

Project Report

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**Corruption and Private Sector Development:
Higher, or Lower, Transaction Costs to Conduct Business?**

Table of Contents

Executive Summary	3
Introduction	6
Research Goal and Objectives	7
Methodology.....	7
Corruption and Reconstruction: An Overview	8
Key findings.....	12
Role of Businesses in Curbing Corruption	13
Role of Government in Curbing Corruption	14
Conclusion.....	16
Recommendations	16
References	19
Appendix: The Global Compact’s 10th Principle.....	20

Executive Summary

Corruption is endemic in all post-conflict countries. Experience from other contexts suggests that tackling corruption is often best achieved through simultaneous top-down and bottom-up approaches and over time. Also, most crucial to the success of anti-corruption efforts is the recognition that those who are the subject of corruption need to want to break with corrupt and corruptive practices. While top-down regulation, oversight, and prohibition are necessary means for tackling corruption through formal structures, they are not sufficient as post-conflict, and largely informal, economies have proven very effective in bypassing all manner of regulation and formality including those aimed at eliminating corruption.

To date little or no attempt has been made to deal with the more difficult aspect of corruption, i.e., the willingness of the general public, including the vast majority of businesses, to give in to corruption and thus contribute to the perpetuation of corruption. Recognizing this dynamic and the necessity of initiating bottom-up approaches to complement top-down measures so far taken by the Government, this research sought to engage private sector actors to establish the root causes of endemic corruption in private sector activity and to identify practical means to cope with corruption while minimizing transaction costs.

Since 2001 a number of initiatives have been taken to ease such burdens on businesses. These include reduction in the number of signature and the length of time required to obtain a business license, establishment of Afghanistan Investment Support Agency to ease obtaining business licenses and business advice, increased empowerment of the Ministry of Commerce and Industry to play a leading role in promoting business activity and business interests in Afghanistan, Customs reform aimed at modernizing infrastructure and increasing human capital to minimize revenue leakages from Customs funds, and capacity building at and professionalization of the Ministry of Finance to systematize the revenue and taxation system. Additionally, in 2008 Afghanistan Chamber of Commerce and Industry (ACCI) merged with Afghanistan International Chamber of Commerce to create a unified body to represent private sector and trade related interests. The new ACCI is tasked with speaking and advocating on behalf of the business community and to ease regulations for a more enabling environment for business activity.

The above initiatives represent major steps in organizing and regulating business activity and facilitating increased formalization of business transactions. Increased formalization is likely to yield a number of significant benefits to businesses and the government. Businesses will benefit from increased predictability and transparency in the operating environment while the government will become empowered to collect taxes, which, ideally, could be used in reconstruction and state building efforts. As the review in the preceding section of other studies on corruption and private sector development shows, however, major challenges remain in business operating environment.

A key conclusion from this study is that, while many efforts have been made by the government and the international donors, in 2011 widespread corruption appears to have become institutionalized and, as such, much more difficult to fight than the period immediately following 2001. The general inability to fight corruption is perhaps best illustrated by general impotence and ultimate failure in 2008 of the General Independent Administration for Anti-Corruption. It remains to be seen how the High Office of Oversight and Anti-corruption (HOO) will cope with the increasingly insurmountable challenge of widespread corruption.

Given the centrality and worldwide recognition of the adverse effects of corruption, there are a number of resources and policy pathways available to governments, and businesses, to fight corruption. The applicability of the various guides, principles, or tools to bring corruption under control remains to be tested in Afghanistan. Despite high levels of corruption in Afghanistan business activity continues unimpeded though weakened and threatened by corruption.

Recommendations

Without adopting some of the various anti-corruption guides and principles and without testing some of the available tools such as those developed by ICC and Transparency International (see Appendix) for businesses and those developed for governments by the UN Convention against Corruption (UNCAC), OECD, and the World Bank, it is difficult to establish which of these sets of guides and tools work best in the business and political environment of Afghanistan.

Should tackling corruption, through adoption or adaptation of the available guides, principles, and tools, become a top priority for the Government of Afghanistan, it is constructive to note the following:

- ACCI has a mandate to promote the interest of Afghan businesses and protect those interests through regulatory change. ACCI currently suffers from insufficient legitimacy among businesses and, according to the traders engaged for this study, has not yet lived up to its mandate. Regardless of whether this is true, a misunderstanding, or the result of lack of sufficient attempts by ACCI to engage Afghan businesses, more trust and a closer working relationship needs to be established between ACCI and its business constituents.
- HOO was set up in 2008 by the Government of Afghanistan and following a Presidential Decree to curb corruption. There is little evidence to suggest that HOO would be more effective than its predecessor organization, General Independent Administration for Anti-corruption (GIAA), which was dissolved due to lack of performance. For HOO to do differently and better than GIAA, other changes in private and public sectors need to occur and concurrently with efforts by HOO to meet its mandate.
- Ministries with potentially important roles in perpetuating or curbing corruption will need to be brought onboard with HOO's mandate to fight corruption. Given the power relations and their evolution since 2001 in Afghanistan, it is unlikely that a new entity such as HOO will be able to intervene successfully in the affairs of well established ministries such as the Ministry of Finance or the Ministry of Commerce and Industry.
- Legal provisions to curb corruption exist but remain ill-enforced, or not enforced. The inability to enforce existing regulations is a function of a more general weakness in maintaining the rule of law by the government and its various offices due, in part, to the pre-occupation with the deteriorating security conditions on the one hand, and the institutionalization of corruption in governmental bodies accompanied with a general resistance to change or cooperate, on the other.
- Traditional business customs such as giving or receiving shrini and bakhshish are likely to continue to play a role in business transactions involving Afghan actors. A complete

banning of this practice is not practical or advisable. It is possible, however, to monitor what constitutes as acceptable gratuity and when gratuity becomes a bribe. ICC's rules of conduct for businesses are instructive in how to apply pragmatism in efforts to bring corruption under control. Similar limitations on the amount of gratuities can be imposed by government law enforcers

- Also based on ICC rules, businesses should be encouraged by ACCI and compelled by regulations to bring their business activities into order by setting up auditable accounting systems. Full set of audited accounts by businesses can then be a significant deterrent to corrupt officials who demand to see bank balances of traders before allowing them to proceed with renewing their business licenses.
- Relating to the previous point, only designated government officials should be allowed to view business accounts. A major concern by many larger businesses is widespread knowledge about their wealth and level of business activity, which may put them in danger of harassment, extortion, kidnapping, or other forms of criminal activity directed at well-to-do Afghans.

Introduction

Corruption is endemic in all post-conflict countries.¹ According to International Chamber of Commerce, corruption is the greatest obstacle to economic and social development around the world. It distorts markets, stifles economic growth, debases democracy and undermines the rule of law. The cost of corruption is estimated at 5% of the global Gross Domestic Product at US \$2.6 trillion with over \$1 trillion being paid in bribes each year. In addition, corruption constitutes an estimated 10% to the total cost of doing business globally, and up to 25% to the cost of procurement contracts in developing countries.²

Experience from other contexts suggests that tackling corruption is often best achieved through simultaneous top-down and bottom-up approaches and over time. Also, most crucial to the success of anti-corruption efforts is the recognition that those who are the subject of corruption need to want to break with corrupt and corruptive practices. While top-down regulation, oversight, and prohibition are necessary means for tackling corruption through formal structures, they are not sufficient as post-conflict, and largely informal, economies have proven very effective in bypassing all manner of regulation and formality including those aimed at eliminating corruption.

Addressing corruption is high on the list of priorities for the Government of Afghanistan and the international donors supporting reconstruction efforts in the country. The high level of importance attached to issues of corruption at all levels has resulted in a series of high level measures to bring endemic and systemic corruption under control as an a key requirement for the sustainability of the reconstruction efforts. For example, on February 2004 Afghanistan signed the United Nations Convention Against Corruption (UNCAC) and ratified it on August 25, 2008. The Convention is a legally binding document outlining a range of measures to be implemented by State institutions and agencies. These measures include the prevention and criminalization of corruption, law enforcement, international cooperation in fighting corruption, asset recovery, technical assistance, and information exchange with other State agencies.

Also, in 2008 the Government of Afghanistan set up the High Office for Oversight and Anti-corruption (HOO) with the mandate to exclusively deliver monitoring and counter corruption measures.³ The HOO replaced General Independent Administration for Anti-corruption (GIAA), which was dissolved due to lack of performance.⁴ Despite these measures, systemic and endemic corruption continues to plague the Afghan political economy and there is little indication of how and through what means the Government and the international donors can bring corruption under control.

To date little or no attempt has been made to deal with the more difficult aspect of corruption, i.e., the willingness of the general public, including the vast majority of businesses, to give in to corruption and thus contribute to the perpetuation of corruption. Recognizing this dynamic and the necessity of initiating bottom-up approaches to complement top-down measures so far taken by the Government, this research sought to

¹ ICC defines corruption as “the abuse of entrusted power for private gain”. See ICC (undated). Clean Business is Good Business: The Business Case against Corruption. Available from:

<http://www.iccwbo.org/policy/anticorruption/icccbgdg/index.html>

² ICC (undated). Page 2.

³ Checchi (2009). Assessment of Corruption in Afghanistan. Report prepared by Checchi and Company Consulting, (Kabul: USAID).

⁴ Checchi (2009).

engage private sector actors to establish the root causes of endemic corruption in private sector activity and to identify practical means to cope with corruption while minimizing transaction costs.

Research Goal and Objectives

The goal for this research was threefold. The first goal was to take stock of what has been done in a top-down manner to tackle corruption in Afghanistan while the second goal was to provide a concise overview on corruption from the perspective of those who pay bribes as part of the transaction cost of doing business. The third goal for this research was to establish policy options to impose effective controls on corruption to minimize and, ultimately, eliminate corruption in Afghanistan. To this end this research was carried out to meet the following objectives:

1. Identify and document measures introduced since 2001 to create an enabling, and less prone to corruption, business environment
2. Assess the effectiveness of these measures against actual business practices to establish whether or not corruption increases, or decreases, transaction costs
3. Identify the available resources to address the most pressing needs for more efficient and transparent business activity
4. Identify and document the roles that can be played by private and public sectors to facilitate the transition to a more accountable, transparent, and less corrupt environment for business activity, and
5. Compile a report that contains detailed recommendations for future interventions aimed at reducing corruption in the business environment.

This study was carried out in Kabul and in collaboration with a number of businesses, business representatives, and government officials.

Methodology

In the initial proposal to Harakat the following methods were proposed for this study:

1. A review of the reforms to date to formalize business activity as a means to minimize corrupt practices,
2. Opening workshop to announce the commencement of the study and its purpose, and
3. Interviews with key actors from relevant governmental bodies and international donors involved in private sector development to collect data on the needed reforms aimed at eliminating or minimizing corruption in private sector development.

Attempts to hold a workshop with representative businesspersons at Afghanistan Chamber of Commerce and Industry (ACCI) were unsuccessful for a variety of reasons, not least because of ACCI's lack credibility among the larger businesses.⁵ Instead, a focus group discussion and business lunch were held at APPRO's offices with participants drawn from large businesses and business representatives in Kabul to seek input on what needs to be done to tackle corruption in such as way as to minimize transaction costs.

⁵ In a focus group discussion with major traders, held in Kabul in April 2011, there were strong suggestions by some traders to create an alternative to ACCI since ACCI had proved ineffective in its advocacy role and ability to influence government policy making to favour and protect private sector interests.

Corruption and Reconstruction: An Overview

Prior to 2006 corruption in Afghanistan was closely linked with counternarcotics and “narcotrade.”⁶ In the turbulent period from early 1990s until 2001, Afghanistan had managed to become an important corridor for an illicit economy thriving on opium production and smuggled goods.⁷ During the first part of the reconstruction efforts in Afghanistan the key focus of counter-corruption programmes was on poppy eradication and building Customs systems to prevent smuggling. In 2006 a report on progress in Afghanistan by the United State Congressional Hearing concluded that a lack of basic democratic structures such as political parties was a key factor in facilitating the formation of unlikely multi-partite alliances that instituted and institutionalized widespread corruption.⁸ In 2006 and 2007 the issue of systemic corruption began to become recognized as a major concern for both private and public sectors, in addition to the pre-existing concerns about narcotrade.

Efforts by USAID and other agencies aimed at curbing corruption have included capacity building, technical assistance, and mentorship for such governmental entities as the Independent Administrative Reform and Civil Service Commission (IARCSC), Attorney General Office (*Saranwali*), Control Audit Office, and HOO. Transparency measures were also included into such programmes as the Afghanistan Sub-national Governance Program (ASGP). Vulnerabilities to Corruption Assessments led by the World Bank and UNDP’s Accountability and Transparency Programme remain as two key initiatives to combat corruption.

At a broader and lower level of focus, Integrity Watch Afghanistan (IWA) and the United Nations Office on Drugs and Crime (UNODC) have both undertaken studies on how corruption adversely affects the livelihoods of ordinary citizens, including the business community.⁹ According to both reports, the scale of corruption in Afghanistan is massive and consistently identified as the key concern of citizens, ranked equal to or higher than concerns about insecurity.¹⁰ In 2010 Afghan citizens faced corruption daily, with UNODC calculating that in 2009 Afghans paid about 2.5 billion dollars in bribes, or 23% of the national GDP.¹¹ The IWR makes a humbler estimate of 1 billion dollars, which constitutes about 10% of the national GDP.¹² IWR also reports that bribes have become a norm to speed

⁶ See, for example:

- General Michael V. Hayden, Director, Central Intelligence Agency, Statement for the Record before the Senate Armed Services Committee. Retrieved from:

http://www.globalsecurity.org/intell/library/congress/2006_hr/061115-hayden.htm

- World Bank et al. 2007. Fighting Corruption In Afghanistan: A Roadmap For Strategy and Action. Informal Discussion Paper.

- Rubin, B.R. (2007). Salvaging Afghanistan. Testimony before the United States Senate Armed Services Committee. (US Government Printing Office: Washington, DC).

⁷ Goodhand, J. (2002). Aiding violence or building peace? The role of international aid in Afghanistan. *Third World Quarterly*, 23 (5), pp 837–859.

⁸ Committee on International Relations (2007). Afghanistan: Five Years After 9/11. Hearing Before The Committee On International Relations House of Representatives One Hundred Ninth Congress Second Session. Serial No. 109–230. (Washington, DC: U.S. Government Printing Office).

⁹ IWA (2010), Afghan Perceptions and Experiences of Corruption: A National Survey 2010. (Kabul: Integrity Watch Afghanistan – IWA) and UNODC (2010), Corruption in Afghanistan: Bribery as Reported by victims. (Kabul: UNODC).

¹⁰ Committee on International Relations (2007).

¹¹ UNODC (2010).

¹² IWA (2010).

up administrative procedures.¹³ The police force, courts, and Customs reportedly have the highest number of corrupt officials.¹⁴

In attempting to understand the underlying causes of such high levels of corruption it is worth reiterating that Afghan society is no stranger to symbolic or actual gratuities being exchanged between parties involved in a transaction and as part of that transaction's cost. For generations, Afghans have offered and acquired rewards as a means of appreciation and strengthening social ties. In recent years, and particularly in the period since 2001, this mostly benign social institution has morphed into a menacing hurdle for the majority of ordinary Afghans who are expected to pay *shirini*, *bakhsheshi*, or plain bribes to clear themselves of the many traps set for them by those in positions of power. Illicit economic activity combined with misuse of vast amounts of international funds pouring into Afghanistan have resulted in the emergence of strongmen and extortionists who are rarely held to account.¹⁵ In a sense, the process exemplifies how a neutral and even useful social institution can turn rogue and destructive when exposed to new pressures and not kept under scrutiny.

Petty corruption in Afghanistan in 2007 reached such proportions that it was reportedly impossible to accomplish an administrative procedure without paying at least some kind of bribe.¹⁶ Yet, IWA (2007) reports that petty corruption is the most tolerable type of corruption and justifiable in the eyes of the public as a product of the low salaries being paid to civil servants.¹⁷ According to UNODC (2010) bribes are paid for specific purposes: 74% paid a bribe to speed up a procedure, 51% to finalize a procedure, 30% to reduce costs of the procedure, and another 28% to receive better treatment.¹⁸ About 25% of the bribes were given to police officers, another 25% to municipal and provincial officers, and about 15% to tax/revenue or customs officers and cadastre officers – in total 65% of bribes were paid to officials with whom business people have dealings for various purposes.

Also, since around 2006-7 a new form of institutionalized corruption has been gaining ground and becoming more and more accepted as the way to completing business transactions, particularly when governmental bodies are involved. *Komishenkari*, or doing commission work, is carried out by middlemen or brokers that help to process paperwork or speed up various administrative procedures for a fee.¹⁹ The most important governmental ministries such as the Ministry of Commerce and Industry and the Ministry of Finance, particularly in its Customs operations, have even formally accepted the role of komishenkars who are ever present and are in fact recommended to businesses and traders as a means to ensure timely and efficient service.

In 2007 the komishenkars played a role in 35% of the bribe giving/taking cases while in 2010 this portion had risen to 44% of the cases.²⁰ The role of komishenkars has also expanded to other areas of interface between the government and the citizens, including traders. Komishenkars are now recognized formal agents by Customs officials for processing importation paperwork on behalf of traders.²¹ As of 2010 the Komishenkars are acting as a

¹³ UNODC (2010).

¹⁴ UNODC (2010).

¹⁵ See UNODC (2010), page 4.

¹⁶ IWA (2007). *Afghans' Experience of Corruption: A Study Across Eight Provinces*. (Kabul: UNDP-IWA).

¹⁷ IWA (2007).

¹⁸ UNODC (2010).

¹⁹ IWA (2007).

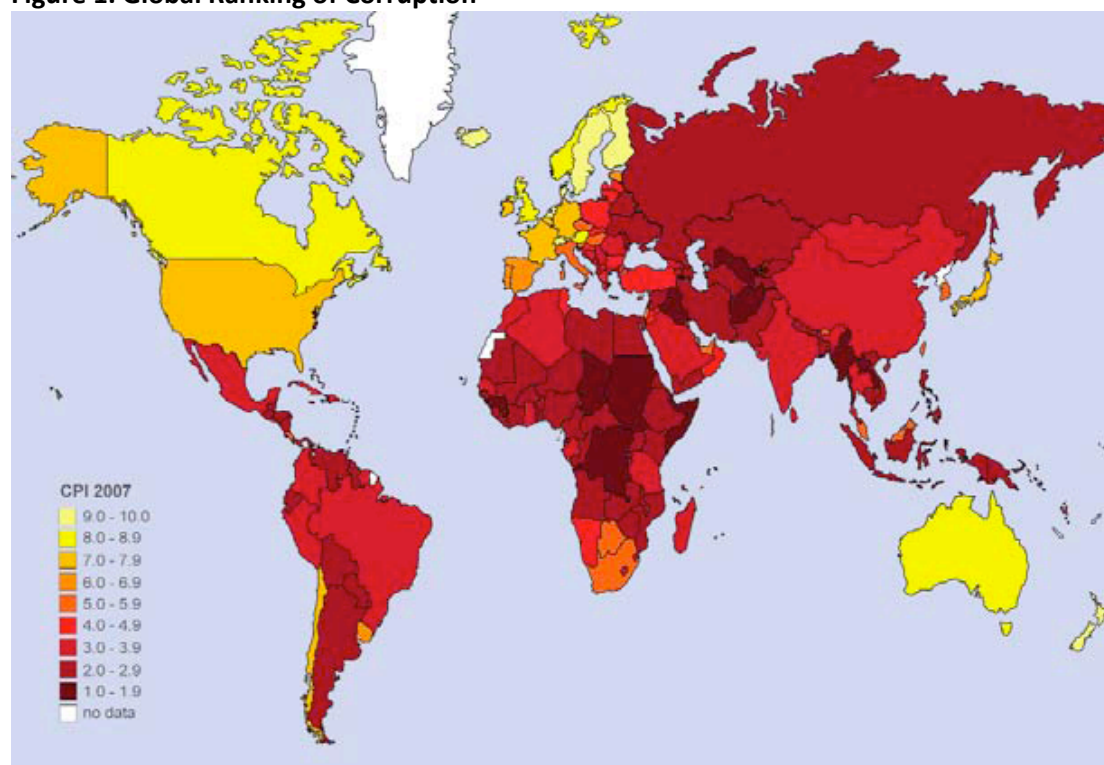
²⁰ IWA (2007) and IWA (2010).

²¹ Key Informant interviewed in Kabul, June 2011.

buffer between corrupt and/or unhelpful officials and traders by helping businesses to navigate a complex system of regulations where there is little or no clarity about the process.²² Only 34% of the respondents in UNODC's (2010) survey who paid bribes indicated that they had enough information to understand administrative procedures, whereas the rest either did not have enough information or were not able to comprehend it due to the poor quality of information or illiteracy.

Afghanistan is ranked as one of the most corrupt countries according to Transparency International's Corruption Perceptions Index (Figure 1). The bulk of corruption in Afghanistan is paid to access basic social services. In 2010 the majority of bribes were paid in rural areas to secure access to education and health, land registry, or to prevent the police from interfering in domestic affairs. In urban areas bribes were paid to purchase official positions, gain access to judiciary, or to reduce payment of duties and taxes.²³ 29% of the bribe-paying respondents in 2010 were traders or self-employed people who willingly paid bribes to officials in municipalities and at the Ministry of Commerce and Industry.²⁴

Figure 1. Global Ranking of Corruption



Note: The map is based on Transparency International's 2007 Corruption Perceptions Index. The score relates to perceptions of the degree of corruption ranges between 10 (highly clean) and 0 (highly corrupt). Source: ICC (undated).²⁵

Corruption supported by businesses reinforces the informal economy and inhibits productive economic activity and growth, as businesses choose a strategy of low visibility to curb extortion and solicitation of bribes by government officials.²⁶ The United States guides

²² IWA (2010). It must be added that komishenkars also help perpetuate corruption in the system by paying pre-agreed rates for the services they receive from their contacts in various governmental offices.

²³ IWA (2010).

²⁴ IWA (2010).

²⁵ ICC (undated).

²⁶ Checchi (2009). Checchi and Company Consulting, Inc. "Assessment of Corruption in Afghanistan." (Kabul: USAID).

for doing business in Afghanistan, going back to 2007 and earlier, identify corruption as one of the key challenges traders face in Afghanistan, which include “a weak legal framework, regulatory enforcement, dispute resolution mechanisms, ... and customs regulations and procedures that are neither transparent nor consistent.”²⁷ In 2009 this challenge was framed in much stronger terms such as, “the inadequacy of the regulatory system, and corruption among those working-level officials who administer it, are larger obstacles to investors than the transparency of the regulations.”²⁸ In 2011 the language became more explicit still: “Corruption is a serious challenge to doing business in Afghanistan.”²⁹

In Afghanistan key governmental entities are charged with responsibilities to set the parameters for the activities of private sector actors in the full spectrum from obtaining a license to start up and operate a business to payment of taxes. Despite a number of reforms initiated by the Government of Afghanistan and the international donors, there appears to be a strong tendency for institutional regression back to the pre-reform status. A good example is the reform initiated by Adam Smith International (ASI) through the Ministry of Commerce and Industry to reduce the amount of time and money (and signatures) needed to obtain a trade license. The number of signatures needed by the time the reform was in place in 2006 was 7. A recent (2011) retracing exercise by APPRO of the steps required to obtain a license documented 17 signatures or confirmations of signatures prior to the issuance of the license.

The process of renewing licenses is even more arduous as additional ministries become involved in the process and even more formal and informal requirements need to be met prior to the re-issuance of the license. As with most multi-step and complicated processes involving governmental agencies, komishenkars thrive in license renewals, a process also plagued by various forms of large and small bribes. The licensing example clearly illustrates that implementing top-down reform is only a part, albeit a very important one, of effecting reform. Another major component of effecting lasting institutional reform is bottom-up pressure and advocacy by private sector actors for more efficient and transparent and less corrupt business practices. For this type of reform to take root businesses must act as major stakeholders. Without incentives and the prospect of significant reductions in transactions costs, however, businesses are likely to show no inclination to assume the role of a major stakeholder in the reform process.

Corruption often presents an opportunity for cost-minimizing / profit maximizing businesses. If taxes are applied inconsistently, some businesses with the right personal, familial, ethnic, political, or other relationships are able to take shortcuts and bypass major hurdles and harassments. Businesses without such relationships have to negotiate a labyrinth of administrative requirements, taxes (often informal and negotiable), and bribes.³⁰ For businesses without the right connections bribes represent the only option to remain operational. A United States government investigation into trucking businesses revealed that paying bribes was the most efficient way to keep trucking companies open while non-

²⁷ US Commercial Service (2007). “Doing Business in Afghanistan : A Country Commercial Guide for US Companies. (Washington DC: State Department) Retrieved from: http://trade.gov/static/afghanistan_ccg_2007.pdf

²⁸ Bureau of Economic, Energy and Business Affairs (2009). Investment Climate Statement – Afghanistan. (Washington DC: State Department). Retrieved from: <http://www.state.gov/e/eeb/rls/othr/ics/2009/117835.htm>

²⁹ US Commercial Service (2011). Doing Business in Afghanistan: A Country Commercial Guide for US Companies. (Washington DC: State Department) Retrieved from http://trade.gov/static/2011CCG_Afghan.pdf

³⁰ USAID (2008). Case Study of Poultry and Grape/Raisin Subsectors in Afghanistan. (USAID: Kabul).

payment often resulted in harassment by local officials.³¹ The investigation also uncovered that the governors, provincial police chiefs, district police chiefs, and local commanders for the National Directorate of Security, in addition to the local ANA and ANP units extorted bribes from the trucking companies for amounts ranging from 1,000 - 10,000 USD per month.³²

Despite the elaborate and often costly programmes undertaken to better manage business dealings in Afghanistan a number of major, structural challenges centered on corruption at different scales remain. In his report to the Majority Staff at the U.S. House of Representatives on June 22, 2010, John F. Tierney reported on the increasing, and destructive role being played by “a shadowy network of warlords, strongmen, commanders, corrupt Afghan officials, and perhaps others” and that “Afghanistan presents an extremely difficult environment for military operations, logistics, and business practices.”³³ Similarly, it has been reported that one in seven adults and 28 percent of all households are affected by bribery in various forms. The high levels of corruption is said to constitute a serious threat to the Afghan economy, the development of small businesses, and the livelihoods of the poorest categories of citizens.³⁴

The next section reports on the findings from the data collected through two focus group discussions held with traders involved in international transactions and interviews with government and business key informants. Where appropriate, these findings are linked with findings from other studies.

Key findings

The major issues of corruption for business are an overabundance of red tape, reporting requirements to various ministries, taxation, and (informal) protection services. Since 2001 a number of initiatives have been taken to ease such burdens on businesses. These include:

- Reduction in the number of signatures and the length of time required to obtain a business license from the Ministry of Commerce and Industry, an effort that has attracted new interest, partially due to the fact that the reforms effected by 2007 have slowly been rolled back.
- Establishment of Afghanistan Investment Support Agency (AISA) to ease the process of obtaining and renewing licenses, a very successful initiative to create a one-stop-shop for obtaining licenses for all areas of business activity except general trade licenses for importers and exporters which are issued by the Ministry of Commerce and Industry.
- Customs sector reform implemented by a range of agencies to automate and computerize Customs processing and, thus, create more effective tracking, transparency, and accountability. This has been a successful project though numerous challenges, mainly regarding corruption, remain.
- Capacity building projects at the Ministry of Finance, particularly in the departments dealing with Tax Identification Numbers (TIN) and collection of taxes. The TIN system allots tax identification numbers and maintains a database recognized by

³¹ Tierney, J.F. (2010). Warlord, Inc.: Extortion and Corruption Along the U.S. Supply Chain in Afghanistan. Report of the Majority Staff, Subcommittee on National Security and Foreign Affairs Committee on Oversight and Government Reform U.S. House of Representatives.

³² Tierney (2010). Page 41

³³ Tierney, J.F. (2010). “Warlord, Inc.: Extortion and Corruption Along the US Supply Chain in Afghanistan.” (Washington DC: United States Government). Page 3.

³⁴ Integrity Watch Afghanistan (2010). “Afghan Perceptions and Experiences of Corruption: A National Survey 2010”. (Kabul: IWA). Page 100.

and according to international standards. The taxation system has also been operating increasingly effectively, constituting an important source revenue for the government.

- The creation in 2008 of a unified body to represent private sector and trade related interests through merging Afghanistan International Chamber of Commerce and Afghanistan Chamber of Commerce and Industry (ACCI). The new ACCI is tasked with speaking and advocating on behalf of the business community and to ease regulations for a more enabling environment for business activity. While the merger of the two bodies into the new ACCI represents a positive step, a number of trades have misgivings about how ACCI fulfils its important task.

The above initiatives represent major steps in organizing and regulating business activity and facilitating increased formalization of business transactions. Increased formalization is likely to yield a number of significant benefits to businesses and the government. Businesses will benefit from increased predictability and transparency in the operating environment while the government will become empowered to collect taxes, which, ideally, could be used in reconstruction and state building efforts. As the review in the preceding section of other studies on corruption and private sector development shows, however, major challenges remain in business operating environment.

To invite input from the private sector on how the current situation can be improved, the focus group discussion participants and key informants interviewed were asked a number of basic questions about how they viewed the operating environment for business activity, the challenges faced by businesses, and what could be done by private sector and/or other actors to overcome these challenges.

Role of Businesses in Curbing Corruption

Key to understanding what role could be played by the private sector in minimizing or eliminating corruption is to first understand what guides the actions of private sector actors. A business enterprise strives to minimize transaction costs and maximize profit. If fighting corruption is likely to result in a reduction in transaction costs and an increase in profits, then private sector actors have the basic motivation to assist in or even demand putting an end to corruption. If, on the other hand, efforts by private sector actors to fight corruption result in increased transaction costs, there is little or no motivation for private sector actors to initiate or participate in measures to fight corruption.

Seeking or maximizing profits from business activity can also mean passing on as much of the operating costs, including transaction costs, on to the customer. This point was aptly summed up by one of the traders interviewed as follow:

Every year I pay at least 40 million Afghanis in taxes and other expenses to the government. But, note that when I pay this money it is not from my own pocket but from my customers' pockets because I raise my prices to reflect the costs I incur. This is unjust to my customers but I have no choice.

Individual Afghan traders, like all private sector actors the world over, are therefore more likely to adapt to a given operating environment rather than try to change it. Put differently, private sector actors act as a dependent variable, with their actions being a function of the environment in which they operate. The operating environment is organized or regulated by the government as the independent variable which sets, or is supposed to set, the rules.

Box 1. ICC Anti-corruption Rules of Conduct for Businesses

ICC offers a range of other articles to be adhered to in fighting corruption as follows:

Article 1: Prohibition of Bribery and Extortion – Enterprises should prohibit bribery and extortion at all times and in any form, whether direct or indirect, including through agents and other intermediaries.

Article 2: Agents and Other Intermediaries – Enterprises should make their anti-corruption policy known to all agents and other intermediaries and make it clear that they expect all activities carried out on their behalf to be compliant with their policy.

Article 3: Joint Ventures and Outsourcing Agreements – Enterprises should take measures within their power to ensure that anti-bribery provisions consistent with these Rules of Conduct are accepted by joint-venture partners as applicable to the joint venture and by parties to outsourcing agreements.

Article 4: Political and Charitable Contributions and Sponsorships – Enterprises should only make contributions to political parties, party officials and candidates in accordance with applicable laws, and all requirements for public disclosure should be fully complied with.

Article 5: Gifts, Hospitality and Expenses – Enterprises should establish procedures covering the offer or receipt of gifts, hospitality or expenses to ensure that such arrangements are limited to reasonable and bona fide expenditures and do not improperly affect, or might be deemed to improperly affect, the outcome of a procurement or other business transaction.

Article 6: Facilitation Payments – Enterprises should not make facilitation payments. In the event that an enterprise determines, after appropriate managerial review, that facilitation payments cannot

be eliminated entirely, it should establish controls and procedures to ensure that their use is limited to small payments to low-level officials for routine actions to which the enterprise is entitled.

Article 7: Corporate Policies – To prevent bribery and extortion, enterprises should implement comprehensive policies or codes reflecting these Rules of Conduct as well as their particular circumstances and specific business environment.

Article 8: Financial Recording and Auditing – All financial transactions must be properly and fairly recorded in appropriate books of account available for inspection by boards of directors, if applicable, or a corresponding body, as well as auditors.

Article 9: Responsibilities – The board of directors or other body with ultimate responsibility for the enterprise, should take reasonable steps to ensure compliance with these Rules of Conduct.

Source: CAC (2005)

Recognizing this, the International Chamber of Commerce (ICC) has emphasized the critical role of compliance by enterprises with self-imposed rules and codes of conduct based on their own values, while also emphasizing the basic and fundamental responsibility of national governments and international organizations in the fight against corruption. The guidelines on good, and anti-corruptive, behaviour by businesses focus on “strict rules defined within the enterprise [to] help businesses fulfill their legal obligations in a more natural and effective way.”³⁵ (See Box 1). However, without strict and formal anti-corruption rules enforced by non-corrupt officials, there is little incentive for businesses to impose rules of their own on their activities and make more difficult their already constrained (and corrupt) operating environment.

Role of Government in Curbing Corruption

³⁵ CAC (2005), page 4. Commission on Anti-corruption. Combating Extortion and Bribery: ICC Rules of Conduct and Recommendations. (Paris: International Chamber of Commerce).

There is much scope for the Government of Afghanistan to take a lead in fighting corruption. The need for government-initiated action against corruption has been expressed time and again by private sector actors in the media and in interviews and discussions held by APPRO researchers for this and other studies of corruption and the business environment.

ACCI has played advocacy roles on behalf of Afghan businesses and is likely to continue to do so. However, without a coherent response from the government such advocacy attempts as undertaken by ACCI are likely to have little or no impact on the actions of the government to curb corruption in the short term. To illustrate, on July 22, 2011 a panel discussion on trade on ToloTV, involving the Deputy Minister of the Ministry of Commerce and Industry and the Deputy of ACCI, concurred that a major problem for Afghan traders was a lack of a broad governmental approach or policy to create an enabling environment for business activity. Further, the panel concluded that there was no coordination or understanding among the relevant ministries as to which ministry or ministries should take the lead in addressing the many challenges, including corruption, faced by private sector actors.

Box 2: ICC Rules of Conduct and Recommendations for National Governments

Capacity Building: Governments should provide adequate resources – including funding, staffing and training – for the organizations combating corruption. These resources should be aimed at raising public awareness of the economic and social consequences of corruption. ...

Strengthen Enforcement: Even though laws prohibiting extortion and bribery have been on the books in virtually all countries, enforcement is weak or nonexistent in many countries. Governments [should] strengthen enforcement of anti-bribery laws, including laws prohibiting extortion by public officials and laws prohibiting commercial bribery. Governments should also establish reporting channels for complaints about corruption. ...

Economic Regulations: Governments should, as far as possible, minimize the use of systems requiring issuance of individual permits, authorizations, etc., because such systems offer scope for extortion and bribery. ...

Public Procurement: Governments should commit themselves to improve transparency in public procurement, including public bidding, and publication of the criteria upon which awards are based. ... In particular, in the case of projects financed by an international financial institution, observance of these principles should be reflected in contractual arrangements between the parties. ...

Political Contributions: Undisclosed political contributions can be a source of abuse. Governments should, subject to the specifics of their national political system, regulate the conditions under which political contributions can be made. ...

Accounting and Auditing: Governments should require auditing by independent public auditors of the accounts of all economically significant enterprises. Governments should also support the adoption of strong and consistent international standards for accounting and auditing. ...

Export Credit Agencies: Export credit agencies should include in their conditions that financing and guarantees are not provided for contracts secured through bribery and that sanctions shall be applied in the event of violations. ...

Official Development Assistance: Development assistance programmes should require strict adherence to anti-corruption rules by government officials and contractors. ...

Source: CAC (2005)

If the government does not or cannot fulfill its functions as the independent, guiding variable by setting the rules as spelled out by ICC (Box 2) to create an enabling environment for licit economic activity, the only other option available to businesses for prompting the government to take measures against corruption is advocacy through business associations such as ACCI. For this situation to emerge, ACCI will need improve its standing with Afghan

businesses and initiate a coordinated national advocacy campaign against corruption at the business (organizational) and government (national) levels.

Conclusion

This report has provided an overview of the measures taken since 2001 to fight corruption by the Government of Afghanistan and the international donors. This overview was based on the substantive body of available reports and documents on corruption. A key conclusion from this review is that, while many efforts have been made by the government and the international donors, in 2011 widespread corruption appears to have become institutionalized and, as such, much more difficult to fight than the period immediately following 2001. The general inability to fight corruption is perhaps best illustrated by general impotence and ultimate failure in 2008 of the General Independent Administration for Anti-Corruption. While it remains to be seen how HOO will cope with the increasingly insurmountable challenge of widespread corruption, two intertwined aspects of this challenge warrant particular attention.

First, it is unlikely for HOO to succeed in fulfilling its mandate while the relationships that have resulted in the institutionalization of corruption, and the failure of GIAA, remain intact. Fighting corruption requires government-led action, as intended through the establishment of HOO, and participation by the private and public sector actors that willingly or unwillingly support and sustain endemic and systemized corruption. Second, for anti-corruption measures to be successful and take root, top-down changes such as new rules and regulation and enforcement are necessary but insufficient in bringing about systemic and sustainable change in the behaviour of the key stakeholder which, in the case of corruption, are both private sector and government actors.

An added element is the (mostly unintentional) corruptive role played by international donors and their national and international contractors and counterparts. It is unclear how the engagement by the international donors and contractors with local businesses is governed, whether international actors are subject to accountability and transparency rules set by the Government of Afghanistan, or whether there can be legal provisions to take international funders and their local counterparts to account for their potentially or actually corruptive activities. In any case, fighting corruption with willing participation of private sector actors will require reform and streamlining of the regulatory environment and assumption of new priorities on fighting corruption by the Government as integral components of reconstruction programming.

Despite high levels of corruption in Afghanistan business activity continues unimpeded though weakened and threatened by corruption. Corruption, particularly in less developed, post-conflict, and in-conflict countries, has been a topic of much discussion in global business forums, the international aid community, and by governments of countries suffering from high levels of corruption. Given the centrality and worldwide recognition of the adverse effects of corruption, there are a number of resources and policy pathways available to governments, and businesses, to fight corruption. The applicability of the various guides, principles, or tools to bring corruption under control remains to be tested in Afghanistan, however.

Recommendations

Without adopting some of the various anti-corruption guides and principles and without testing some of the available tools such as those developed by ICC and Transparency International for businesses and those developed for governments by UN Convention

against Corruption (UNCAC), OECD, and the World Bank, it is difficult to establish which of these sets of guides and tools work best in the business and political environment of Afghanistan.

Effecting change in any situation needs to be based on in-depth knowledge of the means available to the actors who wish to effect change. In the case of Afghanistan, it is constructive to note the following points when adopting or adapting the available guides, principles, or tools to fight corruption:

- ACCI has a mandate to promote the interest of Afghan businesses and protect those interests through regulatory change. ACCI currently suffers from insufficient legitimacy among businesses and, according to the traders engaged for this study, has not yet lived up to its mandate. Regardless of whether this is true, a misunderstanding, or the result of lack of sufficient attempts by ACCI to engage Afghan businesses, more trust and a closer working relationship needs to be established between ACCI and its business constituents.
- HOO was set up in 2008 by the Government of Afghanistan and following a Presidential Decree to curb corruption. There is little evidence to suggest that HOO would be more effective than its predecessor organization, General Independent Administration for Anti-corruption (GIAA), which was dissolved due to lack of performance. For HOO to do differently and better than GIAA, other changes in private and public sectors need to occur and concurrently with efforts by HOO to meet its mandate.
- Ministries with potentially important roles in perpetuating or curbing corruption will need to be brought onboard with HOO's mandate to fight corruption. Given the power relations and their evolution since 2001 in Afghanistan, it is unlikely that a new entity such as HOO will be able to intervene successfully in the affairs of well established ministries such as the Ministry of Finance or the Ministry of Commerce and Industry.
- Legal provisions to curb corruption exist but remain ill-enforced, or not enforced. The inability to enforce existing regulations is a function of a more general weakness in maintaining the rule of law by the government and its various offices due, in part, to the pre-occupation with the deteriorating security conditions on the one hand, and the institutionalization of corruption in governmental bodies accompanied with a general resistance to change or cooperate, on the other.
- Traditional business customs such as giving or receiving shrini and bakhshish are likely to continue to play a role in business transactions involving Afghan actors. A complete banning of this practice is not practical or advisable. It is possible, however, to monitor what constitutes as acceptable gratuity and when gratuity becomes a bribe. ICC's rules of conduct for businesses are instructive in how to apply pragmatism in efforts to bring corruption under control. Similar limitations on the amount of gratuities can be imposed by government law enforcers
- Also based on ICC rules, businesses should be encouraged by ACCI and compelled by regulations to bring their business activities into order by setting up auditable accounting systems. Full set of audited accounts by businesses can then be a significant deterrent to corrupt officials who demand to see bank balances of traders before allowing them to proceed with renewing their business licenses.

- Relating to the previous point, only designated government officials should be allowed to view business accounts. A major concern by many larger businesses is widespread knowledge about their wealth and level of business activity, which may put them in danger of harassment, extortion, kidnapping, or other forms of criminal activity directed at well-to-do Afghans.

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Appendix: The Global Compact's 10th Principle

On 24 June 2004 the first Global Compact Leaders' Summit announced that the Global Compact, the world's largest corporate sustainability initiative, had adopted a 10th Principle against corruption:

Businesses should work against corruption in all its forms, including extortion and bribery.

The adoption of the 10th Principle sent a strong worldwide signal that the private sector and other non-state-actors share responsibility for eliminating corruption and stand ready to play their part. The 10th Principle commits Global Compact participants not only to avoid bribery, extortion and other forms of corruption, but also to develop policies and concrete programmes to address it. Companies are challenged to join governments, UN agencies and civil society to realize a more transparent global economy.

The 10th Principle was the response of the business community and other non-state actors to the adoption of the United Nations Convention against Corruption. The UN General Assembly adopted the Convention in October 2003, and it entered into force on 14 December 2005. As of September 2009, over 140 States had ratified the Convention. As the sole global, legally binding anti-corruption instrument, the Convention provides a unique opportunity to prevent and fight corruption in both public and private sectors.

With this in mind, the 2004 Global Compact Leaders' Summit designated the UN Convention against Corruption as the underlying legal instrument for the new 10th Principle. In fact, while the Convention is legally binding only for countries that have ratified it, its values and principles are applicable to the widest spectrum of society, including the business community. The principles enshrined in the Convention can serve as an inspirational tool for companies adopting or reviewing internal anti-corruption policies, strategies, and measures.

Following adoption of the 10th Principle, the Global Compact established a multi-stakeholder working group to provide strategic input to the Global Compact's work on anti-corruption and to define the needs of the business community in implementing the principle. The Working Group on the Implementation of the UN Global Compact's 10th Principle also aims to contribute to greater coherence by supporting the alignment of existing initiatives and avoiding the duplication of efforts.

The Working Group has established several task forces to develop various tools and resources to help businesses achieve the goals of the 10th Principle. This Guidance is the result of one such effort.

Source: Transparency International (2009). Reporting Guidance on the 10th Principle against corruption. Available from: <http://www.iccwbo.org/policy/anticorruption/id879/index.html>