



SOCIAL DEVELOPMENT PAPERS

CONFLICT PREVENTION & RECONSTRUCTION

Paper No. 18 / December 2004

DRUGS AND DEVELOPMENT IN AFGHANISTAN

William Byrd
Christopher Ward

CPR

Summary Findings

This paper analyzes the linkages between drugs and development in Afghanistan. It argues that the opium economy—including its nexus with insecurity, warlords, state weakness, and poor governance—constitutes a central development problem for the country. The Afghan drug industry is unprecedented in international experience in terms of its relative economic size, its penetration of the polity, economy, and society, and the insecure and lawless environment in which it has thrived. While international experience can provide some useful lessons, Afghanistan's own largely unsuccessful experience in anti-drug efforts suggests the problem is of a different order of magnitude.

The development implications of the opium economy include pluses as well as minuses. Among the former are the support provided by the opium economy to overall economic activity and the balance of payments. The opium economy has boosted rural incomes and has served as a coping mechanism helping large numbers of poor people through wage labor and sharecropping and tenancy arrangements which provide them with access to land and credit, albeit on unfavorable terms.

Major drawbacks of Afghanistan's opium economy, include large price and quantity volatility which can have a major macroeconomic impact, and the price and exchange rate effects of the economy's heavy reliance on opium which could discourage production of other tradables through a "Dutch disease" effect. Substantial numbers of poor farmers are deeply mired in opium-related debt, which virtually requires them to continue cultivating opium poppy and may precipitate drastic measures like mortgaging and losing land, or giving up their daughters in marriage to pay off opium debt. More generally, opium is becoming "capitalized" in the economy and society, affecting agricultural sharecropping and tenancy arrangements, land prices, urban real estate, bride prices in opium-producing areas, etc. Also, drug addiction in Afghanistan may be substantial and appears to be growing.

The nexus of drugs with insecurity and warlords, a vicious circle that would keep Afghanistan insecure, fragmented politically, weakly governed, poor, dominated by the informal/illicit economy, and a hostage to the drug industry, is clearly the most serious problem. This threatens the entire state-building and reconstruction agenda and as such outweighs all the combined economic benefits.

Closely related is the corrosive effect of the drug industry on governance through massive corruption.

The positive and negative development impacts of the opium economy need to be fully taken into account in the counter-narcotics strategy. From a development perspective, it would make sense for the strategy to focus on the most damaging aspects of the opium economy, which would imply emphasis on interdiction of trafficking and processing and sanctions against drug industry principals and sponsors. It is also very important that the strategy include measures to address the adverse side effects of successful anti-drug actions in the macroeconomic, livelihoods, and poverty spheres.

The Government's National Drugs Control Strategy provides a sound framework, but there are tensions between the cautious tone in much of the document and the ambitious targets it sets, as well as pressures for quick and visible results, even if at the expense of longer-term sustainable improvements. There are also implementation issues relating to prioritization and sequencing between interdiction, alternative livelihoods and eradication, and enormous needs to build capacity in governance, law enforcement, and the judicial and penal systems. All in all, and not surprisingly given past experience and the size of the drug industry, there are no easy answers, only difficult trade-offs in the search for a multi-pronged, sustained, and effective response to the drug problem in Afghanistan.

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Acronyms

CND	Counter Narcotics Directorate
DDR	Disarmament, Demobilization, and Reintegration
GDP	Gross Domestic Product
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immunodeficiency Syndrome
NDCS	National Drugs Control Strategy
UNODC	United Nations Office on Drugs and Crime

Foreword

This paper was written by William Byrd, Senior Economic Adviser on Afghanistan at the World Bank, and Christopher Ward, Consultant. The authors gratefully acknowledge comments on this or earlier versions of this paper by Doris Buddenberg, David Mansfield, Alastair McKechnie, David Radcliffe, Mariam Sherman, and Barnett Rubin. Research assistance was provided by Roya Karimy. Responsibility for any errors rests solely with the authors, however.

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DRUGS AND DEVELOPMENT IN AFGHANISTAN

A. Introduction

By any measure, Afghanistan is one of the poorest countries in the world. Average per-capita GDP in 2003 was roughly estimated by the World Bank at \$310, including the opium economy which accounts for roughly a third of the total (see World Bank 2004, Table 1.1). Life expectancy is only 43 years, and other social indicators also are among the worst in the world, with large gender gaps. Agriculture and animal husbandry, and associated downstream activities, have traditionally been the mainstay of the Afghan economy, which is heavily dependent on scarce, underutilized water resources in an arid climate with mountainous topography.

Afghanistan was very poor even before the quarter-century of debilitating conflict and unrest that it suffered starting in 1978,¹ which left the country and several generations of its people out of the economic growth and development experienced, especially in Asia, since then. There was little if any increase in average per-capita income between 1978 and 2001, and social indicators stagnated.

The long period of conflict not only devastated the economy (through destruction of infrastructure, assets, institutions, livelihoods, and not least death and displacement of large numbers of people)—it undermined and rendered increasingly ineffective the state, which lost any semblance of monopoly over the use of force and whose remnants were fought over by different groups and misused for factional purposes. Building an effective, accountable state is therefore seen as the essential core of Afghanistan's reconstruction effort (Afghanistan Government 2002).

Afghanistan's conflict almost from the start has been associated with the emergence and rapid growth of an illicit economy, dominated by opium. Illicit activities were engaged in to provide financial resources to pay for conflict (Rubin 2000). Moreover, the conflict itself over time created a lawless environment in which illicit activities could thrive. As traditional livelihoods were destroyed, incentives and the "enabling environment" became heavily skewed in favor of informal and illicit activities, especially drugs.² And the informal and especially the illicit economy built up strong vested interests for maintaining the status quo of insecurity, lack of rule of law, and weak government.

The situation now, even after the end of major conflict, is that drugs, insecurity, "capture" of large parts of the country by regional powerbrokers, and the weak capacity of the state (including difficulties in centralizing revenue) all contribute to a self-reinforcing "vicious circle" that would keep Afghanistan insecure, fragmented politically, weakly governed, poor, dominated by the informal/illicit economy, and a hostage to the drug industry. This "informal equilibrium" is stable in the sense that in the absence of strong actions to displace it, the vicious circle will become ever more entrenched and will perpetuate itself. While there have been major changes since 2001, not least putting in place an internationally recognized government, the illicit economy and other elements of the vicious circle remain as important as ever, and indeed opium production has rebounded to near-record levels after the successful albeit short-

¹ Major fighting ended in late 2001 with the removal of the Taliban from power, but insecurity, intermittent conflict, and occasional terrorist attacks continue to be the norm in many parts of the country.

² In many countries excessive government regulation, red tape, and corruption encourage the growth of the "informal economy" (which can be defined as activities carried out by enterprises that are not registered and do not pay taxes). In Afghanistan the situation has been different—the informal economy with the drug industry as its lynchpin has been fostered not by economic actors trying to avoid taxation and other manifestations of an effective yet control-oriented state, but rather because the lack of an effective state and rule of law provides an environment in which illicit activities like opium production can thrive. The activities themselves generate resources and interests that are opposed to the emergence of an effective state, thus tending to perpetuate the situation (see World Bank 2004, Chapter 1).

lived Taliban ban on opium cultivation in 2000/01. Thus the opium economy in this broader context constitutes a central development problem for Afghanistan.

This paper, which builds on recent work by the World Bank and partners,³ examines Afghanistan's drug economy as a key development issue—at the heart of the insecurity-warlords-drugs-weak government nexus which constitutes the core development problem facing Afghanistan. The paper first briefly describes Afghanistan's opium economy, focusing on its past growth, size and structure, income implications, etc. Then its development impacts, both positive and negative, are summarized and assessed. Lessons from international and Afghan experience with efforts to curb the drug industry are discussed, and the Government's National Drugs Control Strategy is summarized and associated issues raised. The main options and instruments for strategy implementation are then outlined and their respective advantages and drawbacks assessed. Given the magnitude, complexity, and profound implications of the drug industry in Afghanistan, the emphasis is not on hard-and-fast solutions but rather on gaining a better understanding of the opium economy and its most important linkages, issues, and trade-offs.

B. The Opium Economy in Afghanistan

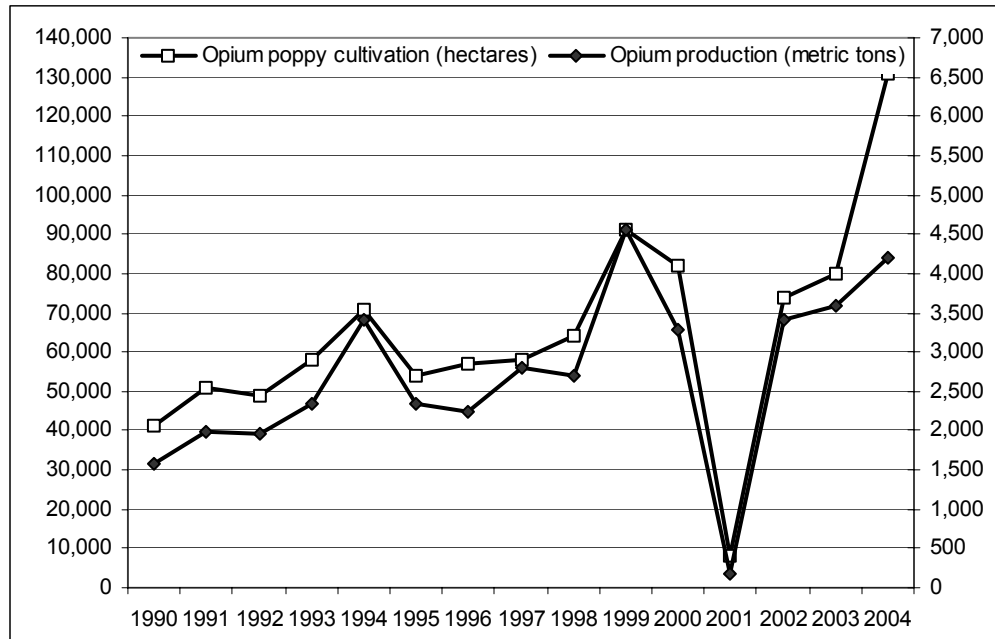
Heroin, made from opium, is an extremely dangerous drug, with some 15 million addicts worldwide and strong links to HIV/AIDS and crime. Global output of illicit opium shot up from an estimated 1,000 tons in 1979 to some 4,500 tons in 2002 (equivalent to about 450 tons of heroin). Afghanistan currently produces an estimated 87% of the world's illicit opium. The impact of the drug industry on Afghanistan's economy, polity, and society is profound, including some short-run economic benefits for the rural population and macro-economy but major adverse effects on security, political normalization, and state-building, as well as on sustainable longer-term economic development.

Growth and Spread of Production

In conditions of lawlessness and impoverishment, and starting from a tiny base in the late 1970s, opium has become Afghanistan's leading economic activity, having spread to all 34 of the country's provinces. Opium production (measured at farm-gate prices) is estimated to have generated around one-seventh of total (drug-inclusive) national income in 2003, and the subsequent trade and processing of opium into opiates (heroin and morphine) generated a somewhat greater amount of income within Afghanistan. Overall, the opium economy accounted for more than one-third of estimated total national income in that year, a share which has further risen in 2004. The proportion of opium refined in-country appears to have been rising, and reportedly most recent drug seizures at Afghanistan's borders have been of opiates.

As can be seen from Figure 1, opium cultivation and production was very substantial in the 1990s, with output peaking in 1999 at over 4,500 metric tons, and was interrupted for only a single year by the effective ban imposed by the Taliban before rebounding. In 2004 poppy cultivation hit an all-time high estimated at 131,000 hectares, while opium production reached an estimated 4,200 tons, the second highest figure recorded. Opium yields, which had not varied greatly in earlier years, dropped sharply from an estimated 45 kg/ha in 2003 to 32 kg/ha in 2004—otherwise production would have set a new record. This decline in yields reflects drought and disease, failure on the part of many farmers to rotate poppy with other crops to preserve soil quality, and many new poppy-cultivating households and localities still being at an early stage in the learning curve for a fairly skill-intensive crop.

³ These include, in particular, World Bank (2004, Chapter 7), on which this paper draws heavily, UNODC (2003b, 2004a, and 2004b), Mansfield (2004), and Ward and Byrd (2004).

Figure 1: Opium Cultivation and Production Trends, 1990-2004

Note: Data for the earlier years up to 1994 are considered less reliable than data for more recent years.
Source: UNODC (2003a, 2003b, 2004b).

Although the proportion of Afghanistan's land and labor resources used for opium production is relatively small—only about 7% of the country's irrigated land area in 2004 despite a large increase in cultivation in that year, as many as two million people may be involved in opium production, earning higher incomes than in other activities. In 2003 the average gross income per hectare from opium cultivation exceeded that of wheat, the main alternative crop, by as much as 27 times. Even with much lower prices in 2004 (discussed in the following section), the margin was still about a dozen times. In some parts of the country where poppy cultivation is concentrated, wage rates of as much as \$11-12 per day for opium harvesting work have been reported, five times the market wage rate for rural unskilled labor. However, returns to opium cultivation have dropped sharply with the large decline in opium farm-gate prices in 2004, with gross revenues per hectare falling from an estimated \$12,700 in 2003 to \$4,600 in 2004 (Table 1). This may also have had an effect on wages offered for opium harvesting labor.

Table 1: Estimated Opium Cultivation, Production, and Incomes 1995-2004

	1995	2000	2002	2002	2002	2004
Production (tons)	2,300	3,300	185	3,400	3,600	4,200
World market share (%)	~52	70	11	74	76	87
Number of provinces producing opium	n/a	23	11	24	28	34
Area under poppy production (ha)	54,000	82,000	8,000	74,000	80,000	131,000
Area under poppy/Area under cereals (%)	2.0	3.2	n/a	3.2	2.8	5.9
Gross farm income per ha (\$)	1,000	1,100	7,400	16,200	12,700	4,600
Value of opiate exports (\$m)	n/a	850	n/a	2,500	2,300	2,800
Gross farm income from opium (\$m)	50	90	60	1,200	1,000	600
Gross downstream domestic income (\$m)	n/a	760	n/a	1,300	1,300	2,200

Note: Estimates have considerable margins of error; there have been some changes in estimation methods over time.

Sources: Afghanistan Government (2004b, Table 1.2); UNDOC (2003a, 2003b, 2004); authors' estimates.

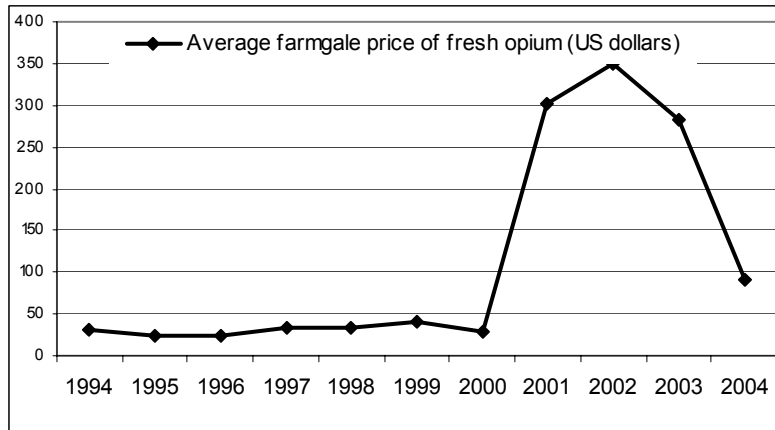
The rapid growth of the opium economy in the past two decades demonstrates its attractiveness to farmers—a durable commodity commanding a good price, having a guaranteed market, with credit and other inputs available from traffickers, easy to transport, and non-perishable. The rise of the opium economy can be in addition attributed to:

- *Exit of other suppliers and growing demand.* Three opium producers (Iran, Pakistan, Turkey) stopped opium cultivation, opening up a supply gap in the world market that Afghanistan could fill. Growing demand for heroin in neighboring countries, particularly Pakistan, and increased demand in Europe starting in the mid-1980s also provided scope for expansion of Afghanistan's opium production.
- *Collapse of governance and law enforcement.* During the conflict Afghan governments effectively lost control of the countryside, and there was no credible law enforcement to hinder the growth of the opium economy.
- *Drugs funding conflict.* Drugs provided a ready source of cash to pay for arms, combatants' wages, and other costs of conflict; an opium for arms trade arose which various actors involved in successive conflicts encouraged.
- *Rural pauperization.* The conflict led to extreme rural impoverishment—more than half of Afghanistan's villages were bombed, livestock numbers dwindled, irrigation networks were destroyed or run down, and over a third of land went out of production. A modest agricultural recovery in the mid-1990s was wiped out by the severe nationwide drought of 1999-2001. Under these dire circumstances, and despite religious and cultural aversion, opium production came to be widely accepted as a coping mechanism and livelihood strategy.
- *Comparative advantage.* Based on its natural conditions, the weak security environment, and experience with large-scale production, Afghanistan now has a strong comparative advantage in opium production, with relatively high yields.
- *Market development.* Market organization is excellent, well adapted to the characteristics of the product and to the nature and intensity of risks. Markets extend from the farm gate to the frontier and beyond, and there is working capital financing available at all stages, as well as credit and other inputs for producers.

Given the relatively small share of Afghanistan's land and labor resources devoted to opium, modest requirements for other inputs, and the level of know-how and market organization, there is ample potential for further increases in production, with few supply constraints. Price declines (resulting from market saturation), wage increases for skilled labor used in opium harvesting, disease resulting from overextension of production, and changing expectations with respect to law enforcement could moderate further growth. However, a survey by the United Nations Office on Drugs and crime (UNODC) in early 2004 indicated that farmers planned to further increase the area under poppy cultivation for the 2004 crop (UNODC, 2004a), and in fact the total area of poppy cultivation expanded by 64%.

Prices and Income Distribution

Farm-gate prices of opium were relatively low in the 1990s, but a nearly 10-fold rise occurred when the Taliban banned opium production in 2000 (Figure 2). High prices of \$300/kg or above were maintained in 2002 and 2003 despite the recovery of opium output, but prices declined in late 2003 and have fallen very sharply in 2004, to an average of around \$90/kg by late summer before rebounding somewhat post-harvest. Although data are imperfect, it is clear that margins between farm-gate prices and border prices of opiates are very large—more than double even when farm-gate prices were at their peak, and well over four times as high currently (based on the gross income estimates shown in Table 1).

Figure 2: Opium Prices, 1994-2004

Source: UNODC (2003a, 2003b, 2004b).

The lion's share of opium income in the 1990s went to traffickers rather than to farmers (Table 1), and several other crops were financially competitive with opium. This pattern changed dramatically after the Taliban ban, and close to half of annual gross income from the opium economy appears to have gone to the farm level in 2002 and 2003, although this share declined sharply as farm-gate prices fell in 2004. The apparently rising share of opium output that is refined within Afghanistan would lead to higher domestic value added accruing to traders and processors. Income from the opium economy accrues to the following groups:

- *Better-off farmers* (characterized by significant landholdings and capital resources), cultivating poppy on their own land (typically as part of a diversified cropping pattern including other food crops and cash crops) and in many cases letting out part of their land to sharecroppers and getting part of the poppy crop in return. These farmers have been major beneficiaries of the opium boom and many of them have become relatively rich.
- *Poor farmers* (probably most of the some 350,000 farm households estimated to be involved in poppy cultivation), typically with little or no land of their own and often burdened with debt, cultivating opium poppy on tiny amounts of their own land or as sharecroppers (with opium cultivation normally required by the landlord). For these farmers, the benefits of high opium prices in recent years have been to a large extent dissipated by servicing high-interest debts and by unfavorable sharecropping arrangements (see Mansfield 2004).
- *Rural wage laborers*, as many as half a million, the bulk of them poor, who engage in harvesting poppy which is a highly labor-intensive activity. Large numbers of itinerant laborers move seasonally following the poppy harvest in different areas. Wage laborers have benefited from the opium boom, although many of them also may be mired in debt.
- *Small opium traders*, roughly estimated at around 15,000 by UNODC (2003b), who buy and sell raw opium at farm gate and at "opium bazaars"; they typically handle small volumes (as little as 100 kg per year or less) and in many cases are involved in the trade on a part-time basis.
- *Wholesalers and refiners*, much smaller in number, who trade in large quantities, organize processing, move product across the border, etc.
- *Local warlords and commanders*, who receive "protection payments" and in turn employ substantial numbers of militia fighters, and may "sponsor" processing facilities.
- *Government officials*, at various levels, who receive bribes from the drug industry in return for favors in law enforcement or other aspects.

The gender dimension of the opium economy also is noteworthy. Women play a very important role in poppy cultivation in northeastern Afghanistan, whereas in the southern, generally more conservative

region, women do not participate directly in opium poppy cultivation but rather indirectly by preparing meals for hired laborers. Although women's labor in poppy cultivation traditionally has been unpaid, local labor shortages have led to women in Badakhshan and Takhar provinces for the first time being paid wages. This is in addition to women's traditional right in many areas to make a final pass through already harvested opium fields to glean what is left. Tragically, daughters are sometimes given in marriage to settle unpaid opium-denominated debts.

Drug Industry Structure and Market Organization

What we know about the opium business in Afghanistan suggests that it more closely resembles a competitive market than a criminal cartel. Entry and exit seem to be relatively easy for both production and trafficking, and the number of participants is high. Opium is openly bought and sold on various markets. Parts of the drug industry are more concentrated, with relatively few and more powerful actors involved in opium refining and cross-border trading. There is, however, evidence of new entrants joining even at these stages of the business, and the existence of a number of trading routes going out of Afghanistan across all frontiers facilitates competition nationally if not necessarily locally. The increase in refining of opium into heroin within Afghanistan may be accompanied by drug industry consolidation. Opium production has been responsive to prices and has shifted locations in response to eradication campaigns, demonstrating that it is "footloose". Prices have been flexible at the micro level.⁴

Some implications of a competitive drug industry are explored in Box 1. In addition the criminal nature of the drug business—and consequent ability and tendency to use violence in the conduct of business—needs to be taken into account. In the Afghan context where government military power and law enforcement have been weak, and where local conflict is conducted mainly with small arms, violence by small actors with limited resources is easy. Moreover, it is difficult for one or a few actors to dominate militarily on a sustained basis. Under such circumstances a fragmented, competitive drug industry could emerge, leading to fragmented capture of the state apparatus at the local level by drug interests, which would be inimical to the emergence of an effective, unified state.

Even though the drug industry appears to be reasonably competitive and relatively efficient, market outcomes are seriously affected by unequal endowments and power relations. Moreover, the opium economy itself can over time lead to worsening inequalities. For example, while better-off farmers grow rich from opium poppy cultivation, poorer farmers without adequate land and financial capital may get stuck in chronic opium-related debt and may be forced to continue cultivating poppy just to make ends meet (Mansfield 2004).

⁴ The maintenance of opiate exports apparently at near normal levels during the year of the Taliban ban, and then the persistence of high farm-gate prices for two years after large-scale opium production was restored, may be explained by the existence of large inventories in the late 1990s, which were sold off to maintain supply during the year of the ban and then were rebuilt after large-scale production resumed. The recent sharp decline in farm-gate prices reflects the impact of oversupply in the face of already high inventories by the end of 2003. But more work is needed to better understand opium price trends.

Box 1: The Competitive Model of the Drug Industry

If the number of actors in the drug industry is great enough that there is no opportunity for strategic behavior, or if anti-competitive behavior is deterred (at least over time) by new entry or its threat, a competitive model of the drug industry may be applicable to Afghanistan. This would have the following implications:

- Opium prices would adjust to the point where marginal cost is equated with demand (as opposed to marginal revenue in the case of a monopoly producer). Thus prices would be lower than in a monopoly situation, and production in a static sense would be higher, unless demand is completely price inelastic.
- Over time the supply curve would adjust through expansion, new entry, etc. to the point where “excess profits” in the drug industry are eliminated. This does not mean no profits, just a normal level of profits competitive with what can be earned in other sectors (factoring in a risk premium and the cost of avoiding law enforcement).
- Production could increase quite sharply (at least from season to season) in response to foreign demand.
- Once there is full adjustment to the perfectly competitive equilibrium, further growth of total opium production would tend to track world demand rather closely.
- Thus the nightmare scenario under the competitive model is one of an efficient, competitive drug industry increasingly embedded in Afghan society and with low opium prices stimulating world demand. Heroin demand is growing slowly in Western European markets but very rapidly in Asia and the former USSR.

The perfectly competitive model suggests that resources for political influence and destabilization would be under fragmented control. Hence there would likely be a pattern of fragmented capture of the state apparatus at the local level and exercise of power by drug-financed local and regional authorities.

Farmer Motivations

An understanding as to why farmers grow poppy is essential for analysis of the drug economy and design of effective strategies to respond to the drug economy. Available information suggests the following:

- Poppy cultivation is an important element in poppy farmers’ strategies for crop mix and risk management, with some farmers specializing in opium out of necessity (particularly highly indebted small farmers) but others cultivating poppy as one among several crops reflecting a strategy of diversified cropping one of whose objectives is minimizing risk.
- For most poor rural households wage income is more important than farm income. Thus they benefit from high demand for labor for poppy cultivation and harvesting.
- The majority of households have to buy most of their food from the market. Opium production or associated wage labor provides assured cash with which to purchase food.
- Widespread availability of grain (imported or domestically produced) on local markets may enable farmers to shift more acreage to opium poppy cultivation by obviating the necessity to grow grain for self-consumption.
- High levels of risk associated with opium production encourage landowners to sharecrop out some of their land for poppy cultivation, which spreads risk and at the same time provides poor households’ access to land and water (and often credit) through sharecropping.
- Many poorer farmers report that they are obliged to cultivate poppy, even if they have misgivings about doing so, due to high debts or sharecropping requirements that in effect force them to grow poppy.
- There is variation among regions, and even among communities in a local area, in the mix of rich and poor opium farmers, the relative importance of farming and wage labor, land tenure arrangements, and access to opium markets.

These stylized facts provide an indication of the complexity of farmer and household motivations and of the rural livelihood impacts of opium. Poppy has enabled some people, not necessarily poor in the first place, to grow rich, but for many more people the opium economy has become an important source of

income to help cope with the poverty and reduce the vulnerability they face. However, many people are mired in increasing dependency on the opium economy—primarily through opium-related debt—while not reaping significant income gains.

C. Development Impact

Not surprisingly given its size and importance, the development impact of Afghanistan's opium economy is enormous as well as complex and multi-faceted. It has very important economic implications and linkages and is a key part of the “informal equilibrium” of the economy as a whole. The various development effects of the opium economy on Afghanistan include pluses as well as minuses (summarized in Table 2). They can be grouped in three major categories: macroeconomic impacts, poverty and social impacts, and the effects on governance broadly defined.

Macroeconomic Impacts

In the short run, Afghanistan's drug industry provides significant macroeconomic benefits for the country. Comprising a large share of total economic activity (roughly one-third in 2003), it is a major source of aggregate demand—for services, durable goods, construction, etc. It provides incomes and livelihoods for large numbers of people. In recent years Afghan farmers have received in the range of half a billion dollars annually from opium production, with another several hundred million dollars probably going to wage laborers (see Ward and Byrd 2004). This constitutes an enormous injection of income into Afghanistan's battered rural economy. The drug industry supports Afghanistan's balance of payments with a net positive impact that is hard to ascertain but may be in the range of \$500-1,000 million annually, facilitating conservative macroeconomic management and supporting the currency. And although the drug industry as an illegal activity does not provide tax revenues directly to the government (except perhaps small local revenues), imports from drug proceeds do generate significant amounts of customs revenue.

The drug industry also has negative macroeconomic impacts, both short-term and longer-term. It is a source of macroeconomic volatility, but not just because opium is an agricultural product subject to the vagaries of climate and—especially in the Afghan context—water availability. Recent experience in Afghanistan has seen enormous price volatility. The sharp price decline in 2004 reduced farm incomes by around \$800 million at the 2004 production level (by \$400 million as compared with gross income in 2003—see Table 1). Eradication and its threat clearly can stimulate sharp increases in farm-gate opium prices, whereas interdiction by disrupting downstream activities may hold down farm-gate prices. On the production side, effective large-scale eradication could result in a \$1 billion plus shock to the rural economy.

Another potential adverse macroeconomic effect of the opium economy is the “natural resource curse” or “Dutch disease” problem. The net foreign exchange inflow associated with drugs could stimulate real exchange rate appreciation, making the rest of the economy less competitive and discouraging production of non-opium tradable goods (for export or for import substitution). Although Afghanistan's real exchange rate has appreciated in two of the past three years, aid and remittances also have been substantial and could have contributed to this outcome. More generally, however, the entrenchment of the opium economy and long-term dependence on it will discourage the sustainable development of other economic activities. For example, with rents and sharecropping arrangements increasingly based on opium in many rural areas of the country, it becomes virtually impossible for other cash-earning agricultural activities to take hold. And finally, an increase in capital flight of drug money to other countries, resulting for example from effective law enforcement measures, could have a significant adverse effect on the balance of payments as well as domestic markets.

Table 2: Benefits and Costs of the Drug Economy for Afghanistan

Benefits		
Benefit item	Specifics	Estimated impact
Aggregate demand	Boosts economy's aggregate demand, including for services, consumer goods, durable goods (vehicles, TVs), real estate, building construction, trade, etc.	In 2003 the drug economy accounted for roughly one-third of GDP. Large stimulus to other economic activities. "Multiplier" roughly estimated at over 2.
Balance of payments	Supports balance of payments as narcotics comprises an "export industry" in Afghanistan; facilitates conservative macroeconomic policies.	Net positive impact on balance of payments may be \$500-1,000 million, taking into account propensity to import from drug proceeds.
Incomes/livelihoods	Provides farm incomes, rural wage labor, incomes for others involved in the opium economy and those providing services to the drug industry.	Some 350,000 farm households involved in poppy production; many others work as wage laborers on poppy.
Coping mechanism for survival of the rural poor	Income from opium is skewed, but production is very labor-intensive and the poor rely on it for modest income and access to land, credit, wage labor.	Hundreds of thousands of wage laborers and many sharecroppers are poor and rely on opium economy to make ends meet.
Costs		
Cost item	Specifics	Estimated impact
Macroeconomic volatility	Can result from major fluctuations in opium output (e.g., due to weather, eradication, etc.), price shocks, capital flight.	Farm-gate price crash in 2004 has reduced farm revenues from poppy by an estimated \$800 million (evaluating 2004 production at 2003 prices); effective eradication could result in a \$1 billion shock to economy.
Natural resource curse/Dutch disease	Foreign exchange inflow from opium revenues could raise real exchange rate and discourage production of non-opium tradable goods (either for export or for import substitution)	Afghanistan's real exchange rate appreciated by an estimated 24% in 2001/02, 0% in 2002/03, and 13% in 2003/04. But aid and remittances also could have contributed to possible "Dutch disease" effect.
Nexus with insecurity, warlords, and weak state	Drug industry funds warlords and their militias undermine state and security, providing an environment conducive to continuing and expanding drug industry.	Revenues accruing to warlords and their militia could well be in the range of half a billion dollars annually in recent years.
Corruption and poor governance	Like any criminalized activity, drugs promote corruption and undermine good governance, on a massive scale given the size of the drug industry.	Anecdotal evidence that many officials at all levels in government are involved in or benefiting from drugs
Political risks and costs to the Government	Government and international backers allocate energy and resources to combating the opium economy, and incur reputational risks internationally and political and economic risks domestically	Success against opium is a key external criterion for judging the Government's performance, yet opium interests are pervasive and success in combating opium would engender violence, economic disruption and political confrontation.
Embedded in and distorts rural economy and society	Land prices, sharecropping rates, credit, bride prices, social status are becoming increasingly tied to poppy. Opium is "capitalized" in the rural economy.	Credit and sharecropping in major poppy growing areas almost universally require poppy cultivation.
Poor become dependent on and stuck in the opium economy	Many poor farmers are mired in debt, often denominated in opium, much of it built up as a result of eradication, which forces them to continue cultivating opium poppy to try to service the debt. Also many poor rural households may rely heavily on wage labor	UNODC survey data suggest a higher proportion of poppy farmers than others took out loans in 2003, in larger amounts, and poppy farmers tend to have more accumulated debt from previous years. Small farmers tend to cultivate poppy more intensely than large farmers.
Growing addiction to opiates within Afghanistan	Drug addiction spurred by domestic availability and return of addicted refugees from Pakistan and Iran.	Limited data suggest an addiction rate of 0.6% in part of the country, but it could well be higher and rising.

Poverty and Social Impacts

Incomes from the opium economy are unequally distributed and undoubtedly skewed in favor of better-off farmers and especially the larger actors involved in trading, processing, and trafficking. Nevertheless, numerous poor people depend on opium for their livelihoods. Most of the estimated 350,000 rural households involved in poppy cultivation are probably poor, many of them engaged in sharecropping or tenancy arrangements that require opium cultivation, virtually the only means by which they can gain access to credit and land for farming. Moreover, as a highly labor-intensive activity, opium production generates large demand for labor. Some of this is satisfied by more intensive utilization of household labor, but there are also large numbers of wage laborers who work on poppy cultivation and harvesting—possibly as many as half a million of them. Considerable numbers of poppy laborers are migratory during the peak season of opium harvesting. High demand for wage labor for opium production raises incomes of the poor both directly through the wages paid and indirectly by contributing to a general rise in rural wages.⁵ Thus the opium economy has in some respects alleviated poverty and has provided a coping mechanism for the poor to help them make ends meet. Abrupt shrinkage of the opium economy or falling opium farm-gate prices without new means of livelihood would significantly worsen rural poverty.

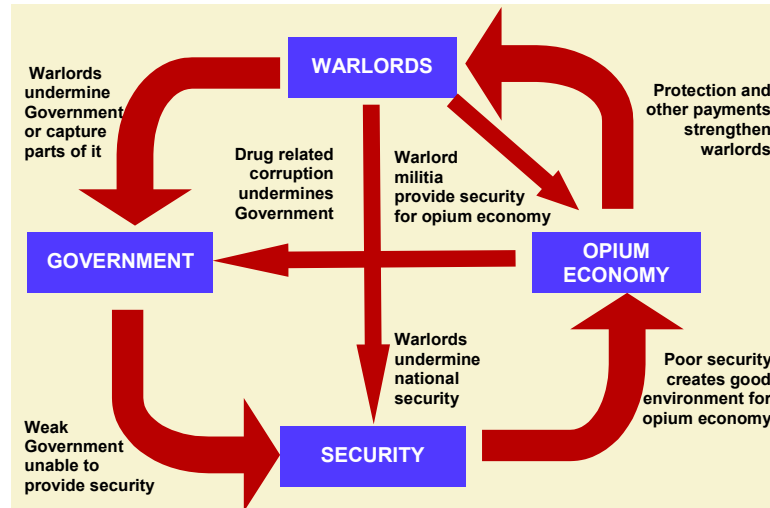
However, the opium economy is a decidedly mixed blessing for many of the poor, particularly those who become mired in opium-related debt from which it is almost impossible to escape and which may necessitate drastic steps like mortgaging or losing land and other assets, giving up daughters to creditors, and the like. The poor are disproportionately vulnerable to the adverse effects of the volatility of the opium economy (discussed above), and are very much affected by the general lawlessness and insecurity associated with the drug industry (discussed below).

Effects on Governance

Afghanistan's opium economy has unambiguous and serious harmful effects on governance, with profound adverse implications for security, politics, and state-building. It contributes to a vicious circle whereby the drug industry financially supports warlords and their militias, who in turn undermine the Government. In fact, many warlords and local commanders directly sponsor or are otherwise involved in the drug industry. As a result the state remains ineffective and security weak, thereby perpetuating an environment in which the drug industry can continue to thrive. The linkages between drugs, warlords, and insecurity add up to a vicious circle of mutually-reinforcing problems, shown in Figure 3. There is also some anecdotal evidence of linkages between drug money and terrorist networks. Warlords, drug interests, and terrorists all promote insecurity and weaken the state, even if their interests do not coincide in other respects. All in all, the security and political implications of Afghanistan's opium economy present a grave danger to the country's entire state-building and reconstruction agenda.⁶

⁵ Rural unskilled wage rates in the winter of 2003/04 (the off-season) were reportedly in the range of \$2.50-3.00 per day, compared with \$1.50-1.75 in the previous winter (World Bank 2004, p. 86).

⁶ See Rubin (2004) for a discussion of these issues.

Figure 3: A Vicious Circle

Like any criminalized activity but on a massive scale given its size, the drug industry engages in corruption and undermines good governance through bribery. It appears that many officials at all levels in government are benefiting from or involved in drugs. The opium economy also has a corrupting effect on society more broadly, with a considerable portion of the population involved one way or another in activities that are widely known to be illegal and considered by most to be immoral.

Another important aspect of governance concerns the risks and costs to the Government associated with its policy stance on opium. All aspects of the opium economy are illegal in Afghanistan, and the Government is allocating increasing resources to counter-narcotics programs (see below). These programs receive strong encouragement from external supporters, which creates expectations and a major reputational risk if the Government is not perceived to be successful. By contrast, domestically the penetration of drug interests into all levels of government makes implementation of counter-narcotics measures very difficult, and effective pursuit of such measures would bring risks and costs in economic disruption and political confrontation that could weaken the Government in the near term.

Finally, growing addiction to opiates within Afghanistan looms as an increasingly serious health and social problem, feeding into criminality. Although limited data for one area of Afghanistan from the end of the 1990s suggest an opiates addiction rate of 0.6% (UNODC 2003b), it could well be higher and rising, at least in parts of the country.

Implications for Counter-Narcotics Strategy

This inventory of the main benefits and costs of the opium economy for Afghanistan suggests certain themes and entry-points for a counter-narcotics strategy. As a general principle, it would make sense for the counter-narcotics strategy to focus on and target those aspects of the drug industry that have the most serious harmful effects. Moreover, counter-narcotics strategy would need to be fully cognizant of the main benefits of the drug industry for Afghanistan and include suitable measures to deal with problems resulting from the reduction or removal of these benefits that would occur as a result of effective efforts to fight drugs.

Among the negative effects of the opium economy, its nexus with insecurity and warlords and its undermining of state-building clearly cause the most serious damage, threatening the entire reconstruction agenda with state building at its core. This suggests that counter-narcotics efforts should focus on the parts of the drug industry that impact most directly on security and state building—drug trafficking and

processing, and their sponsors/beneficiaries both within and outside government. Interdiction would be a primary instrument in this regard, along with broader actions against drug industry sponsors and beneficiaries, including not least removal of them from government positions. Such a focus would also make inroads against drug-related corruption.

The fragmented, competitive character of the drug industry in Afghanistan (discussed on pp. 6-7), and associated likelihood of fragmented capture of local administrations by drug interests, calls for a focus on strengthening local governance to reduce the danger and counterbalance the influence of the drug industry. This would also imply building responsible relationships between local administration and citizens, mediated by community organizations like the elected Community Development Councils that are being formed as part of the National Solidarity Program. While strengthening and improving local governance would be an important part of the reconstruction agenda even in the absence of the opium economy, the drug problem makes it all the more urgent to achieve progress in this regard.

The counter-narcotics strategy would also need to address the adverse side effects from phasing out the opium economy, the most important of which are its positive short-run macroeconomic effects (on aggregate demand, incomes, balance of payments) and the role of the opium economy as a coping mechanism for many poor people. This implies that the counter-narcotics strategy needs to be complemented by measures to counteract the macroeconomic impact of a “poppy shock” (see World Bank 2004, p. 30), including appropriate international assistance as needed. Over the medium term, Afghanistan needs to achieve robust, sustained non-drug economic growth so that at the aggregate level, the economy will generate incomes and livelihoods to “replace” the opium economy as it is phased out, while maintaining an acceptable overall rate of economic growth with rising per-capita incomes.⁷

Macroeconomic impacts of actions against drugs can be complex in the short run and would vary depending on the counter-narcotics instruments used. For example, eradication of a significant proportion of the poppy crop would raise the farm-gate price of opium (the price rise after the Taliban ban is the most extreme example). This means that price and quantity effects would tend to offset each other, with the price effect quite likely being stronger, resulting in higher gross farm-gate income from opium, but going to a smaller number of farmers (i.e., not those whose fields have been eradicated). Hence there could well be no adverse effect on aggregate demand and economic activity, although localized effects in areas subject to more intensive eradication could be substantial. On the other hand, strong law enforcement actions against drug traffickers and their sponsors might stimulate capital flight which would adversely affect the balance of payments as well as aggregate demand. Macroeconomic policy responses would need to take these complexities and different effects into account.

Offsetting or at least mitigating the adverse effect on the poor from phasing out the opium economy is a critical component of counter-narcotics strategy, often referred to as “alternative livelihoods,” discussed below. It is important, however, to distinguish between the poverty and economic/political justifications for action, and between the short-run and medium- to longer-term aspects. The alternative livelihoods concept by definition relates to the poor, since they have few if any existing viable alternatives to involvement in the opium economy and hence would be further pauperized by actions against drugs. On the other hand, the better-off usually have land and other assets and in that sense already have viable (albeit considerably less lucrative) alternative livelihoods available, which they could turn to in the absence of the drug economy. Assistance to better-off poppy farmers to facilitate their developing alternative livelihoods is important, but this is perhaps best seen as part of a holistic rural development strategy to support rapid economic growth to “replace” the opium economy in an aggregate sense. And it should be remembered that alternative livelihoods and rural development are by their nature medium- to

⁷ The *Securing Afghanistan's Future* report (Afghanistan Government 2004) argues that overall non-drug economic growth on the order of 9% p.a. during the next decade and longer will be required in order to maintain 3% annual growth of average per-capita GDP while phasing out the opium economy.

long-term efforts. Short-term actions to “show results on the ground” are more in the nature of symbolic or compensatory measures, which raise issues discussed later in this paper.

D. Lessons from Experience in Fighting Drugs

Several decades of experience, both in Afghanistan and internationally, provide hard-won lessons to help guide counter-narcotics strategy and implementation. However, the drug industry in Afghanistan is of a different order of magnitude than in other countries, and hence the lessons of international experience need to be applied to Afghanistan with caution.

International Experience

Consuming nations have invested heavily in drug control over a long period of time, but success has been elusive. Law enforcement and interdiction of international drug shipments have raised the risks associated with drugs, increased prices, and interrupted supply in the short run. Demand-side interventions such as medical treatment and alternative drug therapy can mitigate some of the adverse effects of drugs, including crime and HIV/AIDS. But there has been no large, sustained reduction in global consumption of illicit narcotics.

There is also rich international experience with supply-side interventions to reduce drug production. This experience is both at the primary production level, where law enforcement (including crop eradication) and rural alternative development/livelihoods approaches have been used, and beyond the farm gate at the processing and trafficking levels, where law enforcement includes interdiction⁸ (seizing/destroying the product and related processing and transport assets, and arrest, prosecution, and punishment of drug traffickers) and actions to interrupt money flows and seize drug-financed assets.

At the production level, a key lesson is that eradication of illicit narcotics in the fields alone will not work and is likely to be counterproductive, resulting in perverse incentives for farmers to grow more drugs (e.g., in Colombia), displacement of production to more remote areas, and fueling of violence and insecurity (e.g., Peru, Bolivia, Colombia), which in several cases forced the eradication policy to be reversed and led to adverse political outcomes. Neither does the approach of making eradication a condition for development assistance work—without alternative livelihoods already in place, premature eradication can alienate the affected population and damage the environment for rural development.

The most successful case of speedy and sustained elimination of opium cultivation was in Iran, where the Khomeini government quickly brought down poppy cultivation from an estimated 33,000 hectares prior to 1979 to zero. Moreover, opium production never returned to Iran subsequently. This was a major achievement, paralleled in part only by the successful Taliban ban on opium production two decades later whose sustainability remained unproven due to the fall of the Taliban. However, there arose a major problem with transit of drugs produced in Afghanistan through Iran, and Iran’s strong interdiction efforts have been met with violence and terror—since 1979 more than 3,000 law enforcement officers have been killed in confrontations with drug traffickers. Moreover, Iran has been left with the highest opiate addiction rate in the world—nearly 2% of the population are regular drug abusers. Mexico succeeded in

⁸ In the international literature on counter-narcotics strategy, the term “interdiction” is often reserved for law enforcement efforts against movements of drugs across borders, in particular interception of drug shipments on their way to or into consuming countries, whereas actions against all levels of the drug industry in producing countries are lumped together as production and refining controls. This categorization is less useful for analysis of drug producing countries like Afghanistan. Therefore in this paper, interdiction is used to refer more broadly to law enforcement actions against drugs beyond the farm level, including actions against drug trading within Afghanistan (as well as across its borders) and actions against opium processing labs etc. Interdiction (so defined), eradication (and associated law enforcement actions directly against farmers), and alternative development/livelihoods are thus the three main supply-side counter-narcotics instruments analyzed in this paper from the perspective of Afghanistan.

eradicating opium poppy by spraying in the mid-1970s, but the drug industry responded by dispersing cultivation to smaller fields hidden in remote areas, and by the early 1980s Mexico was supplying as much heroin to the US market as before eradication.

Thailand and Pakistan succeeded in virtually eliminating opium production on a sustainable basis. Their approach was gradual, taking decades rather than months or years. In both cases, eradication was undertaken only following the implementation of comprehensive alternative development programs which raised incomes in the target areas through development of profitable cash crops. In both cases, poppy cultivation was localized and constituted a small percentage of total national economic activity. Moreover, opium production boomed in neighboring countries (Myanmar in the case of Thailand and Afghanistan in the case of Pakistan), suggesting that the drug industry moved its activities elsewhere rather than shutting down.

International experience with interdiction suggests that it is possible to raise the risks and costs of the drug trafficking business, as demonstrated by the extraordinarily high margins between wholesale prices in major consuming countries and those in producing and transit countries. It is not clear, however, whether further increasing international interdiction efforts beyond current levels would result in further significant price increases in consuming countries. Moreover, it is widely felt that interdiction efforts in drug producing countries are undermined by corruption.

Afghanistan's Experience

Afghanistan has had more than a decade of experience with efforts to reduce opium production. All of these initiatives failed to achieve their objectives (Box 2), except for the Taliban ban which succeeded in drastically reducing opium production for a year—but with questionable sustainability, worsening poverty, and no apparent effect on the flow of opiates into consumer markets. Moreover, the Taliban ban resulted in a sharp rise in the farm-gate price of opium and stimulated a multi-fold increase in opium production in areas outside the Taliban's control. After the Taliban were removed total national output rebounded to near-record levels. Subsequent eradication campaigns carried out largely under the leadership of provincial Governors, involving in 2002 offers of compensation to poppy farmers and in 2003 promises of development assistance, did not reduce total opium cultivation and have been counterproductive in some respects. In particular, the governance of the recent eradication campaigns has been flawed, with the result that eradication is likely to have disproportionately affected the poor and marginalized, while better-off and better-connected farmers mostly escaped eradication.

The “alternative livelihoods” approach, which evolved from earlier “alternative development” and crop substitution initiatives, takes a holistic rural development perspective in implementing projects intended to enable those whose livelihoods currently depend on poppy production to find other, sustainable livelihoods (through a combination of on-farm and off-farm activities). Some relatively small projects have already been initiated and are generating valuable experience with this concept. Except in that it may be associated with law enforcement measures, the alternative livelihoods concept resembles any good integrated rural development program and in that sense is not controversial. There are however some important issues. First, no matter how well designed and implemented, relatively small interventions cannot be expected to make much of a dent in Afghanistan's enormous opium economy. What is really needed is generalized economic growth and rural development—“alternative livelihoods for Afghanistan as a whole”—which can only be accomplished through reforms, policies, and substantial programs implemented nationwide. Thus the alternative livelihoods approach needs to be integrated into the national rural development and poverty reduction strategy. Second, the sequencing of alternative livelihoods initiatives with law enforcement actions (discussed in the final section of this paper) is extremely important for the effectiveness of both and needs careful management.

Box 2: Counter-Narcotics Experience in Afghanistan

Since the early 1990s, there has been a series of attempts to control opium production in Afghanistan, each of which has been in its own way unsuccessful.

Alternative development without security and political support: Starting in 1989 several projects were initiated following the model of “alternative development” used in Pakistan and the Andean region. These projects were in areas where opium production was entrenched and there was insecurity and lack of political support. Benefits were offered to communities (through their councils of elders or *shuras*) in return for a commitment to phase out opium cultivation, but there was no impact on production. An evaluation concluded that the *shuras* were unrepresentative, there was too little connection between project benefits and farmer motivations and constraints, the better-off captured the benefits, and offering benefits with “conditionality” created perverse incentives.

A simple ban vigorously applied: In 2000 the Taliban imposed a complete ban on opium cultivation, severely enforced, which resulted in production in Taliban-controlled areas falling to negligible levels. No restrictions were imposed on trade, however, and the flow of opium out of Afghanistan did not diminish much. Border and consumer prices remained high, while farm-gate prices shot up, suggesting that operators may have maintained turnover by running down large inventories. The eradication campaign pauperized many farmers, leading them to incur debts which they are still repaying. The ban also promoted a shift in cultivation to northern areas outside the Taliban’s control, and shifted trade to the northern trafficking route through Tajikistan.

Eradication with promised cash compensation: The post-Taliban government quickly banned the cultivation, production, abuse, and trafficking of drugs, and in the spring of 2002 an eradication campaign was carried out on about 17,500 ha. Compensation was offered but apparently only actually paid to one tenth of the farmers whose crops had been destroyed. In many areas eradication seems to have involved opportunistic local power plays, with factions trying to destroy the economic power base of other factions. Failure to honor promises of compensation impoverished smaller and highly-indebted farmers and harmed the credibility of the program. Only 12% of respondents to a UNODC survey said that the eradication campaign would deter them from planting.

Eradication with promise of reconstruction support: In 2003 more than 21,000 ha of opium was reportedly “eradicated”, and opium production was reportedly “foregone” through persuasion on 5,000 ha more. Some was eradicated by local authorities who promised that rural development assistance would follow, but this has come slowly if at all. Although there were marked reductions in poppy area in Helmand and Kandahar provinces, elsewhere production grew and spread to new districts and provinces, and the total poppy area in 2003 increased by 8% to 80,000 ha.

Some General Lessons

Growth potential of opium in Afghanistan. There are few supply constraints on the growth potential of Afghanistan’s opium economy.⁹ Given the small share of opium in total cultivated area and the rural labor force, strong marketing, and a growing skill base, there is potential for continuing large-scale expansion of opium cultivation and production over time. This was demonstrated by the 64% increase in area planted to opium in 2004. As skills are further developed, and better crop rotation practices followed, opium yields are likely to improve, contributing to further growth of output. Moreover, lower opium farm-gate prices do not necessarily act as a severe brake on the growth and spread of the opium economy. Despite a very sharp decline in prices in 2004, opium cultivation is still considerably more lucrative financially than other crops, especially when the associated access to credit and land is factored in. Moreover, large numbers of rural households are locked into the opium economy due to opium-related indebtedness and cannot get out almost irrespective of the opium price.

Issues related to targeting. Targeting actions against drugs presents serious problems in Afghanistan, where despite its enormous size and spread across all 34 provinces, opium production takes up only some 7% of the total irrigated area and employs a relatively small albeit larger share of the rural labor force.

⁹ Demand constraints may start to play a significant role at some point, however. Heroin consumption levels are already high in mature markets like Europe, the USA, Iran, and Pakistan; growing markets in Russia, Central Asia, and China have unclear potential and short-run absorption capacity; and opium inventories undoubtedly are very large after several years of high production. This suggests the need for further research on global and regional demand trends.

The drug industry is “footloose” in the sense that it can shift opium cultivation and relocate processing facilities and trading routes in response to law enforcement or other activities against drugs.¹⁰ Thus targeting counter-narcotics measures, for example at the main opium producing provinces, will over time result in spread of opium production to new and more remote areas. This is what has happened. Since the early 1990s, when opium cultivation was concentrated mainly in a few provinces, the share of the biggest opium producing provinces in total national output has progressively fallen, and opium is now found in all of Afghanistan’s provinces. These trends are at least in part attributable to the tendency to focus counter-narcotics efforts on the largest producing areas in the interest of “quick wins” which, however, turn out to be unsustainable.

Moreover, providing development assistance in return for a locality’s commitment to stop opium production, paying farmers compensation for destruction of poppy fields, and implementing alternative livelihoods projects or other development projects in poppy-growing localities—all can generate perverse incentives for others, not currently producing opium, to get into the business in order to become eligible for benefits. While perverse incentives may be relatively weak in relation to the strong incentives to get into opium production in the first place, they may nevertheless further encourage growth and especially spread of the opium economy. In order to minimize the risk of perverse incentives, assistance should not be targeted solely or primarily at farmers and localities currently cultivating poppy.

Price effects. Eradication and other actions to reduce the supply of opium (including successful alternative livelihood projects) will likely result in higher farm-gate prices, increasing incentives for farmers to cultivate poppy. The very large, lasting price rise after the Taliban ban on opium cultivation is a notable example. Such price effects need to be taken into account and may influence the mix and sequencing of actions. For example, interdiction against trafficking and refining, by disrupting downstream stages and at least temporarily reducing demand for opium at the farm gate, may have a lesser (or even negative) impact on farm-gate prices in the short run, holding down production incentives. In contrast, by stimulating sharp price increases, eradication may result in substantial capital gains accruing to drug traffickers holding inventories—inadvertently rewarding the actors that the counter-narcotics strategy should strive to punish.

Short-term versus longer-term implications. Experience has shown that the short-term and longer-term effects of actions against drugs can be different, making sustainable success elusive. For example, eradication even if successful tends to result in shifting of opium production elsewhere, so the outcome over the medium term is that total production has not been much affected but becomes dispersed in more remote areas where it is more difficult to root out.

Prioritization and sequencing. The impact of different actions against drugs can depend very much on how they are combined with other actions and how they are sequenced. For example, eradication in the absence of alternative livelihoods being available does not work, and eradication followed by assistance does not seem to work well, yet eradication (and its threat) can help reinforce alternative livelihoods development if the former follows the latter.

Effects of poor security and governance. Implementation of development programs and law enforcement in conditions of poor security and weak governance is extremely difficult, and distortions inevitably emerge. The credibility and effectiveness of recent eradication campaigns have been weakened by local responsibility for implementation and associated perceptions of factional bias, corruption, and favoritism in the selection of which fields to eradicate. Micro-level evidence from the field suggests that the poor may have been disproportionately affected by eradication (Mansfield 2004).

¹⁰ As an annual crop, opium poppy needs to be replanted every year anyway, which makes it relatively easy to shift production from year to year.

Strategic interactions. From a dynamic perspective the drug industry, which has very large interests at stake, can be expected to respond vigorously to efforts to curb opium production, refining, and trade. The more effective the Government's actions, the more vigorous the likely response from the drug industry, which has a formidable arsenal of instruments. These include: (i) pricing—given the huge margins beyond the farm gate there is scope for the drug industry to raise prices almost to any level necessary to provide adequate incentives to opium cultivators; (ii) location—the drug industry is “footloose” in shifting the location of refining, trade routes, and cultivation; (iii) inputs and extension services—these contribute to the attractiveness of opium cultivation; (iv) corruption—the resources of the drug industry can be used for bribery on a massive scale to undermine efforts against drugs; and (v) armed violence against the authorities, and against others (e.g., coercion of farmers). Likely responses by the drug industry to counter-narcotics efforts need to be factored into the counter-narcotics strategy.

Need for innovative approaches. Limited success in past experience with fighting drugs does not give much ground for optimism, especially in view of the unique aspects of the opium economy in Afghanistan (most notably its sheer size and the environment of lawlessness and deep poverty in which it thrives). No single approach is likely to be effective and sustainable; a combination of different measures, well-designed and well-sequenced, will be essential to have any hope of success. There is also a need to think “outside the box” and explore innovative approaches. Some illustrative examples are listed in Box 3.

E. Government's National Drug Control Strategy

Institutional framework. The Government established the Counter Narcotics Directorate (CND), which reports to the National Security Council, in October 2002. CND is responsible for counter-narcotics strategy development and coordination but not for implementation, which is the responsibility of line agencies. The main tasks of CND are to: (i) develop the national counter narcotics strategy; (ii) coordinate counter-narcotics activities in the Government including budgets and programs; (iii) liaise with internal and external partners; (iv) coordinate drug interdiction programs with neighboring countries; (v) act as a clearing house for projects related to drug control; and (vi) set benchmarks and timeframes and monitor progress. CND has about 50 staff in total. Present activities include policy and strategy development, demand reduction and public awareness activities, legal and judicial reform (including drafting the new Anti-Narcotics Law that was adopted in 2003), coordination of alternative livelihoods efforts (with the Ministry of Rural Development), and coordination on law enforcement with the Interior Ministry. Further strengthening of counter-narcotics institutions is under consideration by the Government, including the possibility of creating a ministry responsible for counter-narcotics efforts.

National Drugs Control Strategy (NDCS). Promulgated in May 2003, the NDCS sets a cautious and gradualist tone: the approach “should be realistic” and “take account of the economic and social causes of illegal cultivation.” “Attention is first needed to establish security and the rule of law, and to create a stable environment to accelerate reconstruction and build institutions”. There is also awareness of the political risks—“in carrying out law enforcement interactions it will be important to balance the political risk of instability caused by counter-narcotics measures with the political desirability of projecting central authority over the entire country and of eliminating the cultivation and production of narcotic drugs.” On the other hand, the NDCS sets ambitious goals: (i) a 70% reduction in opium poppy cultivation by 1386 (five years) with total elimination by 1391 (ten years); (ii) interdiction and prosecution of trafficking, processing, and distribution of narcotics and precursors; (iii) forfeiture of drug-generated assets and controlling money laundering; and (iv) enhancing regional and international cooperation.

Box 3: Examples of Possible Innovative Approaches

A broader approach to alternative livelihoods. The alternative livelihoods approach as implemented so far runs the risk of being ineffective due to the small size of interventions and offsetting responses by the drug industry. Blanketing the entire country with alternative livelihoods projects in theory could deal with these problems but is not feasible and in any case underlines the need to get away from a project focus. What is really needed is sustained growth of the rural economy as a whole—both agriculture and off-farm activities—which will generate livelihoods that those displaced by the shrinking of the opium economy can take up.

Using cost-benefit and/or cost-effectiveness criteria for prioritizing actions. Although such assessments inevitably would be crude and subject to margins of error, they would nevertheless be useful in addressing questions like whether to devote limited law enforcement resources more toward interdiction or toward eradication.

A strong public communications campaign, enlisting support of religious leaders and others respected by rural communities, could be an important part of the national effort against drugs if backed up by other actions. This is called for in the National Drug Control Strategy but so far appears not to be fully exploited.

Going after abusive behavior by the drug industry, e.g., credit at extremely high effective interest rates (over 100%) and denominated in opium. Legal and practical approaches to cancellation of opium-related debts could be explored, although it should be recognized that the tradition of advances carrying very high implicit interest rates is well-entrenched in Afghanistan's rural areas, and other forms of rural credit would need to be available.

Interdicting shipments of chemical precursors into Afghanistan. It takes about four liters of acetic anhydride to yield a kilogram of heroin, so large amounts of precursor chemicals are currently being imported into the country.

Combining anti-money laundering efforts with “grandfathering” of assets from past drug revenues. This could help co-opt parts of the drug economy that are already shifting into other businesses and give them a stake in the legitimate economy. The obvious risk of perverse incentives would need to be taken into account.

Preventing spread of opium cultivation to new areas. Past eradication campaigns focused on the provinces with the highest levels of opium production, where the greatest reduction in production could be achieved in the short run. The dynamic effect, however, has been the growth and spread of opium cultivation in other provinces—making it more difficult to attack subsequently and spreading the adverse political and security impacts into additional parts of the country. A strategy of containing opium production in traditionally important areas and giving high priority to preventing its spreading into new areas could be explored.

Tactical uncertainty and incomplete information. Strategic considerations suggest that maintaining some degree of uncertainty vis-à-vis the major actors in the drug industry—about the Government's plans as well as about next moves and specific actions—may be useful.

The alternative livelihoods concept is central to the NDCS and is considered as an essential condition for eradication. Alternative livelihoods is seen as part of a broad-based economic and social development strategy, to proceed *pari passu* with “phased law enforcement.” A poppy cultivation ban will be enforced where “rural reconstruction has already produced tangible results and alternative livelihoods are sufficiently available.” The NDCS includes an implementation plan, which has been translated into five action plans for judicial reform, law enforcement, alternative livelihoods, drug demand reduction and treatment, and public awareness. These were approved at an international conference on Afghanistan's counter-narcotics strategy held in Kabul in February 2004.

Some issues. The NDCS provides a sound strategic framework for action. It acknowledges the difficulties and proposes many sound and necessary actions. It has provisions for action plans, coordination, monitoring etc. The proposals (e.g., on alternative livelihoods) link to existing activities and programs rather than proposing yet more initiatives for an already overloaded system. Moreover, the purpose of the NDCS is not to put forward a detailed blueprint for all actions but rather to present a coordinated framework including key principles and strategic elements. Some issues that arise related to the strategy are posed below.

- *Ownership and implementation:* The Government is embarking on an important process of generating broad-based ownership through conferences, documents, public communications, a

ruling by the Council of Ulema (religious leaders), etc. But questions remain about the breadth of ownership and implementation capacity for the NDCS.

- *Strategic targets:* The targets are ambitious, in contrast with the cautious language in the document. Are the targets realistic? Are the measures as ambitious as the targets? The strategy lists numerous steps that appear to add up to a broad and integrated attack on the drug problem, yet many of them are already ongoing and have not made a substantial impact. Is much greater concentration of resources and effort needed? In light of experience, are the measures proposed the right ones, or is a “paradigm shift” needed?
- *Institutional architecture and capacity:* The role assigned to CND of coordinating and catalyzing other institutions rather than implementing programs itself seems appropriate. But does the architecture provide for adequate high-level decision taking? In Thailand, for example, the Cabinet meets once a year on drugs, deputy ministers meet quarterly, and the directors of all concerned departments and institutions meet monthly. A second, practical question relates to the profile and capacity of CND itself.
- *Legal framework and law enforcement:* Law enforcement for both eradication and interdiction is problematic. Despite the recent law, the legal framework is unclear, institutional responsibilities are confused, and implementation capacity is in its infancy.
- *Judicial and penal process:* There are questions about the judicial and penal process for drug criminals. The strategy does not discuss the key steps of prosecution and punishment, or measures to get a working judiciary and penal system established.
- *Focus on production or trafficking:* Actions against production, processing, and trafficking are included in the NDCS, but there is no discussion of prioritization. Should limited law enforcement capability be directed toward eradication or toward interdiction?
- *International support:* Will direct international involvement in law enforcement be necessary, particularly in the short run while domestic capacities are being built?
- *Alternative livelihoods concept:* The alternative livelihoods concept that is so prominent in the strategy is left vague and general and is not clearly defined.
- *Priority areas for alternative livelihoods:* The NDCS states that priority will be given to poppy growing areas because the farmers are poor, and to source areas for poppy labor. However, as discussed earlier “favoring” poppy areas may generate perverse incentives.
- *Sequencing of alternative livelihoods programs and eradication:* There appears to be a lack of consensus about the appropriate pace and phasing of alternative livelihoods and eradication. The NDCS appears to endorse the “alternative livelihoods first” approach. Yet there is pressure on the Government to vigorously pursue eradication quickly.
- *Controlling financial flows:* The question of controlling the monetary proceeds of the drug trade, which are transferred through the informal hawala financial system, is important. The subject is mentioned in the strategy but no specific actions are proposed.

F. Options and Trade-Offs in Strategy Implementation

Broader Strategic Framework

Breaking the vicious circle of drugs, warlords, and insecurity, which is so inimical to Afghanistan’s state-building and reconstruction agenda, requires a multi-pronged approach. Drug control measures alone will not be effective. The response to the drug economy must occur within a broader strategic framework including state building and improving security as well as curbing warlords, similar to the strategy for breaking out of the “informal equilibrium” that characterizes Afghanistan’s economy as a whole (World Bank 2004, Chapter 3). In addition to counter-narcotics actions this framework includes: (1) curbing warlords’ power by stopping payments and other support to them, Disarmament, Demobilization, and

Reintegration (DDR) to take away their militias, co-opting them into the Government where appropriate, etc.; (2) building state capacity and resources; and (3) security sector reform and capacity-building (Figure 4). All this needs to happen in an environment of rapid economic growth which allows the drug economy and other forms of illegal activity to be eventually replaced by legitimate economic activities. The rest of this paper focuses on the right-most part of Figure 4 relating directly to the opium economy.

Strategic Objectives, Implementation Options, Trade-Offs

The overall strategic objective of the NDCS is to progressively reduce the size of Afghanistan's opium economy and eventually eliminate it. This challenging and ambitious goal needs to be accomplished in a way that (1) is technically feasible and sustainable and builds required capacity; (2) does not increase rural poverty; (3) avoids pushing the Afghan economy into a recession and handles any macroeconomic fall-out – for example a worsening of the balance of payments; (4) manages the political risks associated with fighting drugs; and (5) takes into account the dynamic longer-term implications and strategic responses by the drug industry.

Capacity and resource constraints mean that it is not possible to do everything, which brings issues of prioritization and sequencing to the fore. Different options need to be assessed on the basis of the above criteria and in light of the lessons of experience, and choices made. Four options involving the three main counter-narcotics instruments are reviewed below.

Option 1: Interdiction. This would involve pursuing drug traffickers and seizing their product, enforcing closure of opium bazaars, and destroying processing facilities. It might also involve sanctions against officials who condone and benefit from the drug trade (including not least their removal from positions in government), seizure of drug-related assets, and legal action against drug money balances and flows. The technical rationale for interdiction is strong, as the trafficking and processing business is more concentrated, more evidently criminal, and has fewer participants than the production stage. Interdiction also does not result directly in rural impoverishment, at least not to the same degree as actions against resource-poor farmers. It is likely that some proportion of the drug trade will be suppressed; risk premia will increase sharply; and the drug business will become increasingly aggressive and well organized in its response. The costs of trafficking and processing could be expected to increase. This will increase the border price of opiates, and it may lower farm-gate prices at least temporarily due to disruptions in the downstream supply chain. In sum, interdiction, if vigorously pursued, has the likely economic advantage of reducing the trade and decreasing its profitability (after risk premia are taken into account) and disrupting the supply chain; it has the moral advantage of attacking what is more evidently criminality; it has the technical advantage of focusing on a much smaller number of actors than eradication; and it has the political advantage of directly attacking the nexus of drugs and illegitimate political and military power.

Three issues arise with respect to implementation: enforcement capability, effectiveness, and political risk. Enforcement requires political will, adequate money, and institutional changes (reinforcement and reorganization of the interdiction forces, judicial reform). The effectiveness of this approach has its limits: neighboring Iran – a well organized, affluent, and committed state with a well-functioning police force and judicial system – has struggled for years in a bloody war on trafficking. Even with this caveat, vigorous interdiction would certainly make a difference, particularly in tackling head-on the part of the drug industry most inimical to the state-building agenda and contributing to insecurity. Political risk is however significant, given that so many people at every level benefit from the drug trade. Thus if the Government opts for an interdiction-led strategy, political consensus would be required, and sustained external support would be essential. The likelihood that the drug industry will respond aggressively with violence and political manipulations has to be anticipated, and the risks and responses taken into account.

Option 2: Eradication. Eradication, involving destruction of opium growing in the fields and possibly associated sanctions against poppy farmers, attacks the problem where it starts and destroys the most visible evidence of illegality. However, experience with eradication has been poor both internationally and in Afghanistan (see above). While eradication can reduce opium output locally, production can quickly shift to other producing areas and spread to new areas (stimulated in part by the higher farm-gate prices caused by eradication), and cultivation can resume in eradicated areas in the following year if there is no follow up. Moreover, the governance and poverty impact of eradication can be problematic. The fairness and consistency of recent eradication campaigns in Afghanistan have been questioned, and poorer farmers appear to have been disproportionately affected (the better off may escape eradication by means of political connections and/or bribes—see Mansfield 2004). Eradication also appears to have worsened the problem of opium-related indebtedness, as indebted farmers whose fields are eradicated fall deeper into debt, which they can manage only by continuing to cultivate poppy. Total national opium production has not fallen as a result of eradication, and at the micro-level many farmers whose poppy fields were eradicated indicated that they will nevertheless continue to plant opium. A UNODC survey in early 2004 (UNODC, 2004a) indicated no difference in poppy planting intentions between areas where eradication took place and those where it did not.

Overall, an eradication-led strategy would face severe problems with implementation, poverty impacts, and political damage. Implementation is very difficult where the authority of the central government is fragile, and experience indicates that it will lead only to changes in the location of opium production. Poverty impacts will be negative, given the dependence of large numbers of poor people on opium for their livelihood as well as the likely distortions in implementation noted above. Political risk is significant, but in a different way than for interdiction. The Government wants to win over the rural poor through inclusive development processes, not aggressive destruction of their livelihoods. Existing rural development and governance initiatives in the countryside, which comprise an important part of the state-building agenda, may be compromised. Finally, there is a moral, political, and economic case for having alternative livelihoods programs in place before commencing eradication.

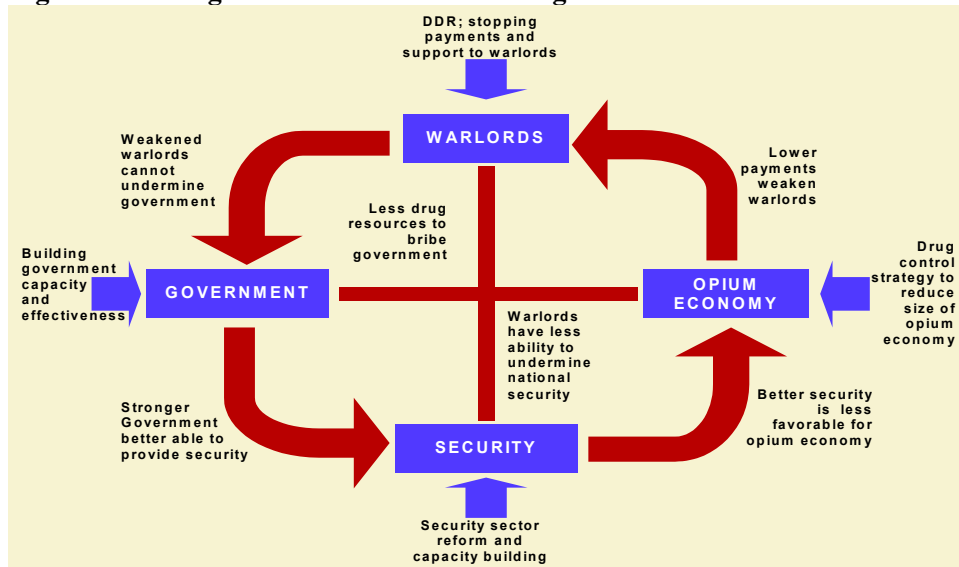
Option 3: Alternative livelihoods. Alternative livelihoods programs, which have a central place in the NDCS, include components of comprehensive rural development, farming, and off-farm income generation. Whatever their impact on drug production, they should contribute to development and poverty alleviation (through creation of assets, markets, and livelihoods) and are non-confrontational. But important issues need to be resolved. Conducting alternative livelihoods programs only or mainly in areas currently growing poppy runs the risk that poppy cultivation will move elsewhere, encouraged in part by perverse incentives. Implementing these programs first in areas currently not growing poppy would have an appropriate incentive effect (for both opium cultivating and non-opium cultivating farmers) but would require programs of a different order of magnitude given that poppy currently is not grown on 97% of Afghanistan's irrigated area. Moreover, such an approach would raise questions about why there is no engagement with the heavier poppy-growing areas. Alternatively, programs could be targeted toward areas "at risk" of getting involved in poppy cultivation, but how should such areas be defined? More generally, alternative livelihoods initiatives cannot be separated from the broad-based rural economic growth and income generation that will be critical in phasing out Afghanistan's dependence on the opium economy. This implies that "mainstreaming" the counter-narcotics dimension in national development programs. In this context, it would make sense to tailor programs to the special needs of poppy-growing areas rather than targeting them one way or the other.

Alternative livelihoods approaches are attractive, but as the primary instrument of a drug reduction strategy they suffer from major weaknesses in time scale, cost, and effectiveness. Completing such programs would take many years and large resources, without visible reduction of drug production in the interim. Moreover, opium would remain the crop of choice particularly for resource-rich farmers, and poorer farmers may continue to be bound to the opium economy by debt and their need to access land and

credit. Thus sole reliance on persuasion through alternative livelihoods approaches is unlikely to succeed in reducing drug production.

Option 4: Alternative livelihoods programs coordinated with eradication. The weaknesses of stand-alone eradication and alternative livelihoods programs suggest that the two approaches need to be pursued together. This is consistent with the national strategy, where broad economic and social development is to take place in tandem with “phased law enforcement”. The key issue with such a combined approach is the need for appropriate sequencing. Eradicating first runs the risk of alienating farmers and reducing their receptivity to rural development efforts in general (including alternative livelihoods programs). On the other hand, implementing alternative development programs first means a delay in eradication, which at the extreme could be quite long. Yet there is pressure on the Government for quick results.

Figure 4: Strategic Framework for Breaking the Vicious Circle



Strategic Trade-Offs. The above discussion of counter-narcotics instruments brings out the difficulty of the strategic choices and trade-offs that must be made. The following points are intended to pose questions and suggest options rather than to make hard-and-fast recommendations.

- *Balancing economic measures and law enforcement.* Both are essential, and coordination is needed between law enforcement and development instruments, taking into account incentives and sequencing issues.
- *Sequencing interdiction, eradication, alternative livelihoods.* The analysis on this paper makes a strong case that, consistent with the National Drugs Control Strategy, the Government should initially give priority to interdiction over eradication, as trying to do both equally would disperse scant political capital, energy, and capacity, and eradication-led approach would have very serious drawbacks as discussed above. Alternative livelihoods programs—and more generally measures to promote broad-based economic growth and employment generation—could be put in place, with the threat of law enforcement measures to follow in due course. Eradication measures could then be planned once implementation capability and political support are mobilized. It is the combination and phasing of the three elements that will be most effective, not any one element on its own.
- *Prioritization.* Given capacity and budget constraints, prioritization is essential. The possibility of using a cost-benefit tool to analyze different options could be explored. In the immediate future, giving priority to action against larger participants in the drug industry would seem to be the most cost-effective approach, and also would have potential for a strong positive public

reaction. A focus on new opium producing areas with little or no history of poppy cultivation would make sense, as it is easier to roll back the practice where the technology and networks are not yet entrenched, and moreover this would help contain the problem and discourage further spread of production.

- *Monitoring progress and impacts and adjusting plans.* The NDCS emphasizes the need for good monitoring, and there needs to be a thorough assessment of the economic and social situation of opium farmers and wage laborers.
- *Law enforcement capability.* Clarifying institutional responsibilities with respect to law enforcement is a priority. Exceptional measures are needed to strengthen capacity.
- *Legal framework and judicial and penal process.* The justice system as it relates to narcotics needs strengthening. The legal framework is under review. Consideration could be given to devising a fair but easily implementable legal, judicial, and penal process for drug offenders, perhaps including special mobile courts dedicated to narcotics cases.
- *Need for international support.* The Government will need to seek sustained international support and cooperation in its efforts against drugs, and in controlling the trade in both transit and consuming countries.

G. Conclusions

This paper has drawn out and emphasized the inter-linkages between drugs and development in Afghanistan. It has argued that the opium economy—including its nexus with insecurity, warlords, state weakness, and poor governance—constitutes a central development problem for the country. The Afghan drug industry is unprecedented in international experience in terms of its size in relation to the economy as a whole, its penetration of the polity, economy, and society, and the insecure and lawless environment in which it has thrived. While international experience can provide some useful lessons, Afghanistan's own largely unsuccessful experience in efforts against drugs suggests that the problem faced is of a different order of magnitude.

The multiple development implications of the opium economy include pluses as well as minuses. Among the former are the support provided by the opium economy to overall economic activity and the balance of payments. The opium economy has boosted rural incomes and has served as a coping mechanism helping large numbers of poor people make ends meet through wage labor and sharecropping and tenancy arrangements which provide them with access to land and credit, albeit on unfavorable terms.

Set against these benefits are the major drawbacks of Afghanistan's opium economy, including large price and quantity volatility which can have a major macroeconomic impact, and the price and exchange rate effects of the economy's heavy reliance on opium which could discourage production of other tradables through a "Dutch disease" effect. Substantial numbers of poor farmers are deeply mired in opium-related debt (in many cases precipitated by the Taliban opium ban or more recent eradication campaigns), which virtually requires them to continue cultivating opium poppy and may precipitate drastic measures like mortgaging and losing land, or giving up their daughters in marriage to pay off opium debt. More generally, opium is becoming "capitalized" in the economy and society, affecting agricultural sharecropping and tenancy arrangements, land prices, urban real estate, bride prices in opium-producing areas, etc. Although reliable data are not available, drug addiction within Afghanistan may be substantial and appears to be growing.

The nexus of drugs with insecurity and warlords, a vicious circle that would keep Afghanistan insecure, fragmented politically, weakly governed, poor, dominated by the informal/illicit economy, and a hostage to the drug industry, is clearly the most serious problem. This threatens the entire state-building and reconstruction agenda for the country and as such outweighs all of the benefits of the opium economy

taken together. Closely related is the corrosive effect of the drug industry on governance through massive corruption.

The development impacts, positive and negative, of the opium economy need to be fully taken into account in the counter-narcotics strategy. This paper argues that from a development perspective, it would make sense for the counter-narcotics strategy to focus on the most damaging aspects of the opium economy, which would imply emphasis on interdiction of trafficking and processing and sanctions against drug industry principals and sponsors, including not least the removal of such persons from government positions that some of them may hold. It is also very important that the counter-narcotics strategy include measures to address the adverse side effects of successful actions against drugs in the macroeconomic, livelihoods, and poverty spheres.

The Afghan Government's National Drugs Control Strategy provides a sound framework for action. There are tensions, however, between the cautious tone in much of the strategy document and the ambitious targets (70% reduction in opium poppy cultivation in five years and complete elimination within a decade) as well as pressures for quick and visible results, even if at the expense of longer-term sustainable improvements. There are also strategic implementation issues relating to prioritization and sequencing between interdiction, alternative livelihoods, and eradication, and enormous needs to build capacity in governance, law enforcement, and the judicial and penal systems. While all three of the main counter-narcotics instruments will need to play significant roles, this paper argues that initially interdiction should be pursued aggressively while alternative livelihoods are being developed, which in turn will create the right conditions for eradication and law enforcement sanctions against farmers who continue to cultivate opium poppy despite viable alternatives being available. All in all, and not surprisingly given past experience and the size of the drug industry, there are no easy answers, only difficult trade-offs in the search for a multi-pronged, sustained, and effective response to the drug problem in Afghanistan.

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