technical assistance with respect to court administration to help introduce effective court management and case management, including computer-based case management systems based on improved manual procedures that comport with the recently redesigned civil and commercial procedures. Human resource capacity is the number one challenge to these efforts. Physical infrastructure (including lack of reliable supply of electricity) is also an impediment in many cases, but the low educational level of court staff make it particularly difficult to rebuild. Efforts in these cases should be supported as substantial assistance will be needed for a number of years as the new systems are established, piloted, revised and rolled out on a national basis.
- While the *Haqqoq* have been successful at provide alternative dispute resolution services similar to court-annexed mediation, the role, jurisdiction, and functions of the *Hoqqoq* need to be more carefully established and limited by law and regulation and responsibilities such as execution of judgments brought under the independent authority of the judiciary.
- As an integral and respected part of Afghanistan's dispute resolution system, the functions of the *shuras*, and their relationship between to the formal system of courts should be more formally recognized and managed, including the jurisdictional relationship, methods of enforcement, and appeals from *shura* decisions.
- Efforts to reform both administrative and appellate practice should be supported.
- Formal institutions for mediation and arbitration should be created.

OPIUM POPPY

Introduction

The magnitude of Afghanistan's Opium Poppy (Poppy) narco-economy is almost unfathomable, reaching up to 36% of the licit GDP in 2004/2005. It permeates the entire economy and culture of the country, influencing effective demand, providing income and employment in rural areas, supporting the balance of payments, and generating government revenues (from customs on drug-financed imports). On the other hand, the opium



economy contributes to massive corruption, undermines public institutions, and hinders the development of the rule of

law. Though ubiquitous and debilitating in its pervasiveness, and despite impeding the emergence of a vibrant and dynamic economy, the story is not all negative and the Afghan people are making great strides in overcoming the influence of Poppy. The results of this Diagnostic suggest that the licit economy is growing and that some of the legal instruments needed to combat the narco-economy are nearly in place. The goal of eliminating Poppy production, or at least of making the impact of the narco-economy negligible, is near at hand and fully achievable, assuming the right development instruments are supported and the political willingness to sustain them is manifest.¹²⁹

Poppy is an agricultural crop which, when processed, is transformed into morphine or heroin. It is grown during the winter months in Afghanistan. It competes with wheat and other winter crops. Like all crops, when production is high, the price tends to fall – when

production is low (and demand remains high) the price often skyrockets. This tendency is accentuated when farmers produce a large wheat crop (due to good weather and adequate rains). Wheat prices then fall dramatically, forcing farmers to produce more Poppy to compensate for their low wheat crop incomes. Of course, the cycle can be repeated over and over as farmers react to these market signals. Afghanistan's government, however, is intent on reducing or eliminating Poppy production because it is a narcotic crop. Although the new laws and implementation strategies are well-intentioned, initial efforts to enforce the laws and implement the strategy have met with innumerable obstacles and constraints.

Social Dynamics

In a nutshell, farmers in Afghanistan are almost forced into producing Poppy as a means of survival, since everything else in their microscopic environment making up their localized economy was destroyed or denied them during the long period of conflict. Poppy could withstand the harsh climatic regimes and natural resource limitations (infertile soils, lack of moisture), could be financed through *salaam* credit due to the existence of the *hawaladars*, had ready and secure markets when all other markets had imploded, was not perishable, could be sold in dry form and stored for long periods, could be transported easily – was not bulky, and did not depend on any degree of security – it, in fact, contributed to insecurity and criminality. In an economy devoid of contract law and any other potential economic pursuits, Poppy was the only survivor. Unfortunately, Poppy began to take over and dominate the entire economy of the country until after the fall of the Taliban and the rule of law began to resurface.

A. The Context of Poppy Production

Poppy production and opium trading permeate the Afghan economy. Although Poppy has been present in Afghanistan for decades, the recent increase after its

¹²⁹ Photo credit: Dr. Jeremy Burgess/Science Source/Photo Researchers, Inc.

prohibition by the Taliban in 2001 has elevated its value and role considerably, increasing from roughly 10% of the GDP and less than \$1 billion to over 30% of GDP and \$2.7 billion in value. The estimated farm-gate income (derived from an average estimation of how much money the grower of Poppy exchanges his crop for at the site of harvest – the “farm-gate”) is roughly only 20% of the border market value, or slightly more than \$500 million, and given the risks involved in Poppy production and marketing (drought, eradication, interdiction and security payoffs), the realized farm-gate value is even less. Nonetheless, the traders, traffickers, and financiers earn substantial sums of money for handling the opium produced, making up the balance up to the \$2.7 million, though not all of this difference enters the Afghan economy directly. A large portion is transferred outside of the country permanently or enters indirectly by financing the purchase of imports.

B. Poppy Production

What is striking about the production of Poppy in Afghanistan is that the acreage of Poppy production was roughly 50,000 hectares up until 1999 when it jumped to 90,000 hectares. With the arrival of the Taliban in 2001, it fell to naught (7,606 hectares), and then boomeranged to 74,000, 80,000, 131,000 and 104,000 hectares from 2002 to 2005 respectively. Farm-gate prices were also low in the early 1990's, at \$23/kg in '95, \$40/kg in '99, and \$28/kg in 2000. But in 2001 the farm-gate price jumped to \$303/kg, then \$353, \$283, \$143, \$137 per kilogram from 2002 to 2005 respectively. Total production acreage as a percentage of total agricultural land, however, remained at only about 2%. Although acreage and price continue to vary, a strong relationship between price and acreage has not been detected (or the analysis with reliable data has not yet been carried out). However, as rural security deteriorates, production increases; when the intensity of the counter narcotics strategy increases production declines. Nonetheless, although the impact of the strategy has been significant in some places, there seems to be a balloon effect – reducing production in one place leads to its bursting out in another. As the intensity of eradication, interdiction and alternative livelihoods programs has increased,

Poppy production has spread into new districts and provinces where previously there was no Poppy.

C. The Role of Poppy in the Rural Afghan Economy

Farmers in Afghanistan are generally poor, illiterate and often landless. Although Afghan farm production prior to the Russian invasion in 1979 was significant and world renown in vegetables and dried fruit, rural farm incomes have always been low, close to subsistence. During the period of conflict from 1979 to 2001, there were periodic droughts, the animal herd was decimated, and inputs and markets for most crops dried up. Only subsistence crops (wheat, rice, maize and barley) were continually grown, at per hectare gross incomes of only a couple hundred dollars. Farmers had few choices for crop selection that would earn them more than subsistence incomes. Then along came Poppy, which could earn over \$1,000 per hectare (ha) in the early years, and upwards of \$5,000/ha since 2001. A small plot of Poppy earned the farmer a substantial income.

But Poppy production is not straightforward. Poppy production is illicit (in contrast to some countries such as Bolivia that allow for the production of a specified number of hectares for non-narcotic uses) and as a result, there are hidden costs to Poppy production for security and protection. Moreover, with the introduction of the Counter-Narcotics Strategy, the threat of eradication and interdiction is real. Nonetheless, when farmers are marginalized from the mainstream production areas for licit crops, and they are landless and poor, they are more likely to grow Poppy. In the early post-Taliban years most farmers had small plots of Poppy.

There is an insidious nature about Poppy production for the poor and marginalized small landowners and the landless. Those who have no alternative means of income, other than a half hectare of infertile land, are virtually forced into Poppy production. Moreover, these farmers have intermediate consumption needs at time of planting, to pay for the seeds and inputs and to cover personal expenses (emergency medical costs, over-winter subsistence, etc.), and so they take out a loan from the Poppy trader. The loan, however, is not

in dollars, but in delivered opium (usually 30kg/ha at harvest time). At the time of planting the value is only \$50/kg (heavily discounted from the expected harvest-time price of perhaps \$150 to \$300/kg) thus making the loan equivalent to \$1,500/ha. Yet, at time of harvest the farmer must repay the loan with 30kg of Poppy, not \$1,500. The difference between the price at planting and price at harvest is the trader's risk, not the farmer's risk for that 30kg. If the farmer can muster some resources to use more land for growing additional Poppy, he will receive the harvest sale price for that increment; otherwise he will not. This system of credit is known as *salaam* and is linked to the *hawaladar* moneylenders or to the opium traders, who themselves use the *hawala* system.¹³⁰

The insidiousness is reflected in the fact that if the farmer loses his crop to drought or eradication and cannot repay the 30 kg, his debt is monetized, not at \$50/kg, but at the \$150 to \$300 price. He then must take out another loan if he is to have a chance of paying off his debt in the succeeding year. Needless to say, the likelihood of avoiding this spiral of indebtedness is low, and often the *jirga* (tribal) courts ultimately step in to provide relief. In the UNODC report,¹³¹ there were two examples of farmers who were unable to recover from this spiral, and each one was ordered to give his daughter in discharge of his debt.

D. The New Alternative Development Economy

Traditional agricultural production in Afghanistan is centered on the grain crops of wheat, barley, rice and maize, and also some cotton and sugar beets. These crops produce low yields and even lower incomes, generally less than \$500/ha. Fruit and nut trees abound, having been planted years ago, many of them prior to 1979, but their yields are also low and they have not been properly pruned, fertilized or genetically improved. Poppy is grown in the fall along with winter wheat. As irrigation and drainage system are rehabilitated, and the road network reconstructed,

summer fruits, vegetables and spices become feasible. The alternative development approach is to introduce high-value crops for summer production that can earn income equivalent to that of Poppy. Focus group analysis of over 30 fruits and vegetables in Afghanistan in 2004 revealed that these crops generally earn from \$1,500 to \$3,000 per hectare per season, employing up to 300 work days with high labor return rates, very similar to the Poppy. To date, such alternatives have been introduced in and around the major rural centers and farmers in these locations have been able to take advantage of access to inputs (from donor sponsored input supply stores) and the proximity to markets in order to produce these crops in lieu of Poppy. Farmers with sufficient land and capital resources to purchase the inputs, hire the labor and to forego the cash advances normally needed at planting time, have been able to wean themselves from dependence on Poppy.

For smaller farmers located in areas a little further away from the rural towns, or the landless who are being pushed farther into the countryside, the ability to forego growing Poppy is greatly diminished. Growing Poppy gives them access to land through shareholding, provides them with cash advances for inputs and consumption needs, and generates significant employment (500 workdays per hectare compared to 100 for the grain crops). And growing Poppy is less risky than growing fruits or vegetables because it needs less water and is less perishable. Yet, in order to grow the Poppy, they must enter indebtedness, with all the negative attributes that that entails as mentioned above. It is, indeed, a vicious circle, that occasionally ends in the enslavement of a daughter.

There are concentric circles around each rural center where the inner circle offers benefits such as, alternative livelihoods programs of cash for work on infrastructure, the ability to grow high-value crops, and the potential for off-farm wage incomes, and the outer circle plunges the marginalized farmer into the low-productivity trap, where land is less productive or not accessible and the climate is harsh, where markets are far distant, and where jobs are scarce or absent altogether. This is the circle of agricultural production that is condemned to Poppy production as the only means of survival.

¹³⁰ See this Report's Chapter on Money Flows for a description of the Hawala System.

¹³¹ United Nations Office on Drugs and Crime, November 28, 2006.

E. The Agri-Business Environment in Afghanistan

One solution that the Counter-Narcotics Strategy could implement would be to promote the development of large scale agri-business. Given the products produced in Afghanistan, before the conflict and since, the potential for such enterprise certainly exists. But how could one possibly suggest that the environment is ripe for agri-business development when there are constant droughts, harsh winters, wars with the Taliban and Al Qaeda, religious conflicts, lawlessness, and underdeveloped transportation, electric, and sewage infrastructures? Yet agri-businesses are beginning to flourish, the rule of law is improving, finance systems are evolving and goods are beginning to move. There is hope in Afghanistan.

Legal Framework

The Afghan Counter-Narcotics Strategy is aimed at reducing opium production by 75% in five years and eliminating it altogether in 10 years, while concomitantly emphasizing and introducing alternative livelihoods. The Strategy has four key priorities: “targeting the traffickers and top-end dealers; strengthening and diversifying licit rural livelihoods; reducing demand for opium; and developing State institutions at central and provincial levels.”¹³² The Interim Afghanistan National Development Strategy (I-ANDS) redefined the objectives of the counter-narcotics strategy in five general points: i) introducing public information and awareness (to convince people to desist in growing Poppy and inform them about the dangers of using opium), ii) implementing Poppy eradication programs, iii) interdiction of opium trafficking, iv) implementing law enforcement and judicial procedures, and v) developing sustainable alternative livelihoods. In 2005, the government approved a new Counter Narcotics Law (Dec 17,

2005), which lays out significant penalties for corruption and bribery associated with drug trafficking; establishes the procedures for investigating and prosecuting . . . offences; establishes the Ministry of Counter Narcotics . . . to coordinate counter-narcotics activities; and . . . creates new tribunals for drug traffickers and drug regulation. The Law is broad-reaching, covering all types of narcotics crops – Opium Poppy, cannabis plants (marihuana, hashish), coca bush, as well as the chemicals and additives used for their processing – precursors, psychotropic substances, regulated drugs, and mixtures and compounds. The Law covers the field of narcotic activities and duly prohibits any and all uses of illicit drugs.¹³³

Implementing Institutions

A. Law Enforcement

Law enforcement is the responsibility of several special forces within the Ministry of Interior; the Counter Narcotics Police of Afghanistan (CNPA), charged with investigation, eradication and interdiction; the Afghan Special Narcotics Force is assigned to interdiction; and the Central Poppy Eradication Force (CPEF) is in charge of eradication. In addition there is a Deputy Minister to coordinate counter-narcotics efforts in the Ministry of Interior, and in December of 2004, a new ministry was formed called the Ministry of Counter Narcotics (MCN). Within that ministry there is a central Eradication Planning and Monitoring Cell.

The results of the law enforcement were less than expected and fell far short of its goals. Although acreage under cultivation fell in 2005 by 21%, output only fell 2% due to high yields. However, the reason for the decrease was due to a large extent to the fear of eradication. Interdiction increased sharply (from a low base) in '04-'05 but only reached 3.4% of opium output. Eradication rose to 5,100 hectares in 2005, 5% of cultivated area, done mostly by provincial authorities, including “voluntary eradication” where farmers agreed to refrain from planting poppy.

¹³² UNODC (United Nations Office on Drug and Crime), Afghanistan: Drug Industry and Counter-Narcotics Strategy, November 28, 2006 <http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/SOUTHASIAEXT/0,,contentMDK:21133060~pagePK:146736~piPK:146830~theSitePK:223547,00.html?cid=1221>.

¹³³ Counter Narcotics Law, Afghanistan, Ministry of Interior (December 17, 2005).

MAIN FACTORS INFLUENCING FARMER'S FARMER'S DECISIONS TO CULTIVATE POPPY, 2005 ¹³⁴			
For Reducing Poppy Cultivation		For Increasing Poppy Cultivation	
Fear of Eradication	35%	Higher Sale Price	26%
Fear of Imprisonment	20%	Personal Consumption Needs	21%
Forbidden by Islam	16%	High Cost of Wedding	16%
Provincial Poppy Ban	15%	Higher Demand	15%
Lower Opium Prices	5%	Expected Compensation for Eradication	7%
Less Demand	5%	Available "Salaam" (credit)	6%
Higher Input Costs	3%	Low Cost of Inputs	6%
No more "Salaam" (credit)	3%	Sufficient Water	3%

and the government would use all possible means to get rid of the menace."¹³⁶

It is clear that the laws have been formulated, passed and are now being promoted, and that the law enforcement institutions are in place, and that the judicial system is beginning to create the courts and tribunals to address the opium Poppy situation.

B. Alternative Livelihoods

"Alternative Livelihoods" (also sometimes called "Alternative Development" and employed extensively in Bolivia and Colombia), seek to create situation where relatively

In February 2007, however, an Afghan newspaper article stated:

"Afghanistan, the world's leading opium producer, vowed to take strong action against the drug and said it had made a start by destroying thousands of hectares of Poppy fields this year. [Last year 15,000 hectares were eradicated, and 4,250 hectares have already been eradicated this year.] Around 1,500 drug traffickers had been arrested since May 2005 when Afghanistan's first-ever drugs court was opened, Deputy Interior Minister General Mohammed Daud Daud said at the opening of a new court building. The court has investigated 740 cases and convicted 326 people for offences such as selling or transporting opium and heroin, officials said."¹³⁵

The following day:

"Minister for Counter-Narcotics Habibullah Qadiri has said that rooting out of poppies is a gigantic task which will take years. Poppies are the root cause of lawlessness... Cultivation of poppies was banned under the Constitution

high incomes can be earned from licit, legitimate pursuits that act as an alternative or substitute to illicit crops. The program has three components: 1) Cash for Work (a daily wage income offered for work on infrastructure projects such as roads, irrigation, drainage, dams, reforestation, etc.); 2) Alternative Crops (the introduction of crops that earn enough income to substitute for the Poppy); and 3) Off-farm Employment, either on someone else's farm or in a non-farm agribusiness, manufacturing, services or public employment job.

Initially, RAMP – the Rebuilding Agricultural Markets Program (a USAID development project implemented by Chemonics International Inc. from July 2003 to June 2006) – was introduced to address the second component of the Alternative Livelihoods strategy – the development of alternative crops and livestock products, as well as the rehabilitation of the irrigation system and road network. This three-year project had a goal of generating \$250 million in new agricultural sales, and ended up with an impact of \$1.6 billion in increased sales. RAMP was followed by an interim public works project in Helmand Province called AIP – Alternative Incomes Program – to provide cash for work during the Poppy planting, cultivation and

¹³⁴ UNODC, *supra* note at 36.

¹³⁵ Daily Outlook, Afghanistan (February 11, 2007).

¹³⁶ *Id.* (February 12, 2007).

harvesting seasons. (AIP was a USAID “bridge” project between RAMP and the beginning of the Helmand South ALP in January 2005) Work was performed on roads, drainage systems, irrigation canals and various types of water retention systems.

Three Alternative Livelihoods Projects (ALP's) were then developed, one for Helmand-Kandahar, one for Nangahar and one for the Badakhshan province. Each of these projects addressed the first two components of the Alternative Livelihoods strategy, and to a certain extent engaged in the third, but to a much lesser extent. A new RAMP project has just been initiated called ASAP - Accelerated Sustainable Agricultural Program - and through this project the Alternative Livelihoods activities will be spread to five new regions. (This USAID development project will be implemented by Chemonics International Inc. beginning in January 2007 and running through December 2010).

A word is in order with respect to the efficiency and effectiveness of Alternative Livelihoods activities: The RAMP project was designed to rehabilitate the irrigation and road networks that were partially and completely destroyed during the conflict period. In a second phase effort after this rehabilitation, a vast network of alternative income activities were introduced. The most extensive activity with respect to farming was to introduce improved wheat seed through farm trials, and to set up village-based Seed Enterprises to sell and promote these seeds. A second activity was to establish village-based livestock laboratories in order to recover the livestock that were decimated during the conflict period. A third activity was to regenerate the grape sector for fresh grape exports and raisins, complemented with a program to recover the apricot subsector. (Afghanistan supplied 60% of the world's dried fruit in the late 1970's.)

There were four programs that were quite promising: The first was a vegetable program in Helmand and Kandahar. This was followed by a program to introduce tunnel production, to extend the growing season in the spring and the fall for various fruits and vegetables. The third program was for storage of potatoes and onions (which were then currently shipped to Pakistan for storage then back to Kabul in the late winter for

consumption). The last program was the most interesting and innovative; a Canadian company started a contract growing program for vegetables and spices to be dried and shipped to Europe for the instant soup market. Today, this company has a processing facility in Parwan, in the Shomali Plains, where they contract-grow in cooperation with thousands of farmers and export two full containers a week to Europe. A new contract with the Helmand ALP will contract with 4,000 Poppy-desisting farmers to grow chili peppers instead.

The three ALP's mentioned above (Helmand-Kandahar, Nangahar and Badakhshan) have similar stories of infrastructure rehabilitation, cash for work programs, alternative crops, livestock feed and health programs, and intensive activities in marketing. Fifty-nine cold storage container units for crop and livestock products have been installed throughout the country in order to assist in marketing products from those ALP's, including, grapes, apricots, pomegranates, animal vaccines and meat, among others. The one component that has not progressed that well in these programs is Off-farm Employment. Two ginning mills were privatized – one in Kunduz and one in Mazar-e-sharif; a flour mill was built in Kunduz; and a sugar-beet facility was privatized in Baghlan, but many more facilities exist that could be rehabilitated, privatized and put back into production.

Supporting Institutions

A. Investment Promotion Organizations

Much of the Alternative Livelihoods strategy is dependent on the development of crop and livestock production, the introduction of input delivery stores, the establishment of packing sheds, cold stores and processing facilities, and the introduction of agricultural raw material manufacturing. The above-mentioned projects all had investment promotion units embedded within them. In addition, they were supported by several government-sponsored organizations such as the **Afghanistan Investment Support Agency (AISA)**, the **Afghan International Chamber of Commerce (AICC)** and the **Raisin and Dried Fruit Export Promotion Association**.

B. Banks

Developing private sector companies to service and support alternative crops, products and enterprises requires financing. Financing for agricultural pursuits in developing countries is generally absent, ever since the small farm credit movement of the 1960's and 1970's was eliminated by the donor community. When farmers grow subsistence grains and legumes, financing is not needed. But if the farmers are to shift to higher value crops (poppies, fruits, vegetables, etc.) financing for inputs at planting time and during cultivation is required. Savings from last year's crop is unavailable for these farmers because they cannot save from one year to the next on their meager earnings (\$200-\$400/ha/year for grain crops). Therefore, in order to provide an impetus for shifting from grains, legumes, roots and tubers, to high value horticulture, an attempt was made to coax the banking system into lending to agriculture, using the growing crop as collateral. So far, little progress has been made, either through the micro-finance banks or the regular state-run or private sector banks. However, some progress has been made in assisting the banks into lending to agribusiness for trade, marketing, packing, storage and processing, albeit in miniscule proportion. More headway is needed in this area, although it is evident that great progress is being made.

C. Hawala System

A vast informal money transfer system exists in Afghanistan called the *hawala*. During the time of conflict and Taliban rule, when the formal banking system was non-functional, it was the only means of transferring money within and out of the country. That system remains today and is highly sophisticated, and can instantaneously move small and large sums of money anywhere in the country, even from the remotest villages to the modern markets of Dubai and elsewhere. Though it is known to move illicit money earned from illegal crops, it is also the method of choice for financing trade and business throughout the country in lieu of the formal banking system. Financing Poppy production is obtained through *salaam* credit agents who obtain money from the *hawaladars* and pre-finance the crop production. However, *salaam* credit is harder to find now than it used to be.

D. The Private Sector in Rural Areas

Current production in Afghanistan consists of certain subsistence crops, some mining and quarrying, nomadic livestock and the collection of fruits and nuts from the still existing trees which endured the conflict period. Rural enterprises are therefore limited in scope. Encouraging the private sector to move to the rural areas to establish production or processing facilities, given the uncertainty of production and the threat of insecurity, is a daunting task. Serious incentives will be required to break this constraining yoke.

In the trading centers of each province there is more potential and it is here that a smattering of businesses are beginning to emerge, and a new USAID project to promote small and medium enterprises has just begun. However, the private sector can and is playing a major role in the creation of large scale agri-businesses. The RAMP project and other government and donor entities, through a combination of investment promotions, technology introduction and financing (bank, leasing and equity), instigated the formation of two ginneries for ginning cotton (Kunduz and Balkh), a sugar beet factory (Baghlan), the rehabilitation of several raisin and dried apricot factories, a couple flour mills (Kunduz and Kabul), 59 cold storage units, six village-based Seed enterprises, fruit and nut drying and packaging companies, rural poultry firms, over 100 village based veterinary services firms, and the most impressive of all, the dried vegetable company Development Works. Although financing is limited, mechanisms are emerging to finance the "best bets"- extending these support programs into more remote, insecure areas of the country.

E. Infrastructure and Transportation

The irrigation systems are being rehabilitated, and the road network is recovering. Potable water is also being developed. Electricity remains elusive but improving, and in the meantime fossil fuels are available, though costly. With regard to transportation, the biggest bottleneck is that Afghan trucks must off-load and re-load onto the truck carriers of neighboring countries when exporting, and vice versa when importing.

F. Farm Technology

During the Russian occupation, the government's farm technology (also called "extension") system disintegrated. Technology workers still abound and have a degree of knowledge of traditional and fruit/nut tree production technology, but nothing that is very modern. All of the sub-projects of the RAMP project introduced private, donor-supported farm technology, and in the last year of that project, RAMP began working with the government farm technology system. The new ALP's are also working with the government farm technology system administered by the Ministry of Agriculture. Eventually, a system of increased and assisted agricultural technology, both government-supported and private sector-provided through contract farming or business services firms, will be available for all farmers.

G. Industrial Parks

The government has embarked on the creation of five industrial parks. Three are already operating or under construction, and two more are in the planning stages. These industrial parks will offer some services and facilities for business operations, and will be a logical location for several much-needed agri-businesses.

Recommendations

It takes tremendous insight to fully understand the complex opium Poppy production, processing and trafficking economy. Nevertheless, the government of Afghanistan has taken great strides in attacking this issue. Although the Counter Narcotics Strategy is on track, and has the potential of reaching its objectives, more support is needed to ensure that these goals are reached in the near-term. Some recommendations are presented below:

- Continue to **support the Alternative Livelihoods Programs (ALP's)**. In each report reviewed for this analysis, the theme was repeated over and over again, that the eradication, interdiction and enforcement strategy cannot succeed without a strong and comprehensive Alternative Livelihoods Program.
- The new ALP's are going into new areas, more marginal areas, less populated areas, and will need concerted efforts to **stay the course** in the face of insecurity and lawlessness.
- The formal banking system will always lean toward the financing of non-agricultural enterprise. Measure must be taken to coax, encourage even force them into **lending to agribusinesses and agricultural activities**.
- **Support for investment promotion** will take on even more relevance and importance in the next couple of years. Private sector investment will not normally reach down to the rural areas endemic to Poppy – the risks, insecurity, uncertainty, etc. are too high to chance it. What can be done to support investors in going this extra mile?
- **A New Investment Model** – This analysis has not only shown the pervasiveness of Poppy production in Afghanistan, but it has also alluded to the elusive notion that Alternative Livelihoods Programs could assist the legal and enforcement efforts in pursuing its elimination. Where Alternative Livelihoods Programs are implemented in their entirety, Poppy reduction is achieved. But how can the three-pronged approach (1) Cash for Work (a daily wage income offered for work on infrastructure projects such as roads, irrigation, drainage, dams, reforestation, etc.); 2) Alternative Crops (the introduction of crops that earn enough income to substitute for the Poppy); and 3) Off-farm Employment, either on someone else's farm or in a non-farm agribusiness, manufacturing, services or public employment job) work, when security is such that the first two prongs are not feasible – lives will be in danger? The solution: Create enclaves of processing facilities and manufacturing plants for the agricultural products that are currently produced or can be produced in the rural areas, in order to create Off-farm Employment opportunities, the third prong of the ALP strategy.
- **Industrial Agri-business Protected Enclaves** - Afghanistan produces more agricultural product than most countries, including the developed world. Afghanistan is the third largest producer of cashmere, but it is not processed in country – it moves to Iran unprocessed. The country produces 13,000 tons of cotton lint, going to Pakistan, when once 45,000 tons were produced. However, three, maybe four to five, processing plants exist in fair to super condition, which could transform this cotton into yarn, cloth and finished garments, providing

jobs for close to 50,000 people. The wool in Afghan rugs is famous, yet it is un-scoured, and the rugs themselves go to Pakistan for cleaning and finishing. Wool scouring and spinning/weaving plants exist but are not functioning. They could be rehabilitated. Afghanistan has ample mulberry, the food for silkworms, and Afghanistan used to be a major player on the Silk Road, producing large quantities of cocoons, and home spinning of shawls and silk fabric. Flax in the north could be transformed into linen, as it is in Russia and Ukraine. 10,000 animal skins are available each day, due to normal morbidity and off-take rates, yet there is no tannery. Leather garments are made in the bazaar and could be developed into a major industry. The textile industry alone could employ several hundreds of thousands of people.

Food processing is beginning for dried vegetables and Development Works hopes to initiate activities and processing in several cities to complement their Charikor plant. A vegetable cannery once existed in Kandahar, and several raisin and apricot drying facilities could still be rehabilitated. With the new technologies of plastic tunnels and greenhouses, vegetable production could expand immeasurably, and compete directly with Poppy in terms of yield and income per hectare. The new sugar plant in Baghlan will start operations soon, and out grow thousands of hectares of sugar beets.

One should note that for all of these processing industries, women will be employed for the most part, in spinning and weaving of cotton, wool, silk, cashmere and linen, and in the cut and sew of leather garments; and women will also be on the canning and fruit and vegetable processing lines. In most countries, women are found producing the fruits and vegetables, and Development Works often contracts with women for the production of dried tomatoes. Women also do almost all of the nut cracking. Adding value to the agricultural potential of Afghanistan will create hundreds of thousands of jobs as well as bring more gender equality to the workplace.

If the Poppy income per hectare can be made to fall to between \$1,000 and \$1,500, then all of these above-mentioned alternative crops can become competitive as alternatives. Moreover, processing these crops will create thousands of off-farm semi-rural jobs, just what the Counter-Narcotics Strategy sorely needs. Although earlier economic analyses of these enterprises had shown that they

could be profitable, sustainable and competitive, the start-up costs, (given the risks and insecurity of operating in the rural areas where Poppy is grown, in areas which have fostered increased criminality, and where the resurgent insurgents roam), are probably more than a wise businessman would undertake. Some form of incentive, guarantee and security perimeter must be provided in order to lure such investors into taking on these endeavors. Hence, the following are also recommended:

- Create Industrial Agri-business Protected Enclaves, either at the site of the new industrial parks or as stand alone areas if necessary, due to the prior existence of a major factory (around Gulbahar Spinning and Weaving, Spinzar Ginning and Oil Processing, Bost Ginney, Kandahar Spinning & Weaving, Helmand Stone Quarry, etc.).
- Identify and design financing incentives – start-up grants plus long-term financing for rehabilitation and operations, with guarantees provided by narcotics funding. (Similar to what is provided in Bolivia, Colombia, Peru and Ecuador to assist companies to start operating in drug-prone areas.)
- Develop grant-funded contract farming programs with funding for inputs and up-front labor, for those who supply the raw materials to the manufacturing facilities. Possibly allow those suppliers to take equity shares in the new firms, similar to an ESOP (employee stock ownership program). (This would allow the new program to be comparable to the *salaam* credit for Poppy.)
- Identify and develop strong markets for the manufactured goods, through advertising, branding, logos, trade fairs, trade missions, etc. (ASAP is currently developing these kinds of programs.)
- Insist that the companies pay “fair trade plus” premium prices (i.e. 1.5 times the traditional price or better) for the raw material at the factory gate. (Each farmer contracted would sign a document to agree to desist from growing Poppy, as has already been done by the Development Works Canada chili pepper growers who are starting to ramp up in Helmand this spring).
- Introduce grant-funded additional infrastructure – improved roads/bridges, cold storage, transportation – where needed.

FOREIGN DIRECT INVESTMENT

Introduction

Foreign direct investment has grown dramatically in Afghanistan over the past four years. Much of that growth is attributable to growth from an almost unmeasurably low baseline, and much of it is due to native Afghans returning from exile. Foreign direct investment has, thus far, failed to deliver on its promise to grow the business infrastructure of a self-sufficient Afghan economy. Afghanistan remains largely a nation of raw exports and re-exports of goods made elsewhere in Central Asia and beyond that are being traded across its borders. While the legal framework appears to support predictability in investment and return, a lack of supporting institutions and underlying social factors conspire to make Afghanistan's climate for foreign investment less attractive than those of the comparable alternatives.

**COMPARING AFHANISTAN TO THE WORLD:
Rankings that Foreign Investors Notice**

- **Ease of doing business: 162 out of 175**
World Bank *Doing Business in 2007*
- **GDP per capita: \$231.83 (2006 est.)**
U.S. Department of State

Legal Framework

Article X of the **Afghan Constitution** commits the country to a “market” economy.¹³⁷ The **Law on Private Investment in Afghanistan** is a 16-page, 33-article document that does much to reverse incentives granted to investors under previous iterations, but it does more clearly lay out the responsibilities of the government and discuss what

should happen in the event of a dispute.¹³⁸ It orders the creation of standing regulations for the operation of its High Commission on Investment and it specifically charters the Afghanistan Investment Support Agency (AISA) with enumerated responsibilities.¹³⁹ Features such as these are likely to increase transparency and thus investor confidence in the regime. Features such as replacing previously explicit concessions and incentives for investors with language like “to the extent permitted in the Income Tax Law” or “to the extent permitted in the Customs Law” are not likely to increase the predictability of the investment landscape or investor confidence. This is because those other laws are often changing at the hands of other constituencies, both in government and outside of it. There are constituencies that often do not have the promotion of foreign direct investment as their primary aim.

On the surface, little of the private investment law reads to be overly vague or onerous, especially when read in the light most favorable to private investors. For example, the law's attempts to control corporate looting and capital flight appear to have an appropriate exception for legitimate spin-off and sale of unproductive factors of production. The section on arbitration with its explicit references to the International Centre for Settlement of Investment Disputes (ICSID) and the UNCITRAL rules, gives foreign investors a comfortable feeling that the government and its instrumentalities are bound to submit to international arbitration in the event of a dispute. Guarantees for compensation in the event of expropriation, unencumbered repatriation of profits, and freedom to sell part or all of an enterprise are exactly what foreign investors want to see in an investment law.

¹³⁷ Constitution of Afghanistan, available at <http://www.embassyofafghanistan.org/constitution.html>.

¹³⁸ The Law on Private Investment in Afghanistan, available at <http://www.aisa.org.af/Laws/New-Investment-Law.pdf>.

¹³⁹ Website available at <http://www.aisa.org.af/index.htm>.

The **Income Tax Law**¹⁴⁰ sets the corporate tax rate at 20% of profits. Much of it is collectable up front by the government in the form of fixed taxes on imports and exports (2% for each and creditable against annual income tax) and tax on gross business receipts (2% – 10% depending on industry which may be taken as a business expense in determining annual tax liability). The tax code is not overly complicated and generally comports with international practice. The **Customs Law** is relatively detailed and while it provides avenues for appeal and mechanisms to enhance transparency, the law does not reflect an overarching policy beyond that of the collection of duties. The **Company Law**, detailed elsewhere in this Report, has a number of inherent weaknesses, and the **Law on Contracts** is notable for its propensity for rescission or avoidance of contractual obligation.

A relatively recent law on **Secured Transactions** promises to broaden the market for credit in Afghanistan and great strides are being made in the implementation of the **Law on Real Estate** which does allow for private ownership of land. Of note, however, foreign persons and entities are forbidden from owning land. The Law on Private Investment in Afghanistan allows for leases of land in these cases of “up to 50 years.” Laws on **Arbitration** and **Mediation** support the legitimacy of agreements between parties to settle their disputes by means other than the courts. Laws on **Intellectual Property**, **Competition**, **Notarial requirements**, and **Civil Procedure** are currently non-existent. Not all of these absences should be counted as deficiencies: Notaries often serve as a useless bottleneck to business and bureaucracy, Civil Procedure may best be developed along with the growth of an effective court system, and there are good arguments for allowing the growth of industries and economies before constraining them with laws on competition.

The laws discussed above are available electronically and in English. Many of the contemplated implementing regulations and some of the institutions mentioned in

them simply don't exist yet. The availability of the texts in English clouds what can be a problem in time of crisis – the availability of the actual meaning (and effect on the recipient) of the laws in their controlling language, Dari. The English texts are not official and translation between English and Dari is apparently, at best, approximate. The complexity of some of the English legal text leads one to surmise that perhaps each and every nuance does not translate precisely. The quality of translation of the official laws (many of which were originally drafted in English) can be expected to vary, since foreign demand has locked up much of the labor market for English/Dari translators.

The Law on Private Investment in Afghanistan and the regime of corporate laws (subject to some exceptions noted above) represent, at worst, an investor-neutral legal climate when compared to international best practices. The investment law does not discriminate against foreign investors, it doesn't require local or state participation in a foreign enterprise, it appears to provide freedom of action in the economic sphere and it provides protections from outright government expropriations. It also allows relatively free movement of capital and factors of production and it appears to guarantee that disputes between the government and foreign investors will be resolved by international arbitration. Similarly, many features of the corporate law will be familiar to Western readers. They appear to enshrine well-known (in the West) Western concepts of free-market economics and many of the corresponding customary duties and practices of Western business.

Implementing Institutions

The Law on Private Investment in Afghanistan creates the **High Commission on Investment (HCI)** (chaired by the Minister of Commerce) which has, as voting members, six different ministers of six different ministries and the President of the Afghan national bank. The **Afghanistan Investment Support Agency (AISA)** is also a creature of that law and is run almost as a quasi-private enterprise whose mandate is to promote and facilitate investment in Afghanistan. AISA has been delegated the authority to register

¹⁴⁰ Income Tax Law, available at <http://www.mof.gov.af/Tax/pdf/Income%20Tax%20Law%20005%20English%2026%20Nov%2005%20Gazette%2020%20%20%20Translation%20Dec%2005.pdf>

enterprises whose ultimate investment is “reasonably expected” to be less than \$3 million (USD). Larger prospective investors must get the approval of the full HCI. Further, “[t]he Commission must discuss with appropriate ministries and institutions, and approve with the consent of such ministries and institutions, on a case-by-case, investment in certain sectors of the economy (and certain types of Investment).” Also, “The commission may from time to time limit the foreign beneficial ownership of business enterprises operating in certain industries or economic sectors, as specified by the Commission ...”

The Law on Private Investment provides no operative constraint to the Commission on either of these exercises of power, save Article 28 which provides compensation for expropriation and the potentially illusory Article 16 entitled the “Right to be free From Discriminatory governmental Actions.” The Law also provides the Commission with no guidance or policy with which to direct these discussions and approvals other than the Law’s stated aim to “encourage, support and protect private investments and enterprises...” In addition, the HCI is “the government’s focal point for policy-making on Investment.”

The HCI is unwieldy, poorly constituted for its mission and over-tasked. Its vague mandate to “discuss” and “approve with the consent of” other “appropriate” ministries is a recipe for logjam and opacity. Likewise, it is a body of overbroad consensus malformed for the purpose of speedily and efficiently promoting and facilitating foreign and domestic investment. As we will see, there are a number of factors external to the government process that threaten Afghanistan’s competitiveness as a destination for foreign investment – government delay doesn’t help that equation.

Finally, in a flaw not uncommon to the current government architecture generally, the roles of policy-maker and policy-implementer have been merged in the HCI. While easier on manpower, this is a model that unfortunately does not capitalize on the strengths of separating the two functions. Implementers without a concurrent policy-making mandate can more efficiently focus on implementing. Also, they are less likely to be sapped by organizational corruption since they lack the

tools to change policy for any one client. While communication between the field and the brain-tank is critical to the development of effective policy, often, critical strategic decisions require a good measure of short-term pain in implementation – pain that implementers are reluctant to bring upon themselves if they can avoid it.

Foreign investors are generally satisfied with AISA’s performance as a “one stop shop” for registration and facilitation of foreign investment. AISA’s fees are seen as being reasonable for the service provided, and the Agency often takes matters and issues from already registered enterprises to the appropriate ministries for resolution or clarification.¹⁴¹ Registration is only the first step in creating an Afghan enterprise, and it’s a relatively easy one compared to the follow-on requirements for permits and licenses. There is no published compendium of these requirements, so they are difficult to foresee. Through the AISA/HCI registration process, potentially large (greater than \$3 million) foreign investments are brought up on the radar screens of the Central Bank and each of the six voting ministries. **Any ministry having a tangential relationship to the proposed enterprise** will also be apprised. What follows registration is an often frustrating, lengthy, and sometimes expensive approval and permit process in which businesses must negotiate individually with interested ministries. Many of the required approvals aren’t intuitive, but become understandable only, for example, when it is revealed that the Ministry of Agriculture owns the land upon which a manufacturing concern is to be sited. Given this dynamic, it is difficult to define exactly what the required panoply of implementing institutions will be for any one typical investor – it could include all of them. The finality, or lack thereof, with which these negotiations are most often concluded, will be discussed in a following section.

AISA has proved to be remarkably adroit in negotiating the sometimes complicated and occasionally opposed interests of various ministries in order to begin the

¹⁴¹ Of note, AISA is not, in fact, the only “shop” for business registration. Registrations can be accomplished through lesser-known avenues in either the Ministry of Commerce or the Ministry of Justice.

development of five exclusive business parks around the country. It shows similar acumen in its aggressive and persuasive advertising and in continuing to fund itself largely from retained fees (much to the envy and occasional outcry of other government departments). Staffed by many who clearly see the vision of the good that modern business can bring to Afghanistan, it is a shame that it remains hobbled by the HCI structure in its current form.

The man on the street and the largest business enterprises agree: **the courts** are to be avoided at all costs - unless you are most likely in the wrong. There is widespread consensus that judicial decisions are for sale and that in the theoretical absence of bribery, there would be no mechanism for a rational or just decision anyway. Notwithstanding the fact that there exists more than one **Commercial Court**, legal training (as Western businesses think of it) of judges and lawyers is virtually non-existent. The dominant principles of adjudication, from tribal custom to *Sharī'ah* to communism and plain authoritarianism have shifted so often in the last 30 years that no single guiding principle remains. Justice means different things to different people. Many of the judges and would-be lawyers aren't young and the Western model, now in roughly its fourth year of a fragmented and sketchy introduction, seems weird and unapproachable. Lingering questions about its "Afghan-ness" and compliance with *Sharī'ah* and tribal custom remain. The courts are generally adrift with little to no practical relevance to Afghan society. Ironically, a force that mitigates the unfocused and dubious authority of the judicial branch is the fact that court judgments are virtually unenforceable. Unless the judge is known personally by the parties and the hearing is actually quasi-arbitration where the parties agree to be bound, the decision is unlikely to be worth much to anyone anywhere.

The **customs** duty quoted in Kabul is often not the same duty levied at the Pakistani border. The customs regime at the border posts – where duties are collected in cash and sometimes in-kind – is generally chaotic. Training and professionalism of customs agents are marginal and, more critically, the mechanisms for controlling those posts are weak. For example, a

Customs Inspector will be dispatched from Kabul or Jalalabad to inspect the operations at one post, and profiteering customs agents, having been tipped off about the visit, will move to another to continue their operations. Duties on goods are not governed by any overarching design of policy, but rather by political appeal and personal persuasion. It is often one battle to lobby the requisite arms of government for a reduction or increase in a tariff and, as mentioned above, quite another to see that tariff actually enacted across the border. There is no standard publication, if any at all; of duties and tariffs currently in force and they are subject to change without notice and with or without concomitant enforcement. Multiple overnight delays and spoilage of perishables at the border are not uncommon.

Supporting Institutions

The following institutions that traditionally serve to support investment are either non-existent or so nascent as to be of negligible value to the foreign investor: **Credit Bureaus**, a **Registry of Secured Transactions**, a comprehensive **Real Property Registry**, **Legal Services**, and a **Registry of Intellectual Property**. Western-style audit and **accounting services** are available from more than one provider, the **print media** have shown a willingness to report on business issues generally, and certain **trade and industry associations** are beginning to make themselves known. There is a Builder's Association, a Banker's Association, a Dried Fruit Association, the Afghan Women's Business Federation, the Afghan Chamber of Commerce and Industry and most notably, the Afghan International Chamber of Commerce (AICC). The AICC is comprised of businessmen and women and investors from various sectors of the economy. The organization was started with help from USAID and is on its way to self-sufficiency through dues and fees raised from specific business services and its work on behalf of the business community. The AICC is ambitiously advancing on a number of fronts including; providing popular education about the benefits of a free-market economy, growing its pool of federated associations and investors, and the development of a persuasive and

influential voice vis-à-vis the drafting, adoption and revision of laws affecting business in Afghanistan.

Afghanistan's first **parliament** in three decades is just now over a year old. Some members are not even old enough to remember the last one. An earnest endeavor in governance beset by fits, starts and growing pains best describes the current state of the legislature. Although consultation and consensus are traditionally Afghan hallmarks, interested parties and stakeholders have had a tough time getting their voices reflected in the growing body of Afghan legislation. Some of that frustration is a product of unclear procedure. Although the Constitution discusses the method of enacting laws, certain dynamics are unclear such as, whether or not the country is currently in a "state of emergency."¹⁴² Much of the failure of stakeholders to be heard is a product of decades of authoritarian government where edicts and decrees came from "on high." In official government, there has to date been little tradition of participatory rulemaking where the laws of the land are derived from the mouths and wills of the people. Public hearings, circulation of draft laws, and laws proposed in their entirety by interested parties are unknown. The concept of participatory rulemaking isn't entirely alien; however, it's just taking some time and effort to become accepted.

Donor agencies, it seems, can't get a fair break. They are criticized for doing too little, too slowly, or they are accused of doing too much and creating dependency. Different donors have different philosophies on development as much as they use different tactics. One donor may use cash incentives to build a "top down" organization, another may use micro-credit to build a grass roots movement. Most investors can agree that the majority of donor effort in Afghanistan is well-intended and is, in fact, having positive impact. Many of the criticisms are true, for example, that donor coordination could stand vast improvement and that project timelines are often unrealistic. But the successes are equally true and are appropriately credited to the Afghans who, with help, worked for them.

¹⁴² See Constitution of Afghanistan, Chapter 9.

Social Dynamics

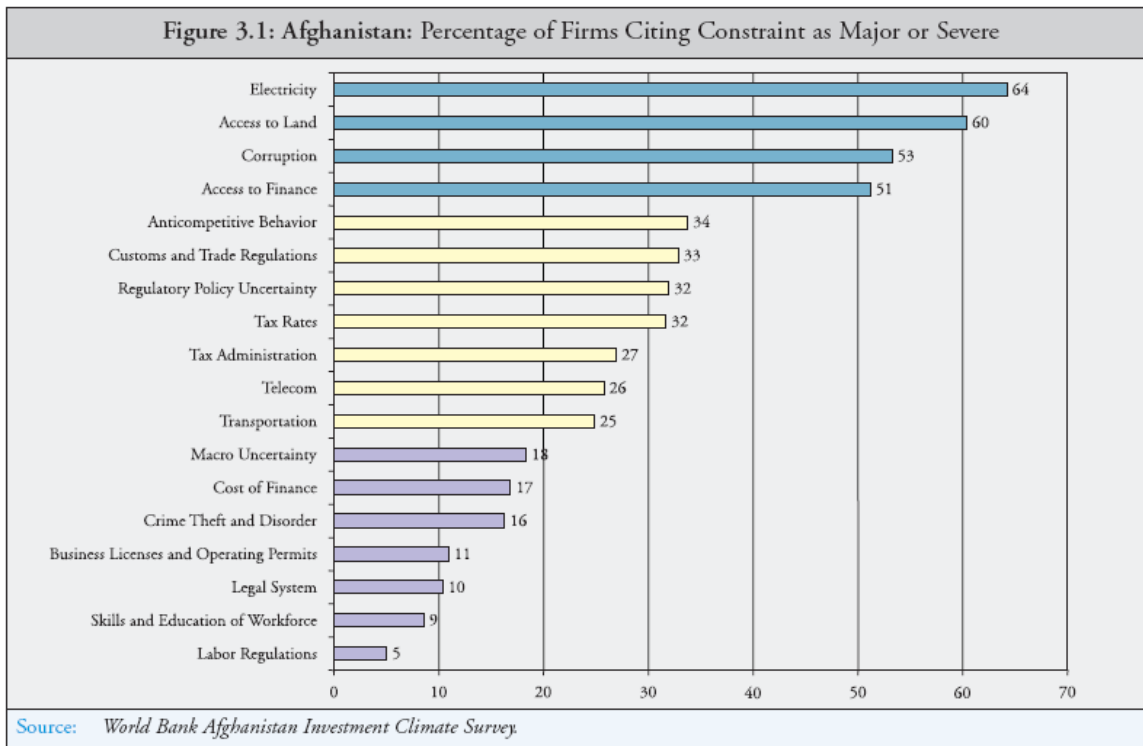
A. Cost-of-Goods-Sold Considerations

Profit drives business – which creates profit that again in turn drives business. And so on. Business for the sake of altruism is viable, as long as everyone in the process gets more to eat because of it. Non-profits make an economic return – they just redistribute it before it is technically realized as profit. Investors have choices about where to put their money, their time, and their energies. Successful investors make careful decisions about where and how they might have the best chance for further success. While homecoming and contribution to the Mother country in a time of need have been part of the business decision for returning Afghan-German or Afghan-American investors, greater foreign investment will need to be drawn to Afghanistan without these motivators. The investment climate will have to compete in terms of dollars, Euros, Afghanis and Dirhams with every alternative available to foreign investors.

Afghanistan has a wealth of attractive investment features: A central location, hectares of arable land, plenty of natural water, an unfulfilled market for almost everything, and an industrious population. There is little doubt among would-be investors that things can be made in Afghanistan and that they can be sold. What concerns all of them is how much making those things is going to cost. Using the production of goods as an example, should the cost to make those goods in Afghanistan significantly exceed the cost to make them elsewhere, they will be made elsewhere. If they are made elsewhere, Afghanistan will continue to receive goods as an importing nation and thus miss the opportunity to build its own production infrastructure and enjoy the consequent employment that those require. Examining some of the more significant components that make up the cost of producing those goods sheds light on many of Afghanistan's biggest challenges in the foreign direct investment arena.

I. Strategic Inputs

Assuming the manufacture of goods as an example, pretty much every manufactured good is made from raw material and some kind of application of mechanical and human capital. Even using a domestic



source of raw material, such as grapes which may be dried to use raisins, producers must reach abroad for some major component, or Strategic Input, of production. In the raisin example, a drying and packaging apparatus would most likely have to be bought from elsewhere – that implies the additional costs of cross-border banking, cross-border credit, tariffs on imports, the potential for irregularity in the customs regime and transportation costs. The requirement for human capital to pick those grapes and run the machines necessarily implicates the additional costs of housing and/or transportation for those workers, training and education of a largely illiterate and unskilled workforce, sourcing those skilled workers from abroad who are not available domestically and competing with the narco-economy for adequately priced labor during Poppy season.

2. Energy

Energy is a universal Strategic Input without which just about every modern industry is doomed. As recently as

last August, the capital city of Kabul enjoyed about five hours of electricity from the national grid – every other night. The World Bank's Investment Climate Survey of 2005 found the largest percentage of domestic firms surveyed reported the lack of energy to be a severe constraint on business. The only practical alternative for businesses to grid-supplied electricity is diesel powered electrical generators. These necessarily implicate the additional costs of the unpredictability of supply, the costs of negotiating contingency arrangements in order to mitigate lack of supply or price gouging by any one supplier, the fluctuation of the regional price for diesel, the costs of storing and protecting diesel, the costs of generators and generator maintenance, and the cost of potential fires.

3. Government Compliance

Investors in Afghanistan frequently tell the story of conclusively negotiating with one arm of the government only to be held up by another and then another arm of the government. Or of successfully negotiating a conclusive deal with one arm of the government, only to have that same agency call back to say that the deal was invalid because of some non-

¹⁴³ *The Investment Climate in Afghanistan*, World Bank (Dec. 2005).

feasance on the part of that agency. For example, a government agency calling a supplier to invalidate their mutual contract on the grounds that the government agency improperly solicited the bids.

Other typical dynamics include a municipality wanting its cut of a deal between a corporation and a ministry and using a claim on lands to be used by the enterprise as a lever. Often, government officials will cite one of the old or even newer laws for the proposition that what is being done by an enterprise in accordance with that law is, in fact, illegal. It's inaccurate to complain that the law is being read or interpreted "out of context," since with neither implementing regulations nor judicial decisions interpreting that law, there really is none.

More than one large firm flatly refuses to pay bribes. They pay for their principled and trailblazing behavior in inordinate and often costly delays by various government instrumentalities and by inflexible and overly onerous spot-enforcement of obscure regulations – to the letter. One company, rather than pay an unofficial \$20 "in-country work visa expediting fee," sent its employee from Kabul to the Afghan embassy in Dubai for a proper work visa at a cost of over \$1000.

4. Taxes and Fees

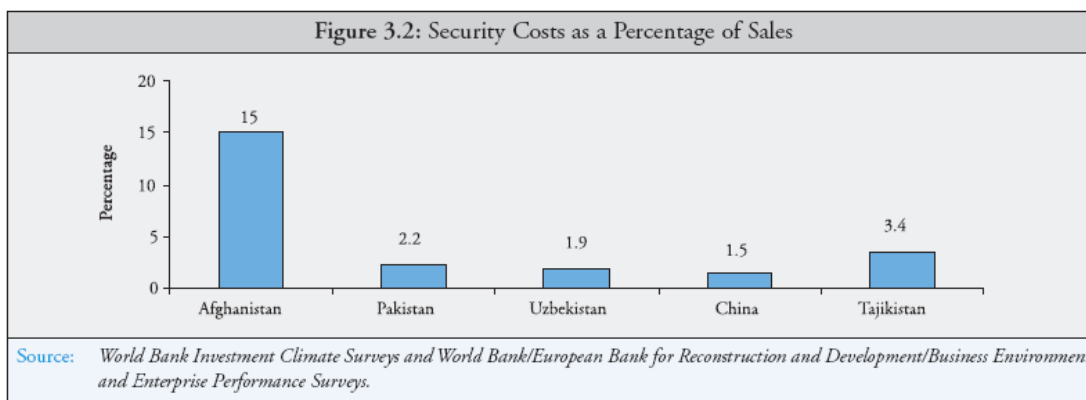
According to Afghan businesses, the Income Tax Law does not begin to catalogue the many taxes and fees levied by various arms of the government on enterprise. Often, the legitimacy of these are dubious –

even with expensive research. The result is a regime in which occasionally neither the payee nor the collector actually knows whether or not the tax or fee sought is properly authorized. These not only represent additional direct costs to business but necessarily implicate the additional costs of uncertainty and research. It is difficult to build a stable projection of how much goods might cost to produce if one of the incidents to that production, these taxes and fees, are unpredictable. Also, moneys set aside to cover contingencies in this area aren't being used efficiently.

5. Security

Officials charged with promoting foreign investment in Afghanistan often lament that "good news doesn't make the papers" and that the security situation in the country is being misperceived as overly dire. The Southeast remains a relatively lawless area and much of the rest of the country has been quieted by co-opting powerful warlords from those outlying regions into the national government. Those individuals retain power and influence in their home provinces and seem, for the most part, to be acting in the best interests of those regions. For example, power generation in Heart exceeds that in Kabul and a cross-border economy is developing there with Iran. Regional violence has been a means of pursuing political and economic ends in the recent past – there is little to suggest that it is no longer a possible option.¹⁴⁴

While there is business in Afghanistan to be done, the cost of doing it is the crux of today's challenge. Investors will do the math on Afghanistan and then do



¹⁴⁴ Id.

the math on the competing opportunities before making their decision. Macedonia is advertising in major Western newsmagazines: 10% business tax and 24/7 electricity. Plus, no war.

B. The Telecom Model – a Promise for the Development of Electricity

Telecommunications in Afghanistan exist in a world separate from almost everything else. The Telecommunications Services Regulation Act¹⁴⁵ creates for the telecom industry all of those implementing and supporting institutions that are necessary to it but that aren't available on the broader market. There is a regulating body with simple transparent mandates that don't suggest or implicate any broader powers. There is a clearly defined mechanism for grievance and adjudication, enforcement and compensation – all contained within the telecom regime and not touching or concerning any of the courts. There is clear provision for foreign investment and participation in telecom and there is little concern about intrusion by the Investment Law since telecoms, having established their own legal regime of apparent sufficiency, are exempted from it. In 32 pages, the Telecom Act succinctly anticipates major current and future contingencies, creates a Telecommunications Development Fund, separates the roles of policymaker and implementer of the telecom regime, and establishes rules to mitigate the effects of monopolistic behavior by major market participants. The government does have a vestigial but small stake in the market but it hasn't appeared to stifle growth and competition. A fourth (multipurpose) license has been sold and wireless telecoms have already penetrated almost 10% of the prospective market. Phone card sellers in Kabul outnumber fire hydrants and foreign investors are responsible for over 70% of the market in wireless telecoms.

The telecom model succeeds by integrating its institutional requirements that can't be met elsewhere. This insulates it from the vagaries of various other law drafters, decree issuers and governmental non-performers. It remains an instrument of, and under

more or less the full control of the government, but the "package" deal gives investors predictability. With predictability, an enterprise can plan for profit. If electricity is the most glaring critical gap in the road to economy-building foreign (and domestic) investment, it would seem that fixing the energy sector would go a long way to fixing the economy.

Telecommunications and energy share significant similarities. They are both ubiquitous services that serve to "glue" the rest of the economy together. They both demand strategic behavior and investment that is focused on the "long-goals" of infrastructure development and perpetual capacity growth. They are both public services with significant political cache'. (As such, they both typically require a government hand to force providers to serve customers who are not profitable in the name of "the public good.") Their nature and structure lends neither to having a large number of market participants and their services are a matter of national pride.

A number of significant hurdles need to be overcome if the Afghan telecom model is to be applied to the growth and development of its energy sector. The government must commit itself to partnerships with private enterprises that hold the necessary capital and technical expertise. Next, the production and delivery of energy needs to be adequately monetized. There are a number of steps inherent in this one, namely, adequate valuation of services, accurate accounting of services delivered, protection from onerous fees and duties by the government (or at least a provision for plowing those fees back into the energy sector – either through or by bypassing the Treasury), and protection from nationalization and other political risk.¹⁴⁶

Afghanistan lacks the capital, the expected future revenue, the technical expertise, and the ability to commit to a strategic plan (without political interference) necessary to develop its energy sector. Short-term contracts to build capacity piece-by-piece won't get the job done because they aren't be able to

¹⁴⁵ Telecommunication Regulation Services Act, available at <http://www.moc.gov.af/Documents/Policies%20and%20Laws-MoC/Telecom%20Law.pdf>.

¹⁴⁶ History has shown that while nascent governments rarely think they can run the nuts and bolts of their own telecom sector, they often believe they can take charge of energy production and distribution in its entirety.

serve a common strategic architecture of capacity development over the long-run. The current ad-hoc band-aids of energy importation and local-source energy (such as wind, solar and diesel) aren't working and donors aren't going to build and grow an energy sector in perpetuity. The best alternatives are either a privatized regime with government oversight and some control (the telecom model), or a public-private venture (PPV) tilted heavily toward the "private." Given the relative stability of Afghanistan's government as an institution capable of surviving the tenure of its current representatives, a privatized regime based on the telecom model has a greater chance for long-term success. In the energy industry, since capacity must build on capacity already built in order to produce and deliver reliably and efficiently, long-term success is the only kind of success.

Recommendations

- Separate the functions of policy-making and policy-implementing at every significant level of government. Merger creates distorted policy goals and the opportunity for corruption.
- Pare down membership in the High Commission on Investment (HCI).
- Apply the Afghan telecom model to Afghan energy development.
- Create incentives for sector self-sustainability and create a negative stigma to undue donor assistance. (Current perception is that "successful" ministries achieve higher rates of donor assistance annually than "unsuccessful" ones. This is a dependence-creating mechanism that must be stopped.)
- Publish an exclusive tax and fee schedule – with a persuasive implementing decree (from the president).
- Build a relevant Commercial Court by training experienced businessmen as jurists and lawyers while recognizing the potential aversion to a semi-secular court and the displacement of current jurists. This could serve as nucleus for the introduction of Western aspects of adjudication in other legal areas.

INTERNATIONAL TRADE LAW

Introduction

An August 2006 report by the Afghan International Chamber of Commerce (AICC) notes optimistically that “Afghanistan’s location at the heart of the expanding Central Asian market makes it a gateway to doing business and investing in the region.”¹⁴⁷ Although land-locked, Afghanistan is a land-bridge between Central and South Asia, such that “investors can reach not only the estimated 25 million people in Afghanistan, but potentially also the 150 million people in close proximity to Afghanistan.”¹⁴⁸ In order to accomplish the AICC’s cheerful dream, of course, tremendous impediments to international trade must first be overcome. The deplorable security situation discourages investment in the critical infrastructure of international trade and discourages travel and transit overall. The disarray of the legal framework – especially the inadequate, and in some cases incoherent, body of commercial law – is described in detail throughout the other sections of this Diagnostic. Summarizing those findings, however, one must note that the absence of commercial laws drafted and implemented to the standards of the international marketplace will severely hamper Afghanistan’s progress toward becoming a meaningful international trading partner.

Afghanistan is one of the poorest countries in the world. It is estimated that at as much as 80-90% of Afghan private sector activity is “concentrated in the informal sector.”¹⁴⁹ Out of a population of approximately 25 million persons, more than two million are directly involved in the opium trade, with many more benefiting at least indirectly from the

narco-economy.¹⁵⁰ Beyond the illicit opium trade, the remainder of the economy is dominated by subsistence farming and unregistered businesses, especially since corruption and other impediments in the regulatory environment make it difficult to engage in licit trade activities.¹⁵¹

Significantly, the ratio of imports into Afghanistan to (at least licit) exports is 8:1.¹⁵² Neighboring countries (especially Iran and Pakistan), and even some slightly more distant countries such as China and India, are pouring their products into Afghanistan. Afghanistan lacks manufacturing capacity and is unable to either produce those products for domestic consumption or to even begin to compete in international trade. While higher taxes on all imports are suggested by many business leaders, as well as more targeted import duties on certain products in order to encourage local Afghan business and industry, the problems with security, power and other basic business infrastructure items (including roads, office parks, trade facilities, and water supply) continue to impede a meaningful role for Afghan business and industry in international trade.

Significantly, as discussed in more detail in this Report’s chapter on Flows of Goods and Services across Borders, an open and transparent trade regime continues to be a priority of the Afghan government. Indeed, “Afghanistan maintains import bans on very few products and imposes no seasonal restrictions, quotas, or other non-tariff barriers” – and assesses an average customs duty of only 4%.¹⁵³ In fact, the Afghan

¹⁴⁷ AICC National Business Agenda (14 August 2006) at 43.

¹⁴⁸ Id.

¹⁴⁹ Id at 7.

¹⁵⁰ I-ANDS Summary Report at 10.

¹⁵¹ Id.

¹⁵² Id.

¹⁵³ AICC report; although customs duties are the largest source of government revenues in Afghanistan, most advisors and government officials agree that import tariffs should be kept as low as possible (especially to discourage corruption and “informal trade”).

International Chamber of Commerce even recommends a 2% across-the-board duty on imports into Afghanistan and zero duty on exports. Several business leaders, during interviews in connection with this Diagnostic, noted that there is a significant tension within the business community on the issue of trade policy. Some businessmen point out that Afghanistan is in a region in which trade protection policies are common-place, citing India as an example of a country with few imports and Pakistan as a country with very high (reportedly as much as 57%) import tariffs on some products. These businessmen strenuously argue that Afghanistan must increase its import tariffs, at least on a targeted basis. Others cite the lack of domestic production capacity, concerns about increased smuggling, and a need for more liberal regional trade in favor of maintaining lower import tariffs. In sum, there appears to be a considerable lack of both understanding and agreement on tariffs and trade policies within the Afghan business community.

Perhaps one of the greatest motivators for Afghanistan to get its economy on-track, looming large on virtually everyone's radar, is Afghanistan's pending World Trade Organization (WTO) accession. The commercial law framework in Afghanistan is being completely reformed in anticipation of WTO accession, with ten primary commercial laws targeted (five of which have been redrafted at the time of this Diagnostic – contracts law, discussed in another section of this Report, being the fifth and most recently completed draft). Moreover, in aspiration of WTO accession by the end of 2010, the Afghan government has benchmarked a number of strategic goals for achievement by that time:

- Government will establish an open and transparent business environment, systematically addressing trade and investment barriers;
- Transit and customs procedures and documents will be streamlined with a view to harmonizing them with the trading partners;
- Government will also pursue general trade liberalization;
- Existing transit agreements will be revised and new transit agreements will be negotiated while capacity is strengthened to implement and monitor the agreements;

- Exports benefiting from preferential agreements with U.S., EU, Japan, Canada, and India will increase;
- The private sector [will be encouraged] to become increasingly engaged in trade facilitation;
- Government seeks to improve operational efficiency of customs while curbing corruption;
- Government is also determined to move toward full computerization and to develop trans[aren't] procedures; and
- Government will reduce average import times by 20 days, and export times by 15 days.

In addition, the Afghan government is committed to increased trade liberalization (complemented by its commitment to a market economy, as discussed in this Report's chapter on Foreign Direct Investment) with a view toward WTO accession; further emphasis on developing other policies and programs to facilitate trade; pursuing opportunities to enter into energy purchasing agreements with neighboring countries; and the encouragement of greater private sector participation in areas of regional cooperation.¹⁵⁴

Legal Framework

There is no specific "trade law" in Afghanistan. Many of the trade laws and regulations typical in developed countries are non-existent in Afghanistan. For example, there are no anti-dumping laws; no countervailing duty laws; no laws supporting secured trade finance on imported or exported goods; and no technical standards. In anticipation of WTO accession and an overall strengthening of the legal framework for international trade, however, Afghanistan (with considerable assistance and input from foreign advisors) has drafted ten commercial laws prioritized for enactment through the Afghanistan National Development Strategy initiated system of benchmarks.¹⁵⁵ These laws, which were reviewed by

¹⁵⁴ I-ANDS report, *supra* note __, at 24.

¹⁵⁵ Ministry of Justice and National Assembly, Prioritized Legislative Agenda for 1386 and Legislative Capacity Needs of Ministry of Justice and National Assembly (January 30-31, 2007), found at <http://www.ands.gov.af/ands/jcmb/src/jcmb4/eng/05%20-%20Moj%20%20P%20Agenda%20&%20Annual%20Legislative%20Plan%20>

the Afghan Ministry of Commerce and the Taqin (the legislative drafting unit of the Ministry of Justice), also have been reviewed by the U.S. Embassy in Afghanistan, reviewed by the U.S. Office of the Trade Representative in Washington, and have been revised where necessary to take account of comments from each of those reviews. According to an advisor to the Taqin, at the time of this Diagnostic, the Partnership Law, Arbitration Law, and Mediation Law actually have been formally enacted, with the Contracts Law being next in line.¹⁵⁶ Of these laws, three of them were highlighted by the Asian Development Bank as an initial priority for private sector and financial markets development: the laws on partnerships, arbitration and mediation.¹⁵⁷ It is also anticipated that a new law on banking will be forthcoming in the very near future, as specifically requested by the Afghan Central Bank.

Also in line for significant reforms are various trade agreements between Afghanistan and its regional trading partners. There appears to be clear consensus both within the Afghan business community as well as among international advisors that most agreements are “quite out of date” and “basically useless.”¹⁵⁸ A common complaint, however, is that this process is moving too slowly and without clear focus. Indeed, a common refrain in interviews is that “Afghanistan has a 1,000 trade advisors and no implementers.”¹⁵⁹

As of the end of 2006, Afghanistan – through its membership in the Economic Cooperation

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¹⁵⁶ It is difficult to ascertain the status of laws, as different interviewees seem to have conflicting impressions as to that status. Part of the confusion may arise from the fact that, while some laws have been signed by the President and formally have the full force of law, they are still being reviewed and possibly revised, and some may have bypassed the Taqin review initially (several interviewees told of at least one law that was quickly signed/passed, even though it was not yet translated from English into Dari and Pashto and had not been fully reviewed by the Taqin).

¹⁵⁷ The fourth law highlighted by ADB is a corporations (company) law: the status of this law is unclear, although at least one interview has indicated that it has passed.

¹⁵⁸ E.g., interview with international trade policy advisor in Kabul on 13 February 2007.

¹⁵⁹ E.g., interview with Afghan businessman in Kabul on 07 February 2007.

Organization (ECO)¹⁶⁰ – reportedly is a party to at least 21 different Memoranda of Understanding (MOUs) for cooperative trade linkages with various international and regional agencies and other organizations. In addition, it is anticipated that Afghanistan will soon become a party to the Declaration on South Asian Regional Cooperation (SARC) through its membership in SAARC,¹⁶¹ and as of the time of this Diagnostic, Afghanistan is successfully concluding the process of becoming a member to the South Asian Free Trade Agreement (SAFTA) as a new Least Developed Country (LDC) member. Both memberships, and especially the SAFTA membership, are seen as an important step toward liberalizing trade between Afghanistan and Pakistan and, quite possibly, also affecting informal trade between the two countries. At the very least, it is anticipated that membership by Afghanistan in SAARC and SAFTA will prove meaningful with respect to various trade issues between Afghanistan and its neighbors.

In addition to the ECO MOUs, and the SAARC and SAFTA initiatives, Afghanistan reportedly is also about to sign a new Trade and Transit Agreement with Pakistan (the Minister of Commerce is reportedly spearheading this negotiation, but none of the interviewees for this Diagnostic knew anything about its terms or scope). One interviewee also mentioned a series of agreements that he understands the Minister of Foreign Affairs has concluded with several EU countries but, again, no more specific information was determined in this Diagnostic.

Finally, Afghanistan is also a party to a number of other international trade agreements, with scopes beyond the immediate region of Afghanistan. Significant among these, Afghanistan has been granted observer status

¹⁶⁰ The Islamic Republic of Iran and the Islamic Republic of Pakistan are founding members of ECO, and Afghanistan's other neighboring countries of the Republic of Azerbaijan, Republic of Kazakhstan, Kyrgyz Republic, Republic of Tajikistan, Turkmenistan, and the Republic of Uzbekistan, most notably, are also members. It is significant also that ECO enjoys observer status with the WTO.

¹⁶¹ Afghanistan was admitted to the South Asian Association for Regional Cooperation (SAARC) at the Dhaka meeting in November 2005.

with the Shanghai Cooperation Organization. Moreover, as noted in this Diagnostic, Afghanistan also has been granted Observer Status in the World Trade Organization and has commenced the process of accession as a member country of the WTO.

The first step toward WTO accession, the creation of a Working Group in Geneva, has been accomplished. Reportedly, the group – which includes representatives from the U.S., EU and Pakistan – has been formed, with the Dutch representative as chairperson. The next step, preparation of a Memorandum of Foreign Trade Regime by Afghanistan, is reportedly underway at the time of this Diagnostic. In that regard, an inter-ministerial task force has been working on the Memorandum, led and funded by the Ministry of Commerce and including the Central Bank, the Central Statistics Office, and the Ministries of Agriculture, Finance, Economy, Justice, and the environmental protection agency. The inter-ministerial task force was formed in August 2005, and is tasked specifically with working on the WTO accession. All the working representatives on the task force are senior level officials in the ministries, just below the level of Deputy Minister. The members of the task force received special training by the WTO, in Geneva with regard to the WTO accession process and trade policy, generally. At the time of this Diagnostic, the Memorandum was in its eighth draft. Significantly, the drafting process has benefited from considerable international advisor input. The Office of the U.S. Trade Representative and various donor-organizations reviewed the sixth draft, and the seventh and eighth drafts have been prepared with considerable assistance from UNCTAD. Currently, a translation of the eighth draft is being reviewed by key Afghan ministries, the Afghan High Commission on Economics, and the office of President Karzai. It is anticipated that a final Memorandum will be submitted to the WTO by the summer of 2007.

Implementing Institutions

The **Ministry of Commerce** and **Ministry of Foreign Affairs** take the lead in matters of international trade. At the time of this Diagnostic, however, the respective roles of each and the lines and

parameters of authority were quite unclear. While the Ministry of Foreign Affairs, for example, initially took the lead in implementing the WTO accession process in 2003, that responsibility was shifted to the Ministry of Commerce in July 2005 because literally no action has been taken (not even meetings). Of course, the bi-cameral **National Assembly** (the *Wolesi Jirga* or House of People and the *Meshrano Jirga* or House of Elders) will have a legislative role in international trade matters, but this has yet to be seen. Similarly, the role of the **President** in international trade and treaties, as executive, is anticipated to be considerable, but still an unknown.

Supporting Institutions

There are only just-emerging trade and investment support institutions in Afghanistan. To the extent that they exist or are operational, they are discussed more fully elsewhere in this Diagnostic, especially in the section on Foreign Direct Investment. Most notable are the **Afghanistan Investment Support Agency (AISA)**, a quasi-private enterprise whose mandate is to promote and facilitate investment in Afghanistan,¹⁶² and the **High Commission on Investment (HCI)** (chaired by the Minister of Commerce and including six different ministers of six different ministries and the President of the Afghan national bank).

Certain trade and industry associations are just emerging. For example, there is a **Builder's Association**, a **Banker's Association**, a **Dried Fruit Association**, the **Afghan Women's Business Federation**, the **Afghan Chamber of Commerce and Industry** and most notably, the **Afghan International Chamber of Commerce (AICC)**.

Social Dynamics

It is difficult to ascertain the social dynamics that impact international trade, mainly because there is very little understanding or knowledge within Afghan society – at all levels – with respect to the framework, parameters, and dynamics of good trade policy and the impact of the current regime. Indeed, there is also a significant

¹⁶² Website available at <http://www.aisa.org.af/index.htm>.

lack of communication within the Afghan business community and the population at large as to the actual status of various trade initiatives, including most notably WTO accession. As such, in various interviews, one realizes that there is a great deal of ambivalence and countervailing opinions/tensions between interviewees. For example, only a few interviewees gave unequivocal opinions as to whether tariffs should be increased or kept low; whether WTO accession is a good step for Afghanistan which will at least provide a further forum for trade disputes and force Afghanistan to “clean up its act” in many areas of government and overall legislation, or whether it is a premature step which will force certain tariff restrictions to the detriment of Afghanistan.¹⁶³

It has been observed that a great deal of resistance to changing the current “system” exist largely due to confusion and lack of knowledge. One advisor commented during an interview that most people in Afghanistan, including even government officials, only know about WTO accession from what they see on CNN.¹⁶⁴ Interestingly, several international advisors noted that the Afghans with whom they had discussed these issues generally did “turn around” in favor of the proposed trade reforms, including WTO accession, but only after the key issues are explained to them.

Recommendations

- A better program of information and training needs to be implemented with respect to trade policy issues, not only at the grass-roots level, but within the Afghan business community and mid-level government offices.
- A WTO negotiation team needs to be formed, including both government officials (apart from the inter-ministerial task force) as well as drawn from the business community and chambers of commerce, to be trained in negotiation skills and English-language skills (particularly technical

vocabulary in areas of business, commerce and economics), and to be tasked with greater exchange of information across areas of technical expertise and across ministry lines.¹⁶⁵

- The legal framework for trade needs to be considerably strengthened and brought to the level of international standards: it is suggested, for example, that anti-dumping laws, countervailing duty laws, and laws supporting secured trade finance on imported and exported goods be studied and enacted as and when appropriate.
- Greater input from the business community needs to be elicited and trade organizations need to be supported and strengthened.
- Strengthen and update trade agreements with regional trade partners, as well as trade agreements with other countries outside the region.
- Nominate a single Ministry to have responsibility for trade negotiations and concluding trade agreements, with the authority to demand allocation of resources and information from other ministries.
- Better coordination and communication needs to be established between the various NGOs and donor-sponsored organizations advising the Afghan government on trade matter

¹⁶³ As one interview pointed out, under the current legal and institutional framework, “trade is easy.” He went on to explain that the system of bribes and the “informal” trade regime worked quite well and, despite some increased costs of doing business at times, it probably should be left intact.

¹⁶⁴ Interview in Kabul on 12 February 2007.

¹⁶⁵ A similar proposal is already being studied and has been recommended by other international advisors, as well.

FLOWS OF GOODS AND SERVICES ACROSS BORDERS

Introduction

This chapter analyzes the legal, institutional and operational constraints that impede trade expansion and recommends practical steps to minimize those constraints. First, the analysis focuses on Afghanistan's legal framework for the Afghanistan Customs Department (ACD). ACD is subordinate to the Ministry of Finance and is responsible for the collection of Customs revenues of the state, and for enforcing the provisions of the Afghan Customs law and any other relevant legislation. Second, the chapter considers the institutional issues regarding ACD management, organizational capacity and operations. Third, the chapter reviews other key public institutions involved in trade facilitation at the border and Customs inland facilities. Next, key supply chain partnership groups such as Customs Commissioners (Customs Brokers), carriers, and other intermediaries/representatives of the trade community are reviewed. Finally, this chapter sets forth recommendations to improve trade facilitation in Afghanistan.

Legal Framework

For a truly facilitative environment, it is critical that the laws and regulations/decrees provide the following: (1) adequate and coherent authority structure for the essential trade-related institutions; (2) clearly stated regulations and procedures and that these authorities strike an adequate balance between facilitation and necessary control; (3) the means to legally employ modern risk management techniques utilizing selective inspections and post release audits to accomplish their respective missions; and (4) a productive environment of cooperation and procedural coherence with the other government agencies with border control responsibilities.

A. Afghanistan's Customs Law

In April 2005, a new Customs law came into effect in Afghanistan. The law reflects effective modern Customs practices such as organizational structure, seizure and penalty authority for Customs violations, collection of foreign trade statistics, joint facilities with neighboring countries, and the acceptance and the use of electronic data for Customs documentation. Certain provisions of the law are problematic, however:

- The Customs Mobile verification teams are codified: ("Customs administrations shall assign mobile customs verification teams to verify customs compliance of transporters in the customs territory along roads."—Afghanistan Customs Law, Chapter 2, Article 11, Section 5.) These teams are reported not to be serving their intended purpose as a smuggling deterrent and have even become a problem as a ready source of opportunity for bribes.
- The Customs Police are under the jurisdiction of the Minister of Interior rather than the Minister of Finance creating inefficiencies and a lack of coordination: ("Customs Police officials shall be part of the organization of the Ministry of the Interior—Afghanistan Customs Law, Chapter 14, Article 164, Section 1.) The Customs Police have also become a source of bribery and do not provide necessary security to Customs ports and stations.
- The valuation, classification and value provisions are practical and straightforward for Afghanistan during this stage in their development. However, these statutes are not consistent with WTO provisions and will have to be revised as part of accession.

In addition, ACD is presently in the midst of implementing the law with the assistance of the donor community.

B. WTO Accession

To join the WTO, acceding countries must enact compliant Customs laws based upon the various GATT agreements pertinent to Customs administrations. Many countries have used the precise GATT language in drafting their statutes. The Customs Law of Afghanistan is not GATT compliant. For example, the basis for valuation of goods for the members of the WTO is *transaction value*. The WTO Valuation Agreement establishes a Customs valuation system that primarily bases the Customs value on the *transaction value* of the imported goods, which is the price actually paid or payable for the goods when sold for export to the country of importation, plus certain adjustments. Because of the risks of undervaluation and the resulting potential revenue loss, Afghanistan uses lists of acceptable values or other means such as catalog costs and world commodity indexes. In addition, other legislative and regulatory changes for GATT compliance must be made that will include rules of origin, harmonized tariffs, intellectual property rights and trade agreements.

Enactment of a GATT-compliant statute and the issuing of the defining and implementing decrees are important steps in WTO accession that remain to be accomplished. Changing processes, enforcing the new rules and educating Customs staff and the Afghanistan trade community are challenges that ACD will face as implementation phases are undertaken and completed. Because of modernization efforts already completed or in process, Afghanistan has already begun to take steps that will ease the accession burden. This is especially true since Afghan tariff rates are already low and have a basis in rationality, i.e. the protection of nascent national industries. Without changing the Customs law, however, careful monitoring, evaluation and planning, conformity with the broader WTO standards and achieving a fast accession will not be possible. More details regarding Afghanistan's potential WTO accession are included in this Report's section on International Trade Law.

Implementing Institutions

The **Afghanistan Customs Department (ACD)** is the principal government agency for border control and is part of the **Ministry of Finance (MOF)**. In general, after many years of conflict, Afghanistan's government institutions are weak, lack coordination, have inadequate resources, and are marked by corruption. However, Afghanistan has made progress toward stability all levels but lacks competent staff to provide even basic government services and functions.

ACD is the lead border agency that provides 53% of Afghanistan's self-generated revenues. The Ministry of Finance recently released revised the total domestic revenue totals for the period of March-June 2005. The total from all sources was \$77.16 million, a 40% increase from the same period in 2004. Of the \$77.16 million, Customs collections represent 53% of the total figure, with \$41.45 million collected within the initial 3-month period. These figures constitute a trend of reduced reliance on Customs duties as the primary source for national revenues.

As stated in the Customs law, the major functions of ACD are:

- Determining the value of goods and collecting the related Customs revenue
- Supervising, detecting, reporting and preventing smuggling
- Detecting and evaluating violations of the Customs law
- Participating in preparing and signing international agreements and conventions in Customs matters, in accordance with Customs legislation
- Preparing, collecting and, upon agreement of the Minister of Finance, distributing foreign trade statistical data to the Ministry of Commerce and other public institutions
- Supervising Customs goods, throughout the entire Customs territory of Afghanistan
- Exercising Customs control over Customs areas
- Maintaining Customs records
- Carrying out all other activities determined in Customs legislation

To perform these duties, ACD has a complement of approximately 1597 staff of civilian customs officers and

support personnel responsible for policy executive management and revenue collection. The ACD is organized as a headquarters in Kabul with 14 official border crossings and 18 provincial Customs Houses where goods are entered, duties paid and released.

A great deal of aid and technical assistance is in place or being readied. A comprehensive Five-Year Strategic Plan is now being discussed with ACD. The plan will tackle many of the issues discussed in this Report: hiring, training, budget formulation, post-release audit, mobile verification teams, WTO Accession, interfaces with the other control authorities, broker administrations and numerous other factors involved in modernization.

The **Border Management Initiative (BMI)** has more immediate goals of increasing security for Customs, and improving and creating facilities and associated infrastructure. Six border stations have been constructed. Long-term goals of efficient, corruption-free processing and the establishment of the Border Management Commission with ACD as the lead are envisioned. Six senior foreign advisors with Customs backgrounds are being recruited.

The methodology to facilitate trade as well as the standards by which to measure its progress are well defined and accepted internationally, making the task of undertaking such reform less dependent on local conditions and culture. There is no debate about the desired end result and the techniques and tools that must be used to obtain it. In our interviews with public and private officials, the ACD was given much credit for the reforms already undertaken and the achievements to date. However, much remains to be done to fulfill their vision.

Implementing Institution Issues to Address

I. ACD Advisors

Plans for advisors to assist Customs for the BMI and for key components of the Five-Year Strategic Plan are in place. Several interviewees stated that the Commissioner of ACD had an excellent advisor from Pakistani Customs in his office. This invaluable

assistance and advice was lost when the gentleman returned to Pakistan.

2. Border Port Confusion

Conditions at border ports are chaotic with poor security, thefts and many unauthorized individuals offering both legitimate and illegitimate services. Additionally, the Customs Police do not assist with security because they are not under ACD's jurisdiction. This jurisdictional overlap between police and Customs causes confusion and hurts port security. This inefficiency and lack of coordination between governmental authorities adds to trader's costs. Also, the borders of Afghanistan are porous with many crossings occurring between the ports of entry for both contraband and legitimate cargo evading Customs scrutiny.

3. Letters of Credit

In Afghanistan, the Letter of Credit (L/C) process is cash secured and not consistent with international standards since local banks are very risk adverse. Generally, the L/C is a document issued by a financial institution that provides an irrevocable payment to a beneficiary against complying documents and terms as stated in the L/C. This means that once the beneficiary or presenting bank acting on its behalf, makes a presentation to the issuing bank or confirming bank, within the expiry date of the LC, complies with the terms and conditions of the L/C, the issuer is obliged to pay irrespective of any instructions from the applicant to the contrary. In other words, the obligation to pay is shifted from the applicant to the LC issuing bank or confirming bank, if any. The LC can also be the source of payment for a transaction, meaning that redeeming the letter of credit will pay an exporter. Letters of credit are used nowadays primarily in international trade transactions of significant value, for deals between a supplier in one country and a wholesale customer in another. Besides inhibiting trade, cash secured L/Cs restrict activities of Afghanistan dealers in comparison to foreign dealers with better access to credit.

4. WTO Accession

Both the public and private sector poorly understand the benefits and risks of WTO accession by Afghanistan. Many misconceptions of the effect of WTO accession on Afghanistan were encountered during interviews with both the public and private sector.

5. Customs Procedures

ACD's procedures are fully manual and require many steps and signatures to gain the release of goods. Traders, brokers and transporters all reported procedural improvements and streamlining in the past year signifying progress and a desire of ACD to improve their cargo operations. However, remaining procedures and a lack of selectivity and risk management enable the widespread practice of facilitating payments/bribes for Customs officers. Import processes, despite improvements, continue to be complex and burdensome leading to delays and increased costs. Additionally, much of Customs mid and lower level workforce is strongly wedded to the existing processes. For example, Afghan Customs Brokers generally do not rate Customs professionalism as high due to lack of training of officers. While recent improvements in processing are noted, revenue collection ranks as a higher priority than trade facilitation. Many officers also view facilitation efforts as an impediment to increased Customs receipts, although in practice they have the opposite result when combined with other internal reform measures. Therefore this is no real push by ACD for such facilitative measures as selectivity in examinations or a post audit approach to regulating trade.

6. Customs Collections

A heavy reliance on upon Customs collections and meeting IMF targets has caused a degree of turmoil in Afghanistan's trade community and has proven counterproductive to trade facilitation: In an emerging economy such as Afghanistan's, too much emphasis on increasing Customs collections can cause Customs departments to arbitrarily raise duty rates and fees, cease refunds, increase the number of unwarranted seizures and penalties and encourage other poor

practices such as misclassifying goods to achieve higher duty rates. These aberrant practices may raise revenue while causing an unintended consequence of inhibiting foreign trade.

7. Automation

The ACD has implemented and deployed the transit module of the UN's modern Customs automated solution ASYCUDA++ (Automated System for Customs Data), which is a great accomplishment and an advantageous means to achieve ACD's ambitious goals of modernization and reform. Rather than relying on a network, ACD is using satellite communications to link ports and stations. The ongoing implementation of the (ASYCUDA) will increase transparency (easy reporting, international classification, performance monitoring) and control (including through a reduction in interface between Customs officers and traders), while facilitating trade (more standardized, predictable, transparent procedures). Reducing the ability of Customs officers to arbitrarily detain and hold shipments is a key method to reduce unofficial payments. Transit is considered a priority: all goods entering into Afghanistan will be reported to the system and automatically discharged when they reach their destination. The first application is operational and reportedly working well. The new procedure covers the transit corridor between the Torkham border point with Pakistan and Kabul and will be extended to the border with Uzbekistan. Additionally, ASYCUDA ++ can be used for many other functions such as risk management, selective examination, collections and trade statistics. Most importantly, AYSCUDA++ will allow truck traffic to clear at the border and eliminate the confusion and additional costs of clearance at the inland Customs houses.

An experienced team of contractors with the necessary technical and operational staff is managing the implementation assisted by a small group of ACD staff. Additionally, an EU system for collecting and disseminating trade statistics, EUROTRACE, is in place and active at the Kabul Customs house.

Use of standard prices maintained and published by Customs for import valuation in lieu of invoice values lengthens the time and cost of preparation of Customs

documentation. In fact, the ASYCUDA team is developing a reference tool for these presumed values. In reality, many emerging Customs services maintain such lists to counter chronic undervaluation. Such use is also in contravention of GATT Article VII that offers model statutes (beginning with transaction value) for Customs valuation that should be followed upon Afghanistan's accession to the WTO.

8. Corruption

Salaries for public servants are very low and do not compete with private sector salaries. Additionally, harsh climates and poor living conditions along with severe security threats often contribute to the poor recruitment levels in Customs stations outside of Kabul. Facilitating payments are universal to the Customs operation as well as any other government unit such as Customs police and mobile verification teams that has the opportunity to hold goods in international commerce. Additionally, entire shipments can be passed through Customs without documentation or duty payment at much higher figures. The trade community provided payment figures ranging from a low of 100 AFG to 6000 AFG depending upon the value of the goods and the "service" being rendered.

9. Staffing

A stable, well-trained cadre of Customs officers is necessary for reform, modernization and the maintenance of an effective and efficient Customs service. Salaries in the ACD are not commensurate with workload and complexity of modern Customs operations. Many of the current Customs staff has held Customs positions for long periods of time including time under the Taliban rule. Generally, mid-level and subordinate personnel are not regarded highly by those we interviewed but that the higher echelons were well regarded. Hiring well qualified individuals for line Customs positions is being attempted but retention rates for these hires is low due to the availability of other better paying positions.

10. Training

Most training for ACD's employees is informal, on the job training. New classrooms and a computer lab are part of ACD's Kabul Customs house's facilities. They are used periodically for special sessions or updates including Brokers' training. A lack of formal Customs training, basic and advanced, is a lost opportunity to enhance professionalism and to correct individual bad practices, weed out incompetent hires as well as to provide standardized curriculums in Customs law, procedures and ethics. Formal training, especially basic courses for new hires, provides opportunities to filter weak selections by dismissing them for failure to pass examinations and practical exercises.

11. Intellectual Property Rights

Training in identifying counterfeit goods does not occur and border officials are unfamiliar with procedures to be followed if counterfeit goods are encountered. This issue must also be addressed in the passage and during the implementation of the WTO statute for Afghanistan.

12. Risk Management

Risk Management is a systematic approach to making decisions under uncertain conditions by identifying, assessing, understanding, planning and communicating risk issues. For Customs and border agencies, it is means to move from an attempt to achieve total control of documents and goods for every shipment to a rational, data driven process to select cargo for intensive examination. Most countries have adopted the risk management approach to facilitate the international movement of goods from compliant importers while devoting their Customs and other control agency resources to goods that have the highest potential impact on revenue, the economy and the health and welfare of its citizens. Risk management deployment simply means that a large proportion of international shipments can cross the border quickly with no inspection and minimal formal requirements. As a result, opportunity for bribe solicitation and payment is reduced because of increased transparency.

The move to capture transaction data in a modern automated system such as ASYCUDA++ provides the essentials for a risk management regime. Risk

Management and the selective examination technique have not yet begun in Afghanistan. All shipments except diplomatic shipments are inspected. Additionally, the Customs law does not support Post Release Audit, an excellent means to verify compliance and refine risk management techniques. A Customs Post-Release Audit is not a financial audit – rather, it serves to determine compliance with all laws and regulations applicable to importers and is an evaluation of company practices and records. It assists in judging the integrity of information supplied in the Customs declaration and the importer's level of compliance with Customs legislative requirements.

Customs overall aim should be compliance with Customs' laws and decrees. True compliance exists when systems and/or departments at importing companies are aware of and take steps to comply with Customs laws and decrees.

Supporting Institutions

Although the ACD is the main implementing institution for the movement of goods, an efficient trading system relies on an interdependent process that includes other trade-related public sector institutions, trade service providers *and* the traders themselves—importers and exporters. Their capacities, honesty and performance can result in significant costs (or savings) within the trading system, and optimized trade facilitation depends on their active involvement. Like the ACD, the trade-related public agencies also need sound management, well-trained staff, modern equipment, modern facilitative procedures and active dialog with the trade to respond timely and predictably to issues while guarding the public safety and security of the country. Additionally, the private sector trade community adds their expertise and familiarity with expert legal and logistical knowledge to the import/export process and as such is crucial to the efficiency and overall compliance of international trade movements.

A. Public Institutions

The traditional border agencies (other control authorities) are present in Afghanistan but in a very limited way. Approvals are based upon pre-filing and pre-approval for goods falling under their jurisdiction.

Interviewees did not report any significant delays or burdens with either clearances by Agriculture or Minister of Health.

Currently, there is little coordination between ACD and the other control authorities—each trader or Customs clearance agency must arrange their individual clearance and forms containing duplicative information on the same shipments abound. While none of the agencies were considered serious impediments to trade, they do suffer many of the same issues of staff retention and antiquated processes and technology as ACD. Limited training has been given to Customs for detection of other control agency shipments problems/issues particularly in the area of animal and plant diseases. In the future, opportunities for the automated system AYSCUDA ++ will be available for the other control authorities. They will be given the ability designate commodities requiring scrutiny for holds or for the trade to file required licenses permits and certificates electronically.

B. Private Institutions

Private importing and exporting firms are limited in number since the bulk of importations are on behalf of donors, NGOs, foreign missions and for the military forces. Most of these relatively immature private sector international trade participants require not only simple trading rules and regulations from the public implementing institutions, but strong private sector supporting institutions to assist in transporting goods to market and completing import and export formalities. Such expertise is beyond the capabilities of the traders themselves.

Private sector institutions, which support the Afghanistan's international trade community, are generally limited in number and weak in human capacity and technical knowledge. Associations and Chambers of Commerce are new and relatively weak in their advocacy efforts on behalf of their membership. Additionally, a lack of dialogue between government officials and the private sector impedes private sector expansion and public-private sector dialogue and partnership. Further, unnecessary checks and balances are often added to government and trade practices with little notice or regard for international best

practices or consultation with the affected private sector entities.

C. The Afghan Trade Community: Importers, Exporters, Transport Sector, Customs Brokers, Express Carriers, and Trade Associations

1. Importers

Although strides have been taken in simplification of import processing, reforms are needed to elevate Afghanistan to acceptable international trade facilitation standards. Because Afghanistan is now emerging from years of conflict, the import market remains undeveloped. Importers are nascent and rely heavily on Customs Brokers to complete their Customs formalities including the payment of unofficial payments.

2. Exporters

The government recognizes the growth of exports as the principal engine of poverty reduction and economic growth. The government's firm and continuing commitment to expansion of exports has resulted in some facilitation measures for the export process. Since 2003, the Afghan Investment Supporting Agency (AISA) has been working with ACD and the Other Control Authorities to simplify the export process, to strengthen key export industries such as marble, grapes, carpets, herbs and fresh fruit, and to disseminate key information to Afghani exporters.

3. Transport Sector

Afghanistan is a large, rural, landlocked country. A modern business orientated trucking industry is vital to the growth of international trade in Afghanistan. Over land trucking is the only mode of transporting imports and exports to and from the port of Karachi or to conduct trade with neighboring countries. Afghanistan conducts cross border trade with its neighbors. Afghanistan's competitiveness is encumbered regionally and internationally by high trade transaction costs that should be systematically reduced:

- Afghanistan's international trade is treated unevenly by its neighbors resulting in higher costs, delays and damage.

- Afghanistan truckers must unload shipments at the Pakistani border for transport to the Karachi seaport by Pakistani transporters.
- Transport and facility operations do not meet international trade standards.
- Poor infrastructure, lack of automated systems, and unpredictable transportation times increase costs further.
- Equipment deficiencies in the availability of rail cars in Pakistan increase demurrage (charges levied by carriers for excessive retention of containers and railroad rolling stock) and overall rail costs.
- Transport business processes themselves are inefficient and antiquated.
- Efficient and cost effective air transport is vital but not available at Afghanistan's airports.

The trade and public sector need training in how to establish manage and operate Customs clearance facilities that are crowded and in disrepair will hinder effective implementation. Private stakeholders are not fully engaged in the dialog within the responsible public ministries in the selection and implementation of the dry port concept. The trade's knowledge of trade patterns, practices and problems in the private sector can be used to minimize mistakes and provide a smooth implementation. Private sector involvement in the operation would ensure competitive pricing for services as well.

Air cargo services are expensive and limited. Shipping by air is not a viable alternative for most of the Afghani trade community.

4. Customs Brokers (Commissioners)

The import process remains heavily bureaucratic, document-intensive and time-consuming. Customs is viewed as a major impediment to progress and the brokers are considered the "grease" that eases the process. Afghanistan Customs brokers, although competent and well regarded, are not as professional or knowledgeable as those brokers in other countries. There are 70 licensed brokerage firms (with hundreds of individuals holding individual licenses) in Afghanistan that is sufficient for current trade volume. Customs trains brokers and administers a test that is not considered rigorous. Although some are competent within the sector, most lack training in current

Customs procedures and rely on personal connections with officials to secure clearance.

Afghanistan Customs must pass on the competency of a Customs Broker before he or she can file an official registration to conduct business. Currently there are about 250 individuals certified as Customs Brokers in Kabul (National figures were not available). Although some are competent within the sector, most lack training in current Customs procedures and rely on personal connections with officials to secure clearance. On the other hand, brokerage and freight forwarding costs are reasonable (even though freight costs are considerably higher) and in line with neighboring countries. Additionally, Customs officers appreciate the value that the brokers provide in representing numerous illiterate traders.

Afghanistan has a small broker's association that meets irregularly. They provide little training to increase and improve human capacity within their sector due mainly to lack of funds and limited knowledge of modern international transport, especially maritime management in Pakistan's ports.

Brokers lack professional training, particularly on commodity classification in accordance with the HS classification system. Generally, Customs' views its initial competency certification as its only function in regulating the industry. No oversight is given to subsequent performance to weed out the incompetent players, nor is there engagement with the sector in assessing and meeting updated training needs. Additionally, lack of knowledge of modern transport practices including supply chain management and inter-modal transport requirements that are necessary not only to compete but also to even participate in the global trade marketplace are generally lacking in the freight-forwarding sector.

5. Express Carriers

Afghanistan's air express industry is becoming an important player the assisting the import and export trader in conducting his business in a timely manner. Much of the volume for these carriers is destined for embassies, ISAF, the donor community and contractors/individuals employed in the reconstruction.

Express shipment planes land at Bagram Air Force base where military parcels are segregated with the remainder of the shipments are trucked to Kabul, a distance of approximately 70 KM. The couriers reported that they have noted improvements by ACD in the past year and are generally satisfied with the services they receive.

6. Trade Associations

Business associations are most often the voice of the private sector in policy formation and implementation. Particularly in a developing country like Afghanistan with underdeveloped public institutions due to the short period of stability, the business sector must accept and strengthen its role in monitoring public performance and participating in policy development. This is done most effectively through trade organizations. These groups must also be actively engaged in improving the capacity of the private sector through its own initiatives, and principally at its own costs. Currently, trade associations are in their infancy and do not exert much influence upon government or business practices. The most promising group is the Afghanistan International Chamber of Commerce that has a staff of 40 and states that it has 3,500 members. Its main goal is to bring back to health businesses and commercial activities that were damaged in previous years of disruption and turmoil. Results are uneven at this point but this organization has the potential to be a positive force in helping Afghanistan achieve a healthy market environment.

Social Dynamics

The climate for improved trade facilitation, growth of the private sector and improved quality of service sector groups to assist the international trader is somewhat positive although major obstacles still exist. It is necessary to support principles of a free market economy, promoting increased foreign investment to achieve export expansion and eliminating roadblocks to trade. There is a daunting challenge in developing modern institutions such as ACD and its supporting organizations and government components in a nation that has seen almost continuous conflict since 1979. International trade can be an important component in

the reconstruction efforts now taking place as Afghanistan takes its place regional and world trade. A robust trade regime is bolstered by an honest and efficient Customs service and constitutes a means to prosperity through increased investments, jobs and infusion of foreign capital.

The government is supportive of modernization efforts but lacks the capacity to achieve the desired results. The top tier of executives are considered to be very good but that mid-level and rank and file employees are weak, mostly corrupt and may constitute serious roadblocks to reform. Donor activity has been strong but transfer of expertise and improved functionality is hard to sustain. The future for ACD is closely tied to the successful implementation of ASYCUDA ++, the reform of basic Customs business processes to utilize system functionality, the training and equipping of a well trained, loyal and effective Customs staff as outlined in the proposed 5 Year Strategic plan and the Border Management Initiative.

Recommendations

- Arrange briefings by countries that have recently acceded to the WTO and WTO experts to provide a common basis of understanding for Afghanistan's accession process. This will curb much of the misinformation about WTO Accession and allow for a more informed dialog. Additionally, a ministerial level committee should be established to provide impetus and overall guidance for the accession effort.
- Rather than raise duty rates to raise revenues to meet IMF targets, rely on reduction of smuggling, corruption losses and the benefits of an efficient trade regime to increase collections.
- Secure a high-level Customs subject matter expert to assist the ACD Commissioner and staff in the reformation and modernization of Customs.
- Implement needed rail improvements and attempt to negotiate better treatment of Afghanistan's trucking industry in Pakistan.
- Create mechanism for consultation between trade community and agencies regarding new and changed procedures.
- Continue development of information technology (ASYCUDA++ Afghanistan's Customs Automated System based upon the UN system), including single administrative document and single-window concepts. Additionally, streamlining, business process improvement and paperwork reductions already begun should continue. The current import process is heavily bureaucratic, document intensive and time consuming. This development of automated processes driving the improvement of associate manual processes should be done in full partnership with the trade community. Continue the gains demonstrated in the development of information technology (transit module deployment), including risk management, collections, use of a single document for all border agencies and "single window" processing. Lastly, a dedicated IT staff for ACD should be developed to lessen the need for contractors and to provide the expertise to run, troubleshoot and modify the system as needed in future years.
- Corruption: Besides the national anti-corruption campaign, institute a Customs-specific integrity program which includes:
 - Paying a salary that is commensurate with a professional position of honor and trust that will attract high quality personnel, and that will support a reasonable standard of living without the need for supplementary income.
 - Establishing high standards for recruits and checking backgrounds, finances, and references prior to employment.
 - Using basic training of new employees to filter weaker candidates.
 - Periodically reinvestigating all personnel for the reasonability of financial worth and check for law enforcement violations or criminal association.
 - Performing "life style checks" to insure employees are living within their means.
 - Continuing to simplify the tariff and Customs procedures and ensure transparency in all Customs matters.
 - Establishing internal controls and audit processes/systems to prevent breaches of integrity and establish audit trails to identify and uncover violations.
 - Publishing standards for cargo clearance and all Customs services and provide appeals for customs decisions.
 - Continuing the automation of Customs processes, building in internal audits and controls, and utilizing and expand systems for

direct deposit of Customs duties and fees to financial institutions.

- Developing a Customs code of conduct based upon the national standard that is a listing of core values and includes a table of discipline that addresses integrity at all levels of the organization. This code of conduct should establish a “bright line” for integrity violations so that employees are able to clearly delineate violations and wrongful acts.
- Establishing an internal organization within ACD to oversee and protect the integrity of the organization, its systems, and employees. The border agencies should be the first agencies in the Afghanistan government to have the services of their own internal affairs unit of investigators.
- Creating an environment in which importers and carriers feel safe in bringing integrity issues to the attention of proper authorities.
- Making it clear to the trade community that corruption on the part of Customs or the trade will not be tolerated. Ensuring that appropriate sanctions are in place for both Customs and business violators.

Instituting practices such as those outlined above will enhance the environment and reputation for integrity and pay dividends in economic terms. Multinational businesses and investors will identify such countries as desirable locations for trade and investment. Failure to institute such behavior will have the opposite effect.

- Importers who display excellence, and are competent and compliant, pose little risk to Customs. ACD should consider establishing a special program for compliant large importers to speed their goods through Customs formalities. This approach could be implemented immediately while the major reforms and programs proceed. Numerous countries have adopted this “Account Management” approach to allow their limited resources to focus on high-risk shipments while providing tangible benefits to legitimate businesses. Treating these companies as accounts, appointing Customs employed account managers and instituting a special set of compliance, risk criteria and post release audit for select companies could allow many legitimate companies “green line” or

expedited service and separate their shipments from the flow of riskier imports.

- Consolidate other border agency functions (such as Health and Agriculture) at Customs clearance stations by assuring adequate staffing, training of Customs Officers in other control authority’s commodity jurisdiction and problem identification, and integrate forms, manual processes and automation.
- Move Customs and other border agency clearance functions except for Reconstruction Opportunity Zones (ROZs) to the border stations when ASYCUDA++ Risk Management module is introduced.
- Revise the export process by continuing to streamline procedures and employing the principles of selectivity. Most nations, even those in a development stage, have eliminated or dramatically reduced export inspections leaving this responsibility primarily with the importing country or through instituting modern risk management principles.
- Improve the quality of the Customs Broker’s sector and create a partnership between it and ACD. Establish a working group of Customs Brokers and Custom officials to promote a better working relationship. This could start by identification of training needs and scheduling of short seminars for the trade. As this relationship progresses, plans could be developed for effective shared oversight of the industry and voluntary reporting of suspected activity. Without acknowledgement of the valuable contribution a reliable and professional Customs Broker’s community can make to facilitation of the Customs process, reform will remain a slow and difficult process.
- Establish a security force (other than the Customs Police) for the control and security of Customs ports, warehouses and locations.

TRADE-RELATED FINANCIAL FLOWS

Introduction

Money is exchanged and transferred in several different ways in Afghanistan. First, cash transfers amongst individuals are commonplace and very fluid for payments of all kinds, for trading, and for merchandise purchases. Second, during the period of conflict, and continuing up to the present, the *hawala* system predominates for money transfers. *Hawaladars* are unregistered money traders who have the ability to transfer money all over Afghanistan, even to the most remote areas, and who can also transfer money into neighboring countries, as well as Dubai, Europe and even the U.S. These transfers can be done almost on a moment's notice. The *salaam* money lenders, who give money advances that are repaid with harvested crops, usually are connected to the *hawala* system.

Since the fall of the Taliban regime, banks have re-emerged quite rapidly. The six original state banks are in a process of privatization and consolidation, and up to 13 new banks have been established. Some are locally chartered banks and others are branches of international banks. Within the banking system, loans, trade financing, deposits and other kinds of transactions are carried out, some in *Shari'ah* compliance and others that are not.

In addition to the formal banking system, there are the numerous microfinance institutions, which act like banks but are not registered as such. These provide financing and credit to individuals and groups for the most part through group lending, but lending on individual account is becoming more frequent. Lastly, there are leasing firms that are emerging, and equity capital funds are also being introduced.

All in all, access to money is unconstrained, and transferring money in and out of the country is relatively easy and uncontrolled. That is not to say that

money is cheap – each system has its costs that are relative to the risks involved, the method of financing, and the security of the transaction (degree of collateral, contractual law coverage, potential for legal restitution in case of default, etc.). In light of the amounts of money being transferred into an economy fueled by donor institutions, however, military spending, and shadowed by the opium economy, money flows are not constrained.

In a recent World Bank analysis, Afghanistan was ranked 16 out of 145 countries for ease of opening a business, as opposed to 122 out of 155 in terms of transaction costs. In terms of transparency, Afghanistan ranked 17th, yet better than Tajikistan, Uzbekistan, Pakistan, Kyrgyzstan and Turkmenistan.¹⁶⁶ Projected growth is 11% for 2007. However, in a World Bank survey on investment climate, major obstacles to investment and growth were cited as lack of electricity – 64%, lack of access to land – 60%, corruption – 53% and lack of financing 51%.¹⁶⁷

Legal Framework

Money flows within and throughout Afghanistan. There is a Central Bank, which is mandated to carry out the basic operations of a central bank, and this includes foreign exchange controls and regulating the flow of money, although the monitoring of exchange practices has been limited to date. Laws are being prepared, and in the process of being enacted, for regulating trade financing, documentary credits, and various forms of financial instruments. Foreign investors are allowed to operate in Afghanistan and trade and investment financing is not considered to be unduly complicated or

¹⁶⁶ *National Business Agenda, 2006*, Afghan International Chamber of Commerce, Kabul, 8/14/2006, p. 6.

¹⁶⁷ *The Investment Climate in Afghanistan*, World Bank (Dec. 2005).

cumbersome. However, the laws do not reach as far as regulating international trade financing, or providing for insurance for financing transactions. Nevertheless, there appears to be a rather free flow of money across borders.

Financial service organizations (bank and non-bank) are required to be registered and licensed with the Central Bank, and are subject to the rules and laws affecting financial crimes (source of origin and investigation on large transfer sums, greater than \$10,000 or any suspicious transaction). However, implementation is lacking, even though tribunals are being established to deal with these situations. Nevertheless, once again, the informal *hawala* system operates outside the control of this mechanism. Penalties for violations are stipulated, including revoking bank or operating licenses when necessary. Other prosecutorial techniques are just being formulated. In spite of the lack of effective regulatory control, the exchange rate has been stable since the new central government has taken control, and hovers around 50 Afghanis (Afs) to the U.S. Dollar. SWIFT is installed and working.¹⁶⁸ Credit insurance is not available in general, but both OPIC (U.S. Overseas Private Investment Corporation) and the Multilateral Investment Guarantee Agency (MIGA) of the International Monetary Fund (the IMF investment insurance arm) are operating in Afghanistan with significant portfolios. An Export Credit Institution is one of the operating state-owned banks.

Implementing Institutions

Investments can be 100% foreign owned. There are no restrictions on transferring or converting funds into freely usable currency at a legal market rate. There is no dual exchange rate, currency controls, capital controls nor any other restrictions on the flow of funds abroad. Access to foreign exchange is not restricted, and informal foreign exchange markets exist in major cities and markets for Pounds Sterling, Dollars, and Euros. There is no delay on remitting investment returns, and there is no limitation on inflow and outflow of funds from profits, debt service, capital gains, returns on intellectual property or imported

¹⁶⁸ U.S. Treasury Questionnaire, U.S. Embassy, Kabul (2006).

inputs, provided taxes have been paid, and anti-money laundering rules have been followed.¹⁶⁹

A. Banking and Financing Institutions

The list of banks and financing institutions registered to operate in Afghanistan are presented below. There is a Central Bank, three state-owned banks (although it has been said that the Export Promotion Bank has been closed or merged with another state-owned bank), eight private commercial Afghan Banks, plus five branches of international banks. There are also 13 microfinance institutions. In addition there is a leasing company (AFC), a new equity fund on the horizon (ACAP), and a couple of cooperatives and credit unions being formed (ACDI/VOCA, WOCCU and MISFA). This table is followed by a chart describing the types of financing instruments that are available in the country. The *hawala* system is extensive and larger in size, but operates outside the registry.

B. The Hawala System

The *hawala* money transfer system operates outside the legal banking and financing system. It is a traditional system that transfers and exchanges money throughout the region and reaches all over the world through family and traditional ethnic, religious and collegial relationships. Payments can be made in one place and collections in another within and throughout the country as well as from just about any place in the world in the time it takes to communicate the transaction. *Hawaladars* generally have the liquidity to transfer and pay out millions of dollars in single transactions. It is the system of choice to fund the illicit opium Poppy production and trade network. Yet it, in and of itself, is not illicit. In some areas the system finances illicit trade at the production stage, makes illegal money transfers outside the country, and then purchases licit commodities for import back into the country.

¹⁶⁹ See U.S. Department of Commerce, *Doing Business in Afghanistan: A Country Commercial Guide for U.S. Companies*, (February, 2006).

BANKS AND FINANCING INSTITUTIONS IN AFGHANISTAN				
Bank	Status	Microfinance	Other	Type
Bank Millie	State-owned	BRAC	Afghan Finance Company	Leasing, Equity, Loans
Pashtuny Bank	State-owned	FINCA	ACAP	Equity
Export Promotion Bank	State-owned	PARWAZ	DEG	First Loss Reserve Fund
Development Bank of Afghanistan	Private Afghan	OXUS	ACDI/VOCA	Credit Cooperative
Afghan International Bank (AIB)	Private Afghan & Donors	AFSG	WOCCU	Credit Union
Arian Bank	National Bank of Iran	WOCCU		
Fist Micro Finance Bank	Aga Khan/IFC	ARMP	MISFA	Wholesale Micro-finance
BRAC Afghanistan Bank	Afghan-Bangladesh	Women to Women		
Azizi Bank	Afghan	CFA		
Kabul Bank	Private Afghan	AMFI		
Arkhozy Bank	Private Afghan	MADRAC		
Bank Alfalah	Pakistan	MoFAD		
Punjab Bank	Indian	SUNDUQ		
National Bank of Pakistan	Pakistan			
Habib Bank	Pakistan			
Standard Chartered	UK			

The degree of transfer for illicit commodities versus licit commodities is blurred, difficult to pinpoint and masked by the size of transactions (large transfers are broken up into smaller sizes at different stages of the transfer trail) and type of commodity traded. In some areas the *hawala* system is comprised of 70% to 80% illicit activities, whereas in others only 30% is illicit. *Hawala* transfer houses are located in all of the major cities, and operate quite openly in these locations. As a result, the flow of money is pervasive, unregulated and unsupervised. If the amount of assets held in the legal banking and financial sector is of the order of \$500 million, the *hawala* system could be moving an estimated five to seven times that amount in the course of a year.

Although this system is pervasive, traditional and well-heelled – i.e. it can be relied upon to the extent that many NGOs use the system to make payments to rural field offices for salaries and procurements – the degree of risk that *hawaladars* are facing is increasing. The physical transfer of money from one *hawaladar* to another is becoming more and more subject to the risk of interception from criminal elements, thus pushing the *hawaladars* to consider using more formal mechanisms such as the banks and entering into the electronic age. As this occurs, supervision of money transactions will improve and the degree to which they are used to finance the illicit trade in Opium Poppy will decrease.

BANKING AND FINANCING INSTRUMENTS	
Instruments Currently Available	Instruments in Process
Import Letters of Credit	Promissory Note
Pre-export Financing	Letter of Arrangement
Post-export Financing	Facility Letter
Handling Import Bill Collection	Letter of Authority
Export Letters of Credit	Letter of Installment
Remittances	Letter of Continuity
Bid Bonds	Letter of Hypothecation
Advance Payment Guarantees	Corporate Guarantee
Performance Bonds	Individual Guarantee
Bank Guarantees	Trust Receipt
Bridge Loans	Letter of Lien & Set Off
Term Loans	Letter of Counter Guarantee
Overdraft Facilities	Memorandum of Deposit of Title Deeds
Cash Services	Pledge of Agreement
Deposits	Loan Agreement
Cheque Clearing	Agreement for Financing
Salary Accounts	
Internet banking	
ATMs	

Supporting Institutions

There are several major supporting institutions in the financing area. The **Afghanistan Investment Support Agency (AISA)** provides a one-stop shop for business registration and formation, as well as other services. The **Afghan International Chamber of Commerce** and the **Afghan American Chamber of Commerce** conduct advocacy campaigns on behalf of their members, and in doing business in general in Afghanistan – issuing informational bulletins and guidelines, drafting new laws and decrees and presenting them to the

relevant ministries and to parliament, promoting new investment opportunities, and identifying new potential investors. Also, the **Afghan Bankers Association** has been formed, is extremely active, and has proposed the series of new financial instruments that were presented in the table above.

In addition there are a host of **donor agencies** and **NGOs** operating within Afghanistan, promoting investments, assisting the banking institutions and developing the Small and Medium Enterprise (SME) sector. The most important activity is the new USAID project, ARIES – Afghanistan Rural Incomes and Enterprise Support – together with the German Kfw program of guarantees, DEG (a German limited company owned by Kfw, the German state-owned finance company). The objective of ARIES is to expand access to rural financial services, primarily to agri-businesses, and to provide a full spectrum of financial services on a sustainable basis. ARIES will work with four banks to develop SME lending, help develop the credit unions and MISFA (the World Bank managed and supported wholesale window for microfinance lending), and work with the new ACAP equity fund. ACAP is a private fund with government support that will offer equity financing in Afghanistan. ARIES will also continue to develop BDS (Business Development Services) services for all enterprises in Afghanistan, especially the Small and Medium Enterprises (SMEs).

Social Dynamics

Every survey that asks the question about what are the major constraints to doing business in the new Afghanistan elicits the comment that access to financing is a major constraint. However, the above analysis clearly shows that financing is available and that the constraints to accessing that financing may be a lack of registered collateral, high interest rates or lack of *Shari'ah* compliance, but not its actual availability at any price. Each of the institutions interviewed is making strides toward overcoming these particular constraints, and new institutions are being formulated that will address the remaining constraints more directly. Afghanistan is making

great strides toward creating an accessible and fluid financial sector.

Recommendations

- Continue to support the development of the money flows, money transfer and exchange rate laws.
- Support the creation of the financial instruments proposed by the Afghan Bankers Association.
- Support the initiatives to legalize and register the *hawaladars*.
- Support the projects such as ARIES in order to develop a rural financial sector that is comprehensive, accessible and sustainable.

TRADE-RELATED FLOWS OF PEOPLE

Introduction

Trade related flows of people are adequate but a series of improvements are needed to achieve international levels for ease of passage and to encourage international trade. Travel, however, and therefore trade-related flows of people to Afghanistan, is very limited at this time because the security environment remains volatile and unpredictable. Tourism (except so-called “extreme tourism”) is out of the question. The ability of Afghan authorities to maintain public safety and order while ensuring the security of citizens and visitors is limited. Even though the capital of Kabul is considered fairly safe, extreme caution is advised in the U.S. State Department’s and other foreign governments’ travel advisories.

Elsewhere in Afghanistan, a significant increase in attacks in the south and southwestern areas of the country has occurred and a seasonal surge in insurgent activity is expected. In particular, many sources predict more violence in the spring of 2007 when snowbound mountain passes reopen. Potential target areas include key national or international government establishments, international organizations, non-governmental organizations and any location with expatriate personnel, as well as public areas popular with the expatriate community. Violence, and the threat of violence, is restricting trade development in many parts of the country, cutting off work opportunities for Afghans and those wishing to invest in Afghanistan.

Despite the effect these concerns of low trade-related people flow in Afghanistan, key infrastructure improvements have been made and more are planned. Over \$8 billion in aid and investment from the international community has greatly improved Afghanistan’s prospects for the future and as needed

stability is achieved will allow for larger numbers of cross border trade related travel.

Legal Framework

In summary, the legal framework for the flow of people is adequate to meet the country’s needs for the foreseeable future. All visitors to Afghanistan must possess a valid passport and an Afghan visa. The basic tourist visa entitles a traveler to 30 days stay in Afghanistan. The Afghan government requires that this one-month visa be obtained prior to traveling to Afghanistan. Visas are secured any Afghan Consulate or Embassy around the world. Only native Afghans living abroad can return for short trips without a visa.

Implementing Institutions

Immigration functions in Afghanistan are handled by the Afghan Border Police (ABP)\ which falls under the Ministry of Interior (MOI). The ABP are responsible for entry and exit of people at the 14 Border Crossing Points (BCPs), Afghanistan’s 4 international airports (Kabul, Mazar-e Sharif, Kandahar, and Herat), and in patrolling the large areas in between the BCPs from the border to the interior of the country for 50 kilometers. Many “informal” crossing points, in excess of 70 rough roads, river /creek fords and open ground access points, are spread across Afghanistan’s extensive borders. Additionally, the air base at Bagram is planned to receive Customs staffing in the near future to handle international courier shipments but no Immigration clearance is planned there for the immediate future.

ABP has over 8200 officers in Afghanistan. Only a small number of officers are assigned to Afghanistan’s traditional passport and immigration checkpoints. ABP officers assigned to these functions must be literate which limits the numbers available for the assignment.

ABP detections of illegal travelers (such as those with false documentation or those using unauthorized crossing points) are minimal. As in many public institutions, corruption is a factor with the ABP. Traders interviewed told us that multiple bribes to different Afghan officials are encountered regularly: On one trip, after the initial Customs gratuity at the port of entry, bribes were solicited by the Customs Border Police, the Customs mobile verification team and the ABP during document checks at informal checkpoints.

The Personal Identification Secure Comparison and Evaluation System (PISCES) is the immigration system that has been implemented partially at Kabul International Airport and is supported by the United States. PISCES, installed in Pakistan and other key nations, provides Immigration Officers such as the ABP and other law enforcement agencies with a tracking system to capture identifying information of travelers. More importantly, it allows governments to identify individuals of interest. PISCES is intended to link all ports and to provide smooth working co-ordination and standardization among various law enforcement agencies with a stake in immigration control. When fully implemented, PISCES will act as an important tool for immigration purposes and the identification for individuals of interest.

The return, care and assimilation of returning refugees from neighboring countries are a large issue for a country undergoing nation building. The large number of Afghan refugees crossing the borders vary according to the seasons found in Afghanistan's harsh climate. Warm weather increases the flow, but the UN processing center during the winter months sees small number of voluntary repatriations. As stated previously, refugee flow will increase during spring season. Flow may be mitigated somewhat since open source media reports suggest returnee numbers may be lower than expected because many refugees are being assimilated in host country after numerous years of residence. In 2007, the Office of the United Nations High Commissioner for Refugees (UNHCR) expects over half a million to 750,000 Afghans to return home – around 400,000 from Pakistan and approximately 125,000 from Iran. There are over 2 million Afghan refugees remaining in Pakistan and slightly less 1 million in Iran.

Additionally, air travel-specific improvements are being made. Following necessary runway and taxiway repair at Kabul International Airport, a much-needed new terminal is being built by the Japanese government. Additionally, the existing terminal is being renovated by the U. S. Army Corps of Engineers. The impact will be better flow of arriving and departing passengers as well as the ability to handle far more passengers than the current terminal in a more comfortable atmosphere. Additional improvements are being made with funding from the donor community at internal airports and the remaining international airports at, Mazar-e Sharif, Kandahar, and Herat.

Supporting Institutions

Adequate flights in and out of Afghanistan are provided by various airlines although no western airlines have yet established service. Ariana Afghan Airlines is the national air carrier of Afghanistan with flights to Tajikistan, China, India, Pakistan, Iran, Kuwait, Saudi Arabia (Jeddah and Riyadh), United Arab Emirate, Germany (to begin in Spring 2007), Russia (via Azerbaijan), and Turkey (Ankara and Istanbul). Ariana is based in Afghanistan with flights from Kabul (Kabul International Airport) and Kandahar (Kandahar International Airport). Regular domestic and international flights are provided by Kam Air and United Nations charter flights.

Social Dynamics

Despite the wariness for participating in international trade in Afghanistan, businesses are beginning to see opportunities in Afghanistan. Visas are relatively easy to obtain for legitimate business purposes and travel by road and air is now adequate and will continue to improve as the infrastructure provided by the extensive donor contributions are realized. The public institutions are viewed by the trade community as gradually improving but seriously weak in the middle management and lower level employees. Also, many complaints of wholesale corruption in the public sector are heard. However, extensive training, mentoring and modern technology donated by foreign governments and institutions continue to make are having a positive

impact on many institutions. Additionally, many top government managers are viewed as talented and willing to make necessary changes and improvements to the vital government services needed for a modern economy. In particular, returning Afghans who have lived and were educated abroad are making significant contributions to the continued economic development of Afghanistan.

Recommendations

- *Upgrade the professionalism and modernization of the Afghan Border Police.* The Government should assist
- ABP in the implementation and emphasis of integrity program at the border, including a

significant independent internal affairs investigatory function.

- *Complete the rest of the installation of PISCES at the remainder of the border crossings and international airports.* PISCES is a practical and effective tool that will greatly assist the detection of individuals who pose a threat to the national security of Afghanistan and its allies.
- *Simplify the visa issuance process.* Relaxing visa requirements and allowing for in-country visa issuance at the arrival airport will encourage more business travel.

FINANCIAL CRIMES

Introduction

Financial Crimes, namely, money laundering and terrorist financing, seem to run unabated throughout Afghanistan. Opium Poppy is a \$2.7 billion dollar illicit industry. And some of the warlords and local militia who were financed by the anti-communist countries (mainly the U.S.) to drive out the Russians and to topple the Taliban, have now become “traffickers”, “protectionist groups”, or “terrorists”, receiving some or all of their financing from the opium trade. Given this situation, the government is attempting to introduce anti-money laundering legislation and combating terrorist financing through improved law enforcement. However, the task is challenging and just beginning to unfold.

Legal Framework

There is little question that the opium money earned from Poppy production is used to finance Al Qaeda, and possibly the Taliban insurgents, even though at one time the Taliban had banned Poppy production. The new Afghanistan government has set up a Financial Intelligence Unit (FIU) at the Central Bank, has trained bank staff and other financing institutions staff in anti-money laundering detection and intervention, and has set up tribunals to prosecute offenders. Moreover, the government has introduced and trained several different kinds of counter-narcotics enforcement agencies (for eradication, interdiction and trafficking crimes), and the record on apprehensions and prosecutions is improving. In February, it was announced that up to 5,000 hectares of Poppy had been eradicated already this year, 1,500 traffickers arrested, 740 cases investigated by the courts, and 326 people convicted.¹⁷⁰ Nevertheless, the financial crimes detection and prosecution is just beginning – no apprehensions or prosecutions have been made to date.

¹⁷⁰ Daily Outlook, Afghanistan (February 11, 2007).

From the legal framework perspective, an Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework and corresponding laws are in place. These are to be implemented by the FIU; however, the vulnerabilities are pervasive. Narcotics proceeds are the biggest generator of funds. Vulnerabilities include the porous border crossings, informal sector transfers (mainly through the *hawala* system) and trade-based value transfers (using illicit funds to purchase imported big ticket items such as vehicles, appliances, etc.). Money laundering is a criminal offense, and the AML law is consistent with the Palermo Convention (The U.N. Convention against Transnational Organized Crime) and the 28 member-nation Financial Action Task Force (FATF) recommendations. Terrorist financing is also a criminal offense and is consistent with the Convention for the Suppression of Terrorism, United Nations Security Council Resolution (UNSCR) 1373 and FATF Special Recommendation II.

The law provides the authority to identify, trace, freeze and seize assets, but before this can be done, Afghan authorities believe that they need to have a relatively “ironclad” case.¹⁷¹ So far this has not been obtained. Although all assets related to the offense can be seized, as mentioned, this has not happened. So far, a specific investigation has not been carried out. Specially designated investigators for Money Laundering and Terrorist Financing have not been selected, and prosecutors and judges need to be trained. Several donors are providing this training – the U.S. Government, the International Monetary Fund, the World Bank and others. There is no extradition law.

All financial institutions are required to report on suspected financial crimes and money laundering. They are required to do Customer Due Diligence and keep records accordingly. Records are required for all beneficial ownership identities. In this process, they are required to report all suspicious transactions. But do

¹⁷¹ Interview with a U.S. Government representative, Kabul (February 12, 2007).

the banks and financial institutions follow these procedures? This is difficult to determine, but probably not.¹⁷²

Implementing Institutions

The **Central Bank** houses the **FIU**, has staffed the unit, and is responsible for implementation and supervision. Staffing needs to be increased and training expanded to include training of those responsible in each financial institution covered by these regulations – banks, financial institutions, money changers, real estate agents, dealers in precious stones and metals, lawyers and accountants. With regard to monitoring wire transfers, and money transfers of all kinds, an **MSB (Money Service Business)** regulation has been issued, but compliance and enforcement is weak.

All transactions over \$10,000 (500,000 Afghani) are supposed to be investigated and reported. So far there have been 5,000 reports per month but nothing “suspicious”. A Memorandum of Understanding has been established with the **Ministry of Interior’s Economic Crimes Unit** and the Counter Narcotics Police in order to gather the information needed for prosecutions. As mentioned, no convictions or prosecutions have been initiated because of the perceived need for an “airtight” case to get started.¹⁷³

The Financial Transactions and Reports Analysis Center of Afghanistan reports as follows:

Overview. The Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA) was established as a Financial Intelligence Unit (FIU) under the Anti Money Laundering and Proceeds of Crime Law passed by decree late in 2004. The main purpose of this law is to protect the integrity of the Afghani financial system and to gain compliance with international treaties and conventions. The Financial Intelligence Unit is a semi-independent body that is administratively housed within the Central Bank of Afghanistan (Da

Afghanistan Bank).

Objectives. The main objective of FinTRACA is to deny the use of the Afghani financial system to those who obtained funds as the result of illegal activity, and to those who would use it to support terrorist activities. In so doing, FinTRACA will make a significant contribution to the overall integrity of the Afghan financial environment, the ability of the Afghan financial system to integrate with the global financial system, and to future economic growth, investment, and prosperity in Afghanistan.

Functions. In order to meet its objectives, the FinTRACA collects and analyzes information from a variety of sources. These sources include entities with legal obligations to submit reports to the FinTRACA when a suspicious activity is detected, as well as reports of cash transactions above a threshold amount specified by regulation. Also, FinTRACA has access to all related Afghani government information and databases. When the analysis of this information supports the supposition of illegal use of the financial system, the FinTRACA works closely with law enforcement to investigate and prosecute the illegal activity. FinTRACA also cooperates internationally in support of its own analyses and investigations and to support the analyses and investigations of foreign counterparts, to the extent allowed by law. Other functions include training of those entities with legal obligations to report information, development of laws and regulations to support national-level AML objectives, and international and regional cooperation in the development of AML typologies and countermeasures.

Security. The FIU recognizes the important roll it plays as an independent intermediary between reporting entities and law enforcement. It rigorously applies its legal obligations to protect the sources and confidentiality of information received, and to use information received only for the specific purposes allowed under the law.

Of course the bane of law enforcement in this area is that the informal financial sector, the *hawala* system, operates outside their radar screen, in excess of two and one half billion dollars. However, there is a plan to develop a *hawala* bank program in the future that holds

¹⁷² This section is drawn from the questionnaire administered by U.S. Treasury, to the advisors to the Central Bank’s FIU (2006).

¹⁷³ Interview with a U.S. Government representative, Kabul (February 12, 2007).

some hope for bringing the *hawalas* under the aegis of a formal banking regime that could at least monitor if not regulate them.

Supporting Institutions

The supporting institutions are all of the financial institutions mentioned above, the *hawala* system, and the enforcement and tribunal agencies and institutions.

Social Dynamics

Although it appears that money laundering and the potential for terrorist financing goes on unabated, the system is getting more and more difficult for the offenders to operate in without risking apprehension. As a result, the opium trading patterns have changed considerably in just the last couple of years. Originally there were many operators at each level of the market chain, from Poppy production to local traders, to mid-level traders, to traffickers and to key traffickers. Now the system has consolidated, and there are fewer operators at each level, entry at the top levels is limited, and they operate more clearly as criminal elements rather than opportunistic economic entrepreneurs. Police and political protection is imperative to continue operations, fostering corruption throughout the system and the government. Currently, the estimated numbers of operators are presented in the table below, but do not include the vast system of protection agents and organizations:¹⁷⁴

Level of Operation	Number
Key Traffickers	25-30
Traffickers	200-250
Mid-level Traders	500-600
Local Traders	10-15,000
Producers	350,000

One conclusion can be made: the effectiveness of the control, regulation and enforcement of the opium trade, and the crack down on money-laundering and terrorism financing has forced offenders into this

consolidation, has pushed them underground, has increased the need for protection, both physical and political, and in the end, may even lead to a reduction in the overall illicit economy. The cost of doing business in the narco-economy has increased, the risks have increased, and the relative alternative licit income earning opportunities have increased. With continued effort, there will likely be even more progress in the near future, if the alternative jobs can be created and the licit economy expanded to pre-conflict levels.

Recommendations

- Technical Assistance for AML/CFT (Anti-Money Laundering/Combating the Financing of Terrorism) strategic planning and risk assessment.
- Drafting laws, updating laws, drafting regulations, and advising on implementation.
- Guidance to FIU on CFT – law enforcement, international assistance, alternative remittances.
- Equipping the FIU and advising on its operations.
- Providing assistance on managing DNFBP (Designated Non-Financial Businesses and Professionals).
- Technical assistance for prosecutors, judges and investigators
- Advice on freezing of assets and forfeitures.
- Drafting international and bilateral treaties.
- Training Assistance for all aspects of AML and CFT.
- Assistance is needed to draft legislation, enact laws, enforce laws, and prosecute actions dealing with money-laundering and terrorist financing through the *hawala* system.

¹⁷⁴ Drawn from UNODC report, Chapter 7 (November 28, 2006).

INTELLECTUAL PROPERTY

Introduction

Intellectual Property Rights (IPR) are legal rights granted to creators and owners of works that are results of human intellectual creativity. These works can be in the industrial, scientific, literary and artistic domain. They may take various forms, including an invention, a manuscript, a recording, a symbol that represents a business, or even an original design of a carpet. In general, the objective of IPR is to protect the right of a work's creator to collect income from or otherwise enjoy the value of his or her creation, while at the same time allowing the general public to access the work. IPR maintains this balance by establishing time-limits on the creator's means of controlling the work. IPR law, including the law of trademark, copyright, patents, and industrial design, regulates the creation, use, and control of protected work.

To have any meaningful effect, IPR law must be accompanied by a set of State institutions that are not only charged with but capable of registering protected works, investigating alleged IPR violations, and enforcing the rights of IPR owners. Effective IPR law must also exist against a backdrop of general public understanding of and support for the concepts of intellectual property.

In Afghanistan, the IPR tradition is wafer-thin, existing almost exclusively in the arena of trademarks. Works that may be subject to IPR protection in other economies – such as books, CDs, computer software and visual designs – tend to be freely accessed and copied without payment or attribution. The fact that Afghanistan's economy is so small, however, means that this issue presents far less of a threat to international commerce and foreign investment than it does in many other countries.

At the time of this Diagnostic, three draft laws pertaining to Intellectual Property were among those identified for consideration in the near-term by Parliament as part of the Afghanistan National Development Strategy (ANDS) benchmarks: the

Trademark Articles; the Law on the Protection of Copyright and Neighboring Rights; and the Registration of Foreign Patents Act. A review of the draft laws reveals that, three years after they were prepared by outside experts, there is nothing close to a local consensus concerning how they are to be implemented or enforced. In fact, the draft laws at once suggest the establishment of a single office handling all types of intellectual property, while also indicating such possible sources of discrete administrative authority as a new Trademark Office; a copyright office within the Ministry of Information and Culture; and, for registration of international patents, an office to be named later.

Enactment of IPR laws in Afghanistan simply cannot go forward until consensus on the placement, structure and funding of the implementing institution(s) is reached. Ideally, the process of achieving this consensus will also provide the opportunity to develop a long-term plan for implementation of IPR law, including drafting of accompanying regulations, institutional establishment and capacity-building, training, public education, and enforcement.

Legal Framework

A. Overview

Although IPR has never been at the forefront of policy concerns in Afghanistan, its underlying concepts are not entirely unheard of. In 1960, Afghanistan enacted a Law on Trade Marks in Afghanistan (Law 100), which has since been the basis for registering trademarks.¹⁷⁵ Afghan commercial courts are generally familiar with

¹⁷⁵ See Jacqueline Klosek and John Mercer, "Rebuilding Afghanistan: Revising the 1960 Trademark Law for Economic Growth," 161 IPWorldonline.com 26 (October 2003) (hereinafter "Revising the 1960 Trademark Law"). A copy of the 1960 Trademark law can be found at http://www.idlo.int/Afghanlaws/Afghan%20Laws/CD%20Laws%201921%20-%20to%20date%20in%20English/Trademark%20PDF_v1.PDF.

the process of registering trademarks, which have taken place with increasing frequency as the Afghan economy has begun to move forward.¹⁷⁶ Whether they have ever handled a case pertaining to trademark enforcement is not clear. Court authority to decide cases of alleged trademark infringement can be found at Section 55 of the Commercial Code of Afghanistan (1955).

Afghanistan has never had a copyright law or a viable system of patent protection, nor does there appear to be protection for industrial designs, such as patterns for carpets and other textiles.¹⁷⁷ On the other hand, Afghanistan's Law on Customs (2005) does include provisions that permit Customs officials to seize counterfeit goods or prevent the release of goods that infringe trademark or patent protections.

In 2003 and 2004, representatives of the Intellectual Property and Technology Working Group of the Afghanistan Transitional Commercial Law Project (ATCLP) launched an initiative to draft a new set of IPR laws for Afghanistan. While acknowledging that trademark, copyright, and patent law differ considerably, the Working Group “developed and implemented a common strategy to address each of these areas.”¹⁷⁸ The Working Group began by drafting memoranda on copyright law models, which it submitted to the Ministry of Justice and to the former Minister of Finance. After the Working Group prepared draft copyright, trademark and patent laws, an Egyptian lawyer traveled to Kabul in May 2003 and again in May 2004 to review and discuss them in technical working group meetings. The sessions in May 2004 included ATCLP lawyers, the Ministry of Commerce, the Judicial Reform Council, representatives of the U.S. Embassy, and the USAID

Afghanistan Governance and Legal Reform Project. Meetings also took place between Working Group representatives and the Minister of Information and Culture.

In December 2005, Afghanistan joined the World Intellectual Property Organization (WIPO).¹⁷⁹ Unfortunately, information about Afghanistan's existing laws and implementing institutions is conspicuously absent from the WIPO website. Afghanistan does not yet belong to the major international conventions pertaining to intellectual property, such as the Paris Convention for the Protection of Industrial Property; the Madrid Agreement on International Registration of Marks; the Berne Convention on Copyright Protection for Literary and Artistic Works; or the Geneva Convention for Protection of Producers of Phonograms against Unauthorized Duplication of Phonograms. In the long run, joining these conventions will solidify Afghanistan's reputation as an economy that intends to be governed by the rule of law. At this time, however, Afghanistan is still at the very beginning of planning for its IPR infrastructure.

B. Trademark

A trademark is a word, phrase, symbol or design (or a combination of words, phrases, symbols or designs) that identifies and distinguishes the source of the goods of one party from those of others. The term is inclusive of service marks, which identify and distinguish the source of a service rather than a product.

In Afghanistan, the draft Trademark Articles, as they are entitled in their current form, are in fact a revision of the country's 1960 Law on Trade Marks. Major changes made to that law are based on the trademark laws of other countries in the region, including Egypt, Turkey, and the UAE.¹⁸⁰ The draft legislation consists of 37 independent articles, which are not placed into independent, subject-specific units. In their current form, the Trademark Articles appear ready to either stand alone or to be plugged into an overarching

¹⁷⁶ Although this statement is difficult to verify from the court records themselves, it is based on a variety of casual reports from businesses of trademarks being registered in recent years.

¹⁷⁷ The 1960 “Trademark Regulations” include “margins and surroundings of textile” in the definition of a trademark, but this inclusion is hardly a substitute for meaningful protection of industrial design.

¹⁷⁸ Jacqueline Klosek, “Rebuilding Afghanistan: Encouraging Foreign Investment in Afghanistan through IP Law Revision,” online publication of Goodwin Proctor LLP.

¹⁷⁹ See website of the World Intellectual Property Organization, <http://www.wipo.int/about-ip/en/ipworldwide/pdf/af.pdf>.

¹⁸⁰ Revising the 1960 Trademark Law, *supra* note 28.

intellectual property law, the latter structure being a common approach to IPR in many other countries.

The draft trademark law includes a variety of features that, if enacted, would be entirely new to Afghanistan. It states that any interested party – and not just an Afghan business or citizen – may object to the registration of a trademark in Afghanistan (Art. 24). In addition, the draft law would extend protection to internationally famous trademarks, even if they are not registered in Afghanistan (Art. 6(L).) The draft law also includes provisions prohibiting the use of trademarks to undermine the interests of consumers, such as through their use to make false or misleading statements (Art. 33).

In 2003, the lead U.S. drafters of the Trademark Articles discussed a key issue of implementation that remains an open question today:

In revising the 1960 law, we aimed to provide the government of Afghanistan with very clear legislation that relied on objective standards as much as possible . . . [T]he central government had been somewhat lax in enforcing the existing trademark laws and regulations and, as a result, local trademark administrators in the various regions of Afghanistan operated with near autonomy. This created a situation where local administrators were able to selectively enforce certain provisions of the trademark law or even to establish rules that differed from the 1960 law. Such a system clearly allowed, if not encouraged, corruption and unfairness in general.¹⁸¹

Thus, among other changes to the old law, the new legislation aims to remove authority for trademark registration from the commercial courts and to place that authority into a single centralized Trademark Office, which would oversee the operations of regional trademark offices.¹⁸² The draft Law does not indicate, however, where the central Trademark Office would sit – that is, whether it is an office within the Ministry of Commerce or whether it is an independent agency. Moreover, other than stating at Article 37 that the Ministry of Commerce “shall be responsible for the

execution of these Articles and their associated regulations,” the Trademark Articles do not assign specific authority for investigation and prosecution of violations. Since the drafting process was completed nearly three years ago, alternatives for registration and enforcement have apparently not been explored through a transparent process that thoroughly examines all options.

C. Copyright

Copyright refers to the legal right granted to an author, composer, playwright, publisher, or distributor to exclusive publication, production, sale, or distribution of a literary, musical, dramatic, or artistic work.

There is no history of copyright in Afghanistan.¹⁸³ Accordingly, the ATCLP began its drafting process in 2003 with a comparison of model legislation drawn from various sources, which it shared with representatives of the Afghan government.¹⁸⁴ Balancing the extremely harmonized nature of copyright law worldwide with Afghanistan’s interest in consistency with the principles of Islamic Law, the drafters elected to base their proposed legislation on a “French-type model of copyright protection, as embodied by current copyright laws of Qatar and UAE.”¹⁸⁵ The drafters were mindful that these two *Shari’ah*-compliant models from the Middle East were drawn from countries that attract significant foreign investment.¹⁸⁶

Following a detailed set of definitions, the draft Law on the Protection of Copyright and Neighboring Rights is organized as follows:

¹⁸¹ Id.

¹⁸² Id.

¹⁸³ In a society with such high rates of illiteracy, this is hardly a surprise. The history of literature in Afghanistan actually reflects a culture of borrowing without attribution – “The ancient art of storytelling continues to flourish in Afghanistan, partly in response to widespread illiteracy,” according to one source. See <http://www.afghanistans.com/Information/People/Literature.htm>.

¹⁸⁴ Patricia Wick and Jacqueline Kosek, “The Clean Slate: Drafting Afghanistan’s First Copyright Laws,” *Copyright World* at 22 (November 2003) (hereinafter “The Clean Slate”).

¹⁸⁵ Id. at 24.

¹⁸⁶ Id.

- **Part One.** Scope and Provisions of Protection
 - Scope and Provisions of Protection
 - Author's Economic Rights
 - Author's Moral Rights
 - Ownership of Works Made for Hire
 - Term of Protection
 - Exploitation of Rights
 - Restrictions on Copyright and Neighboring Rights
 - Provisions relating to the Work after the death of the Author
 - Provisions related to some Works
- **Part Two.** Neighboring Rights
 - Rights of Performers
- **Part Three.** Office of the Protection of Copyright and Neighboring Rights
- **Part Four.** Preventative Measures and Sanctions
- **Part Five.** General (including issues of enforcement).

With a total of 61 articles, the draft law is largely harmonized with international standards and, as stated by the drafters, will likely supply sufficient grounds on which the country can join the major international treaties on copyright.¹⁸⁷ But it also contains some important omissions.

First, the concept of industrial design is one that, in the absence of a separate law, might properly be developed through a new Law on Copyright, perhaps as a “neighboring right.” The term “industrial design” pertains to the design of products made by larger-scale industry for mass distribution. In Afghanistan, an obvious area in which protection of industrial design may be a concern is that of carpet and textile manufacturing. (One exporter of carpets interviewed for this Diagnostic related his experience that his contemporary patterns are used by other manufacturers without attribution or compensation “all the time.” He noted, however, his belief that he is not harmed by this fact due to the superiority of the materials he uses.) Although the draft copyright law

applies to “Works of applied art, whether handicraft or produced on an industrial scale” (Art. 2(A)(8)) and to “textile Works” (Art. 2(A)(10)), it does not at any point reinforce the importance of protecting the artistic designs that are found in a manufacturing environment. Doing so might indirectly strengthen the position of Afghan carpets in the international marketplace – that is, it would underscore the State’s commitment to maximizing the value of the beautiful, original textile products produced in Afghanistan.

Second, although the draft law states that there will be penalties for copyright violation, it leaves blank the statements of specific fines.

Third, as noted, the draft law in its current form plainly illustrates the lack of consensus concerning which agency or combination of agencies will be responsible for registering copyrights and for investigating and prosecuting violations. The drafters of the law have stated their belief that a single IPR unit, one that is responsible for implementation and enforcement of trademark, copyright and patent law, would be the preferred mechanism for registration and, at least on an administrative level, for investigation and enforcement. Such an institution would be “a sort of ‘one-stop shop,’” one that “leverages Afghanistan’s limited resources and provides foreign investors with an efficient office with which to correspond,” the drafters suggested.¹⁸⁸

The draft Law on Copyright itself, however, places an “Office of the Protection of Copyright and Neighboring Rights” squarely in the hands of the Ministry of Information and Culture (Art. 47). In addition to concerns over dissipating the country’s limited resources by establishing more than one office that is concerned with the enforcement of IPR, an additional apprehension has been voiced: namely, that, based on its recent history, this Ministry may be more interested in censoring works of art than in protecting them.

Moreover, the draft law is virtually silent concerning investigation and criminal prosecution of copyright violations. Ultimately, the division of responsibilities among an IPR administrative agency, line ministry

¹⁸⁷ Id.

¹⁸⁸ Id. at 25.

investigators, Customs police, the Attorney General, and/or Ministry of Justice must be agreed upon among those in a position to build understanding and consensus over the matter. Then, the draft laws should reflect that shared understanding. Also, administrative rules and the criminal procedure code must be drafted or amended to reflect the plan for investigation and enforcement of IPR violations.

D. Patent

A patent is a grant made by a government that confers upon the creator of an invention the sole right to make, use, and sell that invention for a set period of time. In Afghanistan, the draft Registration of Foreign Patents Act acknowledges through its brevity (11 Articles) and limited scope that Afghanistan is simply not at a stage where it can do much more than accord legal status to patents granted in other countries. The country is not ready, in other words, to engage in the complicated and highly scientific exercise of examining patent applications for originality and authenticity and then granting original patents. But the act of registering foreign patents, and thereby providing them with legal protection, signals to foreign investors that their bona fide inventions will not be illegally copied in Afghanistan without legal redress.

Even prosecuting violations of foreign patents is a complex issue that may be premature for Afghanistan's current legal and business environment. Through its inability to name an administering agency, the draft law again illustrates that fact that there is not yet a consensus in Afghanistan about how IPR will be implemented and enforced.

As Afghanistan's economic viability becomes more substantial, the absence of meaningful patent protections may be of increasing concern, in particular in the areas of seed protection and protection of pharmaceuticals. A draft National Seed Policy was developed in 2002, which, among other goals, aimed to protect the interests of owners of the rights to certain plant varieties and hybrids.¹⁸⁹ Pharmaceutical production does take place in Afghanistan at this time,

but whether producers currently observe the patent rights to these products as registered in other countries was not a topic examined during this Diagnostic.

Implementing Institutions

At this time, registration of trademarks takes place in the **commercial courts** in a manual process that involves hand-written ledger books authenticated by personal photographs and signatures. Individuals who have gone through the process of registering trademarks report that courts typically request unpublished "facilitation fees" in order to timely process a trademark registration request.

The drafting of the new IPR regime is the responsibility of the **Ministry of Commerce and Industry**. To the extent in the near future that the Ministry will push for the enactment of the IPR laws, it must first take the lead in resolving, through inter-agency and private-sector consultation, just how such a nascent system is to be administered. The questions that must be answered include the following:

- Should the administration of IPR functions take place through a single, stand-alone agency, or should responsibility for individual areas – trademark, copyright, patents and possibly industrial design – fall within the jurisdiction of individual ministries with closely aligned functions?
- Should courts have any role in the registration of IPR?
- What agency or agencies should be charged with handling complaints over IPR violations, including the investigation of complaints?
- Who should be responsible for criminal prosecution of IPR violations? Will private prosecutions be an option? Assuming the Ministry of Justice has a role in prosecution, how will its staff be trained?
- What should the role of courts be with respect to enforcing IPR violations, and how should judges be trained to assume these responsibilities?
- What is the core set of administrative regulations that must be drafted following the enactment of

¹⁸⁹ See http://www.icarda.org/seed_unit/pdf/AFGHANISTAN_SEED_POLICY.pdf.

the IPR laws? How will stakeholders be informed about the content of these regulations?

- How are private companies and the legal community to be apprised of the new structure in Afghanistan for protecting IPR?
- How do Afghanistan's draft laws and proposed institutions conform with the expectations of the World Trade Organization's Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)?
- What other laws, particularly concerning civil or commercial procedure, must be amended in the future to be reconcilable with a new IPR regime?

Although the Afghanistan National Development Strategy has resulted in a strong effort to “put laws on the books,” the area of IPR cannot move forward without a better defined agenda for implementation.

Supporting Institutions

Before and after the enactment of new IPR legislation, there will be a need to integrate and educate the various constituencies that will necessarily be affected by the new regime.

Among the critical agencies charged with watching for IPR violations is the **Customs Department**. At this time, training in identifying counterfeit goods does not occur and border officials are unfamiliar with procedures to be followed if counterfeit goods are encountered.

Unfortunately, there is no **bar association** or **organization of lawyers** that could assume the role of providing continuing legal education for commercial lawyers, not only in IPR, but in all commercial subjects, nor is there a viable **judge's association**.

The state of **legal education** and **higher education in economics** is similarly poor. With the possible exception of trademark law, IPR is not yet among the subjects covered in the curriculum at the Kabul University Faculty of Law and Political Science. It likely is never mentioned in any of the nation's eight additional public universities.

On the other hand, as suggested in earlier sections of this Report, the **Afghan International Chamber of Commerce** may be well positioned to take the lead in educating its community of stakeholders about IPR. The AICC's relatively progressive membership, which includes a variety of manufacturers, may be interested in the topic particularly from the perspective of attracting foreign investment – that is, many foreign companies evaluate IPR protections carefully before making an investment decision. The State-affiliated **Afghan Chamber of Commerce and Industry** is clearly less inclined to march into this new, relatively sophisticated territory, but its infrastructure of offices throughout the country could be a useful resource for educating interested parties over time.

One supporting institution that will be critical in the implementation of any new IPR regime are **the media**, including newspapers, television, and, perhaps most promising, radio. As discussed previously, the opportunities for public education available through the media are not yet being exploited. Government ministries and other change agents – including donors – do not provide sufficient access to the media so that they can thoroughly and accurately carry the news of change to the public. This situation must change in order for significant new systems, such as national implementation of IPR rights, to take root.

Social Dynamics

Whether now is the time to drive for a comprehensive system of IPR registration and enforcement in Afghanistan is a threshold question that has not yet been fully examined by the Afghan government or the donor community.

On one hand, some observers assert that IPR should be given very low priority, in light of the current stage of the country's development. Other issues, such as energy and infrastructure and even other commercial laws, are considered of far greater importance in jump-starting economic growth. The small size of Afghanistan's economy means that it presents far less of an IPR threat to international commerce and foreign investment than that of many other countries. Afghanistan is not, for example, on the Office of the

U.S. Trade Representative's "Section 301 Watch List" for 2006, a survey of major violators of IPR standards.

On the other hand, some actors argue that a legal structure that supports IPR is necessary if Afghanistan aspires to join the World Trade Organization, attract foreign investment, and protect its cultural heritage. Within the WTO, the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) establishes minimum levels of protection that each government is required to give to the intellectual property of fellow WTO members (although the WTO does afford to its poorer members several years to comply). Establishing a framework for IPR will necessarily be part of the country's WTO accession strategy, another policy discussion that is still taking place. Any law that is submitted to Parliament should, of course, be reviewed for consistency with WTO requirements.

From the larger actors in the private sector, there is already some demand for IPR protection. As foreign companies move in – and they have – they desire to protect their trademarks through a system that is less suspect than the current system of registration courts. In addition, local producers of pharmaceuticals feel threatened by cheap imports from neighboring countries and suggest that stronger protection on patents and trademarks may quell this onslaught to some degree. To this end, they advocate better training of Customs officers in seizing unlawful goods.

Finally, Afghanistan faces the challenge of "selling" an IPR regime to a general public that has an unusually high rate of illiteracy and an enormous urgency to simply avoid the daily perils of poverty. The drafters of the proposed Law on Copyrights summarized the mystery to unfold:

There is a rich tradition of music, poetry, and textile arts in Afghanistan. There are also contemporary filmmakers, photographers, writers, etc. who will benefit from a copyright law. It remains to be seen whether an author's autonomy in his work, which we in the developed world may take for granted, will be intuitive to the Afghan people or not.¹⁹⁰

¹⁹⁰ The Clean Slate, *supra*, at 25.

Recommendations

- Prior to the enactment of any new law or set of laws, Afghanistan should develop a comprehensive, long-range plan for conception and implementation of a new IPR regime. The formulation of policy should take into consideration the country's interests in accession to the WTO. In addition, the plan must entail not merely a vision for enacting law, but also a shared understanding of the institutions that will be created through new law or the additional responsibilities that will be placed into existing institutions. Ideally, the plan will entail the creation of a single institution charged with IPR registration, implementation, and enforcement, rather than scattered offices that are independently responsible for trademark, copyright, patents, and industrial design. It will also entail harmonization of the IPR regime with the country's emergent procedural laws. Consensus over the country's long-range plan for IPR should emerge from the executive, legislative and judicial branches of government, and include adequate consultation with the public sector. A period of training may necessarily have to precede the development of a consensus.
- In the long run, courts should not be responsible for registering trademarks or any other form of intellectual property. That function properly belongs in an executive-branch agency.
- With respect to all the public and private stakeholders that are created or already exist within the context of a new IPR regime, plans for training and substantial technical assistance should be devised.
- Afghanistan needs a bar association that, at the very least, can provide a forum for continuing legal education for commercial lawyers. There similarly needs to be an effective judicial training program or institute that addresses the substance of commercial law. Donors engaged in training lawyers and judges should work to develop one or more such organizations. IPR training for lawyers and judges should, for the most part, take place through the new associations, so that sustainability in training will prevail over the *ad hoc*.
- Within the stake-holding community, legal education should not be neglected. A program for teaching law professors about IPR, so that they in turn are capable of teaching their students, should be included in any technical assistance program.

- A new IPR regime should include a component of public education that discourages use of counterfeit or unlawfully duplicated goods.
- Customs officers should receive comprehensive training in recognizing and seizing counterfeit goods.

ATTACHMENT I:

COMPILATION OF RECOMMENDATIONS

ISLAMIC LAW (<i>Sharī'ah</i>)				
No.	Type	Recommendation	Priority	Duration
1.	Education/ Coordination/ Consensus building	International donor organizations and other NGOs involved in commercial law reform must take account of the strong traditions in <i>Sharī'ah</i> and customary law in order to give commercial laws and supporting institutions clear legitimacy, especially outside Kabul. To achieve this, donors would benefit from consultation with Afghan <i>Sharī'ah</i> scholars and clerics, as well as respected Islamic scholars and clerics from other Islamic countries. This would especially act as a counter-balance to extremist Islamic interests in Afghanistan and in the region. International donor organizations and other NGOs involved in commercial law reform should engage in consultation with Afghan <i>shuras</i> and <i>jirgas</i> to determine whether there are any commonalities in regional/provincial laws which should be taken into account in commercial law reform.	High	Long term
2.	Institutional capacity building/ Legal system reform	The court system should be structured to ensure the appointment and meaningful training of judges who are familiar with and sensitive to issues of <i>Sharī'ah</i> (including both <i>Sunni</i> and <i>Shi'ā madhahib</i>) and especially customary law. These judges should have reputations for integrity – possibly a judicial nominating commission that makes recommendations to the President – with greater transparency and an opportunity for input by the public, legal community, and ' <i>ulamā</i> '.	High	Medium term
3.	Judicial Training/ Institutional capacity building	A special judicial training program should focus on the prominent <i>Sunni</i> and <i>Shi'ā madhahib</i> , as well as Constitutional law, civil law, judicial ethics, and legal issues specifically involving women (i.e. unlawful gender inequality and the status of women in Islam) – this should be as a supplement to, and not instead of, better cross-curricular studies between the faculties of <i>Sharī'ah</i> and faculties of law at Afghanistan's nine universities with such faculties.	Medium	Medium term

ISLAMIC LAW (<i>Shar'ah</i>)				
No.	Type	Recommendation	Priority	Duration
4.	Legal Reform/Consensus building	The customary laws of Afghanistan should be better studied and compiled where possible – perhaps in coordination with or drawing on input from Provincial Reconstruction Teams and NGOs working at the local level – and those laws should be taken into account in the drafting of commercial legislation in order to ensure greater coordination, cooperation, and implementation in areas outside of Kabul. Closer coordination is needed among various donor organizations and NGOs in addressing the priorities set forth in these recommendations, especially in ensuring <i>Shar'ah</i> -compliant and customary law-sensitive legal drafting and institutional reforms.	Medium	Long term
5.	Legal Reform/Consensus building	Better coordination is needed among the Ministries and others involved in legal reforms within the Afghan government, including a greater sensitivity to ensuring <i>Shar'ah</i> -compliant and customary law, sensitive legal drafting, and institutional reforms.	Medium	Long term
6.	Legal Reform/Training	The <i>shuras</i> and <i>jirgas</i> should be incorporated into the formal legal system, as courts of first instance (similar to magistrates or small-claims courts), with clearly defined jurisdiction and a right of appeal to the national court system. As part of this, a special judicial training program should be offered to the <i>shuras</i> and <i>jirgas</i> in order to acquaint them with the <i>Qanūn</i> that are the law of the land.	High	Long term

COMPANY LAW AND CORPORATE GOVERNANCE				
No.	Type	Recommendation	Priority	Duration
1.	Legal reform	Reform the company law in accord with the needs of Afghan users, to simplify the requirements for, inter alia, prior company registrations, to the role of the central registry, the role of company directors, board members, and shareholders (see chapter on company law and corporate governance for more details).	High	Long term
2.	Training/Capacity Building	After the law becomes effective with a final text, hold meetings and workshops throughout the country with regional, business, professional, and other concerned persons covering: (a) training and education in the law and company procedures and corporate governance best practices in general, and (b) soliciting suggestions for continuing amendment and revision of the law.	Medium	Long term
3.	Legal reform/consensus building	Consider establishing a committee of government and private practitioners with the stated task of regular review and updating of the company law and corporate governance practices. This can be donor-supported but should not be donor-run or controlled.	Medium	Long term
4.	Institutional development and	Establish a single central company registry (although with regional branches) which combines, consolidates, and fills the gaps in the current three-institution system of the MoCI, AISA, and	Medium	Long term

COMPANY LAW AND CORPORATE GOVERNANCE				
No.	Type	Recommendation	Priority	Duration
	capacity building	the commercial court. That registry could be established in AISA or the MoCI, or it could be a new government body. If it is in AISA, it should be separate from AISA's advisory and investment promotion function. It should not be in the commercial court; the court should be removed entirely from the company registration process.		
5.	Institutional development and capacity building	Establish a single, central, "one-stop shop" for all business permits and licenses. This could be established in AISA, which already has a "one-stop shop" for company registration and investment licensing steps (but not for sectoral licenses). It should have the power to coordinate the process of obtaining all licenses from each ministry or other agency, and all such bodies should be required to provide it in writing with their procedures, forms, fees, contact persons and contact data, and time frames and deadlines, all of which it will publish and make available to any person requesting it. To the extent possible, the procedures and time frames for all licenses should be the same.	Medium	Long term
6.	Institutional development and capacity building/Information sharing	Establish procedures for greater collection and dissemination of data on companies, such as the data listed in "Information on Companies" above. Some of this type of data can be collected when a company registers (for example, identifying its business sector using a standard industrial code system). The information could then be posted on the appropriate agency website.	Medium	Long term

CONTRACT LAW AND ENFORCEMENT				
No.	Type	Recommendation	Priority	Duration
1.	Donor coordination/Consensus building	The Ministry of Commerce and its donor supporters should develop a comprehensive, long-range plan for implementation of the new Law on Contracts, which should be just one part of a comprehensive, long-range plan for implementation of all of the new commercial laws. Implementation should include engaging constituencies from all corners of the Afghan economy, including lawyers, judges, small and mid-sized businesses, business and trade associations, state and provincial authorities, and women-owned enterprises. The long-range plan should include an agenda for using the media to help inform the public about the opportunities inherent in the new system of contracts.	High	Short term
2.	Legal and regulatory reform/Education/Consensus building	Clarity must be reached within the new Law on Contracts about the formal processes for handling contract disputes and enforcement. Although the new laws on arbitration and mediation seek to remove such disputes from the courts, the judicial process shouldn't be forsaken completely. A plan for drafting court rules and regulations pertaining to contract disputes must be devised, and that plan must include collecting input from the likely community of stakeholders. Ultimately, there should be no doubt in the mind of anyone who reads the new law about where his or her formal avenues for redress exist.	Medium	Medium term

CONTRACT LAW AND ENFORCEMENT				
No.	Type	Recommendation	Priority	Duration
3.	Capacity building/ Training	Afghanistan needs a bar association that, at the very least, can provide a forum for continuing legal education for commercial lawyers. Donors engaged in training lawyers should work to develop one or more such organizations. Training for lawyers should, for the most part, take place through the new associations, so that sustainability in training will prevail over the <i>ad hoc</i> .	Medium	Long term
4.	Education/ Capacity building	<p>In cooperation with the central government, the donor community should examine Afghanistan's crisis in higher education, and, for the purpose of implementing its new system of commercial laws, in the law faculties in particular. The following approaches should be considered:</p> <p>Establish faculty training programs. Teaching the teachers is, of course, a tried and true method for reaching exponentially larger groups of people, yet no training programs have been established at Kabul University. These can be as simple as inviting expatriate lawyers working in Kabul to conduct short workshops with faculty in their specialized areas.</p> <p>Engage in curriculum development. With the advent of a new system of commercial law, much work needs to be done with the existing curriculum in both the Faculty of Law and Political Science and the Faculty of Islamic Law. It is time for those actors who are drafting and enacting the new law to reach out more effectively to those who must teach it.</p> <p>Set up clinical legal education programs. As U.S.-based law schools have discovered, clinical legal education provides high impact results and greater understanding. Given the country's special interest in agriculture as a source of economic development, clinical legal education may properly be directed, at least in part, to this arena. The use of contracts would necessarily be part of a commercial law clinic, whatever its focus.</p> <p>Use the law faculty. Law faculties can provide a resource for information within the community of practicing lawyers by developing continuing legal education programs. They would also be an obvious source of content for media programs seeking to educate the public about changes in the commercial law.</p>	High	Long term
5.	Information Sharing/ Education	In the area of government contracts, the legal and business communities and the general public should be kept informed about changes in policy and increased expectations of transparency that will lead to sounder procurement practices. The topic of government contracts should be included within both continuing legal education programs and law school curricula	Medium	Long term

REAL PROPERTY LAW				
No.	Type	Recommendation	Priority	Duration
1.	Pilot project	Extend and expand the LTERA titling project. Consider expanding it to include a pilot project involving more “difficult” categories of land ownership (i.e., categories in which title is not traceable back to previously-titled and recorded land), and to focus also on land transfer issues as distinct from titling and registration issues.	Medium	Long term
2.	Legal reform/ Consensus building	Enact a mortgage law using the draft of the Ministry of Urban Development and soliciting input from investors and businesses dealing in land.	Medium	Short term
3.	Legal and regulatory reform	Encourage foreign investment by making the rules and procedures for land use by foreign persons simpler and more transparent, and thus more secure. Instead of eliminating the basic prohibition of foreign ownership (which at this time would be impracticable), consider the following: <p style="margin-left: 40px;">Amend the Private Investment Law to allow longer term leases to foreigners (for example for 99 years), and consider laws to allow certain foreign persons (such as long-term residents and persons or companies making investments over a stated amount) to have land use rights the same as or similar to those of Afghan citizens; Issue formal regulations or laws clarifying matters about which there may now be uncertainty such as the rules for leasing of state property (see above), foreign ownership of buildings and other attachments on land; companies or joint ventures which are partly foreign-owned; and the holding of land by Afghan citizens for the benefit of foreign persons, as another possible way of facilitating de facto landholding by foreigners; Reform the building permit and zoning permit process; simplify and streamline the applicable rules and requirements.</p>	High	Medium term
4.	Institutional development and capacity building	Create a single independent governmental body for property and title registration, combining the divided functions of the local registries (<i>Makzhans</i>) and courts. This is another project of months or years. It can build on the work of the LTERA titling project.	High	Medium term
5.	Institutional development and capacity building/ Privatization	The non-transparent practices surrounding state land should be reformed. To the extent possible there should be a single governmental body which owns, or coordinates ownership of, all state land. Also, a long-term program should be adopted to privatize state land, particularly the large areas which are not actually used for public purposes.	Medium	Long term
6.	Institutional capacity building/ Education	Establish training programs for governmental officials and judges at all levels on all of the above.	Medium	Long term

SECURED TRANSACTIONS LAW				
No.	Type	Recommendation	Priority	Duration
1.	Legal reform/ consensus building	Achieve consensus among the relevant stakeholders about the form of a new secured transaction law. Modifications to the straightforward and simple approach contained in the current draft should be kept to a minimum. Priority should be given to passage of the new law in the near term.	High	Near term
2.	Institutional development and capacity building	Develop a structure for a collateral registry. This should commence with a review of similar systems utilized in both newly emerging and more established economies, with a focus on implementing a system that is easy to use by those seeking to file registration notices and to obtain information about previously recorded notices. The system should be computer/Internet based, with accessibility provided to those who do not have computers or the Internet available. Simple forms for filing registration notices should be created and promulgated by regulation. Fees, while required, should be minimal.	High	Medium term
3.	Institutional development and capacity building	The Banks Association's ongoing efforts to develop forms to assist in the implementation of the new legislation should continue to be supported. These forms should not, however, become part of the law as enacted or the regulations that are subsequently promulgated. This could create the unintended result that changes to the forms to suit a particular situation could lead a court to refuse to enforce the borrower's obligations. Rather, the forms should be "living documents", in that they may be subject to constant updating and improvements in addition to being capable of adaptation to the particular circumstances of a transaction.	High	Medium term
4.	Institutional development and capacity building	The ongoing efforts to support the growing microfinance and SME lending sectors should continue with particular emphasis on technical assistance to upgrade the lenders' capabilities to make loans to SMEs.	Medium	Long term
5.	Institutional development and capacity building	A credit registry should be established under the auspices of the central bank (DAB)—either as a department within the bank or in conjunction with an independent vendor operating under contract with the central bank. As part of this process, similar systems utilized in both newly emerging and more established economies should be reviewed.	High	Long term
6.	Training and education/ Institutional capacity building	Educational activities should be planned in conjunction with the passage and implementation of the new secured transaction law to include the Afghanistan legal, banking, business, academic, and judicial communities. This could include: A separate workshop for the banking community , to include (1) a presentation to familiarize bankers with the requirements of the new law, (2) instruction on credit determinations and cash flow analysis for purposes of extending credit in real estate and asset-based lending transactions, (3) a loan documentation class to include a review of the forms developed by the Banks	High	Long term

SECURED TRANSACTIONS LAW				
No.	Type	Recommendation	Priority	Duration
		<p>Association, and (4) a workshop on <i>Sharī'ah</i> -based lending to include basic principles of allowed lending practices, loan documentation, and community involvement in the process of <i>Sharī'ah</i> banking.</p> <p>An outreach program to the universities to assist in the training of professors in commercial concepts and laws with a view of developing curricula designed to educate law students on modern commercial concepts.</p> <p>Establishment of formalized and regular judicial training on basic economic and business principles to include study of the new laws and how they relate to everyday commercial transactions.</p>		

BANKRUPTCY LAW				
No.	Type	Recommendation	Priority	Duration
1.	Legal reform	While not a legislative priority given Afghanistan's other needs, work should begin in a deliberative process to review the options available for an insolvency law suited to Afghanistan's needs. This should include a review of bankruptcy laws enacted in other emerging economies and consideration of how those laws have performed in practice.	Low	Medium term
2.	Legal reform	A working draft of a new bankruptcy law should be produced giving consideration to: (1) certainty in application and predictability of results, (2) maximization of the value of the assets available for payment of creditors' claims, (3) equality among treatment of similar creditors, (4) timely and efficient resolution and wind up of the debtor's affairs, (5) transparency in application to ensure complete access to information by all participants, (6) determination of priorities of certain creditors, and (7) the type of entity for which bankruptcy relief should be provided as well as the extent of such relief.	Low	Medium term
3.	Legal reform	While consumer credit is generally not available in Afghanistan, personal liability based on a guarantee of a business obligation does exist. At some point, consumer credit may also become available. A policy decision needs to be made as to the extent of the discharge of debts to be granted to individuals and the conditions for obtaining such a discharge.	Low	Long term
4.	Legal reform/ Consensus building	Once formulated in draft form, the proposed law needs to be circulated widely among the stakeholders to include the lending and business communities through their respective representative organizations, the relevant governmental ministries, lawyers, and members of the judiciary.	Low	Long term
5.	Judicial system	Consideration should be given to conducting a study to assess the viability of commercial courts	Low	Long term

BANKRUPTCY LAW				
No.	Type	Recommendation	Priority	Duration
	reform	designated to deal exclusively with bankruptcy and other issues involved in the commercial credit process.		
6.	Education and Training	<p>Once a draft of the new law has been widely circulated for review and comment, put into final form, and is in the process of passage, educational activities should be planned in conjunction with passage and implementation of the new bankruptcy law to include the Afghanistan legal, banking, business, academic, and judicial communities. This should encompass:</p> <p>A workshop for the banking community to familiarize bankers with the new law and bankruptcy concepts generally.</p> <p>An outreach program to the universities to assist in the training of professors in bankruptcy and insolvency concepts and laws with a view of developing curricula designed to educate law students on bankruptcy and other commercial concepts.</p> <p>Establishment of formalized and regular judicial training on basic economics and business principles to include study of the new bankruptcy law.</p>	Low	Long term

COMPETITION LAW AND POLICY				
No.	Type	Recommendation	Priority	Duration
1.	Institutional capacity building/ Economic reform	Continued focus on building overall economic capacity prior to constraining it with Anti-Monopoly laws.	High	Long term
2.	Institutional reform/ Privatization	The government must be enabled and encouraged to totally and rapidly complete the privatization of the State Owned Enterprises. While it may be uncomfortable in the short-run, privatization of these shell enterprises will produce incalculable benefit by teaching the government and the citizenry that the government is promoting business – not participating in it.	Medium	Long term
3.	Education and training/ Institutional capacity building	<p>Multi-modal education (radio, TV, civic action groups, employee training days, flyers, posters, etc.) across the spectrum of society focused on the following:</p> <p>The benefits of a market economy, Superior authority of laws over the authority of individuals, Celebration of creativity and initiative in all areas of life, Celebration of business and industry heroes to a similar extent as war heroes, and The proper role of the civil servant.</p>	Medium	Long term
4.	Institutional development and capacity building	Continued focus on enabling transparent, globally understood, functioning civil and commercial institutions and processes in Afghanistan that ultimately defeat competing informal institutions through superior service.	High	Long term

COMPETITION LAW AND POLICY				
No.	Type	Recommendation	Priority	Duration
5.	Legal development	Close and quantified monitoring of industry sectors until such time as a Competition Law regime should be called for by a broad cross-section of businesses, academics, government officials, and would-be investors. At that point, Competition Law should be introduced only in the sectors where it can quantifiably be shown to be required, and then only to the extent necessary to correct palpable deficiencies in that market.	Medium	Long term

COMMERICAL DISPUTE RESOLUTION				
No.	Type	Recommendation	Priority	Duration
1.	Education and training/ Institutional development and capacity building	The legal professional lacks an adequate supply of legally-educated practitioners, including attorneys and judges. Efforts to bolster legal education should be supported, including law schools, judicial training centers, etc. This education should include specific and targeted education on commercial law. Relatedly, a bar association is needed to support such efforts as well in order to bolster the legal profession in general.	High	Long term
2.	Institutional reform	There is a need to increase staffing at primary courts to alleviate the need for courts of appeals to also act as courts of first instance. Efforts to reform both administrative and appellate practice should be supported.	Medium	Medium term
3.	Legal reform	Legal limitations on arbitration, while often not enforced, should be removed from the law to avoid future conflict between accepted practice and the law on the books.	Medium	Short term
4.	Institutional reform and capacity building	The length of legal proceedings are unreasonable, and as a result do not provide fair protection of a party's economic interests. Delays exist throughout the system, from basic functions of court administration to execution of judgments, for reasons including rent-seeking behavior, administrative inefficiencies and lack of education. The Supreme Court needs to continue and expand its work in carefully establishing internal strategies, goals, procedures and regulations for the ongoing permanent professionalization of the courts, judges, clerks and administrators. Ongoing reform efforts in this regard must be supported.	High	Long term
5.	Institutional reform	The fee structure for bringing claims is inappropriate and will need to be amended sooner rather than later. Fees are not based on the costs of the services rendered and are only assessed at judgment. If the parties withdraw a case before completion, fees will likely not be paid, or if paid, will only be so after a period of years. The courts cannot effectively predict budgetary needs based on this system of contingent fees assessed against unknown future awards. At the same time, the percentage based accounting creates inappropriate incentives for the courts to award higher fees to make up for shortfalls in budgetary resources. All of these factors serve to discourage legitimate use of the judiciary.	Medium	Long term

COMMERICAL DISPUTE RESOLUTION				
No.	Type	Recommendation	Priority	Duration
6.	Institutional reform	Steps should be taken to improve the capacity of the judiciary. For example, the Supreme Court should set a long-term strategy for providing tenure to qualified judges as they indeed become qualified. This may include a system of testing all judges and dismissing those who fail, or setting performance and education levels that judges must meet within a certain period to obtain tenure. Judge's salaries should be increased to attract well qualified judges and staff.	Medium	Medium term
7.	Institutional reform	Written judicial decisions should be required in all cases.	Medium	Medium term
8.	Institutional reform/ Information systems capacity building	International donors are providing long-term technical assistance with respect to court administration to help introduce effective court management and case management, including computer-based case management systems based on improved manual procedures that comport with the recently redesigned civil and commercial procedures. Human resource capacity is the number one challenge to these efforts. Physical infrastructure (including lack of reliable supply of electricity) is also an impediment in many cases, but the low educational level of court staff make it particularly difficult to rebuild. Efforts in these cases should be supported, as substantial assistance will be needed for a number of years as the new systems are established, piloted, revised, and rolled out on a national basis.	High	Long term
9.	Legal and institutional reform	While the <i>Haqqoq</i> have been successful at providing alternative dispute resolution services similar to court-annexed mediation, the role, jurisdiction, and functions of the <i>Haqqoq</i> need to be more carefully established and limited by law and regulation, and responsibilities such as execution of judgments must be brought under the independent authority of the judiciary.	High	Medium term
10.	Legal and institutional reform	As an integral and respected part of Afghanistan's dispute resolution system, the functions of the <i>shuras</i> , and their relationship to the court system should be more formally recognized and managed, including the jurisdictional relationship, methods of enforcement, and appeals from <i>shura</i> decisions.	High	Medium term
11.	Institutional development and capacity building	Formal institutions for mediation and arbitration should be created.	Medium	Long term

OPIUM POPPY				
No.	Type	Recommendation	Priority	Duration
1.	Institutional capacity building	Continue to support the Alternative Livelihoods Programs (ALP's). The new ALP's are going into new areas, more marginal areas, and less populated areas, and will require concerted efforts to stay the course in the face of insecurity and lawlessness.	High	Long term

OPIUM POPPY				
No.	Type	Recommendation	Priority	Duration
2.	Institutional capacity building	The formal banking system will always lean toward the financing of non-agricultural enterprise. Measure must be taken to coax, encourage, and even force them into lending to agribusinesses and agricultural activities.	High	Long term
3.	Investment strategy development	Support investment promotion in the private sector.	Medium	Long term
4.	Institutional development and support	As part of a new investment model, create enclaves of processing facilities and manufacturing plants for the agricultural products that are currently produced, or can be produced, in the rural areas in order to create Off-farm Employment opportunities – i.e. the third prong of the ALP strategy.	Medium	Long term
5.	Institutional development and support	Create industrial, agri-business protected enclaves focused on the processing of agricultural products from raw material to finished product to increase domestic production capacities.	Medium	Long term
6.	Investment and financing strategy development	Identify and design financing incentives to support start-up grants plus long-term financing for rehabilitation and operations, with guarantees provided by narcotics funding. (Similar to what is provided in Bolivia, Colombia, Peru, and Ecuador to assist companies to start operating in drug-prone areas.)	Medium	Long term
7.	Investment and financing strategy development	Develop grant-funded contract farming programs with funding for inputs and up-front labor, for those who supply the raw materials to the manufacturing facilities. Possibly allow those suppliers to take equity shares in the new firms, similar to an ESOP (employee stock ownership program). (This would allow the new program to be comparable to the <i>salaam</i> credit for Poppy.)	Medium	Long term
8.	Marketing strategy development	Identify and develop strong markets for manufactured goods through advertising, branding, logos, trade fairs, trade missions, etc. (ASAP is currently developing these kinds of programs.)	Medium	Medium term
9.	Institutional development and support	Insist that the companies pay “fair trade plus” premium prices (i.e. 1.5 times the traditional price or better) for the raw material at the factory gate. (Each farmer contracted would sign a document to agree to desist from growing Poppy, as has already been done by the Development Works Canada chili pepper growers who are starting to ramp up in Helmand this spring).	Medium	Near term
10.	Infrastructure development	Introduce grant-funded additional infrastructure – improved roads/bridges, cold storage, transportation – where needed.	Medium	Long term

FOREIGN DIRECT INVESTMENT				
No.	Type	Recommendation	Priority	Duration
1.	Institutional development and capacity building	Separate the functions of policy-making and policy-implementing at every significant level of government. Merger creates distorted policy goals and the opportunity for corruption.	High	Medium term
2.	Institutional development and capacity building	Pare down membership in the High Commission on Investment (HCI).	Medium	Medium term
3.	Institutional development and capacity building	Apply the Afghan telecom model to Afghan energy development.	Medium	Long term
4.	Institutional development and capacity building	Create incentives for sector self-sustainability and create a negative stigma to undue donor assistance. (Current perception is that “successful” ministries achieve higher rates of donor assistance annually than “unsuccessful” ones. This is a dependence-creating mechanism that must be stopped.)	High	Near term
5.	Education/ Information sharing	Publish an exclusive tax and fee schedule – with a persuasive implementing decree (from the president).	Medium	Near term
6.	Institutional development and capacity building	Build a relevant Commercial Court by training experienced businessmen as jurists and lawyers while recognizing the potential aversion to a semi-secular court and the displacement of current jurists. This could serve as nucleus for the introduction of Western aspects of adjudication in other legal areas.	High	Long term

INTERNATIONAL TRADE				
No.	Type	Recommendation	Priority	Duration
1.	Education and training	A better program to satisfy information and training needs to be implemented with respect to trade policy issues; not only at the grass-roots level, but within the Afghan business community and mid-level government offices.	Medium	Long term
2.	Consensus building/ Public- Private partnerships/ Training/ WTO accession support	A WTO negotiation team needs to be formed, including both government officials (apart from the inter-ministerial task force) and members of the business community and chambers of commerce, to be trained in negotiation skills and English-language skills (particularly technical vocabulary in areas of business, commerce and economics), and to be tasked with greater exchange of information across areas of technical expertise and across ministry lines.	High	Medium term

INTERNATIONAL TRADE				
No.	Type	Recommendation	Priority	Duration
3.	Legal reform	The legal framework for trade needs to be considerably strengthened and brought to the level of international standards: it is suggested, for example, that anti-dumping laws, countervailing duty laws, and laws supporting secured trade finance on imported and exported goods be studied and enacted as and when appropriate.	Low	Long term
4.	Public-private partnerships/ Institutional capacity building	Greater input from the business community needs to be elicited, and trade organizations need to be supported and strengthened. Better coordination and communication needs to be established between the various NGOs and donor-sponsored organizations advising the Afghan government on trade matters.	High	Long term
5.	Legal reform	Strengthen and update trade agreements with regional trade partners, as well as trade agreements with other countries outside the region.	High	Medium term
6.	Institutional development and capacity building	Nominate a single ministry to have responsibility for facilitating trade negotiations and concluding trade agreements, with the authority to demand allocation of resources and information from other ministries.	Medium	Long term

FLOW OF GOODS AND SERVICES				
No.	Type	Recommendation	Priority	Duration
1.	WTO accession support	Arrange briefings by countries that have recently acceded to the WTO and WTO experts to provide a common basis of understanding for Afghanistan's accession process. This will curb much of the misinformation about WTO Accession and allow for a more informed dialog. Additionally, a ministerial level committee should be established to provide impetus and overall guidance for the accession effort.	High	Near term
2.	Institutional development and capacity building	Rather than raise duty rates to raise revenues to meet IMF targets, rely on reduction of smuggling, corruption losses and the benefits of an efficient trade regime to increase collections.	High	Long term
3.	Institutional development and capacity building	Secure a high-level Customs subject matter expert to assist the ACD Commissioner and staff in the reformation and modernization of Customs.	High	Long term
4.	Infrastructure development/ Institutional development and capacity building	Implement needed rail improvements and attempt to negotiate better treatment of Afghanistan's trucking industry in Pakistan.	High	Long term
5.	Public-Private	Create mechanism for consultation between trade community and agencies regarding new	Medium	Long term

FLOW OF GOODS AND SERVICES				
No.	Type	Recommendation	Priority	Duration
	partnerships	and changed procedures		
6.	Information Systems development	Continue development of information technology (ASYCUDA++ Afghanistan's Customs Automated System based upon the UN system), including single administrative document and single-window concepts. Additionally, streamlining, business process improvement and paperwork reductions already begun should continue. This development of automated processes driving the improvement of associate manual processes should be done in full partnership with the trade community. Continue the gains demonstrated in the development of information technology (transit module deployment), including risk management, collections, use of a single document for all border agencies and "single window" processing. Lastly, a dedicated IT staff for ACD should be developed to lessen the need for contractors and to provide the expertise to run, troubleshoot and modify the system as needed in future years.	High	Long term
7.	Institutional development and capacity building	<p>Institute a Customs-specific integrity program which includes:</p> <ul style="list-style-type: none"> • Paying a salary that is commensurate with a professional position of honor and trust that will attract high quality personnel, and that will support a reasonable standard of living without the need for supplementary income. • Establishing high standards for recruits and checking backgrounds, finances, and references prior to employment. • Using basic training of new employees to filter weaker candidates. • Periodically reinvestigating all personnel for the reasonability of financial worth and check for law enforcement violations or criminal association. • Performing "lifestyle checks" to insure employees are living within their means. • Continuing to simplify the tariff and Customs procedures and ensure transparency in all Customs matters. • Establishing internal controls and audit processes/systems to prevent breaches of integrity and establish audit trails to identify and uncover violations. • Publishing standards for cargo clearance and all Customs services and providing appeals for customs decisions. • Continuing the automation of Customs processes, building in internal audits and controls, and utilizing and expanding systems for direct deposit of Customs duties and fees to financial institutions. • Developing a Customs code of conduct based upon the national standard that is a listing of core values and includes a table of discipline that addresses integrity at all levels of the organization. This code of conduct should establish a "bright line" for 	High	Long term

FLOW OF GOODS AND SERVICES				
No.	Type	Recommendation	Priority	Duration
		<p>integrity violations so that employees are able to clearly delineate violations and wrongful acts.</p> <ul style="list-style-type: none"> Establishing an internal organization within ACD to oversee and protect the integrity of the organization, its systems, and employees. The border agencies should be the first agencies in the Afghan government to have the services of their own internal affairs unit of investigators. Creating an environment in which importers and carriers feel safe in bringing integrity issues to the attention of proper authorities. <p>Making it clear to the trade community that corruption on the part of Customs or the trade community will not be tolerated. Ensuring that appropriate sanctions are in place for both Customs and business violators.</p>		
8.	Institutional development and capacity building	Customs should consider establishing a special program for compliant large importers to speed their goods through Customs formalities. This approach could be implemented immediately while the major reforms and programs proceed. Numerous countries have adopted this "Account Management" approach to allow their limited resources to focus on high-risk shipments while providing tangible benefits to legitimate businesses. Treating these companies as accounts, appointing Customs employed account managers, and instituting a special set of compliance risk criteria and post release audit for select companies could allow many legitimate companies "green line" or expedited service and could separate their shipments from the flow of riskier imports.	Medium	Long term
9.	Institutional development and capacity building	Consolidate other border agency functions (such as Health and Agriculture) at Customs clearance stations by assuring adequate staffing, training of Customs Officers in other control authorities" commodity jurisdiction, and problem identification, and integrate forms, manual processes, and automation.	Medium	Long term
10.	Institutional development and capacity building	Move Customs and other border agency clearance functions except for Reconstruction Opportunity Zones (ROZs) to the border stations when the ASYCUDA++ Risk Management module is introduced.	Medium	Long term
11.	Institutional development and capacity building	Revise the export process by continuing to streamline procedures and employing the principles of selectivity. Most nations, even those in a development stage, have eliminated or dramatically reduced export inspections by either leaving this responsibility primarily with the importing country or instituting modern risk management principles.	High	Long term
12.	Institutional development and capacity building	Improve the quality of the Customs Broker's sector and create a partnership between it and ACD. Establish a working group of Customs Brokers and Customs officials to promote a better working relationship. This could start by identification of training needs and	Medium	Long term

FLOW OF GOODS AND SERVICES				
No.	Type	Recommendation	Priority	Duration
		scheduling of short seminars for the trade. As this relationship progresses, plans could be developed for effective shared oversight of the industry and voluntary reporting of suspected activity. Without acknowledgement of the valuable contribution a reliable and professional Customs Broker's community can make to the facilitation of the Customs process, reform will remain a slow and difficult process.		
13.	Security/ Institutional development and capacity building	Establish a security force (other than the Customs Police) for the control and security of Customs ports, warehouses, and locations.	Medium	Medium term

FLOW OF MONEY				
No.	Type	Recommendation	Priority	Duration
1.	Legal reform	Continue to support the development of both the flow and transfer of money, and exchange rate laws.	Medium	Medium term
2.	Legal reform/ Institutional development and capacity building	Support the creation of the financial instruments proposed by the Afghan Bankers Association.	Medium	Long term
3.	Legal reform/ Institutional development and capacity building	Support the initiatives to legalize and register the <i>hawaladars</i> .	Medium	Long term
4.	Institutional development and capacity building	Support projects such as ARIES in order to develop a rural financial sector that is comprehensive, accessible, and sustainable.	Medium	Long term

FLOW OF PEOPLE				
No.	Type	Recommendation	Priority	Duration
1.	Institutional development and capacity building	Upgrade the professionalism and modernization of the Afghan Border Police. The government should assist ABP in the implementation and emphasis of an integrity program at the border, and this program should take on a significant independent internal affairs investigatory function.	Medium	Long term

FLOW OF PEOPLE				
No.	Type	Recommendation	Priority	Duration
2.	Institutional development and capacity building/ Information technology development	Complete the rest of the installation of PISCES at the remainder of the border crossings and international airports. PISCES is a practical and effective tool that will greatly assist in the detection of individuals who pose a threat to the national security of Afghanistan and its allies.	Medium	Long term
3.	Institutional development and capacity building	Simplify the visa issuance process. Relaxing visa requirements and allowing for in-country visa issuance at the arrival airport will encourage more business travel.	High	Near term

FINANCIAL CRIMES				
No.	Type	Recommendation	Priority	Duration
1.	Institutional development and capacity building	Provide Technical Assistance for, and training with respect to, AML/CFT (Anti-Money Laundering/Combating the Financing of Terrorism) strategic planning and risk assessment. Provide guidance to FIU on CFT – law enforcement, international assistance, alternative remittances.	Medium	Long term
2.	Legal Reform	Update and draft laws and regulations related to anti-money laundering and provide guidance for the implementation of such laws. For example, assistance is needed to draft legislation, enact laws, enforce laws, and prosecute actions dealing with money-laundering and terrorist financing through the <i>hawala</i> system.	Medium	Long term
3.	Institutional development and capacity building	Provide greater equipment and advice on operations to the FIU.	Medium	Long term
4.	Institutional development and capacity building	Provide assistance with managing DNFBP (Designated Non-Financial Businesses and Professionals).	Low	Long term
5.	Judicial and legal education and training	Provide technical assistance for prosecutors, judges, and investigators with advice on freezing of assets and forfeitures.	Medium	Long term
6.	Legal reform	Provide technical assistance with the drafting of international and bilateral treaties.	Medium	Long term

INTELLECTUAL PROPERTY RIGHTS				
No.	Type	Recommendation	Priority	Duration
1.	Strategy development	Prior to the enactment of any new law or set of laws, Afghanistan should develop a comprehensive long-range plan for conception and implementation of a new IPR regime, including its relation to the country's interests in accession to the WTO and an understanding of the necessary institutional changes and/or creation. Ideally, the plan will entail the creation of a single institution charged with IPR issues and the harmonization of the IPR regime with the country's emergent procedural laws. This plan should be developed through consensus among the executive, legislative and judicial branches of government, and should include adequate consultation with the private sector. A period of training may necessarily have to precede the development of a consensus.	High	Near term
2.	Legal and institutional reform	Courts should not be responsible for registering trademarks or any other form of intellectual property. That function belongs in an executive-branch agency.	High	Medium term
3.	Training and education	With respect to all the public and private stakeholders that are created or already exist within the context of a new IPR regime, plans for training and substantial technical assistance should be devised.	Medium	Long term
4.	Judicial and legal training and education	Afghanistan needs a bar association that, at the very least, can provide a forum for continuing legal education for commercial lawyers. Similarly, there needs to be an effective judicial training program or institute that addresses the substance of commercial law. Donors engaged in training lawyers and judges should work to develop one or more such organizations. IPR training for lawyers and judges should, for the most part, take place through the new associations, so that sustainability in training will prevail over the <i>ad hoc</i> .	High	Long term
5.	Legal education and training	Within the stake-holding community, legal education should not be neglected. A program for teaching law professors about IPR, so that they in turn are capable of teaching their students, should be included in any technical assistance program.	High	Long term
6.	Education and training	A new IPR regime should include a component of public education that discourages use of counterfeit or unlawfully duplicated goods.	High	Long term
7.	Institutional development and capacity building	Customs officers should receive comprehensive training in recognizing and seizing counterfeit goods.	High	Long term

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