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Afghanistan Post-2021: The New Political Economy of Growth

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Afghanistan Research Network

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Key Takeaways

- In the contexts of humanitarian crises and emergency food insecurity, relying on conventional macroeconomic indicators to gauge the 'health of the economy' or to assess the economic well-being of people living in these crises can be misleading.

- In post-crisis situations, positive changes in real GDP should be interpreted with caution as they may reflect statistical base effects rather than actual recovery. In periods of severe crisis, it might be prudent to interpret growth as 'moments of moderations within crisis' rather than 'improvements' in economic outcomes.

- When undertaking macroeconomic analysis of countries with autocratic regimes, ignoring the political economy and institutional contexts can lead to deceptive conclusions.

- Unsuccessful political resolutions do not lead to improvements in business and consumer confidence, even if physical security improves. For example, repressive practices of the Taliban administration have reduced the stability, and therefore, predictability of other institutions, both of which are factors that matter for economic growth.

- Prior to August 2021, the Taliban engaged with the dual taxation system and widespread smuggling, collecting part of the revenues. Within this context, recent increases in tax revenues and trade are likely to be 'formalization' effects rather than actual improvements.

Introduction

The political crisis in Afghanistan of August 2021 led to fundamental institutional changes when Taliban militants deposed the Islamic Republic. The country shifted from democratic institutions to an autocratic political regime; the constitution – that was adopted in 2004 through a nation-wide elected assembly ('loya jerga') – was dissolved; institutions that ensured basic human rights – including women's rights to education and work – were abandoned; religion emerged as a 'formal' meta-institution that overruled all other institutions; and many policies and regulations were reversed or suspended. While conflict was significantly reduced, the Taliban's oppressive practices and human rights violations further led to substantial politico-economic uncertainty.

Abrupt changes in public finance and economic management followed these institutional shifts. With the suspension of official development assistance to Afghanistan – approximately US$3.5 billion per year – development projects ceased and were replaced with humanitarian operations, implemented and managed by the United Nations and other non-governmental organizations. Budget transparency diminished as information on how the Taliban administration spent collected domestic revenues, and how these were used to finance Taliban military expenditures was – and continues to be – unavailable and unverifiable. Government agencies lost qualified civil servants due to technocrat 'brain drain', due to a widespread fear of retaliation. This has further affected basic service delivery in the country.

After the Taliban's establishment of their de facto administration in August 2021, the dual revenue collection system was consolidated into a unified tax system. Prior to this, the Taliban collected municipal taxes; collected transportation tax on freight and cargos; extorted money from illegal mining operations; levied excises on smuggled imports and exports of merchandise; levied royalties on construction projects; collected religious tax duties ('ushr and zakat); and collected electricity bills in areas under their control (Clark; 2022, Azami; 2021, Thomas; 2021, UNSC; 2021, Biruni Institute; 2020, SIGAR; 2020, Latif; 2019, Lakhani & Corboz; 2017, EASO; 2016). These illegal revenue collections constituted a parallel tax system, which shrank the formal tax base for the government of the Islamic Republic ahead of their deposition by the Taliban.

Power structures, too, profoundly altered in the country. Prior to 2021, foreign aid had skewed power relations in favour of political and economic elites. Research demonstrates that donor-funded development projects benefited politically-affiliated and well-connected individuals (Bak; 2019, Harmer et al.; 2017, SIGAR; 2016, Mehran; 2013, Alexander et al.; 2012, Gardizi et al.,; 2010, Delesgues; 2007, Savage et al.; 2007). This resulted in the emergence of widespread corruption under the Islamic Republic's government, led by various power-groups within the government and the private sector, and their vested interests. These power structures fundamentally changed after August 2021; 'religious connections' and 'extremist values' now define how hegemonic coalitions and power hierarchies are shaped (Joya & Rahimi, 2023). While some forms of corruption have diminished – such as expropriation of resources and tax revenues from donor-funded projects by government officials, – other forms of corruption have emerged. The Taliban formalised the extraction of mineral deposits, a process they had previously undertaken illegally through looting. These resources now fund their factional power grabs (O'Donnell; 2002). Similarly, they levy substantial taxes on small businesses, often outside formal tax collection systems (Clark; 2002) and without consideration of equity and fairness.

These institutional changes represent some fundamental shifts occurring since August 2021, and should be considered when producing and presenting macroeconomic analysis. This report will discuss how the new political economy context in Afghanistan should be considered. This is particularly important when improvements in conventional macroeconomic indicators in post-crisis or in-crisis situations are perceived as misleading. This report will principally focus on some practical implications for policy analysis.

Can Conventional Macroeconomic Indicators Be Misleading in Particular Situations?

To start with an example, let us see the Afghanistan Economic Monitor's (World Bank, 2022) depiction of the economic situation in post-2021 Afghanistan. The report, which relies on macroeconomic indicators until October 2022, summarised the economic developments as following:

> "The inflationary pressure has eased since July 2022, helped by lower global oil and food prices. Wages increased modestly in October, coinciding with increased demand for skilled and unskilled labour. Real wages also inched up as inflation eased. The ITA's revenue collection for the first ten months of the current year is marginally better than the previous year's comparable period, with a greater reliance on trade-related taxes and non-tax revenue sources. The AFN to US$ exchange rate has been stable at around 87-89 during the last few months as the country received a steady inflow of UN's US$ cash shipments. The H1-2022 merchandise export data shows strong export growth, outpacing the imports. As a result, the merchandised trade deficit has narrowed H1-2022." (World Bank, 2022)

An easing of inflation; improvement in wages; an increase in revenue collection; currency stability; and a strong performance in exports—as reported in the World Bank's 2022 report—paint a positive and convincing picture of the situation in Afghanistan. A similar picture of the economy was again portrayed in the subsequent issue in the Afghanistan Economic Monitor series (World Bank, 2023). Without context, an uninformed reader could assume that the reports depict a country with a fair growth model that allows wages and exports to grow; strong institutions leading to strong revenue performance; and an independent monetary policy that has ensured price and exchange rate stability. Further, the report suggests in its depiction of Afghanistan that it is not in economic distress or a humanitarian emergency, and is not facing acute poverty. By making no reference to these issues, the report suggests to the uninformed reader that these are not issues within Afghanistan. Moreover, it would be easy to assume that these positive developments are resultant of democratic institutions, as suggested in the theoretical and empirical literatures (Acemoglu et al., 2019; Rodrik, 2000).

These assumptions however are incorrect: the country discussed is post-2021 Afghanistan, which has abandoned democratic institutions in favour of autocratic and repressive institutions; is in the midst of a humanitarian crisis and facing an emergency food insecurity (OCHA; 2023, Brown et al; 2022); is experiencing a labour market crisis due to growing unemployment and restrictions on women's work (UNDP; 2022a); and has lost its monetary policy independence due to a freeze on foreign exchange reserves.

The Whole of Afghanistan Assessment (WoAA) — a REACH-implemented series of annual household surveys — by contrast, provides a bleak picture of the socio-economic situation in the country. The 2022 WoAA relied on a sample of approximately 17,000 households, making it representative at both national and provincial levels. The surveys showed that seventy-two percent of households struggled to obtain food within the previous thirty days of being surveyed, compared to fifty-eight percent in 2021 (REACH; 2021, 2022). Furthermore, thirty-five percent of households in 2022 reported that they had gone to sleep 'hungry' at least once in the previous thirty days, compared to only fourteen percent in the previous year. As such, the proportion of households in the 'moderate hunger' category – as per REACH's definition – increased from fourteen percent in 2021, to thirty-six percent in 2022. Reported household expenditures and income also dropped by 16.7 percent and 16.2 percent between 2021 and 2022 respectively. Finally, fifty-four percent of households in 2022 reported having experienced an 'economic shock' in the previous six months (REACH; 2022).

The socio-economic picture of Afghanistan offered by representative household surveys is very different to what is depicted by the World Bank (2022, 2023), which relied exclusively on conventional macroeconomic indicators and ignored the political economy contexts. Local media and experts in Afghanistan expressed strong discontentment with the World Bank's analysis in the Afghanistan Economic Monitor reports (Amu TV; 2023, Hasht-e Sobh Daily; 2023), while the Taliban welcomed the publications, calling them 'positive and realistic' (BBC Farsi, 2023). Ignoring the political economy factors and the institutional context of the country in macroeconomic analyses can evidently be misleading, especially in crisis situations.

How Should Standard GDP Measures Be Used in Crises Contexts?

Despite its shortcomings, gross domestic product (GDP) is the best available measure of economic wellbeing (Dynan & Sheiner; 2018, Oulton; 2012). Over previous decades, many efforts have been made to develop alternative indicators to track economic well-being and quality of life, however, GDP is still the most widely used to indicate living standards. Real changes in GDP from one year to the next indicate whether households and businesses are better off compared to the previous year. Most economic policies around the world are devised based on GDP or GDP-related macroeconomic indicators.

From a practical policy perspective, however, the efficiency of GDP as a primary anchor for economic policies depends on certain conditions. GDP can qualify as an efficient measure of economic wellbeing in policy analysis if the country meets the following conditions: (i) markets in the country are not excessively controlled; (ii) there are some minimum levels of 'economic freedom'; (iii) there are no strong income inequalities; and (iv) there are no large disparities between 'changes in human development' and 'changes in aggregate income' in the country.

The first condition is necessary because if an economy is excessively controlled, GDP loses its relevance as an anchor for economic policy. In non-market economies, the government would use other criteria and targets for its regulation of the economy rather than GDP growth. The second condition, i.e., basic institutions of economic freedom, is required because if businesses and similar establishments cannot take the decision to employ workers or receive returns on their capital, or, if households do not have the right to have private ownership of assets and capital — as is the case under communist regimes — then GDP does not reflect the well-being of a country's people, but rather reflects the state's level of production. Absence of strong inequalities, the third factor is also important: in countries with high degrees of economic inequality, GDP—which aggregates the income of the entire population without considering the distribution of income between the poor and the rich—cannot reflect the economic well-being of the poor, even if they represent the majority in the country. This is one of the most important criticisms levelled at GDP. Finally, if GDP growth and human development go in opposite directions over a period of time, policymakers cannot rely on GDP growth in designing development policies. Such disparities between GDP and human development may happen, for instance, if a shock, or series of shocks, affects only the poorest and the most vulnerable segments of the population, while the richest benefit from an income growth due to concentration of capital in the economy.

In post-2021 Afghanistan, while the first and second conditions seem to be present (and there are no concerns so far that they will be violated in any near future), the third and particularly the fourth conditions do not seem to uphold anymore. Prior to the 2021 political crisis and before the Covid-19 pandemic, one in every two Afghans lived under the national poverty line. The headcount poverty ratio was 54.5 percent in 2016-17 and 47.3 percent in 2019-20 (Joya et al.; 2022). Since then, the poverty rate has most likely increased due to the adverse economic shocks of both Covid-19 and the 2021 political crisis. The UNDP went as far as forecasting that the poverty rate would escalate to more than ninety percent by mid-2022 (UNDP; 2022b).

With the on-going humanitarian crisis and emergency food insecurity in Afghanistan (OCHA; 2023, Brown et al.; 2022) divergence between conventional macroeconomic measures and human development indicators have widened, as discussed earlier. In such cases, GDP growth and other macroeconomic indicators linked to GDP growth lose their relevance in policymaking and must not be relied upon to gauge the 'health of the economy' or to assess overall economic well-being in the country.

In the contexts where a humanitarian crisis is on-going and human development indicators are worsening, then, a 'positive' real GDP growth in the immediate turnaround of an economic collapse can offer a deceptive picture of the situation. Thus, during a crisis, it is important not to interpret positive real changes in GDP as 'improvements' over the previous year, because they are most often due to a statistical base effect. In periods of severe crisis, it might be prudent and politically correct to instead interpret positive growth as moments of 'moderations in crisis' rather than 'improvements'.

Furthermore, one may use an alternative 'base year' to calculate changes, or growth, in GDP, rather than using year-on-year growth rates. For instance, in the current context of Afghanistan, the World Bank may use either (i) a pre-crisis GDP base, such as GDP in 2019, to calculate economic growth in 2023; or (ii) a five or ten year average GDP prior to the crisis to calculate the economic growth for 2023. In both cases, the deceptive base year effect will be addressed, and the economic growth will show changes in the standard of living (for instance, in 2023) compared to the pre-crisis period (either a single year, or a five to ten year average).

Measuring the ‘gap’ instead of ‘growth’ could also be useful in periods of crisis, by calculating the deviations in current GDP with its pre-crisis trend. One way is to estimate a potential GDP assuming the pre-crisis growth trend had been maintained, and then calculate the current gap with respect to that potential. Finally, defining a socio-economic indicator for Afghanistan that could best reflect the economic, social, and human developments in the country can be more relevant. For instance, a composite index consisting of GDP growth and three to five other social or human development indicators might give a more realistic picture of the situation, rather than relying solely on GDP growth.

Implications for Policy and Economic Analysis

An appraisal of institutional changes and the political economy context can have important implications for policy and economic analysis. In the following, only selected implications will be discussed to demonstrate how political economy considerations help integrate more inclusive perspectives and avoid running into judgmental errors or false conclusions from macroeconomic data.

A. Conflict and Political Uncertainty

The end of a conflict does not always mean the end of political uncertainty. Unsuccessful political resolutions do not lead to improvements in business and consumer confidence, even if physical security improves. Anecdotal evidence from the past two decades of conflict in Afghanistan have shown that the physical impact of conflict (in terms of destruction, human loss, disruption in logistics, disruption in markets, etc.) was heterogeneous across sectors. Some industries, such as extractives and manufacturing, were affected by insecurity more than the others, while agriculture, transportation and some service sectors were able to adapt to the conflict.

However, persistent conflict in Afghanistan generated broader politico-economic uncertainty over the years, undermining investment in all sectors. The economic literature also shows that uncertainty leads to reduced investment and consumption (Di Bella & Grigoli; 2018) and increases rent-seeking and corruption, which in turn raises the cost of business for firms (Farazi et al.; 2018, Angelopoulos & Economides; 2008, Tornell & Lane; 1999). In a forthcoming paper, Joya and Rougier (2023) show that uncertainty associated with the Security Transition — the withdrawal of most international troops from Afghanistan between 2012 and 2014 — led to increased pessimism in the country, which in turn affected economic growth until 2021. This result stands statistically significant even when the level of conflict (measured in fatalities) is controlled in the model.

Hence, it would be injudicious to assume that, as conflict has subdued, business confidence would rebound. In fact, the latter will not materialize unless an inclusive political resolution is achieved in the country.

B. Which Institutions Matter for Economic Growth?

In economic and policy literature, private property and enforcement are often cited as the most important institutions for economic growth. These two sets of institutions are not only important in advanced economies but are perhaps even more important in developing countries where institutional quality is generally perceived to be poor. However, in policy discussions what is often ignored is that 'private property' and 'contract enforcement' require other basic institutions (or meta-institutions) to be effective. Basic political freedoms and participatory democracy are examples of meta-institutions that are essential for other growth-enhancing institutions (Rodrik & Subramanian; 2003, Rodrik; 2000). Although property rights and enforcement also exist in autocratic regimes, especially in autocracies that expect to remain in power for a long period of time (Clague et al.; 1997), existence of basic political freedoms, or at least, absence of repressive institutions are essential (Acemoglu et al.; 2005).

In the context of post-2021 Afghanistan repressive institutions of the Taliban administration, which have resulted in violations of basic civil, political, and human rights, reduce predictability of other institutions that directly matter to economic growth, such as property rights, contract enforcement, etc.. As long as the Taliban's repressive practices exist and as long as basic rights are violated, the mere existence of the institutions of property rights and contract enforcement will not necessarily lead to rebounding of business confidence or increased investment in the country.

C. Do Not Take Formalization Effect as Actual Improvements

In countries where the smuggling of goods and a dual taxation system exists (or existed), increases in formal trade and tax revenues do not necessarily represent increased production (in the case of growing exports), increased domestic demand (in the case of imports), or increased economic activity or lower corruption (in the case of increased tax revenues). As explained in the introductory paragraphs, the Taliban not only engaged in smuggling, but also upheld a parallel tax collection system prior to 2021 (Clark; 2022, Azami; 2021, Thomas; 2021, UNSC; 2021, SIGAR; 2020, Latif; 2019, Lakhani & Corboz; 2017, EASO; 2016).

Therefore, one should not interpret the increases in revenues and exports reported by the Taliban administration for 2022 as reflections of improved economic activity. Indeed, such increases were not entirely unexpected. In 2020, experts at the 'Policy Dialogue on Peace and Economics' conference in Kabul had predicted that if political reconciliation took place, domestic revenues were likely to increase due to the Taliban's collections of huge amount of tax revenues (such as electricity bills) (Biruni Institut, 2020). Furthermore, Joya (2020) compiled a social accounting matrix for Afghanistan using the 2018 data, finding that as much as US$ 2.8 billion were missing from the formal trade and customs systems. In other words, the total value of smuggling in trade was as much as US$ 2.8 billion in 2018 (excluding illicit trade or drug smuggling). Hence, it is plausible that the current growth in exports and customs revenues, observed in 2022, is the result of formalisation of previously smuggled trade, rather than actual increases or improvements.

D. Can We Trust a Dictator's Statistics?

A recent paper published in the Journal of Political Economy studied the manipulation of GDP statistics in autocracies and dictatorships (Martinez;2022). By comparing self-reported GDP figures to satellite night-time-light recordings, the study found that night-time-light elasticity of GDP is larger in authoritarian regimes. The results suggested that autocracies overstate the yearly GDP growth by approximately thirty-five percent.

The international community should appreciate the political incentives that exist for the Taliban to intentionally manipulate the economic numbers. These must not be ruled out, because all fiscal and trade statistics in Afghanistan are collected through systems directly controlled by the Taliban, and the international community does not have real-time access to verify or validate this data.

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PeaceRep: The Peace and Conflict Resolution Evidence Platform is a research consortium based at Edinburgh Law School. Our research is rethinking peace and transition processes in the light of changing conflict dynamics, changing demands of inclusion, and changes in patterns of global intervention in conflict and peace/mediation/transition management processes.

Consortium members include: Conciliation Resources, Centre for Trust, Peace and Social Relations (CTPSR) at Coventry University, Dialectiq, Edinburgh Law School, International IDEA, LSE Conflict and Civicness Research Group, LSE Middle East Centre, Queens University Belfast, University of St Andrews, University of Stirling, and the World Peace Foundation at Tufts University.

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