Afghanistan on the brink of hyperinflation

Introduction:

For the past 17 years Afghans have been struggling for their survival. The war has drastically changed their life styles and has caused social violence, death, injury and destruction. Particularly, the last four years have witnessed the worst human disaster, massive destruction, large population displacement and total collapse of the nation’s social and economic institutions.

Over 500,000 people became displaced when heavy fighting erupted on 1 January 1994 in Kabul city and found shelter in the camps established by the United Nations near Jalalabad. Many lived with their relatives in Jalalabad city and in other relatively peaceful areas within the country while those who could not afford to escape the fight for Kabul were accommodated in public buildings in safer parts of Kabul city. As a result, hundreds of thousands of innocent people were killed, villages and towns, particularly Kabul city destroyed, agriculture severely damaged and industries totally devastated and looted. In addition, flooding and natural disasters in some parts of the country brought about economic havoc and resulted in enormous human and material losses. A large part of cultivated land and crops were washed away by flooding and landslides that occurred in northern and western provinces. Indeed, the damage which the war has inflicted upon Afghanistan can not be easily determined and needs years of intensive research and painstaking work.

The country is now experiencing a hyperinflation which is devastating and destructive to its economic progress and development. The nation is caught in a crisis triggered by continuous fighting among various feuding factions, the government’s failure to adopt a sound monetary policy and crippling fiscal and monetary institutions.

When in 1988 and 1990 Peru was experiencing hyperinflation, a number of publications were devoted to the search of means and tools to curb inflation and help producers and consumers to cope with this problem. Now in Bulgaria political analysts are expecting a split in the ruling party because of a rapid increase in inflation. The newspapers have already started attacking the government’s failure in removing citizen’s anxieties. A few Afghans have recently started thinking about the chaos associated with runaway inflation in their country. This paper aims to discuss the pros and cons of prevailing inflation in Afghanistan and the catastrophe it may bring about. It also attempts to encourage experts and economists of Afghanistan to seriously think about this inflationary process and the policy makers in different regions of the country to be aware of the outcomes of this inflation.
Impacts of inflation

Inflation means an increase in overall price level either temporary or sustained. While temporary inflation has not received much attention by economists and policy makers, the continued inflation has been considered devastating and fatal. During the 1950s and 1960s many economists argued that a moderate rate of inflation, i.e. a rate between 8 to 12 percent a year, could be used as a tool to promote economic growth, reduce unemployment and improve the nation's balance of trade by encouraging exports and discouraging imports. Many modern economists believe a moderate rate of inflation may not be destructive but can have economic costs in any advanced economy. On the other hand, most economists believe that a runaway inflation rate of 50 to 200 percent a day or a month such as those prevailing in war-torn Afghanistan is corrosive and cause a total collapse of the economy. The worst effect of inflation is its redistributive impact on vulnerable groups of a society including sick, disabled, widows, the poor, elderly and those depending on fixed incomes. The inflation also adversely affects holders of real and nominal assets, savers, lenders and borrowers. Other negative impacts include raising inflationary expectation, uncertainty, decline in real value of cash assets, and growing government deficits.

Causes of inflation

In economic theory the causes of inflation are broadly divided into two categories: cost-push and demand-pull inflation. Cost-push inflation results from increase in overall prices and a rapid raise in production costs due to resource scarcity and crop failure, while a demand-pull inflation refers to a rise in prices resulting from increases in expenditures on goods and services. Wage-price spiral is another source of inflation. When the prices increase the purchasing power of workers decreases and workers unions demand for an increase in their wages. This will adversely affect the aggregate supply which leads to continued increase in price level. In Afghanistan, the workers union does not exist at all and all formal and informal social and economic organizations are on the verge of total collapse. Nevertheless, individual decisions taken by workers in order to make a living have increased labour costs in the open market and have made a significant contribution to the inflationary process. Also, an excess in the supply of money to finance the civil war is a major cause of inflation.

Inflation in Afghanistan:

Afghanistan is steadily moving on the brink of hyperinflation, causing the worst economic disaster in the history of the country. Inflation in Afghanistan has been influenced by cost-push, demand-pull and wage-price spiral forces. In addition, continued fighting, economic blockade, intermittent closure of roads, collapse of social and economic institutions, absence of appropriate banking and monetary policies, fiscal policy, diminishing domestic production, declining agricultural yields, etc. have largely contributed to the economic plunge and inflationary process of the country. The Afghani to US dollar rate has changed from 37.9 Afs to a dollar in 1978 to 661 Afs in 1990, 5,500 Afs in January 1996 and 15,000 Afs to a dollar in June 1996. Thus the Afghan currency has lost its value by approximately 39,578% during the past 17 years and by over 273% in the past five months. Although the Afghan currency loses its value almost daily, there is no sign of even a small increase in salaries of the government employees.
This runaway inflation has put the lives of the majority of Afghans at stake. There have been stories of government employees going without pay for months, particularly in remote provinces where living conditions are already weary and income opportunities are scarce. A qualified government employee is paid around 80,000 Afs. per month which is less than Rs.200 or US$ 5 and not enough to buy a bag of wheat flour. Imagine life in Kabul, the capital city, for a family of seven trying to survive, a well paid employee will have to spend his monthly salary in less than a week. Today an average family needs about 300 times more income to buy the same food basket of 1978. There has been a dramatic increase in prices of essential goods, particularly over the past few years. The price of rice has gone up from Afs. 21.41 per kg in 1978 to Afs 311.83 in 1990 to Afs 500 in 1991 and to Afs. 7,000 in May 1996. Wheat flour has increased from Afs. 10.23 per kg in 1978 to Afs.300 in 1991 and to Afs.2,800 in May 1996. Table one shows prices for some items in several regions for the past two months.

This has resulted in increasing incidence of robbery, looting and kidnapping of children for ransom. Corruption is reportedly widespread in government offices throughout the country. Last winter several people were reported to have offered their beloved children for sale in an attempt to prevent them from starving to death. Most Afghan children are suffering from a degree of moderate to severe malnourishment, diarrhoea and other communicable diseases. The aid agencies are worried about a cholera outbreak during the summer. The situation may be even worse in the coming winter if the status quo continues.

While government salaries have only slightly changed over the past 17 years, salaries of military personnel have increased several times. With almost daily fall in the value of the Afghan currency against US dollars and Pakistani rupees, life has become extremely difficult for most Afghans. If the status quo continues, Afghans will have to return to a barter transaction system, which is extremely dangerous to those who do not possess means of production. These people may not have anything to exchange for commodities they need. The government in Kabul made several futile efforts in order to prevent the steadily reduction in the value of its currency. The most meaningless of such policies is the closure of exchange market in Kabul, which shifted the market into the house of a few people who had strong military and political support. The only impact of this was that other money changers who did not enjoy such support were left out of the market. The most positive effort was the recent announcement of the government to provide worth of ten million dollars in food commodities to its employees at subsidized rate.

In the absence of domestic revenue all government expenditures are financed through money creation which has already spilled over the balance of payment via increased imports and has led to a drain in international reserves. The only option for the government to finance the war is to print more money. Hence a sustainable increase in the amount of money in a short span of time is accompanied by a continued surge in prices. It is said that a large amount of fake currencies has been printed by other parties controlling different parts of Afghanistan. As a result of a widespread excess in money supply, reserves have dwindled and the government could no longer maintain a fixed exchange rate. For the first time in the history of Afghanistan, earlier this year D' Afghanistan Bank introduced a flouting exchange rate. To discuss the advantages and disadvantages of this policy is beyond the scope of this paper and needs a separate study.
This rapid increase in money supply has created a yawning budget deficit, virtual economic collapse, and increasing inflationary expectations which will cause further economic and social havoc in the country. Budget deficit is believed to be the mother of all economic diseases and by the time the situation improves Afghans will have to spend much of their resources to pay the debts. In the past, the Afghan economy was largely depending on trading with neighbouring countries and other western states. Before 1978, Afghanistan exported fresh and dried fruits, karakul, cotton and rugs to a number of countries. Afghanistan's natural gas, which forms a larger part of the nation's exportable items, was exported to the former Soviet Union and was a major source of revenue for the government. Presently, the natural gas is under the control of the forces supporting general Dustom who is opposing the central authorities in Kabul.

Afghanistan was importing almost all consumer items from abroad, mainly the former USSR. Now, the country has added certain other items such as wheat, sugar and cement to list of its importable items. Most of these commodities were being imported before war but at significantly smaller amounts. With the continuation of war, international trade has been badly affected in the way that exports have decreased and imports increased. The borders are controlled by different groups who are totally independent from the central government. General Dustom controls the most important border town of Hairaton which links the northern provinces to Central Asian States. The Taliban control the Chaman border in Kandahar and Islam Qala in Herat, while Torkhum is controlled by the Eastern Shura. Therefore, customs duties are collected but not appropriately redirected for government expenses.

Land and livestock taxes are being collected by individual commanders, while taxes on income and corporations are not collected at all. Most businessmen were forced by the situation to flee the country, taking their money to other countries. Afghanistan's foreign trade in 1976 amounted to one million tonnes of which 70% was directed through the former USSR, 20% through Pakistan and 10% through Iran. In 1994, Pakistan closed all transit trade facilities to Afghanistan, while Iran allows a very limited facilities. Internal trade has also been affected by closure of roads and fighting. Most goods in the private sector are being imported and exported through informal channels over which the government has no control. Similarly a large amount of opium resin is produced in provinces bordering Pakistan which is beyond the control of the central government. All these factors have caused a sharp decrease economic growth, an increase balance of payments gap and created rampant inflation. The deficit in 1978 was reported US$ 79 million and US$ 634 million in 1988. This gap has tremendously increased since then.

Inflation is also introduced by the situation prevailing in neighbouring countries, mainly Pakistan. Currently Pakistan is going through an inflationary period. As most food stuffs are imported from Pakistan, the rise in prices of these goods in Pakistan has lead to further increase in their prices in Afghanistan.

Most donors are reluctant to provide bilateral or multilateral donations or lend the needed funds. They are also hesitant to invest in the rehabilitation and reconstruction of Afghanistan, mainly because they are still not sure whether their contributions could be utilized appropriately. Most foreign assistance to Afghanistan takes place in the form of emergency humanitarian assistance coordinated by the United Nations system and international NGOs. Last winter, a significant amount of food and fuel was distributed by the
UN agencies and NGOs to the most vulnerable population in Kabul city under the Umbrella of Kabul Emergency Programme. WFP bakeries provided bread at a highly subsidized rate to the urban poor in various parts of the country. Unfortunately, the authorities in various parts of Afghanistan are no longer in a position to help their needy people. Their priorities are set by military objectives and all resources are utilized to achieve these objectives. All parties involved should bear responsibility for bringing an economic catastrophe for their people and should from now on seriously search for the ways and means of creating relief for the people of Afghanistan who have been suffering for the past 17 years.

Recommendations

Coping with inflation is almost a difficult task to do. Economists have always lived in a world of controversy with regard to the causes and cures of inflation. Monetary and fiscal policies are generally blamed for and adopted to curb inflation. In developed countries the monetary authorities use anti-inflationary instruments such as open market operation, increases in reserve requirements of banks, reduction in commercial banks borrowing from the central bank and restraint in bank lending policies. For Afghanistan the first instrument, open market operation, is typically absent. Securities market does not exist in Afghanistan. The remaining three instruments have very limited implication as the banking system in the country has not yet developed and presently banks of Afghanistan are not functioning appropriately. Therefore, policies followed by these banks have limited effect on curbing inflation. Although increase in reserve requirement can be used to help cure moderate inflation, the commercial banks in the country are running short of deposits a portion of which could be deposited with central bank as reserve requirement. There are stories of people giving a certain amount of their deposits to the officials of the banks in order to withdraw some of their money from the their personal accounts for their daily expenses. This employs that the banks in Afghanistan are adopting a policy of discouraging people to deposit their small savings in the banks. In Afghanistan, traditionally individuals are more trusted than banks. Other instrument which may be effectively used by D'Afghanistan bank is credit ceilings. In several developing countries including Sri Lanka and Malaysia, credit ceilings have been used as supplementary tool of inflation control. In case of Afghanistan where a yawning imbalances exist in external payments, this policy may not have much positive effects. Also credit ceilings do not have much effects unless the government takes steps to reduce budget deficits. A wise decision for the government would be to search for alternative sources of financing government expenditures and substantially cut in the supply of paper money.

An appropriate fiscal policy to fight inflation includes budget cuts and higher taxes. As mentioned earlier the government is not able to raise revenue for its expenditure through tax collection and import duties. It will not be possible for the government to collect or raise taxes because the financial and revenue institutions have either collapsed over the years of war or have been controlled by different parties. The authorities in other parts of the country can adopt a policy to appropriately allocate revenues collected to cover part of their expenditures. This will in fact have a significant impact on the overall situation. The optimal and more effective option for the government is a substantial reduction in its expenditures. The government and authorities in other parts of the country are advised to adopt a policy of reducing privileges rendered to high ranking officials by limiting their access to luxury consumer items including luxury cars, dish antennas, etc. Both monitory and fiscal policies are effective when a strong government is in place whose policies could be implemented
throughout the country. In Bolivia when the government decided not to spend more than it collected in the form of taxes, the inflation came under control in short time. This will not happen so easily in Afghanistan because other qualitative and quantitative variables have to be taken into consideration.

Another possible way is direct price controls. Most commercial activities are undertaken by the private sector over which the government has no control. The economy is currently characterized by an underground economy and prices are determined by black market. Last winter when the price of meat Kabul city reached Afs 22,000 per kilo, the government enforced the butchers to close down their shops for several weeks. This experience was deemed to be a total failure because the government was not able to provide meat for the daily consumption through other sources at a relatively lower price. Therefore, it would be very difficult to anticipate whether the price and wage control policy alone will be effective in controlling inflation.

Given the prevailing conditions in Afghanistan, qualitative variables might have the same impact as quantitative variables. Qualitative variables refer to continuation of fighting, closure and bad condition of supply roads, political instability and lack of a strong central government able to draw up a national policy in order to fight inflation. The authorities in Afghanistan should at least agree to allow free movement of commodities and services throughout the country. Since inflation is a national problem and affects all, both the government in Kabul and opposition groups should initiate negotiations in this direction.

It is recommended that an economic council be established which comprises representatives from all parties involved in the conflict. This council should be mandated to study the overall situation and recommend economic policies aimed at controlling soaring inflation, reducing deficits, improving balance of trade and enhancing domestic production. The council should also encourage appropriate allocation of national resources by different centres of power and collaborate with international organizations in the rehabilitation of Afghanistan.

Religious taxes such as Usher and Zakat are being collected by individual commanders. A special district Shura should be established to collect such taxes and utilize them for social welfare purposes. This will, to a large extent, reduce the burden on poor families and reduce social violence. Other taxes could also be used to cover part of government expenditures in areas under the control of various parties.

A substantial cut in defence budget by authorities controlling different parts of the country will have a large impact in improving the situation. However, this is a difficult task and may not be welcomed by all parties involved, particularly the military officials. There is a dire need to take such a bold decision in order to improve the situation and save the majority of the population from the chaos constituted with continued surge in prices.

Most commanders have become wealthy over the years of war. They don't know how to invest their wealth and earn sustained profit. The authorities or the economic council, if established, should find ways and means to encourage these commanders to invest their money in productive enterprises. This will lead to the circulation of a large amount of stored money within the economy and reduce the increasing demand for paper currency.