

# **On the Brink of Collapse: A Critical Analysis of the Taliban's Economic Policies**

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## **Introduction**

On 15<sup>th</sup> August 2021, the government of Afghanistan collapsed, and the Taliban took control of Kabul ending the two-decade-long international intervention in the country. Since the Taliban's takeover, Afghanistan has been through a period marked by significant challenges and transformations with the country remaining in severe crisis. The country's financial and economic situation in particular is catastrophic. Nearly one third of economy has shrunk since August 2021 (World Bank, 2023) with nearly 20 million people or half of the total population are going hungry (Stefan, 2023) and many more losing their jobs and livelihood (Byrd 2022, 2).

This is linked to a combination of factors including the country's abrupt loss of international aid as well as loss of access to the global financial system. A significant development was the US freezing over nine billion dollars of assets. Such development has led to liquidity pressure and prevented Afghanistan banks from meeting withdrawal demands (Maizland and Baumgartner, 2022). Furthermore, and importantly, the current dire crisis is also attributed to the economic policies that Taliban have been implementing over the past two years.

This paper offers a critical examination of Afghanistan's economy under the Taliban, with a particular focus on the real sector, along with the monetary and fiscal systems. The research explores the economic policies of the Taliban analysing their approaches of managing these key sectors as well as evaluating their resulting implications for the economic stability of the country and the livelihood of the people.

## **Economy in Recession?**

Since the Taliban's ascension to power, the real sector experienced a consecutive two-years contraction casting a shadow of uncertainty to the country and making "even fleeting stability fragile" (World Bank 2023). The GDP declined by 20.7% in 2021 and another 6.2% in the following year (Ibid, 18). Economic activities across all three major sectors of the economy also experienced downturn. The services sector which contributes for nearly 45% of GDP decreased by 6.5%. Agriculture sector

accounting for nearly 36% of GDP contracted by 6.6% while the industrial sector declined by 5.7% in 2022 (Ibid).

The abrupt cessation of international aid, approximately 8 billion US dollars or 40% of the total GDP had a severe impact on the country. For instance, in 2019, the Republic government “received 4.7 billion USD in military support and about 4 billion USD in civilian aid” (Clark 2023, 2). The sudden decline in aid has led to a steep rise in the level of unemployment, poverty<sup>1</sup>, and starvation rates. Additionally, the population growth as well as the deportation of thousands of Afghans from Pakistan has further exacerbated the country’s financial challenges (Ahmadi et al 2023, 3).

After Taliban came to power, aggregate expenditure has significantly decreased leading to a reduction in the aggregate demand and the purchasing power of the people. The country according to economists has thus officially entered a recession. In an interview with CDP-G (2023), former Economy Minister, Musafa Mastoor stated that the economy which experienced a short-term stability in early 2022 is now facing a recession.

During a recession, economists typically advise that the governments adopt expansionary policies, particularly in fiscal and monetary sectors. At the monetary front, the Central Bank should decrease the interest rates. At the same time, at the fiscal level, the Ministry of Finance (MoF) should lower taxes and the customs duties tariffs to boost investments, foster business growth and increase employment rates. The Taliban have been doing the opposite.

### **Shadow Banking Sector**

With the Taliban’s takeover, international financial transactions were obstructed which pushed the banking industry to the brink of collapse. Further, sanctions imposed by the United Nations and the United States severely disrupted trade and transfers (Clark 2023, 2). The Central Bank access to USD9 billion of its reserves was frozen leading to a dysfunctional payment system where majority of transactions reverted to informal Hawala networks. The banking industry has faced with challenges of liquidity as well as risks of stability. Moreover, financial reporting in the banking sector has been sporadic and incomplete. For instance, out of a total of 12 banks, only seven disclosed their financial statements for the year 2022 (World Bank 2023, 39).

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<sup>1</sup> UNDP (2022) reported that 97% of the total population may fall into poverty line by mid 2022.

As result of the unfolding events in 2021, banking businesses were severally impacted resulting in significant losses. In early days, widespread panic led people to rapidly withdraw their deposits causing the banking sector to lose 1.5 billion UD dollars or 41 percent of the total deposits (Faeq 2023, 11). The profitability of banks was affected adversely in both 2021 and 2022. In the first nine months of 2022, the ten banks lost about USD30 m. Among these, only Afghanistan International Bank (AIB) reported a profit of UD\$6.5 million as of September 2022, while the remaining nine banks reported losses (Ibid).<sup>2</sup>

Taliban were able to tackle inflation and the depreciation of local currency, the Afghani. The inflation rate which sharply increased to 18.3% in July 2022, dropped abruptly leading to a deflation<sup>3</sup> of -9.1% as of July 2023. Deflation was mainly attributed to decrease in the aggregate demand, hence hampering the growth and development (World Bank 2023, 19 & 21). UN cash shipments has also played a key role in decreasing prices. Despite halt in development aid, Afghanistan still received a total of three billion dollars in humanitarian assistance over the past two years – USD1.8 billion in 2022 and USD1.12 bn in 2023 (Clark 2023, 7).

Prohibiting the use of foreign currency and the diaspora remittances amounting to approximately US\$1–1.2 billion dollars also contributed to this trend (World Bank 2023, 22). While deflation can have a short-term benefit to boost real wages and household welfare, it can have a damaging impact on business growth in the long-term leading to increased unemployment and underemployment (World Bank 2023, 21). This in turn, can further decrease the aggregate demand and exacerbate the economic recession the country is experiencing currently.

Taliban banned interest rate and have announced the plan to shifting from conventional banking into Islamic banking (PYMN, 2022) which has not demonstrated any significant progress over the past two years. The Taliban’s ban of interest led the sector to incur a substantial loss in interest income, which was a key source of revenue stream. Net interest income contributed about half of the total operating income for the banking industry in 2019 and 2020 (Faeq 2023, 11-2). Interest income dropped by 27% in 2022 compared to 2021 (World Bank 2023, 39). Banning the interests led banks to step away from

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<sup>2</sup> The AIB’s profitability was primarily attributed to commission earnings generated from facilitation of the UN humanitarian assistance, predominantly in the form of cash shipments. There was an almost 250 percent increase in AIB’s annualised fees and commissions for 2022 than 2019 and 2020 (Faeq 2023, 11).

<sup>3</sup> “Deflation refers to a decrease in the general price level, quite different from disinflation, which refers to a deceleration in price hikes. While disinflation is good for the economy despite short-term output loss, deflation may prove harmful” (World Bank 2023, 21).

their prime function of collecting the deposits and extending loans leading banks to increase services costs and hence “losing more ground for informal and shadow banking sector” (Faeeq 2023, 1).

### **Taxation, a Contract or Coercion?**

Taxation played a significant role in fostering more representative and accountable states, establishing a fiscal social contract through which governments bargained with taxpayers, exchanging representation and service delivery for increased taxation (Brautigam, 2008; Moore, 2008). Central to this concept is the idea of taxation as a mechanism to build contract between the state and society. Moore (2008, 37) describes this as a “contractual taxation” which according to him involves “more or less of explicit exchange of revenues for services”. This form of taxation is characterised by an institutionalised mechanism to assess and collect taxes and allow taxpayers to have a voice in policy making related to taxes (Ibid). The key here is the reciprocity in service delivery for taxes and the taxpayer’s participation in the process. However, if services are not provided and taxpayers have limited say, taxation can be more akin to coercion. Moore (2023, 37) refers to this as “coercive taxation” under which tax assessment is arbitrary, and tax collection is influenced by significant coercion, leaving taxpayers with no input or representation in setting tax policies (Ibid).

Following the Taliban’s takeover, they were more efficient than the Republic in collecting revenue including taxes and customs (Clark 2023, 9). In 2022, they collected around US\$2.2 bn with a significant 55.7% of this total coming from cross-border trade (World Bank 2023, 7 & 34). The increase in revenue was attributed to their success in dismantling several networks of roadside checkpoints, where huge amounts of informal rents were being generated in favour powerbrokers in provinces (Alcis & Mansfield 2022, 1 & 6). Former Acting Finance Minister Khalid Payenda in an interview with Afghanistan Analysts Network (AAN) said that they could potentially collect up to eight million dollars a day if trade diversion [smuggling] were managed and goods were assessed with 100% transparency in provincial customs houses (Clark and Shapour 2021b, 2). This would potentially generate about three billion dollars of revenue per annum which would give the Republic much more financial independence.

Despite, improvement in revenue collection by the Taliban, the nature of tax collection was associated with significant coercion and even extortion. They have used intimidation and coercion to extort money from the people who have already been under poverty line (Ehsan, 2023). In a recession-hit economy, where reduction or removal of certain taxes and customs duties are key, Taliban have instead introduced new levies, including land taxes that were absent in the past two decades. Upon their capture of power, they enforced two Islamic taxes nationwide – *Zakat* and *Ushr* on harvest and

livestock (Clark 2023, 10). According to the Taliban's religious interpretation of Sharia Law, citizens have to pay one-tenth of their agricultural products to the Taliban as a form of tithe. In addition, paying *Zakat*, a wealth tax on non-agriculture assets including livestock is also mandatory. According to reports by locals, the Taliban have been imposing these taxes coercively regardless of individual's financial situation, even in cases of acute hunger and starvation (Ehsan, 2023). Further, the Taliban have applied coercive taxation on numerous business owners without adequately assessing the state of their business profitability (Ibid).

### **Conclusion**

The constant decline in GDP, coupled with growing unemployment and poverty rates, has plunged the country into recession. The policies undertaken by the Taliban have not mitigated these problems; they have rather exacerbated the situation. One such policy refers to banning the conventional banking and the interest in particular, a key mechanism for extending loans and attracting deposits. In absence of Islamic banking, prohibiting interest under a conventional banking has pushed banks towards a shadow financial sector, offering the ground for more informal activities.

Furthermore, the Taliban's approach to taxation, which is characterised by coercion and extortion, has further impoverished the people. This will not only adversely impact the people's livelihood and exacerbate poverty, but it will also set the scene for increased political dissent. Such unrest will highly affect not just the economic stability, but also the political stability of the de facto authority of Taliban.

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