

## THE CURRENT ECONOMIC AND FINANCIAL CRISIS IN AFGHANISTAN: CAUSES AND SOLUTIONS



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Center for Strategic and Regional Studies (CSRS)



## THE CURRENT ECONOMIC AND FINANCIAL CRISIS IN AFGHANISTAN: CAUSES AND SOLUTIONS

### INTRODUCTION

With the sudden collapse of the previous government and the rule of the Islamic Emirate over the entire country, however, the ongoing war and bloodshed in the country has stopped, but with this change, the country faced economic challenges as the concerns of Afghans are increasing day by day. The most obvious and serious problem that immediately affected the public was the freezing of Da Afghanistan Bank's reserves in the US, which led to the central bank running out of cash, and as a result, the banks of Afghanistan were unable to pay the people their money. In its first step, Da Afghanistan Bank announced that individual account holders can withdraw 20,000 Afghani or 200 dollars per week from their accounts. Also, on September 15, the central bank allowed private companies to withdraw up to 25,000 dollars in a month from their accounts. As a result of this situation, the Afghani depreciated and commodity prices rose.

Considering the above introduction, various questions arise now. Where is the economic situation of the country going with this new change? Will the new system be able to handle this financial and economic crisis? What are the ways to control this situation? When and how will the situation of Afghanistan's banks and lack of money be solved? What is the role of the central bank in controlling this situation and what can it do now? What are the effects of the depreciation of the Afghani and what needs to be done to prevent it from depreciating? And, as a whole, what are the ways of getting out of this situation?

This research paper discusses these and other important topics and seeks to answer the related questions. Most of the contents of this article are the discussed topics of CSRS's virtual conference.<sup>1</sup> Beside this, the views of experts on the subject, researches and other related materials have also been used.

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<sup>1</sup>The Center for Strategic and Regional Studies held an online conference on September 18, 2021 entitled "A Look at the Current Financial Crisis and the Depreciation of Afghani". Wahid Noshier, former acting governor of Da Afghanistan Bank; Ahmad Khesraw Zia, former governor of some private banks; and Syed Mobin Shah Masamam, founder of Da Afghanistan Bank's policy department and former deputy finance minister, were the keynote speakers. Also, Shakir Jalaly, an expert in Islamic banking and doctoral candidate in the same field, spoke on behalf of the organizing committee of the conference. Another member of the committee, Kamran Malik, an expert in the field, contributed to the organization of the discussions, which were compiled by Hekmatullah Zaland, the center's researcher and executive director.



## THE RECENT CHANGE AND ITS IMPACTS ON THE ECONOMIC AND FINANCIAL SITUATION

With the entry of the Taliban into Kabul on August 15, 2021 and the complete collapse of the previous government, the country witnessed fundamental changes in many areas, the most notable ones were the economic problems of Afghans and the halt of Afghanistan's transaction with the world. With the Islamic Emirate coming to power, the US government immediately announced that they have frozen Da Afghanistan Bank's reserves in the country so that, it won't fall into the hands of the Taliban. This nearly amounts to 9.4 billion dollars. Freezing these reserves has generally had a negative impact on the country's economic situation. The international community's aid to Afghanistan has also completely stopped. Just in November of 2020, in the international community's conference on Afghanistan in Geneva, 12 billion dollars<sup>2</sup> aid was pledged to Afghanistan for the next four years (2021-2025); among this, 1.2 billion euros (approximately 1.4 billion dollars) was pledged by the European Union<sup>3</sup> alone.

On September 13<sup>th</sup> 2021, at a meeting hosted by the UN in Geneva, Switzerland, the international community, once again, promised 1.2 billion dollars humanitarian assistance to Afghanistan, including 64 million dollars pledged by the US.<sup>4</sup> This conference was the first and most important one of international community on Afghanistan since the Islamic Emirate came to power, and the UN Secretary-General said that nearly 14 million Afghans are facing famine. But since the international community has not yet made a decisive decision on how to deal with the Islamic Emirate, there are concerns about the effectiveness of these aids.

Another issue was the impact of the recent change on banking system. Nearly two weeks before the fall of the previous government, when the fall of the provinces began, people rushed to the banks withdrawing their personal assets from the banks. With the collapse of the government, the banks and exchange centers closed due to the fear of robbery, but they remained closed even during the relative normalization of the situation, mainly due to the lack of cash (dollars and Afghans) in the central bank.

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<sup>2</sup>Reuters Staff. Foreign aid to Afghanistan could reach \$12 billion over four years, some with conditions. 24 Nov 2020.

<https://www.reuters.com/article/afghanistan-diplomacy-aid-int-idUSKBN2842S2>

<sup>3</sup>European Commission. EU reconfirms support for Afghanistan at 2020 Geneva Conference. 24 Nov 2020.

[https://ec.europa.eu/international-partnerships/news/eu-reconfirms-support-afghanistan-2020-geneva-conference\\_en](https://ec.europa.eu/international-partnerships/news/eu-reconfirms-support-afghanistan-2020-geneva-conference_en)

<sup>4</sup>The Economic Times. Donors pledge \$1.2 billion in emergency funds for Afghans. 14 Sep 2021.

<https://economictimes.indiatimes.com/news/international/world-news/donors-pledge-1-2-billion-in-emergency-funds-for-afghans/articleshow/86188197.cms?from=mdr>



Although the banks reopened about two weeks later, they began paying people under the restrictions<sup>5</sup> imposed by the central bank. Due to the closure of banks and the lack of money in the market, money exchange markets, especially Sarai Shahzada, the country's largest money exchange center, remained closed for up to three weeks. As a result, the prices of goods in the markets increased and similarly people's concerns and distrust increased day by day.

Beside this, the biggest impact of recent change on the financial situation has been the depreciation of Afghani by which Afghans assess the country's economic situation. Overall, with the collapse of the previous government, the value of the Afghani currency against the dollar has risen from an average of 80 Afghanis to 90 Afghanis. The causes and solutions of depreciation of Afghani are discussed below, but, it is worth mentioning that considering the changes, the value of Afghani relatively stayed stable and it didn't plunge as much as it was expected.

The above factors and the overall situation profoundly affected the economic situation of the people. For example, with the collapse of the previous government, hundreds of thousands of Afghans who worked under the government have not received their salaries.<sup>6</sup> Most of the daily needs of government employees were met through these salaries. However, the Islamic Emirate has promised to pay the salaries of all government employees after some evaluations and reviews, but so far, not much progress has been made in this process.

## FALL IN AFGHANI VALUE AGAINST DOLLAR

Generally, Afghani was depreciating in the last few months. On August 1, one dollar was being exchanged for an average of 80 Afghanis. But with the fall of the provinces, the Afghani's depreciation has accelerated. On August 14, when the war reached the gates of Kabul, dollar rose sharply, and even at one part of the day, one dollar was being exchanged for 95 Afghanis. With the collapse of the government, all banks and money exchange centers closed; but when the Sarai Shahzada reopened, on September 4, the price of a dollar was 87 Afghanis and Afghani was gradually controlled. Even if, after

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<sup>5</sup>To prevent the situation from getting out of control, the Central Bank of Afghanistan allowed banks to permit individuals to withdraw 20,000 Afghanis or 200 dollars in a week from their accounts; and in second step, it allowed private companies to withdraw up to 25,000 dollars from their accounts in a month.

<sup>6</sup>Though, the Islamic Emirate has recently appointed a commission headed by Deputy Prime Minister, Abdul Salam Hanafi, to monitor the country's economic situation, one of its aims is to pay the salaries of government employees. According to the officials of the commission and some other government officials, the salaries of the employees of several ministries and agencies have been paid so far and this process is still going on.



a few days, the dollar fell to 83 Afghanis, but due to the political situation in the country, it rose back to 90 Afghanis in late September.

Looking at the current situation and challenges, the economic analysis is that the Afghani has not lost as much value as expected. Among other factors, now, 50 to 70 million dollars are not being auctioned every week, and more than 120 thousand Afghans have left the country, if we have a simple calculation, these Afghans have withdrawn nearly 1 billion dollars from the market of Afghanistan, but the Afghani has not lost much of its value. One factor is that governmental expenses have been reduced and the pressure on the Afghani is low. Imports have also declined due to banking problems, which decreased pressure on the Afghani. Above all these, there is a need to identify the factors that contributed to the depreciation of Afghani.

One of the main tasks of Da Afghanistan Bank is to manage inflation and stabilize the prices of goods and services; for achieving this goal, exchange rate stability is important. Until now, the value of Afghani was being kept stable through foreign currency auctions or the sale of capital notes. Dollar auctions were conducted by money exchange centers and the capital notes (or valuable documents) were being handed over to the banks, but now both of them have stopped. The dollar auction process stopped due to the lack of dollars and the capital notes stopped due to the usury issue which caused the prices and exchange rates to destabilize to some extent.

Although Da Afghanistan Bank plays an important role in managing inflation and stabilizing the value of Afghani, there are other factors too that affect the value of Afghani. Over-supply and low demand were pressurizing the value of Afghani over the past 20 years, and dollar injections were not a permanent and stable way to control it, now that there is no foreign aid, the pressure on Afghani has increased. General economy, economic growth and exports and imports are other issues which can directly affect exchange rate. Which ways in short-term, mid-term, and long-term can be helpful in stabilizing the value of Afghani are mentioned in the recommendations.

## **A LOOK AT THE SITUATION OF THE BANKS**

The Central Bank of Afghanistan plays a key role in the country's economic affairs. In addition to managing inflation and controlling exchange rates, it regulates the country's monetary policy and acts as a bridge among all private banks. But with the Islamic Emirate in power, the central bank's operations



have been hampered, mainly due to lack of cash and freezing of Afghanistan's reserves. The existing sanctions also made it difficult to do business with the rest of the world, which has hampered Afghanistan's banking system. Beside this, the Covid-19 Pandemic has already affected the global economy in the past year, and especially the banking sector, of which Afghanistan is no exception.

Since August 15, the main problem of Afghanistan's banks has been fluidity or inability to make payments. The fact that the issue of fluidity has not become so serious that it stops Afghanistan's banking system, a few points are worth to be considered. The first is that about 10 to 15 percent of Afghanistan's population conducts their business through banks, and 85 to 90 percent are not done through banking, which makes it somehow easier for Da Afghanistan Bank; especially in controlling the recent crisis, it is a positive point. Another positive point is that Afghanistan is not in debt, when a country is in debt, it has a negative effect on both, fluidity and exchange rates. Generally, Afghanistan's banks are relatively fluid and have great amounts of cash, especially deposits.

Although the banking system has not been crippled by the recent change and Afghan banks have been able to resume its activities, but without any doubt, some problems such as lack of cash have crippled the banking system and the continuation of this situation can pose serious challenges to Afghanistan's banking system in the long and midterms. Although, in late September, some progress has been seen in imposing sanctions on the Islamic Emirate, Da Afghanistan Bank's reserves are still frozen. On September 24, the US Treasury Department issued two licenses<sup>7</sup> allowing the United States and some international organizations to facilitate aid flow to Afghanistan under the rule of the Taliban. This step was also welcomed by the Taliban.

One of the challenges for Afghanistan's banking system from now on is that the new system will apply the principles of Islamic economics, while the rest of the world's banking systems are based on usury transactions. About 85 percent of the money in Afghan banks is still in current accounts and customers should withdraw their money whenever they want, which is mainly because of the usury issue. But no work has been done for long-term investment and this is a challenge for Afghanistan's banking system. There have also been problems with monetary policy over the past 20 years and Afghanistan's monetary policy has not been very effective for two main reasons. The first is that 85 to 90 percent of Afghanistan's

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<sup>7</sup>Press Release. Treasury Issues General Licenses and Guidance to Facilitate Humanitarian Assistance in Afghanistan. 24 Sep 2021.

<https://home.treasury.gov/news/press-releases/jy0372>



economy is semi-formal or informal, and Da Afghanistan Bank's interaction with it was difficult because Da Afghanistan Bank's interaction was with the formal sector, so the impact of monetary policy was minimal. Secondly, several currencies were in circulation, which weakened the monetary policy. The previous government was offering 50 to 70 million dollars to the market in a week to keep the value of Afghani stable, but the dollar gradually rose to 80 Afghanis indicating that the monetary policy wasn't effective.

Overall, banking services as a whole have been an achievement of the last 20 years; therefore, the central bank should try to create such an environment in the bank with which the international community will cooperate and interact, so that this achievement is not lost. The issue of bank fluidity and current constraints is understandable to some extent; as different countries face such situations. In Greece, for example, in 2016, when the financial and banking problems occurred, the same restrictions were imposed on transactions. Despite the difficulties, the banks of Afghanistan restarted its activities, but the important thing is that this situation should not last long and Da Afghanistan Bank, through its policies and measures, change this situation quickly.

## WAYS OF RESCUING COMMERCIAL BANKS

One of the important functions of the central bank is to supervise the banking system and private banks in the country. According to the experts of this field, the following steps should be taken by the central bank so that it rescues the banking system and private banks from falling.

### **1. The Activities of the Central Bank Should Be Made Public by Media:**

The eyes of the nation are on the central bank and its activities, so in order to restore public confidence and hope, the central bank should meet with commercial banks once a week and share the news of these meetings on social media with the public. Banks, in the world, have a lot of media activities and provide something new to their people every day. The general public pays close attention to banks because their assets are with the banks and if any problem occurs to the bank, their assets are at risk. In order to make the people sure through the central bank, it is necessary to increase its media activities.

### **2. Increasing Public Trust in Banks:**

The biggest asset of commercial banks is the trust of the people. At present, banks have lost some of their credibility. Previously, commercial banks were providing the same amount of Afghanis and dollars





as much as the customers were asking for. In order to regain the trust of the people, the central bank can formally advise the commercial banks that they will give the same amount of Afghanis or dollars back as much as the people bring to the banks after now.

### **3. Increasing Cash in Banks:**

The central bank can advise the commercial banks that whatever amount of money the investors deposit to the central bank, to the same extent they can import to the country. Or they can bring whatever amount of dollars they have in homes to the banks and can send the same amount out of the country. This will give the central bank the following benefits:

- Dollars that are not currently in the banks will enter the banking channel from people's homes.
- Dollar pressure on the central bank will ease and commercial banks will receive dollars from the market.
- The dollars of commercial banks, currently in foreign banks, will be received within the country.
- With this, the necessary goods will be imported to the country and the problems of the people will be reduced.

### **4. Relations with Banks of other Countries:**

Since Afghanistan is an importing country and relies entirely on imports, commercial banks need to have links with banks in other countries so that it can send currency to foreign countries for imports and receive goods. The new government can ask its allies to allow the commercial banks to open accounts for our banks and to have business with other countries.

Over the past 20 years, the Afghan government has not provided any assistance to commercial banks in this regard, and the banks have been able to reach out to foreign banks through their own efforts. If the government provides this assistance, banks and citizens will benefit greatly.

### **5. Meeting with Bank Owners or Shareholders:**

Bank owners can move their banks in the right direction or they can lead the banks towards failure. If they want the bank to collapse, they can impose their will on their employees. The central bank leadership should talk to the heads of the banks through video conferences and make them aware that they are responsible if their banks did anything wrong. If it is not possible through online conferences,



then a letter should be sent to the shareholders of the banks informing them not to interfere in the affairs of the banks and if they create any problem then they are responsible for it.

#### **6. Commercial Banks Should Open their Branches:**

As the crowds of the people are on the central branches of the banks and the media gives it a lot of coverage, this increases the concerns of the people. The solution of this is that the commercial banks have to open their branches and solve the problems of the people. The crowd will disappear with it. If the central bank formally advises these banks to open their branches, commercial banks will be forced to comply.

#### **7. Foreign Aid:**

Those countries and donors who provide humanitarian assistance to Afghanistan, bring foreign currency to Afghanistan most of which are dollars. The central bank can negotiate with these countries and agencies to exchange these currencies with the central bank to Afghanistan. This will increase the central bank's foreign currency reserves and it will be able to auction them once in every two weeks.

#### **8. Central Bank Supervision and Control:**

In the current delicate situation, the central bank must have full supervision over the commercial banks and ensure from time to time the functioning of the commercial banks and the implementation of the central bank's documents. Currently, high-ranking employees of commercial banks are out of the country, and in their absence, many illegal activities may take place. The central bank should increase its control and supervision over the banks that are low in rank and the chances of their illegal activities and collapse are always high.

#### **9. Deposit Insurance:**

Currently, the central bank insured very less of the public's deposits. If Da Afghanistan Bank is able to increase the insurance cover for these deposits with the support of any foreign country, it will increase the public's trust in the banks and the banks will be able to save their trust properly.



## 10. Bank Inclusiveness:

The central bank, in order to get the people involved in the banking sector, can in the long term, ask people to pay their electricity bills, children's school fees and so on from their bank accounts. This will enable those people who do not currently have bank accounts to register with banks.

## 11. Positive Comments:

Central bank employees should be made aware to avoid spreading negative news. If they spread negative news among the people, it will further erode public confidence in the banks and lead to financial crisis.

## LONG-TERM STRATEGIES

About 90 percent of the goods imported into Afghanistan's markets are in dollars but sold in Afghanis, and traders who have collected Afghanis are required to exchange them with dollars. Therefore, in order to control the situation in the midterm and long term, there is a need for the government's domestic and foreign policy to be based on national goals and in particular economic development. In this regard, production and job creation should be the goal. If domestic production increases, the demand for foreign currency will decrease and with it the level of poverty will reduce and job opportunities for the people will be made. Therefore, the relevant organs should formulate immediate plans for production, poverty reduction and job creation.

Afghanistan's gross domestic product (GDP) is 20 billion dollars, of which, so far, 65 percent were services, most of which has been dependent on foreign companies. There is now a need to activate the management of internal and external investment and prioritize investment not only in services but also in manufacturing and job creation; this is because when production is available, exports are possible and through it, Afghani can fall into the flow of production.

Afghanistan has a lot of opportunities for investment and production. Mining, agriculture and industry sectors are some of its examples. Labor costs in Afghanistan are low, and now that security costs have been reduced, Afghanistan can encourage domestic investment and focus on production rather than trade and facilitate the construction of small, medium and large industrial factories. For example, the production of goods such as beverages, food and clothing, of which Afghanistan has the potential, should



be facilitated to replace imports. Therefore, the goal of Da Afghanistan Bank's monetary policy should not only be to keep rates stable, but also to maximize productivity, thereby creating job opportunities and reducing poverty. In 2020, 72 percent of Afghanistan's population was unemployed, and 90 percent lived below the poverty line. As population growth is four percent and unemployment is rising by one million people every year, it is a challenge for the future and if fundamental plans are not made, the situation will worsen.

Afghanistan's place in the region as a connecting point to Central Asia's oil, gas and other strategic resources and the vast South Asian market underscores the importance of Afghanistan in the region, therefore there is a desire to invest in Afghanistan. In order to turn negative international and regional rivalries into positive ones, in addition to an advanced banking system, Afghanistan's political leadership must move Afghanistan out of the military state and normalize the situation.

Beside this, banking in Afghanistan is dependent on political, social and economic stability within the country and political and economic relations in the region and the world. Today, many countries rely commercial investment and banking transactions on the political structure and the quality of the political system; freezing the reserves of Afghanistan is a good example as the US tied it to establishing an inclusive government, women's and minorities' rights and not letting the enemy of America to stay in Afghanistan. Beside this, there are global intellectual and political competitions; the major powers have their own regional and global plans to secure their political and economic goals, and the collision of these plans has led to negative competition. Afghanistan, as a result of these collisions, has become the center of these internal conflicts and external interventions. The stability of the system in Afghanistan depends on how Afghanistan manages internal tensions and thus avoids external interference.

Afghanistan is currently at a critical stage economically. As Afghanistan's economy has so far relied on foreign aid and much of Afghanistan's national budget has been provided by foreign aid, and now that that aid has stopped, the fear is that it may lead to inflation and rising prices day by day and hence the poverty rate might increase accordingly. Therefore, there is an urgent need to make long-term plans in addition to short-term ones and gradually control the situation. There are various long-term opportunities to control the situation. Afghanistan is the crossroads of Central Asia and South Asia and can be a practical connecting point for Central and Southern Asia through the projects such as TAPI, CASA-1000 and Lapis Lazuli with which international companies will establish a presence in Afghanistan.



Afghanistan's internal and international political problems and the new government's policy and implementation of the Islamic economic system, while the international system is based on usury, is a challenge for the future economy, for which solutions should be sought in the short and long terms. The central bank must now build capacity for urgent research in various areas, to fundamentally address existing opportunities and challenges and to reconsider its policies and objectives accordingly. Beside this, regional and international campaigns should be organized through various conferences and other means to attract humanitarian assistance.

## RECOMMENDATIONS AND SOLUTIONS:

There are short-term, midterm and long-term solutions for controlling the current situation to be implemented by the new government. From the short-term ones some are pointed at below:

- **First:** Previously, as the value of the Afghani and the exchange rate were being stabilized through the auction of dollars and the issuance of capital notes, now, for short-term, this process can be altered to Sukuk or Islamic bonds. If the Ministry of Finance issues Sukuk and provide it to the market through Da Afghanistan Bank, it will be effective in terms of fluidity of banks and will also help in stabilizing the exchange rate. In this way, if there is any extra Afghani in the market, Da Afghanistan Bank will get it back.
- **Second:** Another issue is the reserves of Da Afghanistan Bank which are around 9.4 billion dollars and are now frozen. This is a politico-economic issue and if left unresolved, Afghanistan could face a humanitarian crisis. Efforts should be made at the national and international levels to unfreeze these frozen reserves, which should be handed over to Da Afghanistan Bank. This will also play its role in controlling the situation as a short-term solution.
- **Third:** The third is the 1.2 billion dollars newly announced humanitarian aid pledged by the international community. If the aid is channeled through the banking sector, it will enable banks to keep the currency and pay its equivalent in Afghani.
- **Fourth:** The fourth is that Afghans living abroad send their money to Afghanistan through the banking system. It is estimated that Afghans send about 800 million dollars to Afghanistan each year.



Beside this, there are some long-term solutions that the new government must consider and work for its achievement. Here are some of the long-term solutions:

- **First:** The first is that there is a huge gap between exports and imports; serious efforts should be made to reduce this gap so that the currency does not go out of the country and Afghani does not go under pressure.
- **Second:** Second is the issue of regional connectivity and major projects such as TAPI, CASA-1000 and the Silk Road projects that connects Afghanistan to Europe. If progress is made on these projects, it will directly help the economy of Afghanistan in the long-term.
- **Third:** The third is the issue of efficient extraction of mines. According to some estimates, Afghanistan has unexplored mines, worth at least 1 trillion dollars, the efficient extraction of which will have a significant impact on the country's overall economic situation. Previously, this was not possible due to corruption, poor governance and security concerns. An example is the Mes Aynak mine in Logar, which has not progressed despite the contract and the start of operation.
- **Fourth:** The fourth is implementation of development projects in the field of agriculture. The contribution of agriculture to Afghanistan's GDP is significant and if attention is paid to this sector, it can help a lot with the country's national economy.
- **Fifth:** Afghan and foreign investors should be encouraged to come to Afghanistan and transfer their capital; because in the past, security was a major obstacle and now that the security situation has improved, they should be encouraged and investment conditions should be prepared and made easier for them.
- **Sixth:** The sixth is the issue of foreign tourists. In the long-term, by creating an atmosphere of security and stability, international tourists should be encouraged to come to Afghanistan. Afghanistan has a significant opportunity to strengthen its economy from this aspect.
- **Seventh:** Given that Afghanistan's economic system will after this be Islamic and the world banking system is based on the usury system, it is now necessary to identify the problems between Afghanistan and the world in international interactions and find solutions with the help of a team of



experts of this field. Considering the experience of some countries, it is necessary to take gradual steps in the implementation of Islamic banking and Islamic economics.

The end

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The Centre for Strategic and Regional Studies (CSRS) is an independent, non-profit, and non-governmental research organization established in July 2009 in Kabul. CSRS is committed to promoting policy-oriented research through conducting authentic and unbiased research concerning Afghanistan and the region.

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