



## **Road to Transformation: Existing challenges to economic sustainability in Afghanistan**

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### **Part 1 of a 6 article series**

In 2001, the ambitious UN backed international peace-building agenda was launched in Afghanistan in the backdrop of an unprecedented political, security and economic vacuum. The economy, in particular, had been severely devastated by decades of conflict, drought, mass starvation, famine and most important of all economic and political sanctions imposed by the US and UN during the Taliban regime (1996-2001). These conditions combined with the lack of governance structures gave way to Afghanistan being recognized as a failed state by 2001. However, since then, both governance and economic structures have begun to rebuild, with the latter slowly recovering with notable progress. The road to state failure is marked by several revealing signposts, the most important being the rapid deterioration of the national economy followed by that of its political institutions.

In Afghanistan, major achievements in this sector took place after the international intervention helping to rebuild Afghanistan from a failed to a democratic state. Improvements in the area of economic growth which averaged at 11.25 percent between 2003 and 2011,<sup>1</sup> GDP per capita income raising from USD 119.9 in 2001 to USD 633.6 in 2014,<sup>2</sup> better public financial management in the allocation of resources, revenue collection, development of tax law, and re-establishment of financial institutions such as commercial banks and insurance companies which had either been destroyed or did not previously exist, all helped to pull Afghanistan out of its failed state status. Nevertheless, like with all major international peace-building missions, this progress has too been mixed. The influx of billions of dollars of aid and assistance, most of it being spent with no accountability or transparency measures, has created unrelenting challenges for Afghanistan. These challenges are becoming more pronounced with the gradual decline of international efforts in parallel to the gradual increase in the Afghan government's responsibilities. The affects of this transition have already become quite visible and daunting.

Presently, Afghanistan finds itself struggling with an exposing dependency on foreign aid, widespread corruption and unfathomable mismanagement of local resources. Additionally, despite the heavy emphasis on regional economic integration, the assumed panacea to all of Afghanistan's economic problems, the country has not been able to forge mutually beneficial economic relations with its neighbors. This holds especially true in the context of Afghan relations with its neighbors in the north- the five Central Asian Republics, namely Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan. Without improvements in Afghanistan's economic relations with these central Asian countries, Afghanistan cannot realize

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<sup>1</sup>Afghanistan Investment Support Agency, "Essential facts on Economic Performance and Investment in Afghanistan," Research and Statistics Department, March, 2012, pg. 1, accessed December 20, 2015, <http://www.aisa.org.af/Content/Media/Documents/economy-fact-english711201413422838553325325.pdf>

<sup>2</sup> World bank, "world development indicators", GDP per capita, accessed February 5, 2016, <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>



its historical role as a regional economic hub and land bridge that can connect South Asia to Europe. This, in return, will act to obstruct Afghanistan's ability to become self-sufficient in the years ahead.

Dependence on foreign aid, corruption and mismanagement of the country's mineral resources has been two primary destabilizing factors hindering economic development in Afghanistan. It is important to acknowledge that these two phenomena could have been avoided in Afghanistan if the international community and Afghan government had done more to regulate and develop infrastructures that could have supported the extraction of mineral resources, use of public – private partnerships to facilitate investment for the construction of road, railway and other infrastructures, and improve institutional capacities. All of this could have put the country on a more stable economic trajectory. The injection of foreign aid infused with unsustainable levels of international spending in all areas from government institutions to civil society have also led to the artificial stimulation of the Afghan economy. This is now reflected in the large government budget deficit that equals to 37 percent of the country's Gross Domestic Product as of 2014.<sup>3</sup> Second, widespread corruption in the country marks the most significant challenge of all at the national level.<sup>4</sup> Corruption has paralyzed the economy placing Afghanistan as the third most corrupted country in 2015 out of 175 countries ranked by Transparency International. Lastly, despite Afghanistan's tremendous endowment of natural resources, which has the potential to boost the economy and improve the welfare of the people, the government has not been able to manage its extraction due to lack of infrastructure, capacity, weak institutions and regulations.

In 2014, Afghanistan marked the end of 14 years of international peace-building which many described as the transitional period in which Afghanistan evolved from a failed state to a democratic nation. Now, that the country has built the foundations for good governance, security, rule of law, human rights, economic prosperity, education, civil society and free media it needs to deepen these pillars and move towards peace and self-reliance in the decade of transformation. However, the stark reality is that the transitions were not successes and has not given the government the “drive, confidence and focus”<sup>5</sup> needed to allow for the successful shift towards transformation. The security transition, which marked the handover of security responsibility from foreign forces to the Afghan National Security Forces (ANSF) has led to a spike in violence eroding investors confidence and lending to the decline in foreign investments and ultimately contributing to the growing unemployment rate in the country. The political transition in 2014, though marking the first peaceful democratic transfer of power in the country's history, was riddled with electoral fraud and eventually led to the formation of a National Unity Government that in essence lacks unity. These outcomes have created an environment filled with uncertainty and anxiety about the future of peace and stability in Afghanistan.

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<sup>3</sup> Trading Economics, “Afghanistan economic indicators”, government budget, accessed February 8, 2016, <http://www.tradingeconomics.com/afghanistan/government-budget>

<sup>4</sup> Sayed Masood Sadat et al., *The Asia Foundation A Survey of the Afghan People: Afghanistan in 2015* (Afghanistan: Kabul, 2015), 22-23

<sup>5</sup> Ministry of Foreign Affairs Afghanistan, “Realizing Self-Reliance commitments to reforms and renewed partnership.” Mofa, December, 2014, pg.5, accessed February 9, 2016, [http://mfa.gov.af/Content/files/Towards-Self-Reliance\(1\).pdf](http://mfa.gov.af/Content/files/Towards-Self-Reliance(1).pdf)



Furthermore, major reductions in aid and donor assistance, which was highlighted in both Bonn (2011) and Tokyo Conference (2012), has also started testing the ability of the Afghan economy in becoming self-sufficient. The gradual decline in overall donor support to Afghanistan is now testing the capacity of the economy in developing alternative sources for economic growth. Reliance on the extraction of natural resources, attracting foreign investment and facilitating trade and transit in the region are some of those alternative sources that the Afghan government needs to exploit to stimulate the economy.

In the decade of transformation, the Afghan government with the help of its international partners will aim to realize self-reliance by focusing on more private investments and revenue generating sources. A key component of this being regional economic integration such as trade and transit, connectivity, and cross-border investment. But in order for Afghanistan to establish a self-sustaining economy in this upcoming decade, it will need to place a great deal of emphasis on two key areas. First area is Afghanistan's geographical location which can allow it to serve as a land bridge connecting South Asia to Central Asia and beyond. In Bonn Conference (2011) the Afghan government and international community underscored this and stated, "We support enhanced trade connectivity along historical trade routes to utilize Afghanistan's economic potential at the regional level."<sup>6</sup>Second, the development of the mining industry could help wean Afghanistan off its dependency on foreign aid as the mining sector has the potential to significantly contribute to the country's gross domestic product (GDP), create direct and indirect employment while providing fuel for industry and power generation, materials for industry and construction for both domestic and export markets. Both of these areas are mutually reinforcing and have the potential to assist the Afghan government in realizing its economic promises.

Since 2001, regional economies have, and can continue to, benefit from a more stable Afghanistan that has adopted very liberal economic policies. However, this cooperation has not been consistent with all of Afghanistan's neighbors and has also had varied results for its own economy. In particular, cooperation between Afghanistan and Central Asian Republics has remained weak and this is visible when looking at Afghanistan's trade record with Pakistan, China and Iran. Nevertheless this gap also presents a unique opportunity for improving economic cooperation between Afghanistan and the republics, which can help strengthen regional connectivity.

Central Asian countries have contributed to rebuilding Afghanistan's economy in the past decade and notably in the energy sector. At present, the majority of Afghanistan's main cities are provided electricity that is supplied through transmission lines coming from Turkmenistan, Uzbekistan and Tajikistan. These transmission lines have served as a foundation for building economic cooperation between Afghanistan and the Central Asian countries in the energy sector. Some primary examples of other energy projects include the Turkmenistan, Afghanistan,

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<sup>6</sup> Ministry of Foreign Affairs Japan, "The international Afghanistan conference in Bonn," MOFA Japan, December 6, 2011, accessed , February 11, 2016, [http://www.mofa.go.jp/announce/announce/2011/12/1206\\_02.html](http://www.mofa.go.jp/announce/announce/2011/12/1206_02.html)



Pakistan and India Natural Gas Pipeline (TAPI) and the Central Asia – South Asia electricity transmission and trade project (CASA-1000).

Current trade relation between Afghanistan and the five Central Asian Republics mostly depend on Afghan's imports. Refined petroleum, wheat and Liquid gas are the major imports coming into Afghanistan. According to the Afghanistan Central Statistic Organization (CSO) in 2015 Uzbekistan was the largest source of imports among all the Central Asian countries, with total imports worth (USD 721 million)<sup>7</sup>, followed by Turkmenistan (USD 464 million)<sup>8</sup>, Kazakhstan (USD 390 million)<sup>9</sup>, Tajikistan (USD 114 million)<sup>10</sup> and the Kyrgyz Republic valued at (USD18 million).<sup>11</sup>In terms of exports from Afghanistan in 2015, a combined (USD 26 million) was exported to four of the Central Asian countries in vegetables and dry fruits.

Overall, Afghanistan imports considerably more from Central Asia than it exports. This means that Afghanistan does not have mutually benefitting bilateral trade relations with its northern neighbors. For Afghanistan the stream of informal trade, lack of transparency in custom clearances, lack of infrastructure for transit and the importing of products that could be produced at home further compound its challenges in ensuring mutually benefitting trade relations with Central Asian countries. However, by using existing regional frameworks such SPECA (Special Program for Economies of Central Asia), RECCA (Regional Economic Cooperation Conference on Afghanistan), and CAREC (Central Asia Regional Economic Cooperation Program) Afghanistan has been given a platform to highlight these concerns and identify opportunities for equal and improved economic cooperation with Central Asian Republics. Areas that require evaluation to facilitate this includes the existing potential of export/import, current and future status of transit connectivity, trade barriers and most importantly what new roles Central Asian Republics can play in improving the Afghan economy in Decade of Transformation.

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<sup>7</sup> Central Statistic Organization, "Afghanistan imports by country & commodity", CSO, 2015 , pg.75, accessed January 10 , 2016,  
<http://cso.gov.af/en/page/economy-statistics/6323/annual-trade>

<sup>8</sup> Ibid., pg.69

<sup>9</sup> Ibid., pg.33

<sup>10</sup> Ibid., pg.56

<sup>11</sup> Ibid., pg.14