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The Economic Impact of
Soviet Involvement
in Afghanistan. (U)

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THE ECONOMIC IMPACT OF SOVIET INVOLVEMENT
IN AFGHANISTAN (U)

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PREFACE

The purpose of this study is to provide an up-to-date analysis of the current economic situation in Afghanistan and how it has been affected by the Soviet occupation. The study highlights important developments which have occurred over the last year, which will affect Afghanistan's economic future, the USSR's ability to tighten its control, and the future prospects for Western economic involvement.

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SUMMARY

The effect of the Soviet occupation of Afghanistan has been catastrophic for the development of the Afghan economy. The evidence suggests a serious decline in the gross national product (GNP) and the abandonment of many Soviet-aided industrial projects which had been completed or were under construction in 1979. With its agricultural base adversely affected by war and collectivization, the country has also become a net food importer after being a net exporter in previous years. In addition, Soviet involvement in Afghanistan has lessened the prospects for beneficial Western economic involvement through both trade and aid transactions. Although living conditions were never high by world standards, the current situation at best can be considered grim.

1. DOMESTIC ECONOMY

Domestic economic conditions in Afghanistan continue to deteriorate as Soviet invasion forces and pro-Soviet factions wage war against Afghan insurgency movements. The country has lost about 3.5 million of its December 1979 preinvasion population of almost 16 million as war casualties have mounted and as refugees have fled to neighboring Pakistan and Iran. These factors combined with a migration to the relatively safe cities has resulted in substantial farm labor losses in many rural areas. In addition, there has been a significant brain drain as skilled workers and the educated have opted to flee. Infant mortality and serious illnesses are also on the rise due to the disruption of health care and sanitary facilities.

Agricultural productivity continues to decline creating severe food shortages. The harvest was especially poor in 1982 with only one-fourth of the 1978 yield and only one-half the 1981 figure. By early April there was no indication of any likely improvement for 1983. Increasing wartime shortages of critical energy supplies have resulted in the stoppage of industries with a marked decline in processed goods. Fears of prolonged shortages of basic subsistence items have encouraged widespread hoarding, dramatic price increases, and an active black market. Periodic spot checks on prices in the bazaars suggest inflation has continued to rise. The average increase in prices of essential commodities (foodstuffs and wood) between September 1981 and September 1982 was 95 percent. While inflation is felt by all, it has been especially severe to poorer segments of the population, who are experiencing a continuing degradation in the quality of life.

The Soviet-supported government in Afghanistan has clearly demonstrated its lack of skill in allocating scarce resources, in knowing whether resources are available, and in general economic management. The regime has attempted to institute measures to control or stabilize prices of food and other essential commodities in order to insure supplies and a decline in inflation. However, these measures have failed to prevent producers from stopping production in response to official low fixed prices, thus shortages and price increases continue.

2. TRADE

The Soviet invasion caused a sharp drop in commercial import and export transactions with the Free World. The volume of imports in 1979, before the invasion, amounted to \$303 million while exports to the West totaled \$159 million. By the close of 1982, these amounts had been more than cut in half with imports declining to \$109 million and exports plunging to \$64 million. The steady decline in the West's trade relationship with Afghanistan has been aggravated by three prominent developments. The first is the suspension of flights by the state-controlled airline, Ariana, to Western Europe and the consequent difficulty of bringing Western goods to Kabul by that route. Second, the decline in Afghanistan's agricultural production caused by the abandonment of farms, thus increasing the dependence of urban areas on Soviet staple commodities such as wheat and sugar. And third, the country's inability to sell surplus products, for example, fertilizers or grapes, on the glutted world market. In addition, the war disrupted traditional economic exchanges between the Nomads and the West.

These groups, which would normally exchange items such as meat for consumer durables, find the customary pattern upset by the paucity of goods.

At present, regime policies are effectively reorienting the Afghan economy to function within the Communist system and to exacerbate Western prospects for economic involvement in Afghanistan. During the winter the value of the Afghanistan currency, the afghani, dropped over 25 percent in comparison with hard currencies due to the regime's policy of printing money without backing and the more recent practice of using afghanis to buy hard currency in Kabul's money bazaar. According to well placed sources, the regime's aim is to allow the value of the US dollar to rise to over 100 afghanis at which point the regime believes it will stabilize as imports from the West decline and Eastern European goods become competitive with the preferred Western products. After the dollar/afghani relationship has stabilized, the regime plans to print afghanis in accordance with Afghanistan's clearing dollar balance with the Soviet Union. The end result of this development is that Afghanistan will be forced to sell its products to the USSR for clearing dollars rather than hard currency for only half the price obtainable in the West, and that the proceeds will be used against the country's substantial debt to the Soviet Union.

The visual evidence of Afghanistan's trading reorientation is supported by Afghan-Soviet trade figures. Afghanistan's trade with the USSR has risen from \$90 million in 1971 to \$496 million in 1979, \$912 million in 1981, and about \$960 million in 1982. These statistics are difficult to check because they represent notional prices fixed bilaterally between the two countries based on a system of barter trade (for example, units of gas for units of wheat). Yet, it is clear that a substantial increase in Afghan-Soviet trade has occurred.

The USSR supplies Afghanistan with machinery for the natural gas industry, air transport equipment, oil, meat, and grain. In return, Afghanistan provides the USSR with natural gas and agricultural products such as raisins, wool, and cotton. Almost all of Afghanistan's natural gas output is directed toward the USSR. This is advantageous to the Soviets for two obvious reasons: (1) They are able to generate hard currency through the export of surplus gas supplies to the West; and (2) convenient access to Afghan gas allows the Soviets to more efficiently supply the fuel needs of the USSR's southern republics. However, these benefits do not outweigh the costs to the Soviet Union. In efforts to sustain the Afghan economy, the Soviets have increased the price they pay for Afghan gas. They have drawn on their hard currency accounts to purchase oil and wheat from abroad to meet Afghanistan's growing deficits in these commodities. And more recently, the Soviets have permitted the Afghans to convert their surplus clearing dollars into hard currency, in order to purchase necessities and consumer durables on the capitalist markets. It is difficult to estimate with any precision the amount of Afghanistan's clearing dollar surplus with the Soviet Union. Recent reporting suggests that the current surplus stands at \$250 million and that the Soviets have raised the price of natural gas from \$125 to \$200 per cubic meter. If these numbers are accurate, the slow rate of decline in Afghanistan's clearing dollar holdings will permit it to continue its purchase of consumer goods. The principal question seems to be whether the Soviet Union will be willing to go on spending its hard currency to keep the Afghan economy afloat.

3. AID

Following the Soviet invasion, Western bilateral aid to Afghanistan was suspended. However, some indirect assistance is being provided by India in the form of food. This food aid is not official Indian assistance to Afghanistan, rather it is grain that is being delivered to Afghanistan to settle the imbalance in India's trade accounts with the Soviet Union. Therefore, officially, these grain shipments are a part of Soviet assistance. In addition, there have been recent discussions between Japan and the Babrak government concerning direct project aid. Although this is a possibility, no agreements have been reached.

Multilateral assistance to Afghanistan amounted to \$3 million in 1979, no aid in 1980, \$222 thousand in 1981, and no aid in 1982. A major portion of this aid has focused on road construction projects and food aid. These programs, sponsored by the United Nations and the World Bank, were initiated prior to the 1979 Soviet invasion, and have not been altered to include any new aid. In fact, multilateral donors have found it increasingly difficult to maintain these programs and their personnel under the present conditions.

The USSR has provided a considerable amount of economic aid (much of it grant form). Soviet new aid extentions were worth \$435 million in 1979, \$395 million in 1980, \$27 million in 1981, and \$25 million in 1982 with annual average disbursements amounting to \$200 million. Yet, it is clear from the available data that these amounts are declining annually, and that a number of Soviet assisted projects have been abandoned. It is suggested that with the declining rate in new extentions, that actual disbursements will also decline in the near future. Currently, there are no signs to indicate any future change in the prevailing trends that suggest this development.

4. CONCLUSION

Although the Soviet Union's purpose in Afghanistan is of a political nature, the impact of its involvement has created an adverse economic byproduct. Afghanistan's economic foundation has been critically damaged, leaving the country dependent on the USSR for its basic subsistence.

Inflation is increasing daily. Thus far the population has been able to live with the increasing money supply, but there is the danger of hyperinflation, when thousands of afghanis will be needed to purchase a few kilos of scarce flour. It is certain that a long-term shortage of basic essentials will inevitably have an adverse effect on the population and that more people will either leave Afghanistan or be forced to support the present regime in hope of obtaining better terms and assistance from their Soviet benefactor.