



Directorate of
Intelligence

~~SECRET~~
NOFORN NOCONTRACT

[REDACTED] [REDACTED]

Afghanistan's Economy: Growing Dependence on the Soviet Union

An Intelligence Assessment

~~SECRET~~

January 1983
OW 343

BEST COPY
AVAILABLE

16



Directorate of
Intelligence

~~Secret~~
NOFORN-NOCONTRACT

Afghanistan's Economy: Growing Dependence on the Soviet Union

An Intelligence Assessment



~~Secret~~
January 1983

BEST COPY
AVAILABLE

Afghanistan's Economy: Growing Dependence on the Soviet Union

Key Judgments

Information available
as of 15 November 1984
was used in this report.

The Soviets have become increasingly involved in supporting the Afghan economy, which has been disrupted by continuing hostilities and the dislocation or exodus of up to half the population. The financial costs are relatively small, however, and are almost certainly an insignificant factor in determining Moscow's stay in Afghanistan. At the same time, the economic dependence of the Afghan regime on Moscow helps keep it under Moscow's thumb.

The Soviet involvement touches every sector of the Afghan economy:

- Most of the cities depend on the Soviets for at least some of their food supplies.
- With a decline in Western aid and trade, the Soviets now account for almost all of Kabul's foreign assistance and about 70 percent of the country's imports. Since the invasion, the Soviets have provided the equivalent of about \$1.3 billion in economic assistance, mostly in the form of grants for commodity imports.
- Afghanistan's export of natural gas—the country's major resource—to the Soviet Union provides 45 percent of government revenues.
- Natural gas production and exploration, the search for minerals, and the remaining economic development projects are completely in the hands of the Soviets.

Although overall food output is probably near the levels reached in the 1970s, some rural areas are facing serious food shortages because of insufficient moisture and military operations. We believe that in areas where domestic supplies are insufficient, particularly near the eastern and southern borders, shortages are largely alleviated by imports from Pakistan.

The military situation makes an improvement in the Afghan economy unlikely any time soon. The Afghan Government and the Soviets lack the military strength and the popular support needed to win effective control of rural Afghanistan. Without such control, the government will be unable to resume development or expand its earnings. Meanwhile, the Afghan population will become increasingly dissatisfied, and more Afghans are likely to join the insurgents.

Afghanistan's Economy: Growing Dependence on the Soviet Union

Afghanistan has few natural resources. Per capita income is among the lowest in the world. Most of the labor force is employed in agriculture, but less than 10 percent of the country is under cultivation because of mountainous terrain and lack of rainfall. Economic development received a boost with the discovery of large natural gas deposits in 1976.

Before the Invasion

Economic growth in Afghanistan

probably averaged only 2 to 4 percent annually from a very low base throughout most of the 1970s. Afghanistan relied heavily on external financial assistance in the form of loans and grants from Communist and non-Communist governments for agricultural and industrial development and commodity imports. By the late 1970s, Kabul also was receiving a significant inflow of remittances from workers in the Middle East.

Agricultural output was growing, albeit slowly, as a result of increased mechanization, better seeds, improved fertilizer distribution, and irrigation projects. The agricultural sector accounted for about two-thirds of the gross national product. Farming was—and is—primitive, with production in any year heavily dependent on the weather. Agriculture has always been almost exclusively in private hands, with most of the rural areas never totally controlled by Kabul.

Industry assumed some importance in the last two decades with the domestic utilization of natural gas and the introduction of manufacturing plants to process domestically grown agricultural products. The public sector controlled most of the industrial activity.

After the leftist takeover in 1978, the government attempted to make fundamental changes in the country's economic system including land reform, a

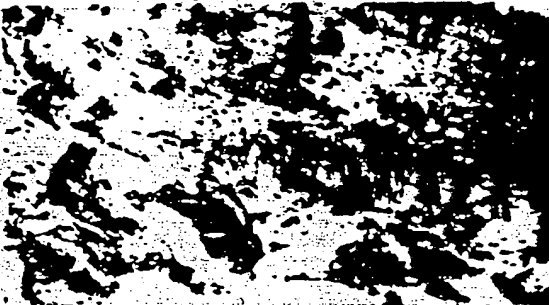
The Afghan Economy at a Glance

The compilation of national income statistics for Afghanistan involves a considerable degree of estimation because much of the information is unavailable or unreliable. The government's lack of access to much of the countryside and the fact that most of the food production is for on-farm consumption complicates the task. Using official government statistics, International Monetary Fund estimates, and other sources, we have compiled the following list of key economic statistics.

Population—midyear 1984	14 million
Natural gas production— FY 1984	2.8 billion cubic meters
Natural gas exports—FY 1984	2.4 billion cubic meters
Balance of payments—FY 1984	-\$170 million
Exports (f.o.b.)—FY 1984	\$680 million
Imports (c.i.f.)—FY 1984	\$940 million
Foreign exchange reserves— FY 1984	\$205 million
Foreign debt—FY 1984	\$2.4 billion
Exchange rate	
Official	Af 50 per US \$
Bazaar—July 1984	Af 115 per US \$

strengthened public-sector role in transportation and distribution, and closer ties to the USSR. The government alienated many of the landowners, religious leaders, and peasantry, and the economy has deteriorated.

BEST COPY
AVAILABLE



Refugees fleeing to Pakistan make camp en route

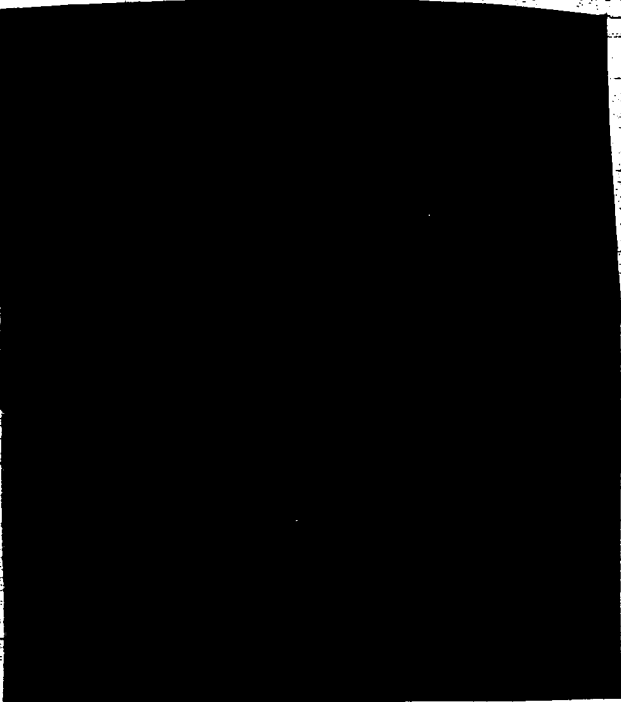
Agricultural Problems and Resiliency

Since the Soviet invasion, the agricultural sector has faced numerous disruptions.

Large numbers of landowners have fled the country, taking valuable machinery and livestock with them. The flight of about 3 million people to neighboring Pakistan and Iran and the displacement of 3-4 million people within Afghanistan have reduced cultivation as well as demand in many areas. Routine maintenance of vineyards, orchards, and irrigation networks is being neglected.

A survey conducted in 1983 concluded that most of the refugees had their homes because of the deterioration of the rural economy caused by the war. Production of wheat, the major food staple and agricultural crop, declined as much as 80 percent from the period before the fighting in some areas bordering Pakistan. Farmers in areas most affected by the war faced the possibility of starvation. (C 37)

Since the Soviet-Afghan Government, and insurgent military operations have resulted in burned crops, damaged grainfields, and destroyed irrigation systems. In some cases the Soviets have deliberately destroyed crops in retaliation for insurgent operations.



Production of industrial crops, even according to government statistics, has dropped dramatically. Harvests of cotton, the most important commercial crop, and sugar beets have declined by two-thirds since the mid-1970s.

Overall Food Situation

The availability of basic food items in FY 1984 and most of FY 1985 probably was near the levels of the 1970s.

BEST COPY AVAILABLE



[redacted] Afghanistan was generally considered self-sufficient in wheat in 1976 when wheat production reached 2.9 million tons and the population was roughly 14.5 million. Nonetheless, shortages still occur—especially in the rural areas—because of crop failures in isolated areas, distribution problems, private stockpiling and hoarding, and the destruction of some food in storage [redacted]

as that of the 1970s. [redacted]

Domestic Food Production

We believe that annual domestic food production since the Soviet invasion has been in the same range

BEST COPY AVAILABLE

Agriculture in Afghanistan

Agriculture is the most important sector of the economy. In the mid-to-late 1970s, agriculture provided about 60 percent of national income and employed 80 percent of the population. Agricultural output grew by 3 percent annually in the mid-1970s, and the country was roughly self-sufficient in food-grain production in 1977.

Afghanistan's cultivated land is scattered throughout the country, mostly in valleys along rivers and other sources of water because rainfall is uncertain and inconsistent. Only 8 million of Afghanistan's nearly 65 million hectares are arable, and, throughout the mid-to-late 1970s, Afghan farmers cultivated on average only about half of the arable land. Total irrigable area is about 3.3 million hectares, of which about 2.6 million were irrigated annually with the balance remaining fallow. About 1.4 million hectares of irrigated land have adequate water throughout the year to make double cropping possible.

The production of foodgrains utilizes 90 percent of land under cultivation. The remaining 10 percent has been devoted primarily to fruits, vegetables, cotton, oilseeds, and fodder crops:

- Wheat, the primary grain crop and main food staple, is grown on about 60 percent of the cultivated area—2.4 million hectares. It is grown through-

out the country and on half of the irrigated land. In 1976 wheat production reached a record 2.9 million metric tons, and no imports were required.

- Corn is the second most important cereal and is used for human consumption and animal fodder. It is planted on about 500,000 hectares, and average production has been about 800,000 tons. Corn is grown primarily in the eastern valleys bordering Pakistan and in the Helmand Valley.

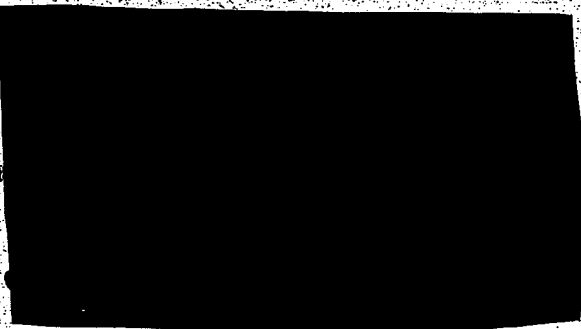
- Rice is grown principally in the north around Baghlan and Konduz; other ricegrowing areas are Herat, Nangarhar, and Helmand. Rice is planted on about 200,000 hectares, and peak production reached about 450,000 tons in 1976.

- Barley is grown on about 300,000 hectares primarily in rainfed highland areas with short growing seasons. It is used for human consumption and animal feed. Peak output was about 400,000 tons in 1976.

- Truck gardens, cultivated orchards, and vineyards, while utilizing less than 10 percent of the arable land, yield an important harvest of vegetables, fruits, and nuts. Peak production was about 1.6 million tons in 1976.

Imports Fill Food Gap

Between 300,000 and 360,000 tons of wheat were brought into Afghanistan—about half from the USSR and half from Pakistan—in FY 1964.





Wheat market

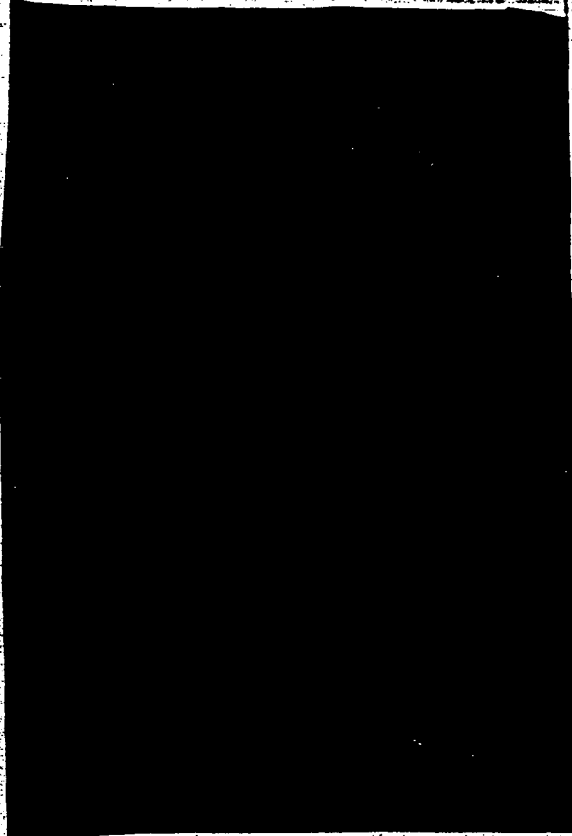
Rural Afghanistan, most of which is controlled by insurgent groups or subject to only limited government control, appears to be almost self-sufficient in food production. [REDACTED] most of the insurgents obtain their food from the local population [REDACTED]

We believe that in most of those rural areas where domestic supplies are insufficient, particularly near the border with Pakistan, shortages are alleviated by imports. [REDACTED]

Food Prices Continue To Rise

Food prices throughout Afghanistan have climbed rapidly in the past five years—averaging more than 25 percent annually—but no faster than nonfood items, according to spot price surveys and official government statistics. [REDACTED]

[REDACTED] a wide range in prices from province to province depending on the degree of self-sufficiency in the area and whether the survey was taken before or after the harvest. Kabul food price increases generally have been much more modest than in the rural areas, primarily because the sizable Soviet food deliveries to [REDACTED]

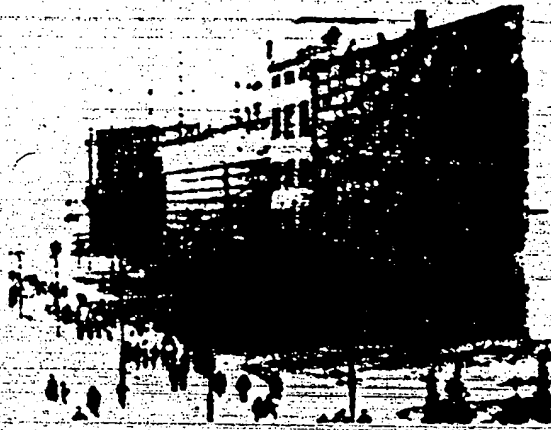


[REDACTED] the capital ensure a degree of normality in daily life. Food prices are fixed and heavily subsidized by the government. [REDACTED]

[REDACTED] that increases in the money supply and rising transportation costs have had a greater effect on food prices than have actual shortages. The local money supply officially has been growing at about 20 percent annually. In addition, [REDACTED] large sums of local currency are being supplied by the Soviets to help finance operations in the countryside. [REDACTED]



Soviet convoy en route to Kabul



Nitrogenous fertilizer plant in Mazar-e Sharif

Energy—Dependence on the USSR

The Soviet Union meets much of Afghanistan's energy needs. Even before the Soviet invasion, Kabul was dependent on imports of petroleum products trucked overland from the Soviet Union. Subsequently, the Soviets have laid two small parallel oil pipelines from the Soviet border to the Bagram Airfield near Kabul. The pipelines are designed primarily to supply Soviet military forces; but, because convoys coming from the Soviet Union to Kabul are often ambushed or delayed, we believe that some supplies probably have been used for civilian purposes.

Despite Soviet supplies,

Kabul has suffered periodic shortages of virtually all petroleum products since 1980. most of these shortages have resulted from Soviet refusal to ship fuel until overdue accounts are paid and from delays caused by insurgent attacks on convoys and the pipelines from the Soviet Union.

War-related disruptions of electricity are also making Afghanistan increasingly dependent on the Soviets for deliveries of fuel for electric power generation.

brownouts and supply interruptions in Kabul are frequent because of insurgent sabotage of transmission lines carrying hydroelectric power to Kabul as well as a lack of rainfall and snowmelt to power the hydroelectric generators.

electricity shortages in Kabul in 1984 have been among the worst since the

Soviet invasion. Other cities such as Herat and Qandahar also are facing serious interruptions of electricity because insurgents have cut transmission lines and fuel supplies used for government and private generators.

Improving the electric power supply will entail greater Soviet involvement. Early this year, the Soviets linked Afghanistan's new river port on the Amu Darya, Jeyretan, to the Soviet electricity grid with a high-voltage line from the Uzbek S.S.R. The line is scheduled to be extended to Mazar-e Sharif, industrial city in northern Afghanistan. According to official statements, the Soviets also are planning an electric powerline from the Soviet Union through Kholm and Pol-e Kholm to Kabul intended for industrial enterprises. Other cross-border lines are being built in Tovarshovki, in Badkhis Province, and to Konduz.

Afghan Gas Still Profitable

The Soviets dominate production and distribution of Afghanistan's natural gas, the country's most important natural resource and major export. Since 1957 the Soviets have provided credits, equipment, and technical assistance for development, and the Soviets

import nearly 90 percent of Afghan gas production. This gas, while not vital to the Soviets, is a useful supplement to fuel supplies in areas bordering Afghanistan as well as a feedstock for a nearby petrochemical plant. The Afghans use the remainder of their natural gas output in a nitrogenous fertilizer plant and a gas-fired electric power station in Mazar-e Sharif, a textile factory in Balkh, and the city of Sheberghan.

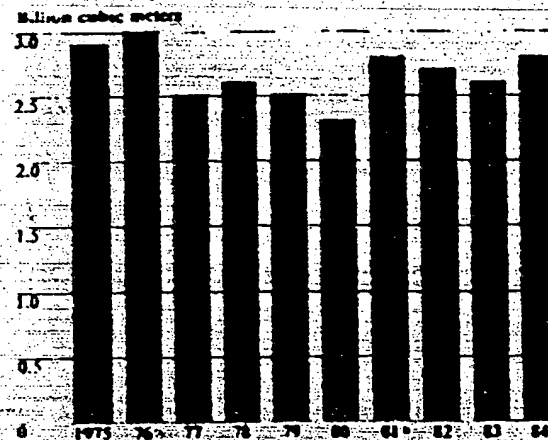
The Afghans have told [redacted] that gas production probably will not show any significant change in the next few years from the current level of 2.8 billion cubic meters annually. They reported that three new gasfields should come onstream toward the end of the 1980s, but [redacted] that at best the new fields will only forestall a gradual decline in output. Special efforts already are needed to maintain production because the reservoir pressure is falling in existing fields.

[redacted] there is little likelihood that significant new discoveries will be found. Occasional insurgent harassment of Soviet exploration teams and interruption of supplies have made the search for, and development of, new gas deposits difficult.

Gas exports to the Soviet Union last year were officially reported at 2.4 billion cubic meters compared with the 2.9 billion cubic meters delivered in 1975.¹ According to a Kabul press report, the FY 1985 contract for exports to the USSR calls for an increase in volume. To ensure exports the pipeline from Sheberghan to the Soviet border is guarded by KHAD (Afghan intelligence), Afghan Ministry of Interior Forces, and the Soviets rather than the less trustworthy Afghan Army.

The Soviets valued FY 1984 gas imports at \$300 million. Moscow has tripled the price it pays Kabul for gas since the invasion, and Afghanistan now

Figure 3
Afghanistan: Natural Gas Production,
1975-84^a



^a Fiscal year ends 20 March.

^b New field on stream, but output significantly less than original target of 1 billion cubic meters.

receives about \$125 per thousand cubic meters—a reasonable price for its major export. Gas exports now account for about 45 percent of governmental revenue compared to less than 25 percent before the invasion.

Other Industry and Mineral Sectors Remain Depressed

The performance of the other industrial sectors has been weak in recent years, with production declines particularly pronounced in the textile, sugar, and vegetable oil industries. The decline is caused by damage to production facilities, shortages of agricultural raw materials, internal transportation difficulties, power outages, shortages of skilled labor, and the loss of Western markets.

BEST COPY
AVAILABLE

Secret

Exploration, primarily by the Germans, French, and Russians, has demonstrated that Afghanistan possesses valuable mineral deposits. Just before the Soviet invasion, Moscow was negotiating with Kabul to build a \$600 million copper smelter at Amiah and develop the iron ore deposits at Hajji Gak.

Nothing to indicate that the Soviets are progressing on the projects or upgrading the transportation network necessary to remove these mineral resources for further processing or export. The iron ore deposits in particular are located at a high altitude in extremely difficult terrain.

The Soviets are continuing mineral exploration in areas that are relatively secure. The Soviets are taking ore samples to determine the quality of the deposits. The Soviets have some facilities for testing in Afghanistan. The Soviets will be in a position to identify and develop potentially rich mineral deposits if the security situation improves.

Foreign Balances Go Red

Afghanistan's foreign payments position went into the red in FY 1982, and the deficit probably reached about \$170 million in FY 1984 as a result of stagnating exports, high imports, a decline in worker remittances through official channels, and a cutback in foreign assistance from Western donors and multilateral aid institutions. Official foreign reserves have fallen to just over \$200 million, less than half that in 1979 and equivalent to less than three months of imports. Throughout most of the 1970s and even into the early 1980s, Afghanistan had a balance-of-payments surplus primarily because of sizable worker remittances, an expanding tourist industry, foreign aid, and rising exports of natural gas to the Soviet Union.

External debt has grown rapidly. The official debt was \$2.4 billion last March, an amount more than three times the current annual value of goods and services reported by the government and twice the preinvasion debt level. Over 80 percent of the debt is owed to Communist countries, primarily the USSR, with long maturities and at relatively low interest rates. The Soviets have repeatedly allowed the Afghans to delay payments of interest and principal.

Table 1
Afghanistan: Balance-of-Payments
Summary *

	1975	1980	1981	1982	1983	1984
Current account balance	-3	-181	-112	-294	-157	-186
Trade balance	-28	-229	-193	-350	-251	-260
Exports (f.o.b.)	218	494	705	691	708	681
Imports (c.i.f.)	-246	-723	-898	-1,041	-939	-941
Net services	25	48	81	56	94	74
Nonmonetary capital	19	259	300	164	147	111
Errors and omissions	10	-18	7	97	-60	-93
Overall balance	56	60	195	-33	-70	-166

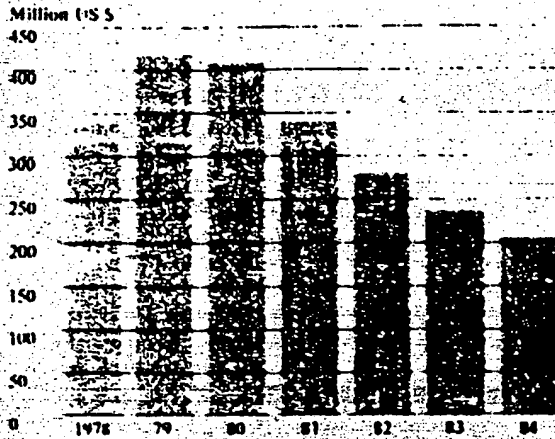
* Fiscal year ends 30 March.

Western Aid Dries Up

Individual Western countries and most multilateral institutions have cut off economic assistance to Afghanistan. The Afghan Government also has been denied access to an additional \$1 billion in development funds promised by the oil-producing states. Total aid from Western countries and the Organization of Petroleum Exporting Countries was about \$100 million annually in the late 1970s. In December 1980 the World Bank had almost 20 projects under way or proposed involving credits totaling more than \$200 million. In October 1981, however, it canceled all but about \$30 million in credits and currently is not making disbursements. The UN Development Program is one of the few international agencies that has maintained funding in Afghanistan, but annual contributions have declined to a few million dollars.

BEST COPY AVAILABLE

Figure 4
Afghanistan: Foreign Exchange Reserves, 1978-84*



* Final year ends 29 March

Confidential
 NO 27

Soviet Financial Support Critical

Soviet economic aid has become critical. The decline in Afghan economic activity, the inability to collect taxes and buy food in most of the rural areas, the decline in Western assistance, and the exodus of many educated officials have made it difficult for the government to provide sufficient food, fuel, and other services for areas under its control. Only with Soviet economic assistance—at least \$1.3 billion since the invasion—and a tripling of the price the Soviets pay for gas has Kabul been able to meet its import requirements.

Until the invasion, Soviet sales of commercial goods and economic assistance were nearly balanced by Afghan exports of gas. Subsequently, the Soviets have provided about \$1 billion in grants, generally to cover deliveries of food and other basic commodities, and about \$100 million in hard currency to settle barter accounts so that the Afghans could procure consumer goods from third countries. The Soviets have also

Table 2 Million \$
Afghanistan: External Public Debt

	March 1978	March 1983
Total	1,008	2,411
USSR	682	1,811
United States	110	113
West Germany	79	100
Czechoslovakia	21	91
Saudi Arabia	15	23
Others	141	273

permitted Afghanistan to defer payments on the services of Soviet technicians, for which the USSR usually requires cash payments.

While security problems have delayed major development plans, the Soviets still provide \$50-100 million in project assistance annually. Much of this is for transportation projects that support Soviet troop movements and resupply. Moscow has also promised to continue oil and gas exploration, complete the Mazar-e Sharif thermal power plant, reconstruct the Towraghondi railway station on the Soviet border, and link Afghanistan to the USSR's rail grid. Other projects promised but probably farther down the road include Afghanistan's first railroad, linking Pol-e Khomri and Kabul with the Soviet border—possibly extending to Iran and Pakistan—and an expansion of the Kabul airport.

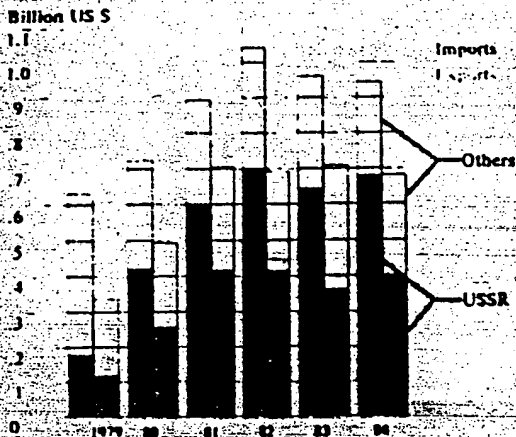
Changing Trade Patterns

The value, composition, and direction of Afghan trade have changed dramatically over the past five years. Recorded exports in FY 1984 were slightly less than

BEST COPY AVAILABLE

SECRET

Figure 5
Afghanistan: Changing Trade Patterns^a,
1979-83^b

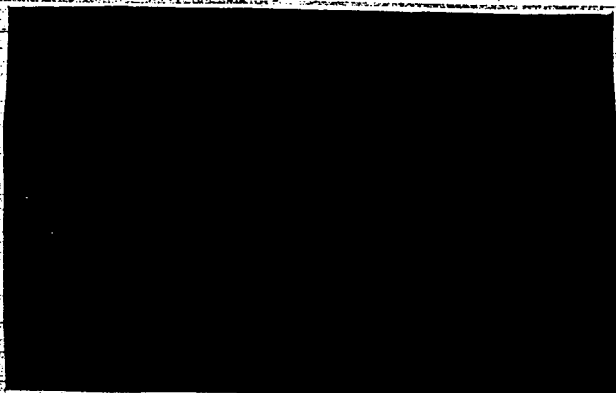


^a Trade is based on government statistics and does not include smuggling or trade in areas controlled by insurgents. The increase in exports between 1979 and 1983 is attributable in large part to a near tripling of prices paid for natural gas by the Soviet Union.

^b Fiscal year ends 30 March.

\$700 million compared to about \$340 million in FY 1979, with almost all of the increase resulting from increases in the price of gas paid by the Soviet Union. The volume of most commodities exported has remained relatively constant or has declined. Recorded imports approached \$950 million in FY 1984 compared to \$630 million in FY 1979. Commercial imports, primarily fuel, manufactured goods, machinery, and food, accounted for most of the increase, with price increases a significant factor. Commodity aid imports also increased, but project aid imports declined.

Trade with the Soviet Union has increased significantly. Moscow's share of recorded exports rose from 35 percent before the invasion to almost 60 percent in recent years. The Soviet Union was Afghanistan's major export market even before the invasion because



it is the only feasible recipient of natural gas exports. The Soviet share of Afghan imports has more than doubled since FY 1979 to about 70 percent in the past few years largely because of increases in food and capital goods imports.

Recorded trade with almost all non-Communist countries has declined. India and Pakistan continue to be important trading partners, purchasing about 25 to 30 percent of Afghan exports. Japan provides about 10 percent of Afghanistan's commercial imports. Trade with the United Kingdom and West Germany, while still important, is about half the value of the preinvasion exchange.

Transportation difficulties have played a major role in the loss of trade with Western markets. Traditionally, much of the trade with the West transited Pakistan or was airlifted. The roads to Pakistan are frequently blocked by the Soviets or the insurgents and are dangerous. Flights of the state-controlled airline to Western Europe were suspended in 1981 following a terrorist incident involving the airline. Transit facilities at the Soviet border, on the other hand, have been improved, and security is sometimes provided by Soviet convoys.

Another important factor affecting trade with the West has been the sharp decline in hard currency aid from Western governments. Afghanistan has recently

SECRET

BEST COPY AVAILABLE

BEST COPY AVAILABLE

asked Western commercial bankers to increase their lines of credit to finance imports.

Areas of Afghan-Soviet Contention

Afghan officials resent some Soviet trading practices.

gets from its involvement in Afghanistan. the Soviets are committed to defending the gasfields and pipelines because they recognize the importance of natural gas to Afghanistan's economic health and because of their interest in maintaining gas supplies from Afghanistan.

The Soviets are unlikely to reduce the amount of economic assistance they provide to the Afghan Government. They still must ensure that sufficient food and fuel are available to feed the population under its control and to meet economic and military transportation needs. economic assistance is a major issue in Soviet policy toward Afghanistan. At the same time, the economic dependence of the Afghan regime on Moscow helps keep it under Moscow's thumb.

The insurgency receives benefits from a deteriorating Afghan economy and disruption in government-sponsored economic activity.

- The Afghan population becomes more dissatisfied with the regime in Kabul and its Soviet sponsors, with more recruits becoming available for the insurgent cause.
- Insurgent morale is bolstered by success in disrupting the economy.
- The cost to the Soviets of propping up the regime is increased.

Outlook: Economic Improvement Doubtful

We do not expect the Afghan economy to show real improvement unless the Soviets and their Afghan allies put down the insurgency. As long as the insurgency continues:

- Transportation will be disrupted.
- The government will be unable to procure agricultural products and collect taxes from the countryside.
- Industry will face shortages of power, equipment, raw materials, and labor.
- The country will remain extremely vulnerable to food shortages caused by unfavorable weather.
- Trade with and aid from the West will be curtailed.

Natural gas will remain the only important viable government industry, and gas imports will continue as the only significant economic benefit that Moscow

BEST COPY AVAILABLE