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Challenges, Pitfalls and Prospects

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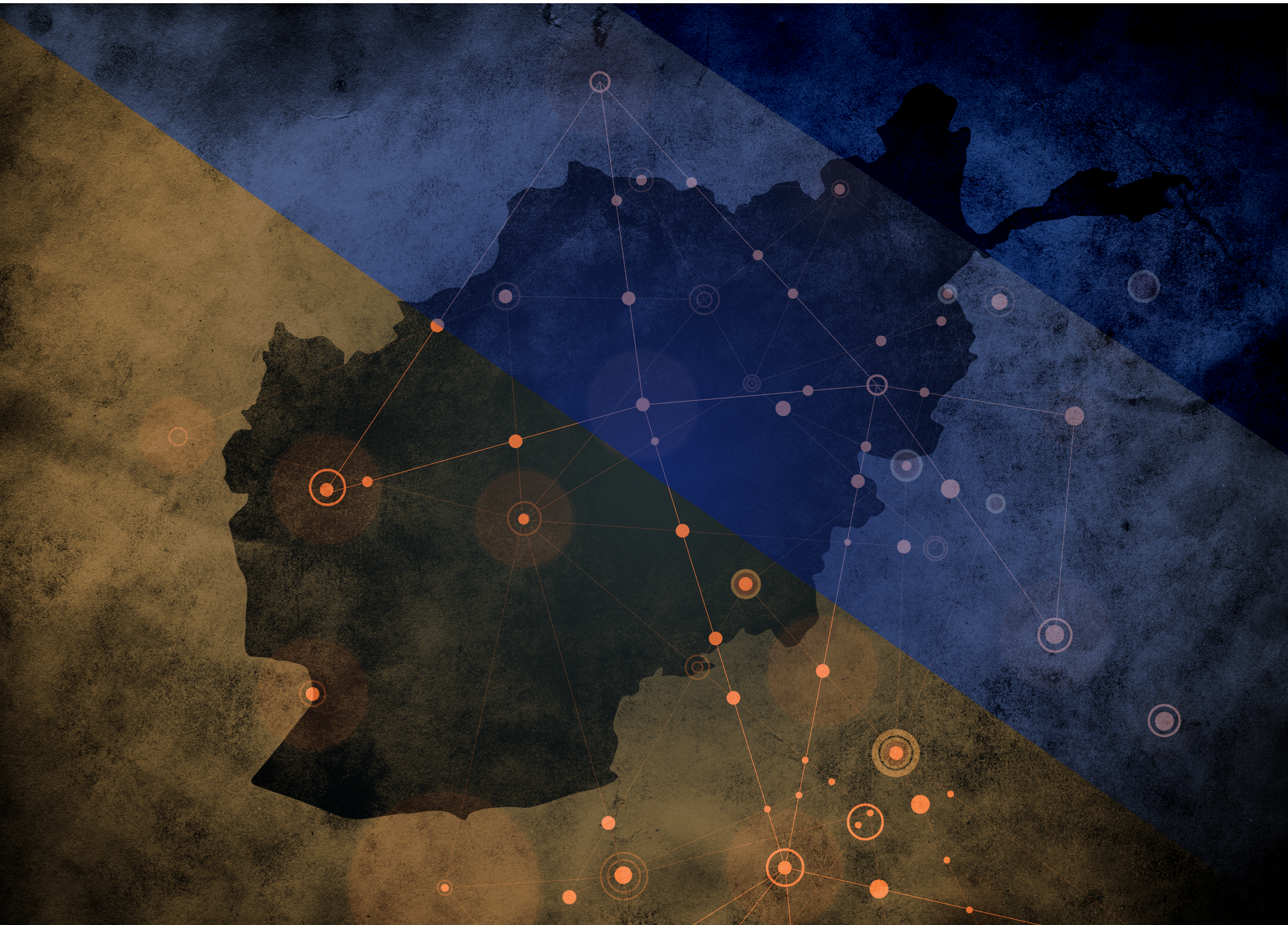

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Introduction

Since the Taliban's takeover of Afghanistan in mid-August 2021, the country has plunged into a severe economic crisis. The economy has shrunk by nearly one-third (World Bank, 2023), leaving approximately 34 million people—around 90% of the population—below the poverty line (UNDP, 2023, p. 10). This crisis has positioned Afghanistan among the poorest countries globally, ranking it at the bottom of the World Happiness Index (Helliwell et al., 2024, p. 18). Women have been especially affected, with their workforce participation nearly halving from 11% in 2022 to just 6% in 2023 (UN, 2024).

In response to these escalating challenges, Afghanistan has received about US$ 6.7 billion in humanitarian assistance since the collapse, aimed at addressing the record-high needs triggered by the crisis. These unprecedented needs arose from severe banking sector disruptions, the abrupt suspension of bilateral development aid, escalating food insecurity and poverty, the most severe drought in 30 years, and concerns over a possible collapse of the public health system (OCHA, 2024).

While the situation has relatively stabilized since the initial period of crisis, marked by a significant reduction in conflict-related displacement and slight improvements in food insecurity and poverty, Afghanistan remains highly vulnerable. The country is highly susceptible to natural disasters, the effects of climate change, and shifting geopolitical dynamics, any of which could rapidly trigger new needs and exacerbate existing challenges (Ibid).

Since assuming power, the Taliban have increasingly promoted the narrative that they have exceeded expectations in managing Afghanistan's economy. However, this portrayal is misleading (Daudzai, 2024). While the Taliban have made modest progress in certain areas of the economy at both national and regional levels, they have also deepened pre-existing challenges over the past three years. As Daudzai (2024) aptly states, the Taliban's governance has resulted in a fragile and unsustainable economic landscape. Their claims of infrastructure development are exaggerated, and the mining sector continues to face significant obstacles.

This paper provides a critical analysis of Afghanistan's economy under Taliban rule including discussing their efforts toward regional economic integration over the past three years. It evaluates the impact of the Taliban's economic policies on the country's overall performance, with a particular focus on key sectors such as the banking and financial system, taxation and fiscal administration, and regional infrastructure initiatives. Furthermore, the research examines the Taliban's strategies for managing these areas and assesses the implications of these strategies for Afghanistan's economic stability and the well-being of its population.

The paper begins by examining the state of Afghanistan's economy under the Taliban rule, providing an overview of its macroeconomic performance over the past three years. This is followed by an in-depth analysis of the Taliban's monetary and fiscal policies in the subsequent sections. It then analyzes the Taliban's efforts toward regional economic integration, highlighting the challenges that have hindered progress in this area. Finally, it concludes by summarizing the key findings.

A Stagnant Economy

Since the Taliban's rise to power, Afghanistan's real sector has experienced a sustained decline, deepening economic uncertainty and leaving the country in a precarious state of fragile and temporary stability (World Bank, 2023). The GDP contracted sharply by 20.7% in 2021, followed by a further 6.2% decline in 2022 (World Bank, 2023, p. 18). By end of 2021, GDP per capita had declined by nearly one-third compared to its level in 2020 (see Table 1).

This economic downturn impacted all major economic sectors. The services sector which accounted for approximately 45% of GDP, contracted by 6.5% in 2022, following a steep 30% decline in 2021. The agriculture sector representing approximately 36% of GDP, experienced a 6.6% contraction in 2022, due to severe drought that reduced wheat yields and impacted pastoral livelihoods, further aggravated by harsh winter conditions. Similarly, the industrial sector shrank by 5.7% in 2022 primarily due to manufacturing setbacks, with output falling by 10% in 2022 – a smaller decline compared to 12.8% reduction in 2021. This contraction was driven by businesses closure caused by limited access to resources and persistent financial constraints. The construction sector also declined slightly by 0.8% in 2022, marking an improvement from the dramatic 35% contraction recorded in 2021. In contrast, the mining and quarrying sector expanded by 4.1%, in 2022, supported by increased coal extraction (World Bank, 2024a, pp. 13 & 18).

The macroeconomic downturn in Afghanistan has deepened the already severe socio-economic challenges faced by households. A UNDP survey highlights that 84% of the population spent less than AFN 2,268 [about US$ 28][1] per person per month, falling below the national poverty threshold (UNDP, 2023, p. 9). When focusing on the food poverty line—which considers regional variations and food inflation—the proportion of the population unable to afford basic necessities at AFN 1,330 per person per month surpassed 90%. This dire situation has caused the funding needed to close the poverty gap to escalate dramatically, reaching an estimated US$5 billion in 2022, up from just US$ 900 million in 2020. Furthermore, the UNDP report reveals that over three-quarters of Afghan households have been forced to rely on borrowing food or money to meet their basic survival needs. Any remaining funds—no matter how minimal—are primarily directed toward essential healthcare and other basic necessities (Ibid, pp. 9–10).

This economic decline has been profoundly distressing for Afghanistan, as hundreds of thousands of young men and women traditionally entered the labor market each year. The situation has been further strained by the forced return of vast numbers of Afghan migrants, including over 600,000 from Pakistan since September 2023, alongside comparable numbers from Iran. Compounding the crisis, approximately half a million laborers lost their livelihoods following the Taliban's 2022 ban on opium poppy

1 Based on the historical average exchange rate for 2023, where US$ 1 = AFN 81.18 (Investing.com).

Table 1: Afghanistan Economic Performance from Emirate 1 to Emirate 2 (1995 -2024)

Economic Indicator	Emirate 1 (1995-2001)	Republic (2001-2021)	Emirate 2 (2021-2023)
Nominal GDP (Billion US$)	3.5 (2000)	20 (2020) **+471%**	14 (2022) **-30%**
GDP Per Capita (US$)	181 (2000)	512 (2020) **+183%**	355 (end 2021) **-31%**
Unemployment Rate	-	11.7% (2020)	30% (2023) **+156%**
Povery Rate	80% (2000)	49% (2020) **-39%**	90% (2023) **+84%**

Daudzai 2024

cultivation.[2] Women have borne the brunt of these economic challenges, with their employment plunging by 25% since the Taliban's return to power, compared to a 7% drop for men. Restrictions have barred women from many government roles, while stringent regulations on dress codes, gender-segregated facilities, and the requirement of male chaperones have severely limited their ability to participate in the few sectors still available to them (Smith, 2024). Furthermore, the Herat earthquake in October 2023 caused significant damage to critical infrastructure, leading to an estimated reduction in GDP growth of 0.5–0.8% (World Bank, 2024a, p. 9), among other natural disasters which have struck the country.

Demand grows when individuals are employed and receive salaries. Currently, 47% of Afghans, including women who face significant limitations on their external activities, are unemployed or underemployed. It is stated that a one-percentage-point increase in unemployment correlates with a two-percentage-point drop in GDP (Sabit, 2024b). Furthermore, the sudden stoppage of international aid, amounting to approximately US$ 8 billion or 40% of Afghanistan's total GDP, has greatly affected the country's employment landscape. For example, in 2019, the Republic government received US$ 4.7 billion in military support and about US$ 4 billion in civilian aid (Clark 2023, p. 2). This drastic reduction in aid has resulted

2 In April 2022, the Taliban authorities introduced strict laws banning opium poppy cultivation across Afghanistan. This policy has inflicted a severe economic setback on impoverished rural households, particularly among Pashtun communities, who previously relied on opium production as a vital source of income. The ban has led to an estimated annual income loss of US$ 1 billion, leaving these communities grappling with scarce alternative employment opportunities and a deeply uncertain future (Byrd, 2024, p. 7).

in significant rises in unemployment, poverty, and starvation (Ahmadi et al., 2023, p. 3). Additionally, factors like population growth and the expulsion of thousands of Afghans from Pakistan have intensified the country's economic difficulties (Ahmadi et al., 2023, p. 3).

> **Economists assert that the country has been in recession since the Taliban's takeover.**

The economic decline has resulted in a marked decrease in aggregate expenditure, subsequently reducing aggregate demand and the purchasing power of citizens. Economists assert that the country has been in recession since the Taliban's takeover. Former Economy Minister Musafa Mastoor, in a 2023 interview, stated that following a brief period of early stability in 2022, the economy succumbed to recession. In such scenarios, economists typically suggest that governments adopt expansionary fiscal and monetary policies. They recommend that the Central Bank should lower interest rates to stimulate economic activity. Simultaneously, the Ministry of Finance is advised to reduce taxes and customs duties, aiming to boost investments, foster business growth, and enhance employment opportunities. Contrary to these expert recommendations, the Taliban's policies have moved in the opposite direction.

A Failing Financial Sector

When the Taliban assumed control of the government, they took charge of key macroeconomic institutions, such as the central bank (Da Afghanistan Bank, or DAB) and the Ministry of Finance, both of which were fully operational and functioning. This stands in stark contrast to the 1990s, when prolonged civil conflict had effectively dismantled government institutions, including critical economic bodies (Byrd, 2023). The government workforce was highly educated and professionally skilled, reflecting the human capital accumulated over the past two decades. Although many senior officials, particularly women, had left the country after the collapse, a substantial number of mid-level staff, including managers and technical experts, remained. Aside from a brief disruption, information technology and other critical systems remained intact and continued operating as they had before (Byrd, 2024, pp. 9-10).

Despite inheriting a functioning banking sector, the industry has struggled to effectively serve the public. It has faced significant challenges stemming from declining assets and deposits, further exacerbated by difficulties with international payments (and bank de-risking due to fear of sanctions) and the transition to Islamic Finance. These pressures have driven increased reliance on cash and alternative payment methods, tightening the money supply and intensifying economic downturns and deflationary trends (World Bank, 2024a, p. 25).

After seizing power, the Taliban issued decrees imposing abrupt restrictions on withdrawals[3] and mandating that the banking system adhere to Islamic principles. These measures undermined public confidence in the banking sector, disrupting the flow of funds from savers to investors and hindering economic growth (Sabit, 2024a; Daudzai, 2024). The limitations sparked widespread panic, leading to a significant outflow of deposits as account holders rushed to secure their funds (Faeeq, 2023, p. 2). As a result, total deposits in the banking sector decreased by 20% in 2021 and an additional 9% decline in 2022 (World Bank, 2023, p. 40). This downward trend continued with aggregate deposits recording another 9% year-on-year decline as of December 2023 (World Bank, 2024a, p. 25).

Even before the political crisis, depositors had begun withdrawing their savings as a precautionary measure. Confidence in the banking system was further undermined by growing uncertainties surrounding the political and economic environment. The Taliban's takeover exacerbated these fears, culminating in a 'full-scale bank run' (World Bank, 2022, p. 7).

This crisis resulted in a substantial loss of US$ 1.5 billion, equivalent to 41% of the banking sector's total deposits. Deposits dropped sharply from US$ 3.6 billion to US$ 2.1 billion, with private banks enduring a 44% decline (US$ 1.2 billion) and state-owned banks experiencing a 33% reduction. This situation was particularly dire for two private banks, which suffered losses of nearly 80% of their reported deposits (Faeeq, 2023, p. 2). The crisis had a profound impact on the profitability of the banks in both 2021 and 2022. By the first nine months of 2022, the ten banks collectively reported losses totalling approximately US$ 30 million. Notably, only Afghanistan International Bank (AIB) recorded a profit of US$ 6.5 million as of September 2022, while the remaining nine banks reported significant losses (Ibid, p. 11).[4]

After seizing power, the Taliban issued decrees imposing abrupt restrictions on withdrawals and mandating that the banking system adhere to Islamic principles.

Due to limited data availability, the full extent of the crisis remains unclear. Since August 2021, only seven of Afghanistan's twelve commercial banks have published their financial statements. As noted by the World Bank, the quality of the sector's assets is also uncertain, partly because of the forbearance measures implemented since 2021" (World Bank, 2024a, p. 25). The Afghanistan Banks Association (ABA), which appears to collect quarterly data from all twelve banks, reported a 10.54% year-on-year decline in the sector's total asset base as of December 2023. This marks an estimated 25% contraction in the total asset base since

3 Withdrawal limits were set at AFN 30,000 (approximately US$ 400) per week for individuals, or a lump sum of AFN 100,000 (around US$ 1,200) per month. The central bank issued a decree allowing corporate clients to withdraw up to US$ 25,000 per month (including the AFN equivalent) or 5% of their deposited assets, whichever was lower (World Bank, 2023, p. 40).

4 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 (Faeeq, 2023, p. 11).

2020, underscoring a troubling trajectory for an already small industry where total assets accounted for less than 20% of GDP in 2020 (Ibid).

While global Islamic banking has successfully integrated with conventional financial systems, the Taliban's rigid interpretation of Islamic finance principles has caused significant dysfunction.

While global Islamic banking has successfully integrated with conventional financial systems, the Taliban's rigid interpretation of Islamic finance principles has caused significant dysfunction. The absence of a functioning stock market, combined with the looming collapse of the banking system, has triggered a broader financial crisis, drawing parallels to similar crises in the late 1990s (Daudzai, 2024). The Taliban's ban on interest rates, coupled with their sluggish efforts to transition the sector from conventional to Islamic banking (PYMNTS, 2022), has severely disrupted the financial sector, leading to a 27% decline in interest income in 2022 compared to 2021 (World Bank, 2023, p. 39).[5] This ban has further impaired core banking functions such as deposit collection and loan issuance, forcing banks to raise service costs. As a result, the formal banking sector has ceded considerable ground to informal and shadow banking systems (Faeeq, 2023, p. 1), exacerbating financial instability and weakening the country's economic foundation.

On the other hand, international partners imposed a series of sanctions[6] that significantly weakened Afghanistan's banking sector (Sabit, 2024a). Restrictions on international financial transactions pushed the banking industry to the brink of collapse. Clark (2023, p. 2) argues that sanctions imposed by the United Nations and the United States severely disrupted trade and financial transfers. Furthermore, the freezing of the Central Bank's access to US$ 9 billion in reserves caused a dysfunctional payment system, forcing the majority of transactions to revert to informal Hawala networks. This freeze has also exacerbated liquidity pressures, preventing banks from meeting withdrawal demands and further increasing challenges and risks to financial stability. Additionally, financial reporting within the sector has been sporadic and incomplete. For instance, out of 12 banks, only seven disclosed their financial statements for 2022 (World Bank, 2023, p. 39; Maizland and Baumgartner, 2022).

5 The net interest income accounted for nearly half of the banking industry's total operating income in 2019 and 2020 (Faeeq, 2023, pp. 11–12).

6 In early 2022, President Biden signed an Executive Order on the property of the Central Bank, blocking all of Afghanistan's central bank reserves held in the United States (Federal Register, 2022, p. 8391). Of the total US$9.5 billion, US$7 billion was held at the Federal Reserve Bank of New York, with the remainder kept in Afghanistan and other foreign financial institutions (Congressional Research Service, 2023). Further sanctions imposed by the US and the UN further isolated Afghanistan from global financial systems, as banks and correspondent institutions avoided cross-border transactions with the country due to strict compliance requirements (Erisen, 2023; Clark, 2023b, p. 4). Following the Taliban takeover, major financial institutions such as the IMF and the World Bank also suspended funding to Afghanistan, with the World Bank citing concerns about the country's development prospects, particularly for women (BBC, 2021).

Deflation, a Blessing or a Curse?

When the Taliban assumed power, they implemented decisive measures to combat inflation and stabilise the Afghani, Afghanistan's local currency. After depreciating to a low of 105 Afghanis per U.S. dollar in January 2022, the currency strengthened significantly, appreciating by nearly 45% to trade at 71 Afghanis per dollar—surpassing its pre-takeover value (Elesar, 2024). Inflation, which had peaked at 18.3% in July 2022, has seen a dramatic reversal, transitioning into deflation at –9.1% by July 2023 (World Bank, 2023, pp. 19, 21). This deflation deepened to –9.7% year-over-year by February 2024, driven primarily by substantial decreases in food prices (–14.4%) and non-food prices (–4.4%) (World Bank, 2024a, p. 9). This steep deflation is largely attributed to a significant decline in aggregate demand, which has hindered economic growth and development (World Bank, 2023, pp. 19, 21). The decline in aggregate demand was linked to reduced household savings, a sharp drop in incomes following the ban on poppy cultivation, and austerity measures that have constrained government spending (Elesar, 2024).

Some media outlets have highlighted the Taliban narrative, portraying the Afghani as one of the world's best-performing currencies in 2023. However, this performance was the result of several contributing factors (Daudzai, 2024). Chief among these were the Taliban's prohibition on foreign currency usage and the steady flow of diaspora remittances, estimated at US$ 1–1.2 billion annually (World Bank, 2023, p. 22). Moreover, substantial cash shipments from the United Nations have played a pivotal role in stabilising prices. Despite the suspension of development aid, Afghanistan has received approximately US$ 6.7 billion in humanitarian assistance since the Taliban's takeover, aimed at addressing record-high humanitarian needs resulting from the ongoing crisis (OCHA, 2024).

While deflation may seem beneficial in the short term by boosting real wages and improving household welfare, its long-term effects can be damaging.

While deflation may seem beneficial in the short term by boosting real wages and improving household welfare, its long-term effects can be damaging. It undermines business growth, leading to rising unemployment and underemployment (World Bank, 2023, p. 21). Elesar (2024) notes that the decline in prices have temporarily relieved Afghanistan's poorest populations by increasing their real incomes. Supporting this, World Bank data reveals that the proportion of Afghan households unable to meet basic needs has declined from 70% to 62% over the past two years (Ibid). However, this apparent stability is unlikely to last, as it does not reflect genuine economic health. When the Taliban eventually issue new currency, inflation—or even hyperinflation—is expected to follow (Daudzai, 2024) undermining these fragile gains.

Although declining prices may benefit consumers in the short term, they threaten the profitability of businesses in the long run. Sabit (2024a) explains that while a nation's currency value may rise as prices fall, deflation reduces business profitability, prompting firms to scale back production and lay off workers. This, in turn, weakens consumer purchasing power, further diminishing aggregate demand. As economic activity slows, businesses struggle to sell their goods and services, leading to a contracting economy (Ibid).

Finally, deflation poses a profound threat to economic stability. It increases the real burden of debt, erodes purchasing power, and suppresses demand. This situation poses a conundrum: "why make purchases today when prices are anticipated to drop tomorrow?" (Elesar, 2024). Consequently, businesses delay development investments, and individuals reduce major expenditures. This stagnation results in declining business profits, stagnant nominal wages, and reduced government revenues. Together, these dynamics are set to exacerbate poverty levels. Breaking free from the deflationary cycle presents a significant and complex challenge (Ibid).

A Coercive Non-Transparent Taxation System

When the Taliban assumed control in 2021, domestic revenue collapsed amidst political turmoil and unrest. Total domestic revenues for the year fell to AFN 140 billion, a significant decrease from AFN 173.2 billion in 2020, representing a nominal decline of 20%. Even before the Taliban's full takeover, revenue collection faced considerable challenges. By July 2021, major border crossings had come under Taliban control, leading to a sharp decline in customs revenue and further eroding public confidence in the Republic government (World Bank, 2022, p. 10).

Despite significant disruptions, the Taliban demonstrated improved efficiency in revenue collection, particularly in taxes and customs.

Despite significant disruptions, the Taliban demonstrated improved efficiency in revenue collection, particularly in taxes and customs, compared to the previous Republic regime (Clark, 2023a, p. 9). By 2022, total revenues had rebounded to AFN 193.9 billion (approximately US$ 2.2 billion) (World Bank, 2023, pp. 7, 33), reflecting a remarkable recovery from the significant setbacks of the previous year. In 2023, the Taliban successfully met their revenue target, primarily driven by increased import taxes and non-tax revenues (World Bank, 2024a, p. 17).[7] Total revenue for the fiscal year 2023 climbed to AFN 210.7 billion or US$ 2.9 billion, a 30% increase from 2022 (UN Security Council, 2024; World Bank, 2024a, p. 17). This consisted of AFN 108.1 billion from customs and AFN 102.6 billion from inland revenue, marking the first time the Taliban slightly surpassed their revenue target of AFN 210 billion [US$ 2.9 billion]

7 The reliance on increased import volumes and the accompanying rise in border tax revenues is not beneficial for the economy. Runde et al. (2024, p. 8) warn that this dependency on imports risks deepening Afghanistan's reliance on foreign goods, potentially undermining the development of its domestic economy. Furthermore, "one-time non-tax revenues, such as vehicle registration fees, passport issuances, and royalties," remain unsustainable as recurring income sources (Runde et al., 2024, p. 8).

(World Bank, 2024a, p. 17).

The rise in revenue was largely attributed to the Taliban's efforts to dismantle extensive networks of roadside checkpoints, where powerbrokers and even their own insurgents had long extracted substantial informal rents across multiple provinces (Alcis and Mansfield, 2022, pp. 1, 6). Another significant factor was the Taliban's success in addressing the pervasive corruption that had plagued the Republic (Felbab-Brown, 2024; Byrd, 2023). This was especially evident in customs houses, where the Taliban implemented stricter measures to combat smuggling, bribery, and the separate trade levies previously enforced by their insurgency.

> **Reports from locals reveal that wealth taxes have been enforced coercively, often without consideration for individuals' dire financial circumstances, even amid acute hunger and starvation.**

In an interview with the Afghanistan Analysts Network (AAN), former Acting Finance Minister Khalid Payenda stated that up to eight million dollars a day could potentially be collected if trade diversion [smugglings] were addressed and goods were assessed with complete transparency in provincial customs offices (Clark and Shapour, 2021, p. 2). This could potentially generate about three billion dollars in annual revenue, which would have offered the Republic significantly greater financial independence to fund its operations.

The significant improvements in revenue collection under the Taliban have come at a human cost. Their methods of tax collection have been marked by severe coercion and outright extortion. Intimidation and force have been routinely employed to extract payments from individuals already struggling below the poverty line (Ehsan, 2023). In a collapsing economy plagued by widespread unemployment, many citizens were already grappling with the challenge of basic survival. The imposition of additional taxes only exacerbated these hardships, creating even greater obstacles for struggling workers (Hakimi, 2023).

Typically, in a recessionary economy, fiscal policymakers focus on reducing or eliminating taxes and customs duties to alleviate the burden on citizens. However, under Taliban rule, new levies have been introduced, including land taxes that had been dormant for two decades. Following their ascent to power, the Taliban implemented two nationwide Islamic taxes—*Zakat* and *Ushr*—targeting agricultural harvests and livestock (Clark, 2023a, p. 10).

Under the Taliban's interpretation of Sharia law, citizens have been obligated to pay one-tenth of their agricultural produce as *Ushr* and *Zakat,* a wealth tax applied to non-agricultural assets, including livestock. Reports from locals reveal that these taxes have been enforced coercively, often without consideration for individuals' dire financial circumstances, even amid acute hunger and starvation (Ehsan, 2023). Moreover, business owners have faced additional financial pressures, as the Taliban imposed taxes arbitrarily, with little regard for the profitability of their enterprises (Ehsan, 2023). This aggressive taxation policy has further deepened the economic crisis, leaving many citizens and businesses struggling to cope.

In addition to the coercive nature of its taxation, the Taliban regime has also fundamentally lacked meaningful financial transparency, particularly regarding their expenditures. They have demonstrated no sense of responsibility or accountability to taxpayers, having dismantled existing structures for public financial reporting. The transparency that once existed has completely vanished, raising serious concerns about the allocation and use of the collected tax revenue (Clark, 2022, p. 5). Runde et al. (2024, p. 8) argue that Taliban have not disclosed how funds have been allocated between security forces, intelligence operations, and prisons versus essential public services such as food, healthcare, and education. Additionally, the regime has not provided any criteria for awarding government contracts, selling public property, or issuing licenses (Ibid).

The Taliban's lack of transparency regarding revenues or public expenditure has created uncertainty about how funds collected from taxes, fees, customs duties, and natural resources are being utilized. Judging only by what is presented to the public in terms of Taliban activities, it seems that a significant portion of these revenues has been directed toward salaries for civil servants and security forces, government operations, and a limited number of large development projects, particularly those focused on water management and road infrastructure (Sabit, 2024a).

Despite their claims of improved security, expenditures on the security sector continued to dominate their national budget. Data from the Taliban's first ever announced mini-budget—a three-month budget for the fourth quarter of 1400 (21 December 2021 to 20 March 2022)—shows that AFN 22 billion (US$ 258.3 million), or 40.7% of the total budget, was allocated to the security sector (Clark and Shapour, 2023, pp. 11-13).

Of this total three-month budget expenditure of US$ 634 million, 16.6% (US$ 105 million) was allocated to the Ministry of Interior, 15.9% (US$ 101 million) to the General Directorate for the Security of the Prime Minister, 6.7% (US$ 42 million) to the National Security Council, 0.7% (US$ 4.5 million) to the Ministry of Defence, 0.5% (US$ 2.9 million) to the Ministry for Promoting Virtue and Preventing Vice (morality police), and 0.4% (US$ 2.8 million) to the General Directorate of Intelligence. Overall, 91% of the proposed expenditures (AFN 49 billion or US$ 579 million) were allocated to operating costs, primarily for salaries, while only 8.7% (AFN 4.7 billion or US$ 55.5 million) was designated for development projects (Ibid).

This allocation stands in stark contrast to the Republic government, which allocated 66% of its budget to administration and 34% to development.[8] The Taliban's priorities are further reflected in the disproportionate share of administrative expenses directed to the Ministry of Interior Affairs, which absorbs approximately 20% of the national budget. Meanwhile, Afghanistan's healthcare system and education sector (only US$ 31 million or about 5% of total mini-budget) have remained severely underfunded and critically in need of support (Elesar, 2024; Clark and Shapour, 2023, pp. 11-13).

8 Despite these stark contrasts, the Republic government was heavily reliant on military and development funding from the international community. For example, while the Karzai administration generated approximately US$2.5 billion in annual revenue, the cost of maintaining the security forces was three to four times higher (Carlstrom, 2011). the state's coercive power entirely dependent on external support for funding, armament, and training (Suhrke, 2011, pp. 237-8).

Regional Economic Integration: A Myth or Reality?

In recent decades, conflict rendered Afghanistan a major obstacle to regional development. However, since 2021, the relative stability under the Taliban has rekindled regional aspirations for trade corridors linking South and Central Asia, breathing new life into longstanding plans to facilitate the movement in particular of goods, gas, and power. Both the Taliban and neighboring governments have expressed interest in advancing such economic ties, driven by their respective strategic objectives (ICG, 2024, p. 18).

The Taliban leadership also has actively sought foreign investment in key sectors such as mining, irrigation, and infrastructure development. Notably, they have expressed their intent to participate in China's Belt and Road Initiative (Runde et al., 2024, p. 12) reflecting a desire to align with broader regional economic frameworks.

In their effort to diversify regional and international partnerships, the Taliban have strategically distributed economic agreements among various nations, including rivals like the United Arab Emirates and Qatar (Felbab-Brown, 2024). Since assuming power in 2021, they have announced over 200 mining agreements, including 15 major contracts with a combined value exceeding US$ 6.5 billion. These contracts allegedly have been awarded to companies from China, Iran, Turkey, Qatar, and the United Kingdom, although the specific terms of these agreements have remained undisclosed (Sabit, 2024a).

This focus on regional collaboration and investment has particularly attracted significant interest from China. In late 2021, shortly after the Taliban regained power, several Chinese companies visited Afghanistan on "special visas" to evaluate potential lithium projects on-site. This visit marked a tangible initial step toward exploring opportunities to tap into Afghanistan's vast mineral resources, particularly its lithium (Global Times, 2021). By January 2023, reports emerged highlighting the potential value of Afghanistan's lithium reserves (Ruttig, 2023, p. 6). Subsequently, a Chinese firm, Gochin, proposed a US$ 10 billion investment plan, which included the establishment of lithium ore processing facilities, battery manufacturing plants, and critical infrastructure projects such as hydropower dams, road networks, and the construction of a second Salang tunnel. This initiative was projected to create approximately 120 thousand jobs (Boltaev, 2024; Ruttig, 2023, p. 6). Afghanistan's lithium reserves are highly appealing to China, the world's largest electric vehicle market, where lithium plays a vital role in battery production (Ruttig, 2023, p. 6).

Further strengthening economic ties, a significant partnership was established in early 2023 between the Taliban and the Xinjiang Central Asia Petroleum and Gas Company (CAPEIC). Under a 25-year agreement, CAPEIC pledged to invest up to USD 150 million in the first year (2023) and an additional USD 540 million through 2026 in the Amu Darya River Basin in northern Afghanistan. The agreement will grant the Taliban a 15% royalty fee from the project, with initial daily oil production expected to start at approximately 200 tonnes, gradually increasing to around 1,000 tonnes (Boltaev, 2024; Taipei Times, 2023).

The Afghan part of the Amu Darya River Basin comprises five identified fields, estimated to hold 87 million barrels

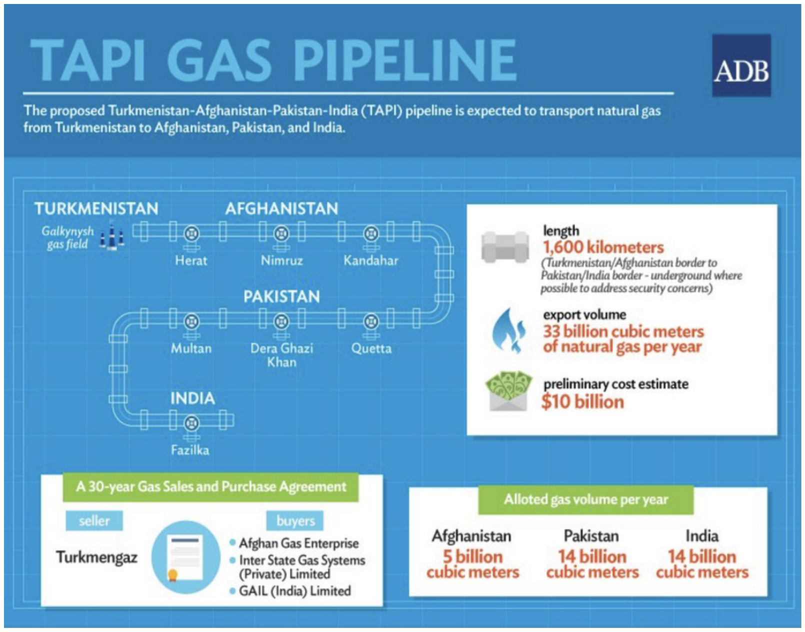
Mes Aynank mine project. Jerome Starkey/Wikimedia Commons

of crude oil (Taipei Times, 2023). CAPEIC will drill across three designated blocks, spanning an area of over 5,000 square kilometres. The Amu Darya Basin itself, shared by Afghanistan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan, holds the world's third-largest oil and natural gas reserves, ranking behind the Persian Gulf and Russia's Western Siberia. Notably, 95 percent of the basin lies within Afghanistan's northern neighbours, Turkmenistan and Uzbekistan (Ruttig, 2023, p. 4).

China has continued its engagement in Afghanistan's resource sectors. The Fan China Afghan Mining Processing and Trading Company has revealed plans to invest US$ 350 million over the next few years in diverse areas, including power generation, the establishment of a cement factory, and initiatives to improve public health (Karam Shah, 2024). Furthermore, in May 2023, Pakistan, China, and Afghanistan agreed to strengthen economic ties by extending the China-Pakistan Economic Corridor (CPEC), a key initiative backed by Beijing, into Afghanistan, aiming to maximise the country's role as a regional connectivity hub. The three nations emphasised their commitment to leveraging Afghanistan's strategic potential and advancing trilateral cooperation under the Belt and Road Initiative (BRI). This agreement underscores their shared vision of integrating Afghanistan into broader regional economic frameworks (The Economic Times, 2023).

That said, despite a gradual increase in low-key trade between China and Afghanistan, the Taliban, like their predecessors, remained dissatisfied with the limited scale of Chinese investment. For example, in July 2024, a ribbon-cutting

Figure 1: Map of the TAPI Gas Pipeline Extension Project



Source: ADB, 2016

ceremony—reportedly the tenth one—was held at the Aynak Mes copper mine,[9] where China has held a mining license for 15 years, yet no actual extraction has begun (Felbab-Brown, 2024). The Aynak Mes copper mine project dates back to 2008 when a 30-year lease was awarded to a Chinese company to extract approximately 11.08 million tonnes of copper. However, more than halfway through the lease period, the company has yet to begin developing the mines (Kumar and Noori, 2023).

Additionally, the Taliban have promoted progress on the Turkmenistan-Afghanistan-Pakistan-India (TAPI) gas pipeline project (Daudzai, 2024), an 1800 kilometres long pipeline designed to transport up to 33 billion cubic meters of natural gas annually from Turkmenistan to Afghanistan, Pakistan, and India. It is anticipated that the project will create thousands of construction jobs as well as generating approximately US$ 400 million in transit duties annually for the Afghan treasury (ADB, 2018; Hamidzada and Ponzio, 2019, p. 18).

In August 2024, the Taliban announced that they were close to finalizing an agreement with the World Bank to launch the CASA-1000 project, claiming that work would begin soon and be completed by 2026 (Afghanistan International, 2024). Earlier in the year, the World Bank (2024b) confirmed that the project would move forward at the request of the three neighbouring countries involved. CASA-1000, a US$ 1.2 billion regional initiative, aims to transmit clean energy from Tajikistan and the Kyrgyz Republic to Pakistan through Afghanistan. While construction in the other three participating countries is nearly complete,

9 The Aynak Mes copper mine is situated in the arid landscapes of Logar Province, approximately 40 kilometres south-east of Kabul. It holds one of the world's largest copper deposits, offering a substantial potential revenue stream for Afghanistan.

Figure 2: Map of the CASA-1000 Electricity Transmission and Trade Project

Source: CASA-1000.org

work on the Afghan part will resume under a ring-fenced framework. This approach ensures that all construction payments and future revenues are managed externally, limiting the involvement of the Taliban administration (World Bank, 2024b).
By strengthening energy connectivity, promoting electricity trade, and fostering economic growth, CASA-1000 stands to benefit all participating nations (Khan, 2024).

Potential Challenges and Pitfalls

Despite the potential benefits of these projects to Afghanistan, significant challenges and uncertainties continue to hinder their progress. The lack of detailed information and tangible advancements raises doubts about the feasibility of these investments materializing in the near future (Karam Shah, 2024). These projects face substantial risks, including technical and logistical hurdles, political instability, governance issues, and persistent security threats. Additionally, the Taliban regime's lack of international recognition and limited diplomatic relations with many governments further exacerbate obstacles such as "financial sanctions, restricted access to state assets abroad, and strained diplomatic relations" (Khan, 2024).

These challenges have significantly contributed to severe delays in the implementation of these projects. For example, while the Taliban have claimed that their administration is more effective than the previous government in advancing the TAPI pipeline, international sanctions have created formidable barriers to its construction. Furthermore, Afghanistan's underdeveloped legal framework has created additional barriers to progress. The ongoing threat of violence further destabilizes efforts, casting serious doubt on the project's already overdue completion (Daudzai, 2024).[10]

Although violence has decreased since the Taliban's takeover—largely because they themselves were a major source of violent insurgent activity—terrorist and militant groups remain active. Groups like Tehrik-e-Taliban Pakistan (TTP) are likely to align with the Taliban due to shared ideological goals and may avoid disrupting certain initiatives, particularly Chinese investments. However, the Islamic State-Khorasan Province (ISKP) poses a stark exception, maintaining a fierce and ongoing conflict with the Taliban (Karam Shah, 2024) and potentially impacting external investment.

According to an ICG report (2024, p. 9), ISKP's operational capabilities have alarmed regional actors, particularly as the group has increasingly targeted citizens of neighbouring countries both within Afghanistan and beyond. In 2024 alone, ISKP demonstrated its reach through high-profile attacks on Iran, Pakistan, and Russia, signalling its growing influence and threat (Karam Shah, 2024). Such incidents undermine the Taliban's claims of being reliable security guarantors, further weaken their already fragile international relations, and enhance ISKP's ability for recruitment (ICG, 2024, p. 9).

While the ISKP threat is particularly significant, broader security concerns also obstruct the progress of key projects. This has been particularly evident in China's slow progress in its investments in Afghanistan. Beijing's objectives in [Taliban-controlled] Afghanistan are predominantly security-focused rather than driven by economic interests. For instance, China's investments such as those in lithium mining are aimed at fostering constructive engagement with the Taliban to safeguard Beijing's core security concerns, rather than pursuing economic gains (Karam Shah, 2024).

A major concern for China is the Turkestan Islamic Party, an Uyghur extremist group that Beijing holds responsible for unrest in its Xinjiang province. The Taliban have been criticized for harbouring Uyghur militants and failing to adequately address China's security concerns. Additionally, Beijing remains apprehensive about the potential for instability in Afghanistan spilling over into South and Central Asia, regions where China has significant economic and political interests (Siddique, 2023).[11]

In addition to security concerns, the absence of key international donors such as the World Bank and the Asian Development Bank has severely impeded the progress of mega-projects in Afghanistan.[12] For example, the lack of financial backing from these institutions has stalled the TAPI pipeline's development, largely due to the international community's refusal to recognize

10 The TAPI project was initially conceived in the 1990s, but has faced persistent delays due to security concerns, political instability, and competing interests among regional stakeholders. Although agreements were signed during Afghanistan's Republic government in 2016, followed by an official groundbreaking ceremony in 2018, actual progress on the ground has remained negligible (Mohammadi, 2024).

11 During the Taliban's rule in the 1990s, they permitted Uyghur groups, notably the Turkestan Islamic Party (TIP), to conduct operations in Afghanistan. The Taliban are believed to have maintained ties with them. Following their return to power, the Taliban relocated Uyghur militants from Badakhshan province, which shares a 76-kilometer border with China, to other regions, including Nangarhar province in the east, in an effort to address Beijing's concerns (Siddique, 2023).

12 The World Bank recently announced that it will deploy funds from its International Development Association (IDA) to Afghanistan through UN agencies and other public international organizations. These funds will remain outside the control of the Taliban and are aimed at supporting basic services, with a particular focus on initiatives benefiting women in the country (World Bank, 2024c).

the Taliban regime or fund it directly (Tolo News, 2024). Similarly, although Afghanistan's untapped mineral wealth—particularly lithium—offers immense potential, the Taliban lack the expertise and resources to develop the mining sector independently. As a result, they remain heavily reliant on external support for commercialization (Karam Shah, 2024).

Regional rivalries and the Taliban's prioritization of alternative projects have significantly complicated the implementation of major initiatives.

Regional rivalries and the Taliban's prioritization of alternative projects have significantly complicated the implementation of major initiatives. For instance, the TAPI pipeline has become entangled in regional competition involving Pakistan and India, Iran and Turkmenistan, and Turkmenistan and Qatar, which is India's primary gas supplier (Tolo News, 2024). Compounding this complexity is the Taliban's focus on constructing the Qosh Tepe Canal, which has raised concerns in Turkmenistan over potential environmental damage and water scarcity.[13] In response, the Turkmenistan government has revived discussions on the TAPI pipeline, pursuing non-binding commitments to bolster its negotiating leverage. The Taliban will lose on TAPI, if they persist with the Qosh Tepe Canal ignoring "water allocation agreements and canal specifications" (Daudzai, 2024).

These multifaceted challenges underscore the urgent need for Taliban to implement critical measures, such as "strengthening security, enforcing uniform policies, combating corruption, facilitating funds from international organisations, thorough technical planning, and developing local expertise" (Khan, 2024). To address these issues, the Taliban regime must align with the expectations of the international community, which include establishing an inclusive government, adopting moderate policies—particularly regarding human rights and girls' education—and taking decisive action against terrorism (Ibid).

Despite the absence of international recognition, the Taliban must adopt strategic measures to implement these infrastructure projects successfully. Collaboration with international NGOs on humanitarian initiatives and fostering transparent, anti-corruption governance could be instrumental in building trust with potential donors and investors (Ibid).

13 Spanning 285 kilometres in length, 100 meters in width, and eight meters in depth, the Qosh Tepa Canal is engineered to transport approximately 650 cubic meters of water per second (cusecs), providing irrigation to several northern provinces in Afghanistan. Drawing an estimated 10 billion cubic meters of water annually from the Amu Darya River, the canal is set to transform around 550,000 hectares of desert land into fertile farmland. The project was launched in 2018 under President Ashraf Ghani with support from the United States Agency for International Development. Construction began in March 2022 under the Taliban's administration, with the second phase initiated in 2024 (Ranjan, 2024, p. 1).

Conclusion

The collapse of the Afghan government to the Taliban in mid-August 2021 marked the onset of a persistent economic decline. This downturn, characterized by rising unemployment and escalating poverty rates, has plunged the country into a deep economic recession. The crisis has not only undermined the country's key macroeconomic sectors, including its financial and fiscal systems, but has also severely impacted the livelihoods of millions of households, leaving them unable to meet their most basic needs.

In response, the Taliban have pursued certain monetary and fiscal policies aimed at stabilizing the economy. However, these measures have largely failed to produce meaningful results. Instead, they have exacerbated existing challenges, deepening economic instability and placing additional strain on the already fragile financial and fiscal systems.

Recognising the importance of regional cooperation, the Taliban also pursued initiatives aimed at fostering economic integration with neighbouring countries. Several proposed mega-projects emerged, accompanied by agreements with regional partners. However, despite shared interests and promising opportunities, these initiatives have encountered significant setbacks due to technical, political, and security challenges, leaving Afghanistan's regional economic ambitions largely unrealised.

From an economic policy perspective, economists generally advocate for expansionary monetary and fiscal policies during a recession to stimulate economic growth. On the monetary side, central banks are encouraged to lower interest rates, reducing borrowing costs, which promotes business expansion and boosts investments. On the fiscal side, finance ministries are advised to reduce tax rates and lower customs tariffs to increase consumers' purchasing power, thereby driving up aggregate demand for goods and services. When effectively coordinated, these policies can stimulate economic activity, reduce poverty, and create employment opportunities, fostering a more resilient and dynamic economy.

Taliban have pursued policies that further exacerbated Afghanistan's economic crisis.

In stark contrast, the Taliban have pursued policies that further exacerbated Afghanistan's economic crisis. On the monetary front, they have banned interest rates mandating a transition from conventional banking to Islamic banking. This abrupt transition severely disrupted core banking functions such as deposit collection and loan issuance, causing significant profit losses for banks. Moreover, restrictions on bank withdrawals eroded public trust in the financial system, leading to a sharp decline in deposits and further hampering economic growth.

Similarly, the Taliban's fiscal policies have contradicted recessionary best practices. Instead of reducing the tax burden, they introduced new Islamic taxes such as *Ushr* and *Zakat*, while simultaneously raising existing tax rates. Although the Taliban achieved some success in revenue collection, their method is characterised by coercion and extortion, further impoverishing an already struggling population. Furthermore, the Taliban's fiscal operations suffered from a profound lack of transparency—not only in how revenues were collected but also in how public funds were allocated. This absence of transparency and accountability generated widespread uncertainty and further eroded public trust in the Taliban's fiscal system.

> **At the regional level, the Taliban have actively sought foreign investment and pursued initiatives aimed at fostering regional economic integration**

At the regional level, the Taliban have actively sought foreign investment and pursued initiatives aimed at fostering regional economic integration. Despite notable interest from regional powers, particularly China, several proposed mega-projects in critical sectors such as mining, irrigation, and infrastructure development have made little to no tangible progress. These delays can be attributed to a range of factors, including technical and logistical challenges, political instability, governance shortcomings, and persistent security threats.

Compounding these challenges, the Taliban's restrictive policies on women's and human rights have drawn international criticism and discouraged potential investors. Additionally, concerns over the potential risk of terrorism spillover to neighboring countries have made regional actors increasingly cautious about engaging with the Taliban on regional economic initiatives. These factors have collectively hindered meaningful progress and significantly strained the potential for deeper regional economic collaboration.

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