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# Afghanistan: The Economy Under Marxism

An Intelligence Assessment

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# Afghanistan: The Economy Under Marxism (U)

An Intelligence Assessment

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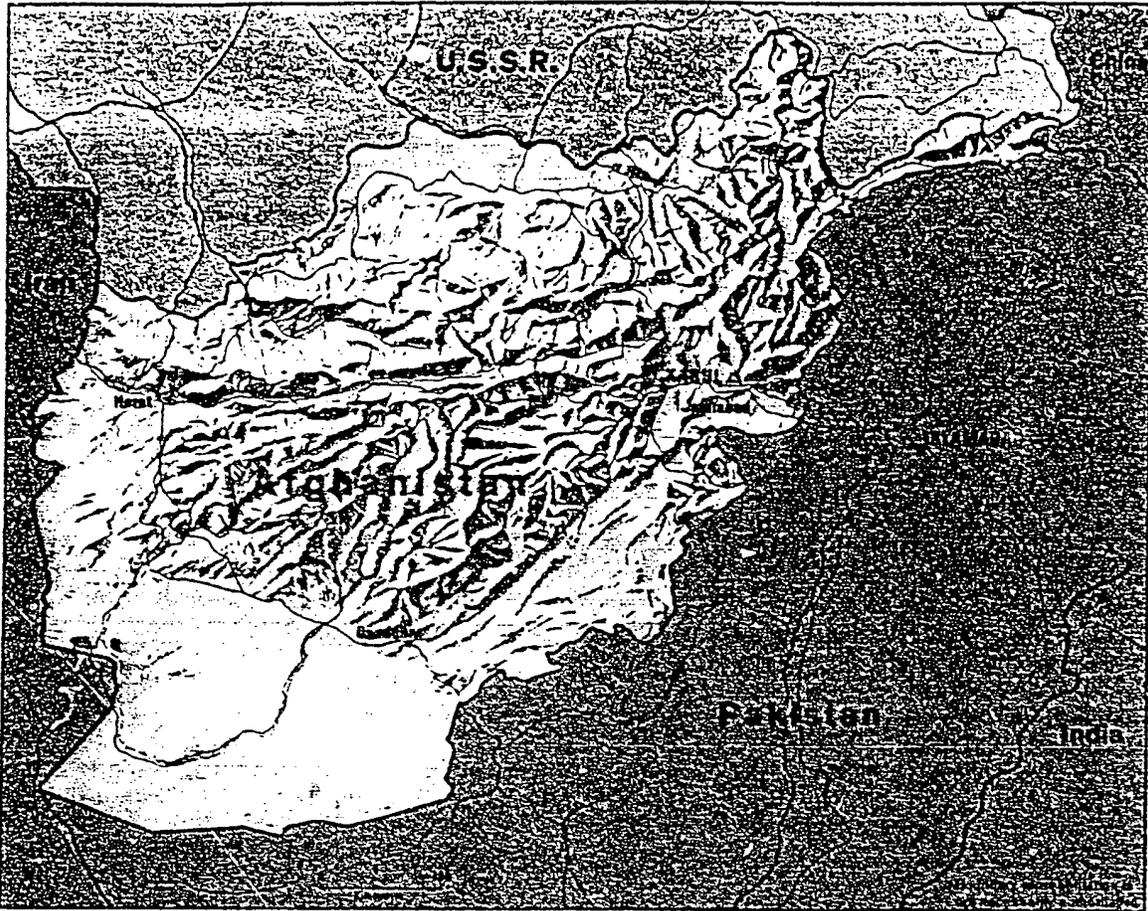
### Summary

Even before the December 1979 Soviet invasion, Afghanistan's economy was faltering and its minimal economic gains had ground to a halt. Land and credit reforms initiated by the pro-Soviet Marxist government that took power in April 1978 caused major disruptions in economic activity and helped spark the insurgency that has now spread throughout the country.

Kabul's land reform program, coupled with unfavorable weather in 1979, resulted in a drop of 400,000-500,000 metric tons in wheat production. Government attempts to tighten control over commerce produced frequent shortages of essential goods and led to capital flight by bazaar merchants, who are a major factor in overall trade and economic activity.

Since the Soviet invasion, economic activity has slumped further. The insurgents are hampering food and fuel deliveries to Kabul. In the capital, the Soviet-backed Babrak government has imposed price controls on items such as meat and tea and established special distribution centers for essential commodities.

Longstanding Afghan-Soviet trade and economic aid ties are likely to be strengthened in the wake of the Soviet invasion. Soviet economic support is critical for Kabul now that Western aid donors have suspended their small but important programs and multilateral financial institutions have halted disbursements pending a reviewing of their operations. Even with Soviet help, the durability of the Babrak regime is in doubt because it has failed to rally popular support and it is viewed by nearly all Afghans as atheistic and anti-Islam.



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### The Current Picture

The Babrak regime shows few signs of actually functioning as the government. The operation of key ministries and government departments is in the hands of Soviet advisers.

Economic activity in the small modern sector of Afghanistan's economy has slowed sharply since the Soviet invasion. In major cities such as Herat, Jalalabad, and Qandahar, unrest is widespread and anti-Soviet demonstrations have occurred. Travelers to Herat and Jalalabad report that those cities are tense; business activity in Herat in early February was almost at a standstill following several days of antigovernment demonstrations. In Kabul, civil servants' resentment against the Soviet invasion is taking the form of work slowdowns in ministries and government offices.

Insurgents, in addition to harassing troop convoys, are interfering with the flow of food and fuel from the countryside to the cities, and Kabul is experiencing the effects of these supply disruptions. Since mid-January meat and wheat have been scarce in the city's bazaars and prices are increasing rapidly. The capital is also suffering shortages of firewood, charcoal, and kerosene—crucial household heating and cooking fuels. The new government recently acknowledged that the shortages are serious and placed price controls on essential commodities including meat, tea, and vegetable oil. The government also ordered special distribution centers established in Kabul, at which essential commodities will be sold at subsidized prices. Soviet troops in and around Kabul may be contributing to the pressure on food supplies by buying food at local markets to supplement their rations.

International disapproval of the Soviet invasion is taking concrete form through a halting of economic aid:

- West Germany, which had been financing communications, electric power, and irrigation projects, has suspended aid disbursements indefinitely and recalled its aid technicians.
- Japan has blocked \$2 million of project assistance committed last year.
- The European Community has cut off food assistance that would have totaled 3,300 metric tons<sup>1</sup> of cereals and milk powder in the Afghan fiscal year ending 20 March 1980.
- Kuwait's financing of a sugar mill under construction near Kabul has halted.
- India has told US Embassy officials that over the next few months it will phase out the few remaining technicians working on aid projects by attrition and early termination of tours of duty. (At one point in 1979 nearly 100 Indian aid experts were working in Afghanistan.)

The World Bank has notified Kabul that it is halting \$115 million in loan disbursements until a review of bank-financed projects is completed. The Asian Development Bank has also stopped loan disbursements pending a review of operations. Work on most Western-sponsored aid projects had already slowed or stopped altogether when the December coup that toppled Amin occurred. Aid donors and multilateral institutions had gradually withdrawn their people because of the deterioration of the security situation in the countryside late last year.

<sup>1</sup> Tonnages are given in metric tons throughout this assessment. (U)

### Babrak's Inheritance

Even if the Babrak government were now in a position to address Afghanistan's underlying economic problems, it would face a herculean task. Afghanistan is one of the poorest developing countries in the world. Despite steps toward modernization of the economy since the mid-1950s, Afghanistan's economy remains primitive. Roughly 90 percent of the country's 15 million people are illiterate, and per capita income is about \$200 annually—approximately on a par with Burma, Zaire, and Pakistan. (U)

After more than two decades of economic development efforts, Afghanistan exists as two distinct societies. The traditional society consists of 90 percent of the population that resides in rural areas, which is dominated by local tribal and Islamic religious leaders. The modern sector of the economy embraces the 10 percent of the population that lives in urban areas. This sector is dominated by Kabul, Afghanistan's largest urban center with a population of about 700,000 people. Kabul's disparity with the rest of the country is striking: it has 80 percent of the nation's automobiles, 80 percent of its doctors, and 60 percent of national electricity generating capacity. (U)

Economic progress since the mid-1950s has been slow and uneven, partly because, until the 1978 Marxist coup, successive governments moved cautiously in implementing economic change to avoid upsetting traditional customs and patterns of livelihood. As a result, 80 to 90 percent of the people remain dependent on agriculture for their living, much of it subsistence farming. The industrial sector is small and poorly developed and consists largely of firms processing agricultural raw materials and manufacturing light consumer goods. Heavy industry is limited to a handful of government-owned firms producing cement, fertilizer, and simple engineering products. The transportation system still consists solely of a road network that is barely adequate for the modest requirements of the economy; there is no railroad.

Like most developing countries, Afghanistan has been unable to mobilize domestic financial resources for investment. At less than 7 percent, the tax/GNP ratio is nearly the lowest in the world, while the share of

Afghanistan's tax revenues that comes from foreign trade—more than two-thirds—is inordinately large. The banking system is also poorly developed, with commercial banking primarily confined to Kabul. Although bank branches exist in the provinces, they frequently serve as little more than a safe place for holding funds. (U)

Existing alongside the rudimentary banking system are the bazaar money traders, which are concentrated in Kabul. The traders may account for as much as two-thirds of annual turnover in foreign exchange. They also make consumer loans and advance working capital and housing and construction loans. Some experts from international financial institutions who have examined the Afghan economy believe the bazaar money market may be more important as a source of financing than formal institutions. Because Afghanistan has been unable to finance its own development needs, it has had to rely on foreign assistance. The USSR has been by far the leading single contributor, providing slightly more than one-half of total foreign aid since the mid-1950s.

### Developments in 1978-79

Economic gains since the pro-Soviet Marxist coup in April 1978 have been few, if any. The economic difficulties and the insurgency that the Babrak government now faces have their origins in tribal and peasant reaction to economic and social reforms pressed under the Taraki and Amin regimes. A credit reform law (Decree Number 6) announced in July 1978 and a land redistribution program (Decree Number 8) initiated in January 1979 have been the particular focus of discontent and open opposition (U)

Decree Number 6 provided for the cancellation or only partial repayment of debts. Debts owed by sharecroppers and farm laborers were canceled in their entirety, while debts owed by small farmers (defined by Kabul as owning less than two hectares of land) were repayable according to a sliding scale. Debt incurred before 1975 was canceled in its entirety, debt incurred in 1976 was reduced by 20 percent, by 40 percent if incurred in 1977, and so on. (U)

**Agriculture.** As a complement to the debt law, Kabul promulgated a land redistribution program that provided for transferring land free of cost to landless farmers according to the quality of land. Farmers could receive one hectare of top quality land, such as acreage that is irrigated, and as much as five hectares of arid land. The program also limited farm size to six hectares for large landholders and called for the formation of 1,500 agricultural cooperatives by the end of 1979.<sup>2</sup> Farm extension services were expanded to include 100 teams operating on a village-to-village basis to aid in implementing land reform. Kabul also outlined its aim of redistributing water rights on irrigated land, which accounts for two-thirds of cropped land. (U)

By mid-1979 Kabul reported that 500,000 to 600,000 hectares out of 730,000 hectares appropriated by the government for redistribution had been turned over to 296,000 landless peasant families. More than 50,000 hectares were also set aside for the formation of state farms. Kabul announced the completion of land reform in mid-1979 after Moscow advised the Taraki government to end the program in order to calm opposition from farmers.

Kabul's program wrought havoc in the agricultural sector, especially among farmers growing wheat, the leading food staple. At the beginning of the 1978/79 crop year (November 1978-October 1979) recipients of land who had traditionally relied on credit from large landholders and money lenders found it difficult to get loans. As a result, farmers were unable to purchase essential supplies such as fertilizer, seed, and equipment. Large landholders, anticipating the loss of most of their land, planted only the acreage they expected to keep, further reducing the 2.3 million hectares usually planted in wheat. The government's newly established agricultural credit fund was of little help. Funding was sufficient to meet only a small part of the total requirement for agricultural credit.

To make matters worse, Afghanistan experienced unfavorable winter weather that hurt the 1979 wheat crop. An unusually mild winter cut water availability

<sup>2</sup> Approximately 250 agricultural cooperatives were already in existence when the April 1978 coup occurred.

from melted snow for irrigation. The combination of the weather and the reduction in planted acreage lowered wheat production by 20 percent from the 2.3 million tons it has averaged in recent years. Import requirements jumped to 600,000 tons in 1979 compared with an annual average of 200,000-300,000 tons in the late 1970s.

Kabul arranged for imports from both the USSR and Western suppliers to cover the bulk of the shortfall. The USSR agreed to supply 265,000 tons; Australia 100,000 tons; and India and Turkey 50,000 tons each. Data on actual deliveries of wheat imports in 1979 are only partially available. Through the end of September 1979, Afghanistan had taken delivery of approximately 300,000 tons of wheat, including 46,000 tons from the United States under the Food for Peace program.

Wheat imports, other than those from the USSR, move through the port of Karachi, Pakistan, and then by rail to the Pakistani-Afghan border. Congestion and slow unloading of cargoes have been longstanding problems at Karachi, and cargo delivered for transshipment to Afghanistan is usually given low priority by Pakistani authorities. Despite strained relations between the two countries, Kabul received assurances from Islamabad last year that Pakistan would move Afghan-destined wheat through the port as expeditiously as possible. However,

one familiar with conditions at Karachi, reported that wheat offloading operations were moving slowly. Wheat was piling up at dockside under poor storage conditions; in some instances the wheat was completely exposed to the elements and showed signs of rotting.

Afghanistan could face another large wheat shortfall this year. Acreage planted in late 1979 may have fallen 15 to 25 percent below normal levels as farmers left their villages to join the insurgents or fled Afghanistan with their families as the tempo of fighting increased.<sup>3</sup>

<sup>3</sup> The refugee exodus has accelerated since the Soviet invasion. Pakistan estimates that the number of refugees at the end of January 1980 was approximately 500,000. An unknown but smaller number of Afghan refugees are in Iran.

estimate there are 80,000 refugees in the Iranian Province of Khorasan. All told, approximately 3-4 percent of Afghanistan's population may have fled as refugees since the April 1978 coup.

Even if good growing conditions prevail through mid-1980, when harvesting of the winter wheat crop is completed, the production decline could range between 600,000 and 800,000 tons. Should this volume of wheat imports become necessary, however, Kabul is in a good position to pay for foreign purchases. Foreign exchange reserves were a near-record \$420 million when the Babrak government took power. At current prices for wheat in international markets, imports would cost Kabul \$120 million to \$150 million in foreign exchange outlays for shipments delivered to Karachi.

**Trade Nationalization.** Government actions to bring trade and commercial activities under tighter controls led to further disruptions in the economy during 1978-79. Soon after the April coup, Kabul required that all imports by the private sector be handled through the government. Until then only imports of essential goods such as sugar, petroleum products, and trucks, were monopolized by the government, and businessmen were free to deal directly with foreign firms for all of their other needs. Kabul also moved to limit profit margins for wholesalers and retail merchants. After deductions of certain expenses, wholesalers were allowed a net profit of 8 percent and retailers, 5 percent. (U)

Kabul's actions led to a sharp drop in government revenues from import duties as businessmen cut back purchases through organized channels and brought in their goods through unregulated bazaar traders. In the three-month period July-September 1978, customs receipts fell by nearly 90 percent to about \$3 million, while shortages of essential commodities, such as rice and vegetable oil, developed in various parts of the country. Kabul's efforts to crack down on the bazaar traders proved fruitless. From the very first, the Marxist government considered the bazaar as a logical initial target in asserting its control over the economy. Kabul could not for long tolerate an unregulated, freewheeling commercial sector in the midst of its attempts to socialize the economy. Nonetheless, last year the government abandoned a six-month effort to tighten control over bazaar activities after persistent rumors that bazaar merchants were sending large amounts of money out of the country.

Several businesses still in private hands when the April 1978 coup occurred were singled out for nationalization including hotels, handicraft enterprises, and small food-processing firms. Although the country's largest hotel, the Intercontinental in Kabul, was nationalized immediately after the coup, Kabul still had not moved against other hotels and these business activities when Amin was overthrown. The Babrak government has announced that it is backing away from further nationalization, for the moment. In an effort to revive the flagging economy and deal with current shortages, Kabul intends to return import privileges of certain goods to the private sector, including auto tires, rayon yarn, and dried milk.

#### **Soviet Economic Ties**

Despite two successive pro-Soviet governments in Kabul, bilateral economic relations with the USSR have not increased substantially. The level of Soviet economic aid disbursements to Afghanistan in 1978-79 failed to rise much above the 1975-77 levels, which averaged \$50 million annually in project aid disbursements and \$10 million annually in commodity aid. A flurry of bilateral economic aid and technical assistance agreements signed after Taraki took power in April 1978 largely represented implementing agreements negotiated by the ousted Daoud government.

Economic aid was a contentious issue between the Taraki-Amin regimes and Moscow. For its part, Kabul had unrealistic expectations about the level of aid it could expect from the Soviets. Kabul's proposed economic development program for 1979-83 reportedly carried a price tag of more than \$4 billion, with the Soviets expected to provide the lion's share of the goods and services. The Soviets, as well as several prospective Western aid donors, described the plan as more of a wish list than a coherent plan for economic development. The Soviets repeatedly rebuffed Kabul's request for increased assistance, citing Afghanistan's inability to absorb more aid because of insufficient managerial and technical talent and poor infrastructure development, especially internal transportation links. Moscow also reminded Kabul that it had

\$300 million in outstanding credits that were still unallocated. Nonetheless Kabul attempted to loosen Soviet purse strings by requesting membership in the Council of Mutual Economic Assistance (CEMA) in 1978; this was also turned down. Moscow, however, boosted the number of Soviet economic technicians working in Afghanistan by nearly 1,000 in 1978-79 to 2,000 people.

The major development in Afghan-Soviet relations during 1978-79 was Moscow's agreement to pay a higher price for natural gas imported from Afghanistan. With exports of 35,000-40,000 b/d oil equivalent gas (via pipeline) is Afghanistan's major export to the Soviet Union. Gas sales in recent years have accounted for 20 percent, on the average, of total Afghan exports and 40 percent of exports to the Soviet Union. The Soviets agreed to a \$0.14 increase to \$0.59 per thousand cubic feet soon after the April 1978 coup, and agreed early last year to pay \$1.08. Afghan trade data for January-September 1979, however, suggest that the \$1.08 per thousand cubic feet price was not in effect. Even at this price, gas prices would still have been well below the average price of Soviet gas delivered to Western Europe in 1979.

Gas exports will play an even larger role in bilateral trade in the next few years given the onset of production in February 1980 from a new field at Jarquduq in northern Afghanistan, about 80 kilometers from the Soviet border. Production from this field, which was discovered in the early 1970s and developed with Soviet technical assistance, is expected to reach 35,000 b/d oil equivalent upon completion of a new pipeline and gas processing facility, and the drilling of additional wells. Gas from Jarquduq and an older nearby field, provides a small supplement to fuel supplies in the Tadjik Republic, USSR.

Afghanistan's economic relations with the Soviet Union are entering a new stage in the aftermath of the Soviet invasion, which will result in much closer ties. For Kabul and Moscow the closer ties will pose a dilemma: Should Western aid donors fail to resume their programs, or resume them at reduced levels; Afghanistan will expect the Soviets to fill the gap. If

this occurs, both Kabul and Moscow would be hard pressed to project an international image of Afghanistan as anything more than a Soviet client state firmly wedged in the Soviet bloc.

#### The Continuing Political Drama

At present, the staying power of the Babrak government is in doubt. The Soviets apparently are disappointed with Babrak's inability to rally broader popular support. Rumors were rife in Kabul at the end of January that Babrak would probably soon be replaced. At the head of the list of possible candidates are Deputy Prime Minister Sarwari, who was head of the security services under Taraki, and Major General Qader, a former Defense Minister imprisoned in mid-1978 and now a member of the Revolutionary Council. Qader reportedly left for Moscow in mid-January on an unpublicized four-day visit. Also mentioned is Commerce Minister Jalafar, a non-Marxist who served in the Cabinet of former President Daoud.

The Babrak regime has moved unsuccessfully on several fronts to garner domestic support and to counter the pervasive perception that it is a Soviet puppet government. In particular, it is acting to project an image of respect for Islam. In a widely publicized move, Kabul has announced that it will replace the country's red flag introduced by Taraki with a new flag that will include the color of Islam, green. However, Babrak's claim that his is the first government in 50 years to allow religious freedom is unlikely to impress a population that equates Marxism and the USSR with atheism and views many of the reforms the government advocates as antireligious.

The new government appears intent on pressing the economic and social reforms initiated under Taraki and Amin. Kabul shows no inclination to back away from land reform despite the resentment and chaos the program has caused. Agriculture Minister Mohmand recently stated that the government will enlarge the public sector's role in agriculture. He indicated that existing agricultural programs would continue, with concentration on promoting the growth of cooperatives and, ultimately, state farms.