

INTRODUCTION AND OVERVIEW

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I. BACKGROUND AND METHODOLOGY

Introduction

The magnitude and importance of Afghanistan's opium economy are virtually unprecedented and unique in global experience – it has been roughly estimated as equivalent to 36% of licit (i.e. non-drug) GDP in 2004/05, or if drugs are also included in the denominator, 27% of total drug-inclusive GDP (see Chapter 2). The sheer size and illicit nature of the opium economy mean that not surprisingly, it infiltrates and seriously affects Afghanistan's economy, state, society, and politics. It generates large amounts of effective demand in the economy, provides incomes and employment including in rural areas (even though most of the final "value" from Afghan opium accrues outside the country), and supports the balance of payments and indirectly (through Customs duties on drug-financed imports) government revenues. The opium economy by all accounts is a massive source of corruption and undermines public institutions especially in (but not limited to) the security and justice sectors. There are worrying signs of infiltration by the drug industry into higher levels of government and into the emergent politics of the country. Thus it is widely considered to be one of the greatest threats to state-building, reconstruction, and development in Afghanistan.

UNODC's (United Nations Office on Drugs And Crime) regular surveys, extensive data, and its 2003 comprehensive report (UNODC, 2003) provide invaluable insights into the overall size and characteristics of the opium economy, and much good fieldwork has been done at the rural household level.² There have also been general overviews like Ward and Byrd (2004). But the opium economy beyond the rural farm and household level remains very under-explored and under-researched, despite its obvious importance for Afghanistan's security, governance, and development agenda. As a result, counter-narcotics policies and actions have had to cope with a limited evidence base, further increasing the risk of mistakes in addressing what is an enormously complex and difficult problem in the first place.

This volume, a joint effort edited by UNODC and World Bank staff and including work by a number of contributors, constitutes a first attempt to remedy this situation—by broadening the analysis of Afghanistan's opium economy to encompass, in addition to the rural farm/household level: opium trading, price patterns and pricing behavior, the drugs/informal financial transfer (*hawala*) nexus, the organized crime perspective, and macroeconomic dimensions. While it aspires to greater comprehensiveness, this is not at the expense of depth of coverage, as most of the research presented in the volume is based on newly-gathered primary data from fieldwork, or in-depth technical analysis of available information. However, while it is beginning to put together the pieces of the jigsaw puzzle—or in other words to fill in the overall picture of the opium economy in Afghanistan—this volume's findings and conclusions must be considered preliminary, subject to further verification, adjustment, or correction through additional research.

¹ The World Bank and UNODC. This chapter has been written by the editors of this volume and presents some main themes and implications / recommendations of the volume as a whole. The views, findings, interpretations, and conclusions expressed in this chapter are those of the authors and should not be attributed to the United Nations Office on Drugs and Crime or to the World Bank, its affiliated institutions, its Executive Board of Directors, or the countries they represent.

² See work by Mansfield, Pain, Goodhand, and others, cited in various chapters, especially Chapter 3.

After a discussion on methodological issues below, the rest of this introductory chapter briefly distills some main themes, summarizes the other chapters, and puts forward policy implications and recommendations for consideration. Chapter 2 provides an overview of the macroeconomic implications of Afghanistan's opium economy and of counter-narcotics actions, based on a simple macroeconomic model. Chapter 3 synthesizes the fieldwork conducted on the opium economy at the rural household level and draws out key findings and implications. Chapter 4 looks into the next level up—opium traders and patterns of opium trade—based on fieldwork in two provinces. Chapter 5 analyzes available data on prices of opium and opiates using various statistical and econometric techniques, to assess market patterns and trends and market integration. Chapter 6 explores the very important but murky nexus between the drug industry and the informal financial transfer system (*hawala*). Chapter 7 looks at the drug industry in Afghanistan from an organized crime perspective, focusing on its consolidation, changing internal structure, and linkages with different levels of government.

Methodological Considerations

It should be emphasized up-front that Afghanistan's opium economy is a difficult target for research. Not only is it very much in the informal sector – activities are unregistered and hence for the most part no official national data are available – but those involved in the drug industry have strong incentives to conceal their activities and roles and not to provide accurate information. The sensitivity and controversy surrounding the drug industry, in Afghanistan or in any other country, exacerbate the difficulties for research. In some respects the situation in Afghanistan is even worse than elsewhere due to insecurity, logistical constraints, and other barriers to information gathering. Moreover, the information base to start with—whether in terms of macroeconomic data or statistics on arrests and other law enforcement actions—is much weaker in Afghanistan than in most other countries. Much of the research presented in this volume represents initial forays into new areas where existing information is very limited or almost non-existent.

Nevertheless, it is certainly possible to conduct meaningful and productive research on Afghanistan's opium economy. In the first place, although it suffers from serious limitations, the quantitative data available on the opium economy is by no means insignificant, based on serious and credible efforts at information collection, primarily by UNODC. There are annual surveys of opium poppy cultivation, from which, based on yield estimates, estimates of opium production are derived, both for Afghanistan as a whole and by province. Opium price data in a number of markets are regularly collected by UNODC and can be used to develop estimates of gross revenues and the potential export value of opium (see UNODC, 2003, and Chapter 2). Some useful information and insights can be gleaned from rural household survey data and other available information not specific to the opium economy. Overall, despite its limitations, the quantitative data base for the opium economy is generally no worse, and in many respects better, than the data available on the rest of the Afghan economy.

Second, and perhaps even more important, there has been a tradition of openness and willingness to be interviewed, discuss, and provide information about the opium economy on the part of many of its actors. This is in part a legacy from the earlier period when opium was not widely seen as illegal and activities were relatively open (e.g. opium bazaars in key opium producing and trading areas). It is also related to the methodology used, exploring the

issue of opium poppy cultivation within the wider framework of rural livelihoods rather than focusing solely on drugs, which typically enhances the responsiveness of interviewees. Researchers who built up their contacts and networks earlier continue to benefit, and new researchers, provided they have suitable introductions, also can get meaningful access to some drug industry actors and knowledgeable observers. While this accessibility has been greatest at the level of rural households involved in the opium economy (i.e. farmers and wage laborers), it is also possible to meet with *hawala* dealers (in the informal financial transfer system), small opium traders, mid-level traders, and even sometimes more important actors, as well as with knowledgeable people in law enforcement and other positions. All in all, the situation in this respect appears to be considerably better in Afghanistan than in many other countries with large illicit sectors, especially those involving drug-related activities.

This openness carries its own challenges: How to distinguish valid information and perceptions from gossip, innuendo, and outright prevarication? The quality of field research and interview techniques in particular is critical in this regard. There is no substitute for painstaking legwork. Sound approaches have been developed both by researchers working on Afghanistan (see, for example, Chapters 4 and 6 as well as the fieldwork reported on in Chapter 3) and in research work on criminal activities in other countries (see the discussion and references in Chapter 7). Key elements include:

- Interviews structured around a common set of well thought-out questions, albeit open-ended and exploratory (these are the critical raw materials of research).
- A sufficient number of interviews to build up a reliable knowledge basis.
- Interviews with different types of actors and other informants so as to build up a relatively accurate composite picture.
- Interviews in a variety of locations, as appropriate for the topic (recognizing the diversity of the opium economy in different settings).
- An iterative approach to information collection (both during a single research project and sequentially across studies), to build confidence and trust over time.
- Meticulous recording of interviews (usually through note-taking and ex-post compilation, as recording devices can be detrimental to the quality of responses).
- Careful sifting and cross-checking of interview materials, reconfirming through re-interviews where necessary and possible, and cross-checking with information from other sources (both contemporary and historical) to better assess veracity.
- Making observations and drawing conclusions only when there are multiple corroborations from a number of interviews (or confirmation from other sources).
- Effective training and guidance of local surveyors when they are used.

Finally, strict confidentiality and anonymity of interview sources is essential. If not assured of this, sources may withhold information or distort their responses, and the environment for future field research on the opium economy could be compromised. More generally, whereas "naming names" is essential for counter-narcotics investigations and prosecutions, it would be counterproductive in the sphere of research and analysis. Not only must the confidentiality and anonymity of interview sources be maintained, but referring in research reports to individuals who are said to be linked to the drug industry would detract from the proper focus of research and analysis which is on strategy and policies, not individual cases. Moreover, any naming of individuals could be misconstrued and might well give rise to doubts about the objectivity of research, undermining the impact of associated recommendations.

Interviews and surveys can also be a fertile source of basic quantitative information—in particular for ascertaining "stylized facts" about the topic. The field research on rural households and the opium economy, some of whose main findings are summarized in Chapter 3 (see references cited in that chapter), involves much basic analysis of simple quantitative information gathered from households (while fully recognizing that samples are not necessarily statistically representative). Moreover, combining and cross-checking information collected through interviews with quantitative data from other sources can be a powerful tool. This is done, for example, in Chapter 4 to develop a quantitative picture of opium trading flows in Helmand and Ghor provinces, and in Chapter 6 to ascertain rough percentages of informal financial transfers in different localities that are likely to be drug-related.

Turning to analysis of quantitative data, standard economic tools can be applied, but taking into account data limitations and the context of Afghanistan. A simple macroeconomic model is developed in Chapter 2 to illustrate the various macroeconomic implications of different actions against the drug industry. Chapter 5 applies several statistical and econometric techniques using available price data to shed light on the question of whether opium markets in Afghanistan are "integrated", based on a technical definition of this term. Both chapters develop policy implications from the analysis, while fully recognizing the limitations and the need to contextualize analysis and recommendations for Afghanistan.

Other tools also can be productively used in research on the opium economy, for example graphical devices like diagrams to develop ideas on structural and dynamic aspects. Chapter 7 uses this device both in the interviews conducted and to illustrate the structure of the drug industry and its evolution in recent years. Chapter 3 uses diagrams to convey analytical findings about the diversity of the rural opium economy and of its response to counter-narcotics actions. Another example is case studies (while maintaining anonymity), presented in a number of boxes in Chapter 3.

In summary, it is definitely possible to conduct meaningful and productive policy-oriented research on the opium economy in Afghanistan, as the chapters in this volume demonstrate. They are based on extensive and careful research, use credible methodological approaches, and show full awareness of the limitations and preliminary nature of the conclusions that are drawn. Moreover, the chapters don't stop with research and analysis but also strive to draw out relevant policy implications of their findings.

II. MAIN THEMES

This section outlines some of the main themes that run through the papers collected in this volume. The discussion below makes no attempt to achieve comprehensiveness in coverage; instead the approach is thematic—weaving together some of the main findings and conclusions into a coherent story.

First, the studies in this volume bring out very strikingly *the full breadth of Afghanistan's opium economy and its multi-dimensional impacts on the national economy, polity, and society*. Opium permeates much of the rural economy, with critical links to employment generation, access to land, and credit. Opium markets, prices, and traders populate the Afghan landscape and provide important signals to economic actors.

Drug money is a very important, often dominant ingredient in the informal financial transfer system (*hawala*), which is also the main vehicle in Afghanistan for payments and transfers of funds, including remittances and much aid. And through protection payments and connections the drug industry has major linkages with local administration as well as high levels of the national government.

Second, the papers shed light on the question: ***What is the overall impact of the opium economy on Afghanistan and what are the pluses and minuses?*** It is very large in aggregate, and has a macroeconomically significant effect on aggregate demand, employment, the balance of payments, and to a smaller extent government revenue. However, the macroeconomic impact of the opium economy is moderated and in some respects dampened due to its characteristics as a set of illegal export-oriented activities. Since much of the income accruing to the opium economy beyond the farm level (i) never enters into Afghanistan in the first place, (ii) may be sent out of the country, or (iii) is used for imported goods or real estate investment, its positive economic impacts appear to be considerably less than its size would indicate. By the same token, actions against the drug industry may correspondingly have less of an adverse macroeconomic impact (in particular on the balance of payments) than if this were a legal productive activity being phased out. ***Even with these qualifications, the macroeconomic impact of the opium economy is substantial, especially on rural economic activity and livelihoods.***

Third, at the micro level ***the diversity of the drug industry in Afghanistan is impressive.*** It plays multiple and different roles—vis-à-vis different actors, in different parts of the country, and changing over time. Depending on the situation of a rural household, the opium economy may be a source of land and credit, seasonal employment, a virtually guaranteed market, high financial returns, and secondary multiplier effects (e.g. demand for goods on local bazaars, construction, etc.) However, it can also exacerbate indebtedness, insecurity, and poor governance. The adverse development and poverty impacts of actions against drugs are concentrated on poorer rural households whose livelihoods and access to key assets like land and credit depend on the opium economy, and whose alternatives are fewer and more constricted than those of better-off households or households located in areas with better resources and access to markets.

Fourth, many of the papers bring out ***the flexibility of the opium economy and its ability to effectively respond to changing economic and enforcement environments across space and time.*** Opium has progressively spread to all of Afghanistan's provinces (even though its presence in some of them is only nominal). Success in reducing cultivation in one province typically translates into increases elsewhere rather than a sustained decline in total national cultivation. The different actors in the opium economy—traders, processors, wage labor, and even to a significant extent farmers—are mobile, and respond flexibly and speedily to economic opportunities as well as to changes in the law enforcement environment. Financial flows through the *hawala* system are smooth, fast, and efficient. This is not to say that the opium economy can be transplanted to any place in Afghanistan (yields, and even the ability to grow opium poppy at all, are affected by climate, altitude, knowledge of agricultural techniques, etc.). Moreover, areas with stronger licit economies and wider economic opportunities can be "weaned from" or "inoculated against" the opium economy with some effort. But nevertheless, the drug industry has demonstrated that it is "footloose" and spreads easily to many parts of the country. This flexibility is evident also in the upper

levels of the drug industry, whereby patterns of capture and corruption can shift across ministries and other institutions, and involve changing actors and changing degrees of visibility, depending on the political environment and reform of different institutions (e.g. Ministry of Defense, versus Ministry of Interior).

Fifth, as will be discussed at greater length in the final section of this chapter, ***the diversity, flexibility, and dynamism of the drug industry must be taken into account in designing the Government's and international community's responses.*** The available counter-narcotics instruments are often blunt and unwieldy, and this needs to be factored into decisions about their deployment and use. For example, strong enforcement efforts against farmers (discouraging opium poppy cultivation, threat of eradication, and actual eradication, as well as interdicting against local opium markets and traders) may be effective and sustainable in better-off localities where viable licit livelihoods are already available, whereas such efforts may be ineffective, even counterproductive in poorer, remote areas with limited resources, assets, and markets. Counter-narcotics programs (whether law enforcement or development activities) can never hope to be as nimble as the opium economy, which implies that nationwide efforts, covering both areas producing opium and those which do not but could be at risk of doing so, are required. The time horizon of interventions needs to be long enough to respond to the flexibility of the opium economy. All these considerations point strongly toward "mainstreaming" the counter-narcotics dimension in national development programs rather than relying primarily on specialized alternative livelihood projects.³

Sixth, in an environment of poor governance, weak capacity, and lack of rule of law, ***the significant albeit patchy eradication efforts against drugs in recent years have been having undesirable side effects,*** including most notably the following:

- ***Eradication efforts are a vehicle for corruption,*** with farmers being forced to pay in order not to have their opium poppy crop eradicated, police confiscating drugs and then selling them on and/or returning part of the seizure in return for a payment, favoritism on the part of government officials toward associates in the drug industry while cracking down on "competitors" to drive them out of the market, and more generally larger "protection payments" being exacted.
- As a result largely of corruption and other irregularities in enforcement, ***the impact tends to be felt most by the weakest and poorest actors*** involved in the opium economy (poor rural households), who lack political support, are unable to pay bribes, and cannot otherwise protect themselves.
- ***The credibility of enforcement efforts is gravely weakened*** by the corruption in implementation, detracting from the moral legitimacy of the fight against drugs.

Seventh, there are clear signs that ***the changing (and generally tightening) environment against narcotics is contributing to a consolidation of the drug industry*** around fewer, more powerful, and politically connected actors, with compromise of key institutions like the Ministry of Interior (MoI) and police and involvement by other security forces. This should not be understood as a straightforward trend toward "mafiaization", and – with many powerful actors becoming engaged in politics and distancing themselves from open association with the drug industry – trends are complex. Nevertheless, findings both at the field level (small-scale opium traders) and from interviews with knowledgeable sources point toward increasing organization of "protection" for the drug industry in a criminalized environment, with some government agencies and leaders playing an important role in this, and

³ Individual alternative livelihoods projects can provide valuable experience on a pilot basis, serve as a vehicle for learning, and play a catalytic role and generate potential for scaling up in other development programs. But a projectized approach to alternative livelihoods (i.e. with specialized alternative livelihoods projects as the main vehicle) cannot have a significant longer-term impact on the drug industry overall – resources are too small, geographical coverage limited and scattered (allowing narcotics production to shift to areas not covered by projects), integration of interventions difficult, and sustainability questionable.

with smaller and more marginal actors increasingly being left out and often becoming targets of enforcement efforts. These trends could have potentially serious adverse implications for the future – making the fight against drugs all the more difficult.

Finally, as will be seen from the summaries below and in individual chapters, *there is a great deal of thematic unity among chapters*, even though they cover a variety of topics and use different techniques of analysis. While there are differences of views in some respects, much more striking is the relatedness and consistency of the findings across different dimensions of the opium economy. This should provide greater confidence in the general directions for counter-narcotics policies and actions that are put forward at the end of this chapter.

III. CHAPTER SUMMARIES

Macroeconomic Implications

This chapter analyzes Afghanistan's opium economy from a macroeconomic perspective. Although very large, the share of the opium economy in total economic activity in Afghanistan has been falling in recent years – not because it has been declining but rather because the rest of the economy has been growing rapidly while the opium economy has remained roughly constant in absolute terms. Nevertheless, opium remains the country's largest source of export earnings, and a major source of incomes and employment in rural areas. Opium GDP is estimated at in the \$2.6-2.7 billion range during the last two years, equivalent to 27% of total (drug-inclusive) GDP and 36% of licit GDP in 2005/06.

The macroeconomic impact of the opium economy depends in particular on how much of the proceeds actually enter the Afghan economy, and how this is allocated between consumption, investment, and savings, as well as more generally how it translates into demand for domestic and imported goods and services. The chapter argues that whereas farmers and wage laborers could be expected to spend rather than save the bulk of their earnings from the opium economy, mostly on domestic goods and services, opium traffickers and processors are assumed to save a substantial proportion of their receipts, and to spend more on imports. Opium-related demand, along with aid inflows, is contributing to a "Dutch disease" problem for Afghanistan, whereby prices of nontradables and production factors get pushed up, with an appreciation in the real exchange rate, weakening Afghanistan's competitiveness in non-opium export markets and in competing with imports. The positive fiscal impact of the opium economy is indirect (customs duties on imported goods purchased with opium receipts, taxation of real estate transactions, etc.) and is marginal compared to its cost in terms of government spending on counter-narcotics efforts. While the opium economy has a very significant net positive impact on Afghanistan's balance of payments, this is reduced by drug-related outflows of funds (including capital flight as well as spending on imports).

A critical set of questions addressed by the chapter concern the macroeconomic impact of successful actions against drugs, and how adverse macroeconomic consequences can be managed. In this regard, the chapter makes a number of points:

- ***Counter-narcotics efforts have been intensified but have fallen short of objectives.***
- ***A well-sequenced and balanced approach is needed,*** including all of the instruments in the counter-narcotics arsenal.
- In particular, ***more progress in implementation of alternative livelihoods programs is needed,*** with a medium-term time horizon, as opposed to focusing on quick-impact programs like short-term employment generation programs, which lack sustainability.
- A successful counter-narcotics campaign could have an adverse effect on licit GDP growth, the balance of payments, and government revenue. However, ***such effects will be smaller than the overall size of the opium economy would indicate,*** given that a large portion of opium receipts never enter Afghanistan in the first place, or leave the country through capital outflows and/or purchases of imported goods. The economic shock would also be smaller to the extent that the burden falls on drug traffickers as opposed to farmers.
- Over the medium term, ***reduction in the size of the opium economy would ameliorate the Dutch disease effect and stimulate better competitiveness and growth in the non-drug economy.***
- With respect to the macroeconomic policy mix, ***the Government should not resist a nominal depreciation of the Afghan currency, as long as this remains consistent with monetary policy objectives.***
- Second, while the balance of payments needs to be monitored in the context of counter-narcotics efforts, ***the net impact on licit balance of payments flows and on reserves may not be too large.*** The same is true of the impact on fiscal revenues.
- The macroeconomic impact of counter-narcotics efforts can best be managed if ***there are progressive, sustainable reductions in the size of the opium economy over time, rather than sudden but reversible declines*** as seen in recent years, which can be disruptive.
- And finally, ***the critical adverse development impact of actions against drugs is on poor farmers and rural wage laborers, so these should be the focus of alternative livelihoods programs.***

Responding to Diversity in the Rural Opium Economy

This chapter summarizes and develops the findings of extensive fieldwork on the role of the opium economy in rural livelihoods and household decision-making. It argues that diversity in household characteristics, assets, and access to markets means a diverse pattern of dependency on the opium economy, and of decision-making about whether to cultivate opium poppy under varying local circumstances. This in turn implies that there is diversity in households' responses to shocks like elimination of opium poppy cultivation in their locality, and in the degree to which they are able to cope and move into alternative livelihoods, or whether they will remain dependent on opium. And finally, all this diversity calls for a commensurate response in the counter-narcotics strategy, which will have to take into account the differences among households and localities in designing and implementing the strategy. Only in this way will there be a prospect to achieve sustained reductions in opium poppy cultivation in Afghanistan.

While Afghanistan in general has proven to be a favorable environment for the expansion of opium poppy cultivation, nevertheless ***opium remains a relatively minor crop in terms of relative cultivation levels***, accounting for only around 3% of total national agricultural land. Nearly half of the 364 districts in Afghanistan still report no opium poppy cultivation (although it is found to varying degrees in all of the country's 34 provinces), and the intensity of cultivation by district can range from very small to as much as 70-80% of the agricultural land in a district. Moreover, levels of cultivation and production have fluctuated widely—nationally, by province, and by district.

Diversity and change in patterns of opium poppy cultivation reflect in large part the varying assets and opportunities available to Afghan rural households, which in turn are closely related to geographical location. Households that are smaller, have a higher ratio of able-bodied males to total household size, own significant land, have other assets like livestock, and which are located in areas with a favorable climate, good irrigation water, and access to commodity and labor markets—these have more options and greater flexibility in terms of activities and responding to shocks. For such households opium poppy cultivation is a means to maximize the returns on their assets, both directly and through mobilizing outside labor on favorable terms through share-cropping part of their land, as well as through providing credit on highly favorable terms to the creditor, and holding opium stocks beyond the harvest period so as to benefit from higher prices.

On the other hand, households with limited human capital (large household size, few able-bodied workers), no or small landholdings, limited other assets, and located in areas with poor irrigation and infrastructure and far from commodity and labor markets, have far fewer options and tend to be more dependent on opium poppy cultivation. For these households, the opium economy provides access not only to income opportunities (primarily through share-cropping and wage labor) but also to critical assets like land and credit, enabling them to make ends meet. Many poorer households carry a heavy burden of opium-related debt, with continuing opium poppy cultivation being necessary to be able to service the debt.

Under these circumstances, ***eliminating opium from their livelihood options carries grave and counterproductive implications for asset-poor households.*** Their response is likely to increase their dependence on the opium economy over the medium term (sale of livestock, mortgage or sale of remaining land), and/or could have severe adverse human consequences (marrying off under-age daughters to offset opium debts, reducing food consumption and quality, cutting expenditures on health). The chapter points to examples of poorer farmers whose opium poppy crop has been eradicated several times but who still plan to cultivate opium poppy in the next season, in particular as the only means to service their debts and gain access to land for farming.

The chapter explores the experience with the nearly complete nationwide Taliban opium ban of 2000/01 and the more recent strong and largely successful efforts to eliminate opium poppy cultivation in Nangarhar province, one of the country's largest opium producers. There is evidence that ***the Taliban ban carried the seeds of its own lack of sustainability, due to a many-fold increase in the burden of opium-related debt*** (locking many households into dependence on future opium poppy cultivation), forcing asset sales to make ends meet, etc. It also appears that the opium ban weakened the Taliban politically.

Thus the sustainability of the ban beyond the first year was highly doubtful, even if the Taliban had not been overthrown in late 2001.

In *Nangarhar* the emerging pattern is that *localities with good land and irrigation resources and access to commodity and labor markets have sustained or largely sustained the elimination of opium poppy cultivation for a second consecutive year*, something unprecedented in the history of counter-narcotics efforts in Afghanistan. At the other extreme, in the most remote, resource-poor localities the ban on opium poppy cultivation never really took hold and cultivation increased in the second year. Intermediate areas between these two extremes face great difficulties, with strong pressures to resume opium poppy cultivation but also efforts to continue the ban, and with resource-poor households caught in between and resorting to drastic coping actions like out-migration.

The chapter ends with a call for a commensurate response in the design and implementation of counter-narcotics strategy to the diversity found in Afghan rural households, in their involvement in the opium economy, and in their responses to counter-narcotics measures. Fundamentally, *there is a need to work with the diversity that exists in rural Afghanistan rather than ignoring it*, and to make use of the knowledge that has been gained about opium poppy cultivation and the factors that contribute to households' decisions in this regard. This would imply a more differentiated approach by locality (e.g. district), continuing field research to further build the evidence base and capture the ongoing evolution of the opium economy in rural areas, and avoiding a static mind-set and mechanical application of counter-narcotics instruments. The implication for alternative livelihoods programs (and for "mainstreaming" of the counter-narcotics dimension in development activities) is that they need to target the asset-poor households and localities with limited resources, and to begin to address the shortcomings that make these households and areas highly dependent on opium in the first place (in particular, lack of access to land and credit, lack of alternative income-generation opportunities, and distance from markets).

Opium Traders and Trading Systems

Based on intensive fieldwork conducted in 2005, this chapter studies opium traders and trading systems in two contiguous provinces of Afghanistan, Helmand in the south and Ghor toward the west, which have quite different roles in the opium economy. Helmand has long held a dominant position as an opium producer, accounting for around 25% of the total national opium poppy area in recent years, while cultivation of opium poppy in Ghor is more recent and accounts for only around 3% of the total national area. Helmand is essentially an economy of arid plains dominated by a river irrigation system, while Ghor has classic features of a remote mountain economy. In terms of climate, the irrigated parts of Helmand are almost ideal for high-yielding opium poppy cultivation, whereas Ghor is much more marginal, with crop failure always a risk in large parts of the province. These geographical differences, coupled with significant drug-related economic interactions between the two provinces, have shaped the very different size and evolution of the opium trade in Helmand and Ghor.

The chapter estimates very roughly that opium trade through Helmand—including both local production and opium from other provinces—accounts for up to half (2,000 metric tons) of Afghanistan's total opium production. Ghor on the other hand supports both a much

smaller transit trade in opium from the north (roughly in the range of 100-200 tons per years) as well as its own production, also estimated at around 100-200 tons per year.

These production and trade estimates are matched against reported numbers of opium traders and individual trade levels, generating estimates that are broadly consistent with the supply estimates determined from production data. It is roughly estimated that Helmand has some 1,000-1,500 small opium traders and 300-500 bigger traders. In Ghor the numbers are much smaller—perhaps in the range of 30-50 transit traders (bringing opium from northern provinces down to Helmand), some of whom are Helmandis, and a number of small traders dealing in Ghor's own opium production, numbering some 100-150 in Chaghcharan district with much smaller numbers elsewhere.

Attention is drawn to the issue of opium inventories and the different reasons for which they are held (although the chapter could not address this subject in detail). Ghor is characterized by an apparent absence of significant stocks of opium, but the picture in Helmand is quite different. With opium production highly seasonal and sale of opium out of Helmand taking place episodically throughout the year, larger traders in the province maintain short-run stocks in order to meet demand and take advantage of favorable prices. Various sources suggested that perhaps 40% of the purchase at harvest time would be kept as stock for trading during the year. In addition, there has been an accumulation of opium stocks during the years of high prices, which appear to have been held on to in the hope that prices would recover. Based on very rough calculations, a trader purchasing around one metric ton of opium per year could have built up a total long-term stock of opium of at least a ton over the past 4-5 years.

The development of the opium transit trade through Ghor offers insights into the expansion of Helmand-based trading networks and the dominant role they appear to play in shifting production to other provinces. At the same time, the significance of traditional informal networks in developing opium trade (virtually all of the Ghor transit traders had a background in the livestock trade) is demonstrated. More generally, the chapter argues that especially before the more recent "criminalization" of opium trading, patterns and practices in the opium trade had considerable similarities to other informal markets in Afghanistan (see AREU, 2004 and more recent publications by AREU).

Rather fragmentary data on value chains was collected, which allows only a few broad conclusions to be drawn. Price margins appear to be modest close to the farm gate, in the range of 7-10% between farmers and small traders. But there appears to be a rather larger margin for traders beyond the locality, perhaps on the order of 50%, consistent with the shift in the share of gross opium revenues in favor of traders since 2003. Margins are widely reported to increase sharply the closer to the border the trade moves.

The research obtained significant insights into trading risks. The common thread emerging from interviews is that the most important risk is price risk due to short-term (daily) price fluctuations, sometimes of up to 30%. These fluctuations appear to be driven by the episodic nature of demand from outside buyers and a degree of collusion on the part of bigger traders. Risks associated with theft and seizures were widely reported. Risk of loss due to adulteration of the product was reported but appears to be less common and greatest for inexperienced traders.

A persistent theme is the engagement of key provincial and district authorities in the opium economy, and both interdiction and eradication measures may have contributed to key drug industry actors and their sponsors gaining tighter control over distribution and trade. It was commonly reported in interviews that payments were exacted from both farmers and traders to avoid eradication of poppy fields or seizure of opium stocks and shipments.

Key conclusions of the chapter relate to the continuity of trading systems from the past, including traders moving from one product to another, and between legal and illicit goods, in response to opportunities. The chapter also argues that there is evidence of a somewhat fragmented rather than unitary market for opium in Afghanistan.

Policy implications center around the consequences of eradication and interdiction measures in an environment of weak governance and lack of rule of law, and also issues related to informal regulation of markets in general. More specifically, numerous examples were reported of harassment by local authorities, such as exacting payments from farmers to avoid having their poppy fields eradicated (and coming at harvest time to collect a further "tax"), seizing opium shipments but for re-sale not destruction, and "encouraging" small traders to move into market buildings owned by key local drug industry actors. Smaller traders without connections have been finding it increasingly difficult to stay in business.

There is a case for anticipatory action in Ghor to restrict the spread of opium poppy cultivation in that province. Note is made of comparative work on middle markets in Europe, which in certain respects resemble those of the two provinces studied. These similarities include the fragmented and regional nature of markets and the critical role of kinship and ethnic ties in trading systems, albeit with clear evidence of reaching out beyond ethnic groups as well (e.g. in the case of the Ghor transit trade).

Prices and Market Interactions in the Opium Economy

This chapter analyzes the fairly extensive data available on opium and opiate prices in (and to some extent around) Afghanistan, with a view to better understanding price structure, price trends, price behavior, and market integration. Prices are important because they are a critical determinant of the overall level of opium/opiate revenues in the Afghan economy and its distribution among different actors. Prices provide market-based signals to producers, traders, and other actors. Opium prices directly affect asset values, capital gains, and decisions on size of opium inventories, as well as opium-related debt burdens, debt distress, and associated adverse consequences including for rural poverty. Finally, price behavior may shed light on the characteristics of opium markets and of the drug industry, providing indications on how to respond more affectively.

The chapter finds that there have been large changes in opium prices (most notably associated with the Taliban opium poppy cultivation ban in 2000/01), as well as considerable volatility in prices. Supply side factors (weather, cultivation bans) have a strong influence on opium prices, albeit mediated somewhat by inventory adjustments. The maintenance of farm-gate opium prices during recent years at levels well above those prevailing in the 1990s, suggests that, despite the failure to reduce opium production, the "risk premium" associated with opium poppy cultivation has risen considerably, reflecting criminalization of the activity (it was essentially legal during the Taliban period except during the ban near the end of

their rule), significant albeit patchy and haphazard enforcement efforts, and likely greater extortion of "protection money" from farmers by various authorities.

The chapter raises serious questions about whether higher prices in themselves further broader counter narcotics-goals and should be seen as a policy objective. In particular, higher prices: (i) increase the incentives for opium production (particularly in areas where counter-narcotics pressures are less); (ii) raise the value of opium inventories (enriching large traffickers and others holding sizable inventories); (iii) increase the burden of opium-related debts on poorer farmers; and (iv) if due to eradication or cultivation bans, make those who still cultivate opium poppy better-off while leaving those who do not cultivate, or have their fields eradicated, far worse off.

An investigation of the spatial pattern of opium prices suggests that opium markets are flexible and mobile. While actions against the opium economy in a given area can be effective locally and in the short run (including having an impact on local prices), they tend to encourage a shift of production and trade to other areas. Regional (particularly cross-border) differences in prices and the potential profits from trade suggest that interdiction of opium trade, in particular at borders, may be effective, although sealing remote, mountainous and porous borders like those of Afghanistan will be very difficult.

Analysis of the "vertical" structure of opiate prices (from farm-gate through trade and processing to prices in transit countries and consuming countries) suggests that:

- The value of raw opium at one end of the chain comprises only a tiny fraction of the final retail value of heroin in Europe or the United States.⁴
- There have been great price fluctuations at the upstream end of the price chain, whereas prices appear to have been much more stable at the downstream end (although there is evidence of substantial adjustments in purity). This means that there must be absorption of price shocks from the upstream end of the value chain, in transit countries and perhaps in wholesale markets of consuming countries.
- At both extreme ends of the "value chain" (farmers and the traders who purchase directly from them, and final consumers and the retail street dealers who sell to them), markets are characterized by numerous actors who are "price-takers" and have little or no ability to manipulate prices. But at key intermediate stages there are much fewer actors, who probably can influence prices.
- There may be some premium placed by the drug industry on avoiding very sharp overall movements in wholesale and retail prices in consuming countries (with adjustments in purity playing a role instead), while at the opposite end of the value chain prices clearly adjust in the face of supply shocks—perhaps considered necessary to elicit the necessary supply and incorporate changing risk premiums.
- The absorption of price shocks implied by these patterns would appear to be pursued through inventory adjustments, adjusting profit margins at key intermediate stages, and adjustments in purity at downstream stages.

Finally, a range of statistical and econometric approaches are applied to questions about the degree to which opium markets in Afghanistan are "integrated", the technical definition of which is that prices in different markets are closely related, generally move together, and do not get too far out of line with each other. Main findings include:

- There are strong correlations between prices in some Afghan opium markets, but with

⁴ This feature is common among agricultural products that go through processing, branding, and packaging before final consumption (although there is only limited branding and packaging of opiates), but it is found in extreme form in the drug industry.

- Mazar-i-Sharif and especially Badakhshan appearing to be more isolated.
- For the two markets with a longer time series of price data (Kandahar and Nangarhar), based on econometric tests the markets were integrated prior to the 2000/01 Taliban opium poppy cultivation ban, but not in recent years.
- Helmand and Kandahar for all intents and purposes can be viewed as a single opium market.
- Based on analysis of price data for recent years, Helmand/Kandahar appear to be functioning as a "central market" for opium in Afghanistan.

Possible implications of these findings include, first, that significant counter-narcotics actions can disrupt opium markets and apparently reduce the degree to which they are integrated. To the extent that efficient market functioning is good for the drug industry, this disruption is a positive outcome. More concretely, such market disruption could result in higher costs, less efficient adjustment to various shocks, and other difficulties for the drug industry. However, this impact should not be overstated, particularly in the case of more localized interventions.

Second, it is doubtful whether the Taliban's opium ban was a major factor behind the reduction in market integration, since it applied to production and not trade and was applied virtually nationwide in areas under Taliban control (including Kandahar and Nangarhar). Moreover, there are signs of continuing close links between markets subsequent to the ban. The important finding that the opium markets in Kandahar and Nangarhar are no longer integrated most likely is primarily due to the sharp reduction in opium production and trade in Nangarhar in 2004/05, reflecting strong and effective counter-narcotics measures including raids on and closure of opium bazaars in that province.

A final question concerns the implications of Helmand and Kandahar functioning as a single market and also in some sense serving as a "central market" for opium in Afghanistan as a whole. Would focusing counter-narcotics law enforcement efforts— notably interdiction of trade and destruction of processing labs and large stocks of narcotics etc.— on the Helmand/Kandahar nexus be effective in disrupting opium markets more generally in Afghanistan? This question demands further thought and analysis.

The Nexus Between the Drug Industry and *Hawala*

This chapter represents a first attempt to build a qualitative story, with quantitative estimates, on the important nexus between drugs and *hawala* (informal money transfer system) in Afghanistan. The objective is to enhance knowledge about the *hawala* system and the methods used to launder the proceeds of drug trafficking. The analysis in the chapter is based on interviews with a sample of 54 *hawala* dealers in the main centers of *hawala* activity of Afghanistan as well as during a visit to Peshawar, Pakistan. In addition, interviews were conducted with users of the *hawala* system (drug dealers, businessmen, traders, international aid workers), regulators (government officials, central bank personnel), and formal service providers (bankers, accountants). In this way a broad picture of the *hawala* system and its nexus with drug money was built up, along with some rough quantitative estimates. However, and despite careful cross-checking and other measures to ensure maximum integrity and comparability of data, the data and methodological problems in attempting a serious study of this difficult and largely clandestine topic should not be underestimated.

Nevertheless, the chapter does provide new insights into the nexus between drug trafficking and the *hawala* system in Afghanistan, and provides an initial evidence basis for policy.

The field research found substantial evidence that the *hawala* system does facilitate the transfer of drug-related funds in Afghanistan. *Hawaladars* reported turnover of the highest order during the two phases of opium cultivation and harvesting. The chapter offers a provincial breakdown by dealer size and proportion of total financial transactions related to drug money. It also confirmed that in the settlement process *hawala* dealers are heavily reliant on formal banking channels in regional countries around Afghanistan.

Each of the four localities covered by fieldwork provides a different perspective on the laundering of drug funds, which demonstrates how difficult it is to gain a sense of the aggregate drug money laundering problem in Afghanistan. The field research in Faizabad, for example, indicated that during certain times of the year close to 100% of the liquidity of the *hawala* system in the province is derived from drugs, whereas in Herat it was estimated that only 30% of the *hawala* market's overall transaction volume is directly linked to drugs. Analysis of data gathered in places like Herat was complicated by confirmed links between drug money and legitimate imports. The southern region (Helmand and Kandahar provinces) is also a key centre for money laundering in Afghanistan (about 60% of the funds are drug related and 80-90% of the *hawala* dealers in Kandahar and Helmand are involved in money transfers related to narcotics). Helmand has emerged as a key facilitator of the opium trade, both between provinces and exports, while overall estimates of the local *hawala* markets' drug-related component are of a similar order of magnitude to those in Kandahar. This finding adds weight to the notion that the major trading centers in these two neighboring provinces should be treated as essentially one market. Bearing this in mind, the study calculated that Helmand could account for roughly US\$ 800 million of Afghanistan's drug-related *hawala* business and that Herat is the second largest contributor, with in the range of US\$ 300-500 million of drug money laundered annually.

Furthermore, Dubai appears to be a central clearing house for international *hawala* activities (see Maimbo, 2003, and sources cited in Chapter 6). In addition, various cities in Pakistan, notably Peshawar, Quetta, and Karachi, are major transaction centers. It appears that even in the case of drug shipments to Iran, payments for them come into Afghanistan from Pakistan.

Overall, the chapter confirms that the *hawala* system has been key to the deepening and widening of the "informal economy" in Afghanistan (see World Bank, 2005), and has provided the cover of anonymity and opportunity to launder money for those wishing to abuse the system. However, these findings should also be viewed in light of the positive contributions of the *hawala* system. It has been central to the survival of Afghanistan's financial system through war and, as argued by Maimbo (2003), "integral to processes of early development and vital for the continued delivery of funds to the provinces." The *hawala* system also plays an important role in currency exchange. It participates in the Central Bank's regular foreign currency auctions, and was instrumental in the successful introduction of a new currency for Afghanistan in 2002-2003.

In drawing up an appropriate policy response to the *hawala* system, it is crucial for policymakers to:

- ***Recognize the positive impact of the hawala system*** on Afghanistan's economy and society. Without its transfer mechanisms, basic assistance could not have been delivered to people in need during the civil conflict or reconstruction process.
- ***Involve hawala dealers in the policy process***, as their knowledge can be drawn on.
- ***Develop real incentives for compliance with current registration and taxation initiatives***. The adversarial relationship that *hawala* dealers have had with corrupt law enforcement and tax authorities needs to be reversed through progressive building of trust between *hawala* operators and government officials.
- ***Enhance the effectiveness of the Central Bank's registration program***.
- ***Ensure that the assistance and business communities are diligent in their use of the hawala system***, with proper checks to protect their transactions from becoming intermingled with illicit transfers.
- ***Encourage genuine anti-money laundering compliance in countries that have banking links with Afghanistan*** including Pakistan and Dubai. While they have publicly agreed to the Financial Action Task Force (FATF) standards, evidence on the ground suggests that implementation still needs to be strengthened.
- On the other hand, ***the FATF guidelines must be viewed within, and if necessary adapted to suit, the Afghan context***. There is a risk that international banks, applying FATF guidelines in an inflexible way, could alienate the population and thereby undermine the objective of developing a formal financial sector.

Because of the cross-sectoral nature of the drug industry and its reliance on regional partners, a combination of interventions beyond the *hawala* system itself and anti-money laundering will be required, including a gradual and properly sequenced (as between law enforcement and development) strategy to reduce the size of the opium economy, rapid and sustained growth of the legal economy (which will require identification and development of international markets for Afghanistan, especially for the country's agricultural goods); and strengthening the Afghan formal financial system while enforcing anti-money laundering controls in neighboring countries.

Organized Crime and the Drug Industry

The final chapter of this volume analyzes Afghanistan's drug industry, and its recent evolution, from the perspective of organized crime. Reliable information about the "commanding heights" of the drug industry in Afghanistan (i.e. the small number of key traffickers and their associates and sponsors including in government) is even more difficult to obtain than for other segments of the opium economy. Nevertheless, based on intensive interviews over a short period of time and drawing on secondary sources, this chapter makes an initial effort to build up an understanding of the organization of the drug industry and how it has evolved in recent years, especially at the upper levels. The chapter also develops a conceptual framework for thinking about organized crime in Afghanistan, and outlines schematically the changing constellation of actors and their interrelationships in the "drug industry pyramid".

The chapter starts by reviewing the definition of organized crime groups, which encompasses a wide variety of entities ranging from loose networks of as few as three people to large, hierarchical, and structured mafia-like organizations. Thus there is a "spectrum" of organized crime entities, with those which constitute the greatest threat in Afghanistan becoming increasingly structured and hierarchical. Whereas loose criminal networks operate in larger illicit markets that they cannot influence, the more structured, hierarchical organized crime groups strive to exercise effective control over criminal markets, in particular through offering "protection" services (i.e. extorting revenues from economic actors in return for enabling and facilitating their businesses to operate). Organized crime thrives in an environment of weak governance and poor security; hence post-conflict societies are particularly vulnerable to growth of organized crime.

The chapter focuses on three parallel but closely related developments since 2001:

- ***The transformation of warlords and unofficial armed groups***—in particular warlords distancing themselves from direct involvement in narcotics (due in large part to international pressure, and their interest in taking on new roles in politics), and the process of Disarmament, Demobilization, and Reintegration (DDR) for organized militia forces and the more recently initiated process of Disarmament of Illegal Armed Groups (DIAG).
- ***The changing roles of different government agencies, notably the Ministry of Defense and Ministry of Interior***, with the former being reformed in the context of DDR and the formation of the new Afghan National Army (ANA) and the latter remaining to a large extent unreformed, leaving it vulnerable to being compromised by the drug industry, including through senior police appointments.
- ***The evolution of the drug industry itself***—in the direction of greater consolidation; coordination (including across ethnic groups); close association between government, business, and criminal operators; exclusion of new entrants especially at upper levels; dynamic responses to law enforcement (including higher levels of secrecy); and development of more systematic and well-organized mechanisms of criminal protection.

In an environment of criminalization of narcotics, increasing (albeit patchy) law enforcement and eradication campaigns, and ongoing efforts to rebuild state institutions, the drug industry in Afghanistan is becoming increasingly consolidated. At lower levels (farmers, small local traders, etc.) there is still freedom of entry and choice in transactions, but this becomes progressively less as one moves up the pyramid. At the top level, the chapter argues that around 25-30 key traffickers, the majority of them based in southern Afghanistan, control major transactions and transfers, working closely with sponsors in top government and political positions. A form of "checks and balances" appears to be exercised to ensure smooth flows of narcotics and protection payments.

Entry at the top level and the one below (some 200-250 large traffickers nationwide) is severely restricted, and the degree of secrecy is high. Entry also is becoming less easy for mid-level traffickers (perhaps some 500-600 of them in the country), with secrecy increasing. Southern traffickers largely control the flow of opium from northern Afghanistan to the south which has become the center of the drug industry, whereas interconnections with the Northeast (Badakhshan) appear to be much less, in part due to the latter having its own local heroin processing facilities.

A key part of this emerging pattern is the "capture" to a considerable extent of the Ministry of Interior and its use as a means of providing "protection" for and facilitating consolidation of the drug industry. At the lower levels, payments to police to avoid eradication or arrest reportedly are very widespread. At higher levels, provincial and district police chief appointments appear to be a tool for key traffickers and sponsors to exercise control and favor their protégés at middle levels in the drug industry.

The chapter emphasizes that there are no easy answers, simple formulas, or quick-fix solutions to the drug industry as an increasingly organized set of criminal activities. Three aspects are highlighted.

First, *the emergence of organized criminal activities may require using new analytical frameworks and dispensing with pre-accepted notions* (e.g. that different ethnic groups don't work together). In this context, it will be essential to build knowledge and monitor developments closely.

Second, *countering organized crime in Afghanistan requires a careful balancing act*: action that is too assertive may risk undermining the delicate political process that is underway, whereas too little action against criminal actors and activities may in the long run lead to subversion of the political process itself. This calls for, on one side, a concrete focus on ensuring higher integrity in law enforcement, with better oversight and building core groups of honest law enforcement officials. On the other side, there may be merit in prosecuting a limited number of high-profile traffickers through Afghan courts, irrespective of political or ethnic affiliation or connections. This will send an important signal and reinforce more systematic approaches at lower levels.

Third, *improvements in specialized law enforcement agencies alone will be far from sufficient* to tackle the drug industry, and there must also be a focus on attacking the enabling environment for such criminal activities. This will require first and foremost continuing state-building, improving governance, and instilling rule of law. Reform of the Ministry of Interior is a priority issue in this regard.

IV. CONCLUSIONS AND POLICY IMPLICATIONS

As the foregoing chapter summaries highlight, this volume includes a diversity of topics and research techniques, but there is a high degree of consistency in the main findings and themes. Although distilling policy implications from this diverse set of chapters is challenging, it is essential to do so, building on the evidence, analysis, and conclusions presented in them.

Most broadly, the chapters in this volume clearly highlight that *a "smart" counter-narcotics strategy will be essential for the effectiveness and sustainability of the fight against drugs*. The diversity, flexibility, and dynamic character of the drug industry (and its financial channels through the *hawala* system) have been amply demonstrated in recent years. It must be recognized that counter-narcotics efforts—whether enforcement actions or development of alternative livelihoods—inevitably cannot be anywhere nearly as nimble or quick as the activities they are targeted against, and they inevitably take time,

measured in decades rather than years in the case of alternative livelihoods programs.

This makes it all the more important to design and deploy these instruments in an intelligent manner that maximizes the prospects for them to be effective and sustainable. For example, experience strongly suggests that counter-narcotics actions against farmers are more effective and more likely to "stick" in areas where access to land and water resources is better, there is proximity to markets, land-person ratios are higher, etc.—all of which taken together mean that licit livelihoods are possible. This suggests concentrating such efforts in these areas. Experience also suggests that strengthening enforcement in areas that have not yet become dependent on drugs can pay substantial dividends in discouraging opium production in such areas. On the other hand, in remote, poor areas with limited land and irrigation water, dependency on the opium economy is much greater, and premature efforts to eliminate it will be hard to sustain and could likely prove counterproductive. More generally, geographical issues with respect to application of counter-narcotics strategy and policies are very important and need to be explicitly factored in.

In addition, the counter-narcotics strategy needs to be sensitive to issues relating to provinces and localities not currently cultivating opium poppy. Non opium-producing areas need to receive development support (in addition to enforcement actions against cultivation as it arises) that will prevent start-up of cultivation. In this way, the threat of displacement and spread of opium poppy cultivation can be reduced.

A second important implication for strategy and policy is that, with modest resources and weak institutions fighting against a diverse, flexible, mobile, and dynamic drug industry, ***expectations about what can be accomplished in the short run must be kept reasonable***. Overly inflated expectations—whether about eradication, other enforcement measures, or alternative livelihoods—inevitably lead to disappointments, which given the political sensitivity of narcotics in turn can lead to overreaction and policy mistakes. This has been demonstrated by the experience of other countries. Thus there is no alternative to a sustained long-term effort, with success inevitably being modest and elusive in the short run.

A third, related implication is that ***sequencing and complementarity issues need to be fully taken into account*** in the design and implementation of a "smart" counter-narcotics strategy. A one-dimensional approach which focuses on a single instrument, a single time, or a single place does not make sense—the drug industry will respond dynamically, leaving such efforts endlessly chasing moving targets. For example, consistent with reasoning developed earlier in this chapter, it would make sense to target enforcement efforts against opium poppy cultivation first in better-off and less opium-dependent areas (including areas not currently cultivating significant amounts of opium poppy), and take on poorer areas which are heavily dependent on opium more gradually over time. There is a strong argument that enforcement efforts against opium poppy farmers should follow rather than precede the availability of viable alternative livelihoods.⁵

A fourth implication is that ***available data on the opium economy and analysis of such information should be utilized to inform the design and implementation of counter-narcotics strategy***. Some data, for example satellite imagery, is already being used to some extent, but more use should be made of local data from field research (e.g. on characteristics of rural households). The National Risk and Vulnerability Assessment

⁵ Areas with better land and water resources and access to markets as well as higher incomes, more household assets, and lower dependency ratios in effect already have "alternative livelihoods" available, which is why enforcement efforts can be more effective and sustainable in these areas.

(NRVA) rural household data, which covers the entire country, could also be very useful in combination with in-depth field information for selected localities. Statistics on opium prices, collected on a monthly basis, can be productively utilized. It is also important to further expand the knowledge base on opium, particularly as the drug industry continues to evolve and transform itself.

A fifth implication is that *the design and implementation of counter-narcotics efforts need to factor in the adverse side effects of interventions*. Some of these are well-known as developed in several of the chapters. For example, with respect to eradication and other enforcement efforts against opium poppy farmers, adverse side effects which need to be factored into the counter-narcotics equation include, among others: (i) lowered incomes for the poor (from sharecropping, wage labor); (ii) reduced access to land and credit for those lacking such resources; (iii) increased opium-related indebtedness, with tragic consequences for many rural households; (iv) reduced economic demand in the rural economy due to multiplier effects; and (v) possibly reduced political support for the government in rural areas.

Interdiction efforts can be more selective and targeted than eradication, but in the context of Afghanistan this may open up greater scope for abuse and associated adverse side effects (discussed further below in relation to governance and corruption). A key potential adverse side effect of interdiction, particularly if it goes after higher-level traffickers and their sponsors (some of whom are in or have close ties with the government), is the political fall-out. This needs to be taken into account in advance so that the government is prepared to respond as needed.

Adverse side effects relate closely to the sphere of governance, which is critical both to understanding the opium economy and in counter-narcotics efforts. While the drug industry itself constitutes a serious threat to the state-building agenda in Afghanistan, ill-considered counter-narcotics actions can be counterproductive in terms of governance, possibly exacerbating an already difficult situation. On the other hand, strengthening local government administration clearly has a role to play in fighting drugs through improving governance.

More specifically, *the evident risk of corruption and consequent distortions in the implementation of the counter-narcotics strategy must be fully taken into account*, as this has potentially very serious adverse consequences which go beyond the opium economy itself and could adversely affect Afghanistan's state-building and reconstruction agenda more broadly. For example, experience demonstrates that implementation of eradication programs—especially if they are partial or "targeted" within localities—inevitably is distorted by corruption, so they disproportionately affect the poor and those without local political connections. This suggests that, in areas where eradication is being pursued (for example in areas with good access to land, water, and markets as recommended earlier), it should be applied wholesale with the objective of eliminating opium poppy cultivation in the area. This will minimize the risk of favoritism and corruption in implementation—if virtually everyone is being prevented from cultivating opium poppy and/or having their poppy fields eradicated, the scope for irregularities and distortions will be less.

In relation to interdiction, the corruption issue is just as challenging. In addition to reforms in the key institutions involved (e.g. the Ministry of Interior, police, and army, the

approach to and targeting of interdiction may need to be rethought. While it may make a great deal of sense to focus interdiction efforts against higher-level elements of drug trafficking networks, these are more difficult targets because of their political connections. On the other hand, focusing interdiction on smaller actors (e.g. small and medium-sized opium traders) using unreformed law enforcement agencies runs the risk of systematic corruption in implementation with associated distortions (including not least facilitating consolidation of the drug industry). There are no easy answers, but it is clear that ignoring corruption in the implementation of drug control policies, and not taking it into account in their design and deployment, will undermine the whole effort. This also needs to be factored into discussions and dialogue on governance.

The macroeconomic implications of actions against drugs need to be closely scrutinized. Although they are likely to be less than the sheer size of the opium economy would suggest, there nevertheless could be significant complications for macroeconomic policy, which the government should be aware of and prepared for. In particular, trends in the balance of payments need to be monitored closely, with exchange rate policy responsive to any shocks that arise from counter-narcotics actions. But the biggest adverse macroeconomic impact of successful efforts to reduce the size of the opium economy (as well as the greatest effect in terms of worsening poverty) will most likely be on economic activity in some rural areas and on the rural poor. Any efforts to offset this impact (such as those in Nangarhar during the 2004/05 opium ban there) inevitably will be too little and too slow. So counter-narcotics strategy should focus not only on offsetting adverse macroeconomic and poverty impacts of actions against drugs, but also needs to re-think the size and speed of eradication and other enforcement efforts in heavily drug-dependent and poorer areas, with a view to ensuring that the adverse effects on incomes and livelihoods of the poor are manageable.

There are difficult dilemmas in dealing with the hawala system, which in addition to transferring drug industry proceeds is an indispensable mechanism for payments, deposits, and licit financial transfers including notably remittances. Thus a frontal attack on the *hawala* system is unwarranted and could be damaging. The way forward is, first, to recognize the positive impact of the *hawala* system on Afghanistan's economy and society. *Hawala* dealers should be brought into the policy process, incentives developed for compliance with current *hawala* registration and taxation initiatives, and the Central Bank registration program strengthened. Since regional banks especially in Pakistan are deeply involved in the *hawala* network, genuine compliance with money-laundering standards by such banks is required. On the other hand, very strict enforcement of FATF guidelines within Afghanistan appears to be hindering the development of the formal financial system in the short run, and discouraging Afghans from depositing their cash in banks. This may call for adapting FATF guidelines to better suit current conditions in Afghanistan. Finally, the assistance and formal-sector business communities need to be diligent in their use of the *hawala* system, for example by making proper checks on dealers to protect their transactions from becoming intermingled with illicit transfers.

The implications of the consolidation of the drug industry, and the apparent role of elements of the security forces (including police at provincial and district levels) in facilitating its activities, are potentially very serious. The credibility of the counter-narcotics strategy as a whole, the legitimacy of the government, and more generally the state-building and security sector reform agendas could be severely damaged. This

means that interdiction against high-level drug traffickers and their sponsors (inside and outside of government) would have high pay-offs in the short run, especially in terms of arresting the trend of consolidation and compromising of government institutions. But by the same token, such an effort would be all the more difficult against a consolidated, entrenched, and powerful "core" of the drug industry. These trends also call for accelerated institutional reform and strengthening of the Ministry of Interior and police force so that they can be more resistant to being compromised by the drug industry.

Although it is beyond the scope of this volume to look in detail at the drug industry beyond the borders of Afghanistan, this has been touched on in different chapters—in discussions on drug-related financial flows and the balance of payments, opium trading, opiate price patterns and trends, and the *hawala* system. ***The regional and global character of the drug industry clearly calls for a commensurate response at these levels.*** In particular, interdiction against high-level drug traffickers and those who profit from the trade needs to occur beyond Afghanistan's borders as well as within the country. The flow of drug money globally, including through financial institutions in many countries, is an essential facilitating element for the drug industry (including in Afghanistan) and hence cannot be ignored. And the demand side of the equation for global illicit narcotics in many respects is at the core of the problem, so demand reduction will comprise an essential component of an effective global counter-narcotics strategy.

Finally, it seems appropriate to close this introductory chapter by emphasizing that ***it is possible to look into the "black box" of the drug industry***, both from its "edges"—i.e. the farm production stage at one end and final consumption at the other end—but also at some of its core elements beyond the farm level, like financial channels, trading networks, price patterns, and higher-level organizational structure, as well as the multi-faceted interactions of these elements with the rest of Afghanistan's economy, polity, and society. Although this is not easy to do, the chapters in this volume demonstrate that despite the difficulties, such analysis is not only possible but can be very illuminating. It is hoped that as a result of the research presented in this volume, further in-depth research on these and other aspects of the opium economy will be encouraged, and the evidence from good research will be fully factored into counter-narcotics strategy, policies, and actions. Only in this way will it be possible to make substantial and sustained progress in the fight against illicit narcotics in Afghanistan.

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