Afghanistan and the Search for a Sustainable Economy

Megan E. Liaboe
The Project on International Peace and Security (PIPS)
Department of Government
The College of William and Mary
P.O. Box 8795
Williamsburg, VA 23187-8795
pips@wm.edu

P|I|P|S Project on International Peace and Security

Institute for Theory and Practice of International Relations
Government Department
The College of William and Mary
P.O. Box 8795
Williamsburg, VA 23187-8795
T. 757.221.3020
F. 757.221.1868
www.pips.wm.edu
pips@wm.edu

POLICY BRIEF

For almost a decade, the United States and much of the industrialized world has committed its wealth and power to establish a secure Afghanistan; yet, in spite of these efforts, the Afghan government remains heavily dependent on the international community and foreign aid. In order to secure a strong central government independent of international assistance, Afghanistan must develop a stable source of domestic revenue to cover its expenditures. Absent this sustainable revenue stream, the Afghan government will remain dependent on the international community and, should foreign assistance decline, risk devolving into a failed state. This paper argues that the most effective means for the Afghan government to generate sufficient domestic revenue is to tax countries and corporations seeking access to Afghanistan's vast mineral deposits, including copper, iron ore, gold, and uranium.

The U.S. and International Community's Strategic Goals in Afghanistan

The United States and the international community share a number of objectives pertaining to Afghanistan's future. These objectives include:

- Strengthening the Afghan central government,
- Preventing Afghanistan from becoming a safe haven for radical Islamist groups, and
- Preventing Afghanistan from becoming a major source of narcotic production and exportation, especially opium and hashish.

Accomplishing these objectives would create a relatively stable and secure state in a highly volatile region of the world. These goals, however, require an exhaustive and expensive build up of the Afghan state, which at present, is largely subsidized by the international community. *For a strong central government to exist in Afghanistan, a stable source of domestic revenue must be found so that the government has the resources necessary to extend and maintain its control over the countryside.*

The Afghan Government's Reliance on International Aid

Afghanistan is almost entirely dependent on foreign aid, with approximately 90% of the national budget financed externally.[i]

- *Government Unable to Meet Administrative Costs*: The Afghan government needs to increase its tax revenue by at least 50% to cover its administrative costs. According to the IMF, the Afghan government's expenses in 2007 were approximately $1.3 billion, while its tax revenue was only $525.6 million.[ii]

- *Government Unable to Meet Security Costs*: Currently, the United States and international community provide the bulk of the funding for the Afghan National Army (ANA) and the Afghan National Police (ANP). In 2008 the U.S. Government Accountability Office (GAO) estimated that sustaining the Afghan National Security Forces (ANSF) would cost $2 billion annually.[iii] The U.S. military, however, estimates that the ANSF needs to almost triple in size to effectively fight the Taliban insurgency.[iv] With this expansion, the cost of sustaining the ANA will rise to approximately $3 billion per year, while funding the ANP will cost approximately $1 billion.[v]

When accounting for both administrative and security functions, the Afghan government will need to increase its revenue by approximately $4.25 billion per year in order to achieve financial independence.

The Danger of Afghan Reliance on International Aid

The primary concern with Afghanistan's foreign aid dependence is that the international aid will eventually dry up, and Afghanistan will be unprepared to compensate for the loss of international support.

- The international community will eventually succumb to "aid fatigue" and stop providing Afghanistan with aid.
    - The international community pledged $39 billion from 2002 to 2011, but only approximately 40% has been disbursed.[vi]
    - "The Donor Financial Review for 2008" finds that the international donor community is only fulfilling 48% of Afghanistan's estimated needs.[vii]
    - Development aid generally falls by 30 to 40% during recessions.[viii]
    - In 2009, the UN threatened to turn to Bill Gates for financial assistance due to the slow disbursement of development aid to Afghanistan. Kai Eide, the UN's special representative for Afghanistan, also stated that agriculture and infrastructure remained "dangerously underfunded."[ix]

- A sudden stop of foreign aid to an unprepared Afghanistan will likely result in a severe weakening and possible failure of the Afghan state.
    - Defense Secretary Robert Gates said in 2007 that "military success is not sufficient to win" in Afghanistan, and that "there is a need for a dramatic increase in spending on the civilian instruments of national security - […] foreign assistance, civic action, economic reconstruction, and development."[x]

Historic Sources of Government Revenue

Historically, Afghanistan has been plagued by consistently low levels of government revenue, despite a variety of sources. Minimal revenue is one factor that has prevented the emergence of a strong central government.[xi]

- Income Taxes and Afghanistan's Limited Tax Base
    - The established tax system depends on a monetized tax base but most Afghans survive on subsistence agriculture and remain outside the tax collector's reach.[xii]
    - Extreme remoteness of villages, rugged terrain, and scarcity of all-weather roads also severely inhibit centralized tax collection.
    - Large rural landowners historically used bribes and their connections to avoid government taxation.[xiii]

- Taxing Trade
    - Taxes on foreign trade were the Afghan government's major tax base in 1970s.[xiv]
    - Natural Gas
        - In the late 1970s, Afghanistan supplied 70 to 90% of its natural gas output to the Soviet Union through Uzbekistan.[xv]
        - At that time, annual natural gas exports totaled approximately $150 million.
        - Natural gas exports constituted 44% of all government revenue in 1982.[xvi]
        - The Soviet Union ended the import of natural gas from Afghanistan after it withdrew from the country in 1989.[xvii]
    - Raisin Cultivation and Exports
        - Due to its hot, arid climate during the months of August and September, Afghanistan is an ideal location for producing high quality raisins.
        - In the 1960s and 1970s, raisins from Afghanistan accounted for 60% of the world market and their annual export revenue totaled $48 million.[xviii]

Economic Options for a Self-Reliant Afghan Government

To achieve independence from international aid, the government must raise $6 billion annually. Currently, the Afghan government currently faces a shortfall of $3.25 billion, which will increase to approximately $4.25 billion with the expansion of the Afghan National Security Forces (ANSF) and the expansion of the government's administrative capability throughout Afghanistan. Presented in this paper are four options for bridging the financial gap by utilizing Afghanistan's domestic resources: oil and gas production, taxing transportation routes, expanding fruit exports, and mining.

Current Potential Sources of Income:

(1) Oil and Gas Pipelines: Building a pipeline from Turkmenistan through Afghanistan to Pakistan and India (TAPI) could generate an estimated $200 million a year in transit fees for the Afghan government.[xix] Such a pipeline may connect to the Pakistani port of Gwador, which China is helping to develop. Currently, only one operational pipeline exists that transports natural gas 80 miles from the Sheberghan gas fields in northern Afghanistan to a partially operational power plant near Mazar-i-Sharif.[xx]

Challenges:

- Building a gas pipeline through Afghanistan involves significant economic costs because of difficult terrain and risk due to an uncertain security environment.
- The TAPI pipeline would not tap into Afghan natural gas reserves; it would only transport Turkmenistan's natural gas.
- Turkmenistan has committed to four export routes: north to Russia, east to China, south to Pakistan, and west to Europe. Routes to Russia and China are more lucrative with less risk and, therefore, take higher priority over a route through Afghanistan.[xxi]

(2) Transportation Routes: The government could tax trade transiting the "Ring Road," which encircles approximately 80% of the Afghan interior. Former Finance Minister Ashraf Ghani estimated in the spring of 2005 that income from a transit tax could net the Afghan government $200 million a year.[xxii]

Challenges:

- The benefit of taxing commercial traffic would be limited because revenue from transit fees would be offset by the cost of maintaining the road.

- As maintenance of the "Ring Road" is expected to cost Afghan government $200 million annually, estimated transit fees of $200 million a year would only serve to offset the maintenance cost, and would not garner surplus government revenue.[xxiii]

(3) Reinvigorating Afghanistan's Fruit and Agricultural Production: Forty years ago, Afghanistan was renowned for its fruit exports, especially its pomegranates, apricots, and raisins. Since the 1970s, the country's fruit industry has plunged into chaos; however, as the country's security and transportation continues to improve, there is hope for a resurgence of these crops. In 2007, Afghanistan produced almost 4 million metric tons of wheat, 95,000 metric tons of watermelons, 350,000 metric tons of grapes, and 38,000 metric tons of apricots. This production amounted to $165 million in exports of fresh and dried fruits.[xxiv]

Exports could prove to be a vital revenue source for the Afghan government as 8% of the government's 2007 total revenue came from taxes on international trade. The government's revenue from international trade taxes is equal to the sum of its revenue from taxes on income, profits, capital gains, goods, and services.[xxv] A modest tax on fruit and agricultural exports could provide a sustainable revenue source for the Afghan government. However, it is doubtful that the revenue garnered from agricultural exports alone would be significant enough to fill the major financial gap in the Afghan budget.

Challenges:

- It is extremely difficult to tax farmers, most of whom survive on subsistence agriculture. Furthermore, the remoteness of villages, difficult terrain, and lack of dependable transportation routes would seriously impede tax collection.[xxvi]

- Due to the Afghan government's "hands off" approach to the fruit industry, the lack of cold-storage infrastructure, and the country's broken irrigation system, agricultural exports remain a fragile market and most agricultural exports need to be protected from taxes for the near future.[xxvii]

- In 2009, Pakistan imposed a 4% import tax and a 14% sales tax on Afghan vegetables and fruit, significantly decreasing Afghan exports to Pakistan.[xxviii]

- In 2005, the Afghan government agreed in principle to exempt fruit exports from taxes in order to boost exports, but the exemption was largely ignored.[xxix]

- As the U.S. government focuses on substituting poppy fields with alternative crops like wheat, saffron, or pomegranates, it is imperative that these alternative crops produce greater revenue for Afghan farmers than opium.[xxx] *Export taxes on agricultural goods would diminish farmer's profits on alternative crops, encouraging farmers to return to opium production.*

(4) Mining: Mining is the only industry with the potential to subsidize a large portion of the Afghan government's revenue needs. There are over 300 types of mineral deposits in Afghanistan, including coal, copper, marble, emeralds, and blue lapis lazuli stone.[xxxi] In 2007, the Chinese paid the Afghan government $3 billion for exclusive mining rights to the Aynak copper mine.[xxxii] The government may accrue additional annual tax revenue estimated between $300 million and $730 million during mine construction. Some estimate that annual tax revenue could reach $955 million when the mine is at full production.[xxxiii]

There are many mineral deposits that the Afghan government can make available to development bids. These mines could bring in not only revenue for the government, but also jobs for its people.

- *Hajigak Iron Mine*

  - The Afghan government recently opened up the Hajigak iron mine for development bids. It is estimated that 60 billion tons of ore are buried beneath the surface and lies approximately 60 miles west of Kabul in the Bamyan province.[xxxiv]
  - According to Afghan Minister of Mines Wahidullah Shahrani, Hajigak is expected to generate substantially more revenue than the Aynak copper mine.[xxxv]
  - With China, India, and Russia all expressing interest in acquiring rights to the mine, Afghanistan is in a strong negotiating position to secure a lucrative deal.[xxxvi]

- *Gold*

  - Gold deposits in Badakshan province are significant enough to provide a source of local industry and employment.
  - The precious metal could be easily exported utilizing the forthcoming railroad north into Tajikistan.[xxxvii]

- *Uranium*
    - There is a uranium deposit located in Helmand province, which could prove to be extremely profitable should the security situation improve.[xxxviii]
    - Uranium is desired in many countries, and could be transported to Kandahar using the Ring Road. From there, it could either be shipped out of the provincial capital's airport, or continue south to the Pakistani border to Spin Boldak and Chaman to connect to the Pakistani railroad system.

- *Marble*
    - Some experts estimate that billions of metric tons of marble exist untouched throughout Afghanistan.[xxxix]
    - In Herat Province, Chest-e-Sharif district, the Chest-e-Sharif marble mines produce marble of global quality.
    - In 2009, U.S. entrepreneurs explored investing in Afghan marble mines.
    - The deal included all-weather improvement to a 120km stretch of Highway 2; this part of the road network links Herat to Kabul without going around the Ring Road and saves 3-4 days of travel.[xl]

The mining industry offers the Afghan government the possibility of a stable, long-term, and lucrative source of revenue. For example, the Aynak copper mine alone has the potential to cover almost 25% of the government's current financial gap. The Hajigak mine is expected to generate even more revenue, despite iron ore's current low price. Precious metals, like gold and uranium, have the potential of generating significant revenue. With smart negotiations and contracts, the Afghan government has the opportunity to secure financial independence and generate the needed revenue to extend its influence throughout the countryside.

---

i "Background Paper: Afghanistan Reconstruction Trust Fund." Promoting Generation of Public Expenditure Reforms. The World Bank. London, UK. January 29, 2010. http://siteresources.worldbank.org/INTAFGHANISTAN/Resources/Afghanistan-Reconstructional-Trust-Fund/Public-Expenditure-Review_Summary.pdf , pg. 1.

ii International Monetary Fund. *Government Finance Statistics Yearbook 2008*. Pg 38.

iii United States Government Accountability Office Report to Congressional Committees. "Afghanistan Security: Further Congressional Action May Be Needed to Ensure Completion of a Detailed Plan to Develop and Sustain Capable Afghan National Security Forces." June 2008. Pg 3. http://www.gao.gov/new.items/d08661.pdf.

iv McChrystal, Stanley A. "Commander's Initial Assessment." August 30, 2009. http://media.washingtonpost.com/wp-srv/politics/documents/Assessment_Redacted_092109.pdf?.

v "Factbox: Afghan National Security Forces." March 27, 2009. http://www.reuters.com/article/idUSISL112818.

vi Waldman, Matt. "Falling Short: Aid Effectiveness in Afghanistan." ACBAR Advocacy Series. March 2008. http://www.acbar.org/ACBAR%20Publications/ACBAR%20Aid%20Effectiveness%20(25%20Mar%2008).pdf.

[vii] Ashdown, Paddy and Joseph Ingram. "Falling Short on Afghanistan." *New York Times*. April 29, 2009. http://www.nytimes.com/2009/04/30/opinion/30iht-edashdown.html?_r=1&ref=global.

[viii] Tolentino, V. Bruce J. "Foreign Aid & the Global Economic Crisis." April 1, 2009. http://asiafoundation.org/in-asia/2009/04/01/foreign-aid-the-global-economic-crisis/.

[ix] Deen, Thalif. "U.N. Decries Aid Shortfall in Afghanistan." *Inter Press Service News Agency*. June 30, 2009. http://ipsnews.net/news.asp?idnews=47477.

[x] Gates, Robert M. "Landon Lecture (Kansas State University)." November 26, 2007. http://www.defense.gov/speeches/speech.aspx?speechid=1199.

[xi] Afghan government revenue only grew by 26% between 1939 and 1972. Nyrop, Richard F. and Donald M. Seekins. *Afghanistan Country Study*. (Washington, D.C.: American University Press, 1986): pg 155-157.

[xii] Ibid.

[xiii] Ibid.

[xiv] Ibid.

[xv] Clough, Langdon D. "Energy Profile of Afghanistan." January 21, 2007. http://www.eoearth.org/article/Energy_profile_of_Afghanistan.

[xvi] Nyrop, Richard F. and Donald M. Seekins. *Afghanistan Country Study*. (Washington, D.C.: American University Press, 1986): pg 155-157. http://www.gl.iit.edu/govdocs/afghanistan/Afghanistan-Chapter3.pdf.

[xvii] Ibid.

[xviii] Synovitz, Ron. "Afghanistan: China's Winning Bid for Copper Rights Includes Power Plant, Railroad." *Radio Free Europe Radio Liberty*. November 24, 2007. http://www.rferl.org/content/article/1079190.html.

[xix] Riphenburg, Carol J. "Afghanistan: Out of the Globalisation Mainstream?" *Third World Quarterly*, Vol. 27:3 (2006): pg 519.

[xx] Clough, Langdon D. "Energy Profile of Afghanistan." January 21, 2007. http://www.eoearth.org/article/Energy_profile_of_Afghanistan.

[xxi] Foster, John. "Afghanistan, the TAPI Pipeline, and Energy Geopolitics." *Journal of Energy Security*. March 23, 2010. http://www.ensec.org/index.php?option=com_content&view=article&id=233:afghanistan-the-tapi-pipeline-and-energy-geopolitics&catid=103:energysecurityissuecontent&Itemid=358.

[xxii] Danspeckgruber, Wolfgang and Robert P. Finn. "The Afghan Economy." *Building State and Security in Afghanistan*. Ed. Wolfgang Danspeckgruber with Robert P. Finn. (Princeton, NJ: Woodrow Wilson School of Public and International Affairs, 2007) pg 133.

[xxiii] Nasuti, Matthew. "The Ring Road: A Gift Afghanistan Cannot Afford." *Kabul Press*. September 29, 2009. http://kabulpress.org/my/spip.php?article4093; McCarten, William and Javier Suarez. "Trade and Regional Cooperation between Afghanistan and its Neighbors." February 18, 2004. pg. 38.

[xxiv] *The Europe World Year Book 2009*. 50th Edition, Volume 1. Routledge: New York, 2009. Pg 507-508.

[xxv] World Bank. *World Development Indicators 2009*. April 2009. Pg 248.

[xxvi] Ibid.

[xxvii] Zonn, I.S. "Water Resources of Northern Afghanistan and their Future Use." Presented at Informal Planning Meeting: Water, Climate, and Development Issues in the Amudarya Basin, Philadelphia. June 18-19, 2002. Pg 5. http://www.ccb.ucar.edu/wkshp/centralasia/docs/zonn.pdf.

[xxviii] "Afghanistan Food Security Update." USAID. September 2009. http://fews.net/docs/Publications/Afghanistan_FSU_2009_09_final.pdf.

[xxix] Mohammadi, Zainab. "Fruit exports may be exempted from taxes." *Asia Pulse*. June 16, 2005. http://www.mof.gov.af/english/press-review-june-10-16.htm#a11; "Case Study of Poultry and Grape/Raisin Subsectors in Afghanistan: Guided Case Studies in Value Chain Development for Conflict-Affected Environments." USAID microReport #106. March 2008. http://pdf.usaid.gov/pdf_docs/PNADN388.pdf.

[xxx] Donadio, Rachel. "New Course for Antidrug Efforts in Afghanistan." *The New York Times*. June 27, 2009. http://www.nytimes.com/2009/06/28/world/asia/28holbrooke.html; Khalaj, Monavar. "Iran fights for its saffron

status." *Financial Times.* March 24, 2010. http://www.ft.com/cms/s/0/d8fe5456-3765-11df-9176-00144feabdc0.html.

[xxxi] Riphenburg, Carol J. "Afghanistan: Out of the Globalisation Mainstream?" *Third World Quarterly*, Vol. 27:3 (2006): pg 519.

[xxxii] Landay, Johnathan S. "China's thirst for copper could hold key to Afghanistan's future." McClatchy Newspapers. March 9, 2009. http://www.mcclatchydc.com/2009/03/08/63452/chinas-thirst-for-copper-could.html.

[xxxiii] McMahon, Gary. "No More Enclaves: Aynak in Afghanistan." US Institute of Peace. February 10, 2010. http://www.usip.org/files/McMahon%20USIP%20presentation%20Aynak.pdf.

[xxxiv] Landay, Johnathan S. "China's thirst for copper could hold key to Afghanistan's future." McClatchy Newspapers. March 9, 2009. http://www.mcclatchydc.com/2009/03/08/63452/chinas-thirst-for-copper-could.html.

[xxxv] "PDAC-Afghanistan looks to attract foreign mining companies." Reuters. March 10, 2010. http://www.chinamining.org/News/2010-03-10/1268200404d34469.html.

[xxxvi] Landay, Johnathan S. "China's thirst for copper could hold key to Afghanistan's future." McClatchy Newspapers. March 9, 2009. http://www.mcclatchydc.com/2009/03/08/63452/chinas-thirst-for-copper-could.html; Nematova, Anna and Owen Matthews. "Russia Invades Afghanistan—Again." *Newsweek*. April 3, 2010. http://www.newsweek.com/id/235886.

[xxxvii] "Preliminary Assessment of Non-Fuel Mineral Resources of Afghanistan, 2007." US Geological Survey. October 2007. http://pubs.usgs.gov/fs/2007/3063/fs2007-3063.pdf.

[xxxviii] Danspeckgruber, Wolfgang and Robert P. Finn. "The Afghan Economy" in *Building State and Security in Afghanistan*. Princeton, NJ: 2007, 137.

[xxxix] Motevalli, Golnar. "Afghanistan sees great white hope in marble sector." Reuters. April 20, 2010. http://www.reuters.com/article/idUSTRE63K00C20100421.

[xl] Conversation with Colonel John Bessler, Director of Security, Reconstruction, and Transition. U.S. Army Peacekeeping and Stability Operations Institute. April 9, 2010.