



## Review of Afghanistan's Economic Development Status during Republic Government (from 2001-2021)

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<http://dx.doi.org/10.18415/ijmmu.v10i3.4549>

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### **Abstract**

In 2001, Afghanistan was stuck in war and conflict which started in 1979, when 9/11 occurred and it became again the center of the world's attention. The international community intervened and the new Afghan government established hope that a stable economy and functional state could be built. The international community poured huge amounts of aid into the Afghan democratic government. The country's economy grew, public institutions developed, education and health services intensified and state banks upgraded. Twenty years passed and the Afghan government never found the capability to finance its national budget. The foreign grants shared around 97 percent of GDP by 2011 and it was 40 percent by 2021. The country was addicted to foreign assistance; aid funds provided a large portion of the public budget, however a greater part of grants were carried by doors themselves (off-budget). The economic development areas that are generating revenue and ensuring sustainability; agriculture, natural resources and transit did not expand. The Afghan government did not acquire functionality and could not stand on its feet in the last twenty years in spite of experiencing economic growth. Afghanistan remained poor with persistent poverty and humanitarian challenges. The prevailing poverty, weak economy and state failure now indicate that Afghanistan is at the status that it was in 2000. The economic growth and development was unsustainable.

**Keywords:** *Afghanistan; Economic Development; Public Expenditure; Domestic Revenues*

### **1. Introduction**

The pre-war Afghanistan economy was stable and sustainable. The per-capita income was similar to most other developing countries (Zhang et al. 2019). The country was self-sufficient in food and was being exported as agricultural products. The percentage of the population living in urban was less the 10 percent. The major economic sectors were agriculture and animal husbandry, small industry, and some natural resources (essentially gas and minerals) (IMF 2003). The Afghan government was generating revenue through taxes on agricultural exports (Zhang et al. 2019). The existing economic and social

stability was lost in the late twenty century and never returned. In April 1978 communist regime came into power in Afghanistan and in December 1979 Soviet Union invaded Afghanistan to support the communist regime and war started (Afghanistan 2022) since that Afghanistan has been considered a typical failed state. The failed state index (FSI) ranked Afghanistan in the top 10 failed countries in the world in 2002 (Collier and Hoeffler 2004). By the end of 2001, most of the country's infrastructure had been severely damaged and destructed. The economic activities were disrupted by war and the foundations of economic development were ruined. Government services dramatically declined, including health care and education.

Following the events of September 11, 2001 in Afghanistan a new democratic government was established. US President George W. Bush invoked the Marshall Plan when pledged to reconstruct Afghanistan in 2002 (The US War in Afghanistan). In January 2002 Conference on Reconstruction Assistance to Afghanistan held in Tokyo, donors committed aid for Afghanistan reconstruction to support Afghanistan's economic and social recovery, excluding humanitarian assistance. The new Afghan government authorities committed to achieving financial stability, supporting the reconstruction and recovery of the economy by adopting a National Development Framework (NDF) in 2002. The NDF focuses on three pillars of development: (a) security and human development; (b) rebuilding physical infrastructure, and (c) inclusive economic growth. They are also dedicated to establish transparency in government operations and advancing economic management. The economy was based on liberal and open markets, led by the private sector with low state intervention (IMF 2003). In short, the new Afghan government commitment based on NDF was to build a strong economy and promote unity and security. The social and economic background of the country changed (UNOCHA 2021). The gross domestic product grew, public institutions developed, government departments such as finance, health and education and the central bank upgraded (Bizhan 2018). All these achievements lack stability and sustainability. Economic activities, providence of basic services (health and education) were aid-dependent. Also, none of the domestic revenue generators developed to ensure long-term sustainability. Afghanistan failed to build a self-sustaining national economy and the government never found the capability to finance its national budget (Ahmed 2021). Also, the security remained unsolved, though, sustainable economic activities require a stable and secure environment (Sandbu 2021). The Afghan government received huge amounts of foreign aid in the last twenty years, but that democratic west-back government was considered failed and inefficient. Afghanistan remained poor with persistent poverty and humanitarian challenges.

The aim of this paper was to outline economic development and transformation in the recent two decades. The first section outlines a historical context of economic and social breakdown due to war in pre-2001 Afghanistan. The second section describes the last twenty years of economic performance and growth drivers. The third section explains government expenditures and system of disbursement; national budget and donor-managed own costs. The fourth section describes domestic revenue generation progress. Finally, the conclusion is driven.

## **2. Methodology**

Since this paper is a review article, it synthesized quantitative (systematic reviews) and qualitative works through an intensive reading of published and unpublished journals, articles, government and international organization reports, books, and even prestigious media. In addition to qualitative and narrations components, tables and figures are used in this article. First, we outline the pre-2001 situation in Afghanistan to reflect the country's status before the time interval that this paper is considering it. Second, we studied macro-economic development factors in detail, and finally the government expenditures and their components (domestic revenue and foreign grants). Based on the real situation expressed by the components studied the conclusion was run.

### **3.Pre-2001 Afghanistan**

In 1979 after the Soviet troops invaded Afghanistan and the conflict started, it was called Soviet-Afghan war (Johnson 2014). The Soviet Union withdrew from Afghanistan in 1989 and afterward the civil war started among various groups in the country in 2001. War disrupted economic activities, and the foundations of economic growth the infrastructure were severely damaged and millions of people became homeless. In 2001 Afghanistan was considered one of the poorest countries in the world. Its economy lay in ruins. Gross domestic product (GDP) in 1997 was approximately \$5 billion, half of which was from the transit trade, primarily the smuggling of duty-free goods into Pakistan (Goodson 2001). The \$5 billion GDP was both legal and illegal like drugs but the genuine GDP was even lesser. At that time Afghanistan was a fragile state and the thrust data was not available. According to another report, the GDP was \$3.7 billion in 1977, and it fell continuously to around \$2.7 billion in 2000 (Wahab and Youngerman 2010). There was virtually no banking system through which savings could be mobilized to support investment. Economic activity was based on agriculture, however, the agriculture sector was also severely affected, mainly during the drought years in 1998 onward which sharply reduced crop yields. Several million Afghans were facing starvation and food shortage in the coming winter. Fruits and nuts, many of them native to Afghanistan, once accounted for half of all exports. Many rare fruits and nuts were cut down during the war. According to reports, 75% of farming and irrigation areas were destroyed between 1979 and 1989. Agricultural activities had all been abandoned, which led to famine, economic hardship, and violence in the late 1990s (Zhang et al. 2019). Trade was disrupted in the absence of most governmental services. During the period 1995–2001, both import and export values of goods were very low, suggesting a weak integration of Afghanistan in the international market for goods. (Rocha 2017). The illegal economic activities were opium growing, processing and export, heroin manufacturing and smuggling, arms trafficking, and smuggling of duty-free goods. Virtually there was no industry functioning. Afghanistan fell behind modern development to a pre-modern level of existence (Goodson 2001). In Kabul, most government employees go unpaid, with high inflation, and shortages of vital goods. Afghani, the state currency, had been produced by Northern Alliance-produced and flowed to all countries. Afghanistan earlier built infrastructure and institutions were severely damaged. The infrastructure of the country had been severely damaged in frontline zones, and had deteriorated through lack of maintenance and repair in areas where less conflict had occurred. Nearly all the institutions of a functioning society had been destroyed, including the parliament, the courts, much of the civil service, and most of the educational and health systems (Sevastik 2019). The political system had collapsed, there was no central government nor the national army or police force. The Ministry of Defense was nominally in control by a large number of disjointed militia forces. Almost all resources were dedicated to military needs. (Ibrahimi and Maley 2019). Vast quantities of weapons of all sorts could be found in civilian hands. Most government services ceased, and nearly all women were dismissed from employment outside their homes (Otfinoski 2004).

Foreign humanitarian operations in Afghanistan continued to decline in 1999. There was extensive poverty, unemployment and a lack of goods and production. Almost all assistance was allotted to food programs to meet the basic need to survive, more than two-thirds of Kabul's population was relying on humanitarian assistance to survive (Wahab and Youngerman 2010). Kabul has had no regular supply of electricity for several years, and water throughout the entire country is unsafe to drink. (Goodson 2001). War had a profound effect on Afghan society and culture. About 2 million Afghan lives were lost in the fighting (Bizhan 2014). Afghanistan has produced the largest population of refugees and displaced persons in the world every year since 1981. In 1990 around 6.7 million Afghans refugees were living abroad (Holzmann 2018).

### **4.Post-2001 Afghanistan**

After the 9/11 occurrence in the United States in 2001, international coalition forces led by the US in 2001 attacked Afghanistan. Neglected Afghanistan became vital to global security. The new

government was established based on the Bonn Agreement in December 2001, interim governments for six-months and then for two years created by Hamid Karzai (Afghanistan 2022). The new government was recognized as legitimate by most Afghans and by the world community (Bizhan 2018). The democratic, central government established hope that a stable economy can be built. The hopes never came true, because post-2001 administrations had no economic agenda, political and social integration and were massively corrupted that did nothing to help Afghanistan to stand on its own two feet (Otfinoski 2004). Afghan government in the last twenty were considered a failed state in spite of experiencing economic growth (Del-Pino and de Los 2011), all four post-ruled governments failed to build a self-sustaining national economy. Foreign aid provides three-quarters of the government's national budget. Afghan government's main revenue generator sectors did not grow (Zhang et al. 2019).

### 5. Afghanistan Economy Growth

Afghanistan's gross domestic product (GDP) in 2000 was estimated at US\$2.7 billion (0001). However, the economy has shown considerable growth since 2001 onward; in 2002 it was US\$4.06 billion and reached US \$15.86 billion in 2010 and quickly it reached to US\$20 billion in 2012 but after there no more rapid expansion. The country experienced a high economic growth rate, averaging 9 percent per year, from 2003 to 2012 (Rocha 2017). Per capita GDP level rose up from US\$330.30 in 2002 to a highest level US\$587.57 in 2013. The per capita GDP increased 74% between 2002 and 2013(OECD 2019). A key driver of economic growth was the establishment of a new government and sectoral structure changes through foreign aid.

Afghanistan's GDP growth rate showed an unsteady change from 2002 to 2020; in 2009 it reached the peak of 21.39 percent. Since 2012, the GDP growth rate has fallen from 12.75 percent to 2.72 percent, based on World Bank data. This extreme fall in GDP growth is due to the withdrawal of foreign forces, as well as election disputes, declining business confidence, and it even paved the way for the escape of capital from the country. However, a split government with lots of political tensions arose in 2014, and the new government sped up efforts for economic growth through regional trade, transit and investments in Afghanistan. To some extent it was effective; and it kept the growth stable and prevented further contraction of the economy, while it was the time that the foreign aid were severely dropped. Afghanistan's GDP growth rate declined to (-1.94) in 2020 due to the global Covid-19 pandemic (Fig.1).

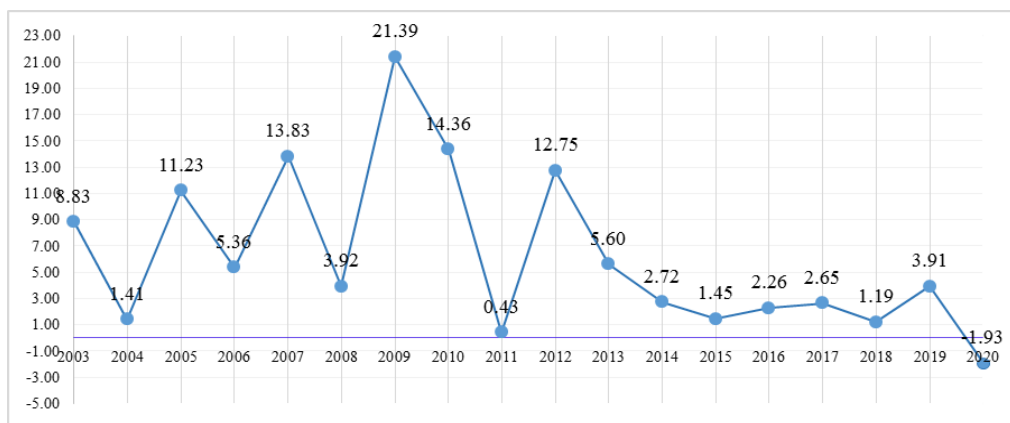


Fig.1 Afghanistan annual GDP growth 2003-2020.

Sources: Calculated by author from the World Bank Development Indicators, 30 Dec. 2021

The high economic growth was fueled by large aid flows which drove the demand for and consumption of goods and services, mainly imported (Rocha 2017). The GDP growth and economic development were heavily reliant on aid flows. Till 2011, foreign aid accounted for 97% of Afghanistan's GDP (Zhang et al. 2019) and in 2021 foreign aid accounted for more than 40 per cent of gross domestic

product (Parkin 2021). Foreign aid improved Afghanistan's economy but lacked stability and sustainability. As international support declined, growth rates have dropped significantly. Because the reconstruction period ended and international aid declined, meanwhile political instability, and insecurity arose. Most economic and growth indicators showed after 2011, felt lower than other South Asian economies (Poole et al 2018).

## 6. Drivers of Economic Growth

Afghanistan's main economic performance indicators are agriculture, services and industry. These sectors remained dependent on foreign aid flow within twenty years. The economic growth has been dramatically influenced by structural change that has gradually shifted from an agriculture based to service based. The reason was due to the flow of foreign aid and creation of jobs with contracted companies, manufacturing and industries was strongly linked with the service sector, while agriculture as the main livelihood of rural people has not been prioritized. Agricultural value added in the gross domestic product (GDP) declined from 43.7% in 2002 to 28.3% in 2020. In the same period, the service value added share increased from 34.6% to 58.7% of GDP, due to foreign aid and institutional development in the country. However, the industry sector has not changed much, its growth was steady from 2002 to 2015 and afterward, it declined slightly; reducing from 22.7% in 2015 to 13.1% in 2020 Fig.2. The reason is the reduction in construction due to low aid flow.

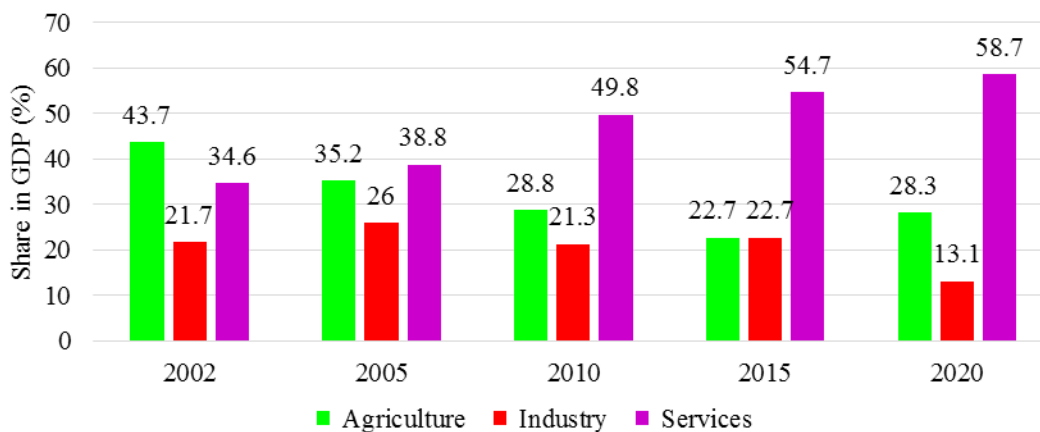


Fig. 2 Afghanistan GDP Composition, 2002–2020  
Sources: Calculated by author from the Asian Development Bank report.

As it is indicated, in the last twenty years the contribution of agriculture has declined as the service sector expanded. Afghanistan's economy was dominated by services and highly volatile agriculture that faced several constraints, such as flow of foreign aids and contractors from overseas companies that are temporary and fragile.

In most of the countries with fast economic growth, the importance of services in adding value to gross domestic product tends to grow over time at the expense of agriculture, and Afghanistan is no exception (Ibrahimi and Maley 2019). Despite remarkable changes in sectoral shares in GDP, agriculture remains the dominant division in Afghanistan's economic skeleton, since the service and industries including manufacturing, construction and transportation are highly linked to foreign aid and the presence of overseas forces. It has already been proven, after the security transition in 2014, Afghanistan experienced a sharp increase in poverty, from 38 percent in 2011 to 55 percent in 2016, and the major poverty projection was in urban areas due to job losses and unemployment intensification (Chaudhuri 2018).

Agricultural products account for the main export items of the country, hence, the development of the agriculture sector is more important and it could be realized as an economic growth sector for achieving employment and food security. So, the agriculture sector is a reliable and truthful division in the economic structure of Afghanistan that investment in the last twenty year could result in sustainable economic development, however agriculture is also faced with uncertainty due to repeated droughts, as consequences of climate change and global warming.

### 7. Afghanistan's Public Expenditure and Budget

Since the start of reconstruction in 2002, development partners have accounted for a substantial portion of the government's budget expenditure (ADB 2017). Dozens of countries have provided assistance to Afghanistan, either through the Afghan government national budget or directly managed by donors themselves without going through government systems termed 'off-budget'. The grant portion of the national budget is called the 'on-budget' system. Both on-budget and off-budget constitute the "government total expenditures" and run Afghanistan's economy in the last two decades (DAB 2020). It is difficult to explain total spending due to limiting data about the off-budget funds offered by donors. Even the World Bank could not clarify how much money was spent by off-budget funds, however, that bank reported Afghanistan public expenditure in 2019 \$11 billion (UNDP 2021) and same amount for 2018 (World Bank 2019). Asian Development Bank reported \$9 billion in the total foreign grant to Afghanistan in 2016 (ADB 2017) which will surge to \$11 billion if government own revenues add to it.

Government total expenditures based on available data for 2018 according to the World Bank is given in (Fig. 3). The government's own revenues were around \$2.5 billion and the rest was provided by international donations that comprise about 75 percent of Afghanistan's public expenditures. The gap between revenues and expenditures was too wide. In the absence of aid, it was difficult to run the Afghan economy.

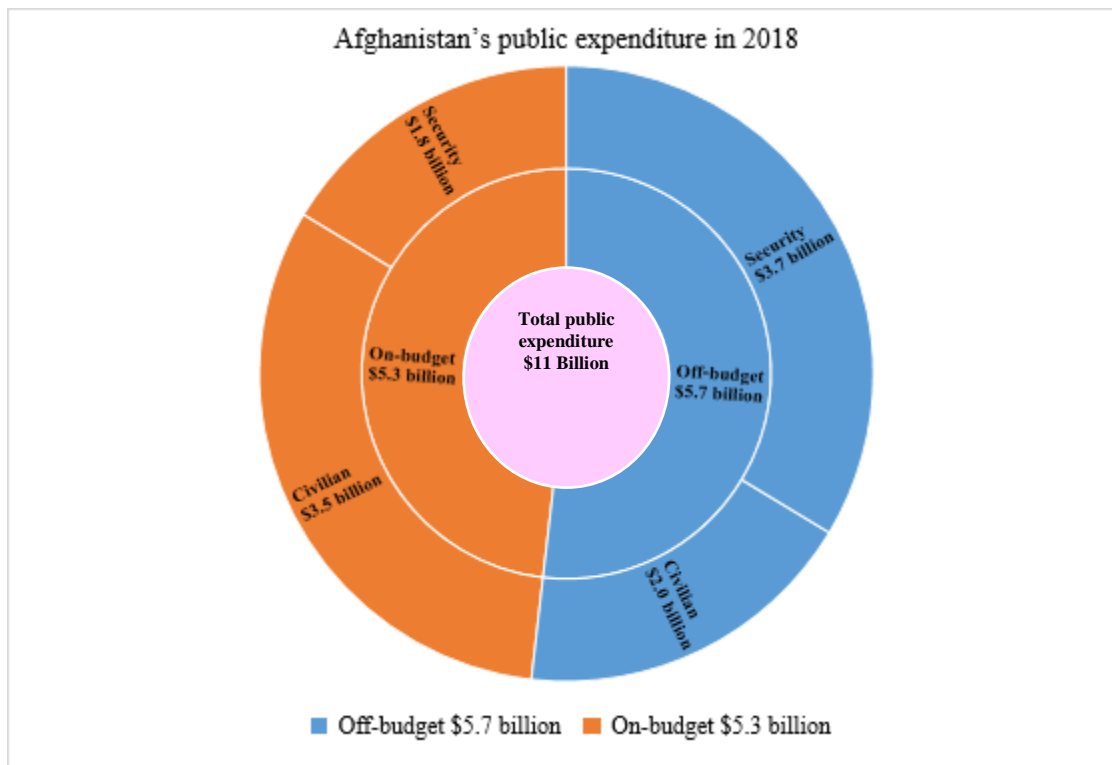


Fig. 3 Afghanistan's public expenditure and its composition.

Sources: World Bank (2019)

Significant portion of expenditure was carried off-budget, \$5.7 billion (around 52%) (World Bank 2019). Half of government expenditure (\$5.5 billion) goes toward security. The Afghan government took less money than was allocated to its army, hence security aid mostly delivered through an off-budget system. About 66 percent of it was spent through off-budget. High security expenditures raised total public expenditure. The United States as a main donor provided Afghanistan with a critical \$4.8 billion in assistance per year, which funds 80 percent of the Afghan government's security expenditures (Ayotte et al 2021). United States civilian assistance was \$922 in 2018 (Haque and Roberts 2020) and dropped to \$480 million in 2019 (Mashal 2019).

## 7.1 National budget

The national budget expenditures are divided into two classes; recurrent expenditure *or* operating budget and development expenditures. The operating budget (wages and salaries, purchases of goods and services, transfers, subsidies, pensions and other), constitutes 70 percent of the national budget. The development expenditures; government investment projects and development programs (GoA 2021). Both the operating and development budgets were financed mainly by donor assistance because the government has low revenue-generation capacity (ADB 2017).

The Afghanistan national budget was made of domestic revenues and foreign grants in the last twenty years, given in (Fig. 4). Afghanistan's fiscal year has changed from 2012 (1391). The new fiscal year begins from December 22<sup>nd</sup>) that is approximately corresponding to the international calendar year, the old and new fiscal year is adopted in the figure (DAB 2020). Afghanistan national budget in the fiscal year 2002/03 was just 15.2 billion *Afghani* (Afs), it increased to 56.7 billion Afs during the 2005/06 fiscal year. In the 2010/11 fiscal year the national budget expenditure rose to 160 billion Afs and it became 301.4 billion Afs during the fiscal year 2015. The national budget contentiously stretched, it reached 444.1 billion Afs in 2020 and the domestic revenues increased simultaneously, but foreign aid made up the greater percentage of the government budget. The national budget increased in 2020 due to the Covid-19 pandemic and much of its expenditures were provided by foreign aid, hence the foreign grant portion also increased.

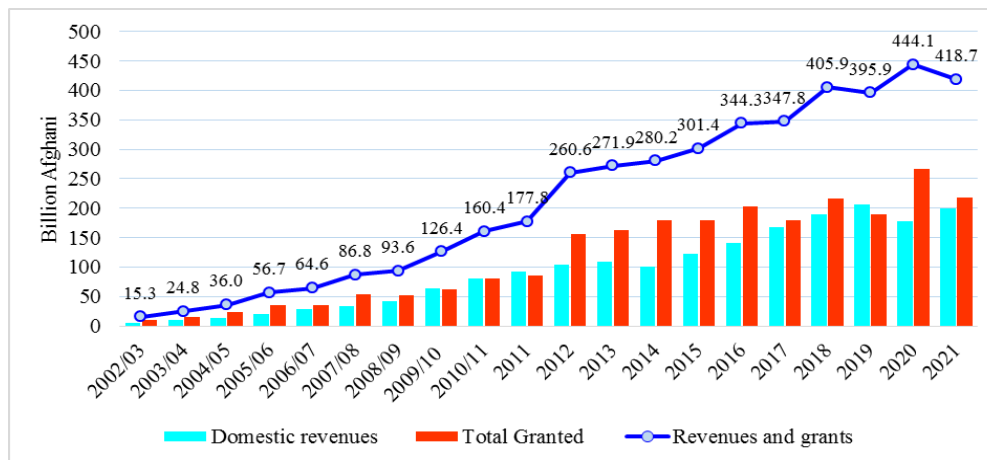


Fig. 4 Central Government Budget and its sources, 2002-2021

Sources: Calculated by author from the IMF reports.

Only one-third of the national budget is allocated for development expenditures (Ayotte 2021). Development budget consists of discretionary and nondiscretionary funds (UNDP 2021). The discretionary development budget; funds that the Afghan government itself can freely allocate across projects and programs of its choosing. Only forty percent were spent by discretionary development budget. The nondiscretionary development budget; were funds that were spent on donor-oriented specific projects and programs and the Afghan government had not chosen to do so. Sixty percent of development

was spent through nondiscretionary funds (Ayotte 2021). The development budget was mainly funded by the international community.

## 8. Domestic Revenue

From December 2001, after the Bonn Agreement till 15 August 2021, Afghanistan had legitimate governments that were supported by the international community. During this period Afghanistan experienced major state transformation and development. The country practiced political, social and economic progress. In the past two decades economic sectors significantly improved, gross domestic product, increased threefold from power in 2001, domestic revenues increased largely (GoA 2014). Afghan government revenue generates through taxes on exports and imports and has historically struggled to collect taxes. Former government revenues were derived from three main sources: (a) extraction and exportation of mineral resources, mostly gas; (b) income from state-owned enterprises (SOEs), such as cement, wool, fertilizer, and agricultural goods; and (c) customs duties, taxes levied on agricultural land, hotels, residential dwellings, and sales tax on real estates and cars (IMF 2003). Total revenue components are categorized as tax revenue and non-tax revenues by the International Monetary Fund (IMF). Tax revenues comprise taxes collected from income, profits, capital gains, international trade and transactions, taxes of goods and services. Non-tax revenues encompass State Own Enterprise (SOE) rents and sales, telecommunications fees, etc.

In 2002 total domestic revenues (tax revenue and nontax revenue) were 5.864 billion Afghani and after one year in 2003 it increased about double of 2002, reaching 10.168 billion Afghani by 2005 the total domestic revenues projected to 20.5 billion Afghani. The revenues continuously increased by 2010 it reached to 80.4 billion Afghani, it reached to 100 billion Afghani in 2014, the transition year. The domestic revenues projected subsequently from 2002 to 2014 but not too fast. After 2014, through establishing a new government under President Ghani the domestic revenues increased strongly. In total domestic revenues total revenues in 2015 reached 122.3 billion Afghani compared to 100 billion Afghani in 2014, it showed 12.3% over preceding year. The peak was in 2019 that reached 207 billion Afghani Fig. 5. Revenue performance was strong through 2018, growing by 13 percent. However, the economy grew at 2.7 percent owing to industry and services overcoming the decline in agriculture due to a devastating drought (IMF 2019). In 2019, revenue also increased by 12 percent. In 2020, domestic revenue fell by 16 percent compared to the previous year due to COVID-19 crisis (UNDP 2021).

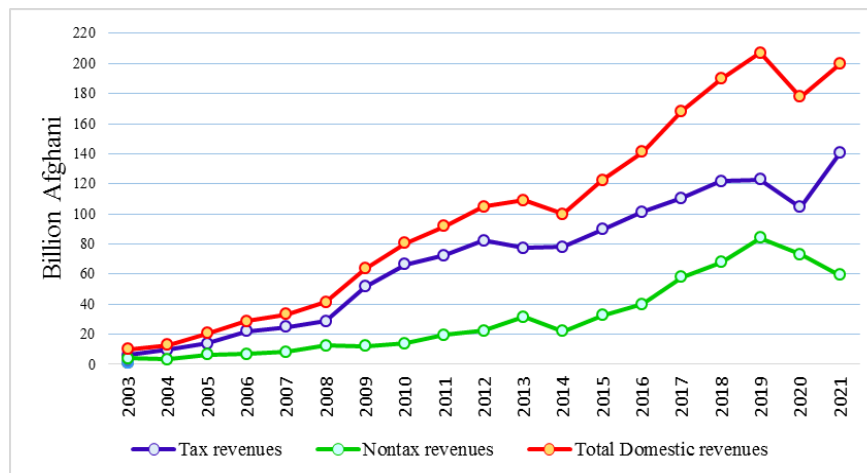


Fig. 5 Revenue growth and composition, 2003-2021

Sources: Calculated by author from the IMF reports.

In the 2014 presidential election, Ashraf Ghani was elected as president. President Ghani's core policy was to turn Afghanistan into a self-reliant economy through investment, trade, transit and



implementing reforms. Afghan government domestic revenue has steadily increased since 2014 as a result of his policy, despite weak economic conditions and a deteriorating security situation. The strong revenue performance was mainly driven by; improved administration, one-off factors, tax and non-tax policy changes, and macroeconomic factors, each accounted for 46, 30, 15, and 9 percent, respectively, of the cumulative revenue increase since 2014. The Ghani administration has combated corruption, the Anti-Corruption Justice Center (ACJC) established. Anti-corruption efforts were promising, the public spending became transparent specially the procurement (IMF 2021). In 2020, the World Bank noted that the procurement reforms saved the Afghan government an estimated \$868 million, a huge amount, given that the entire Afghan government budget was \$5.5 billion that year. (World Bank 2020)

## **Conclusion**

Establishment of new Afghan government in Bonn Agreement on December 2001, an enormous euphoria in Afghanistan created and hope came that a stable economy will be built. There was an improvement in economy over the period 2003–2012, has been performed relatively well, have been experienced 9 percent growth per year. After 2012 Afghanistan economy reduced with declining in international aid and severely suffered from slow growth and high unemployment. The foreign aid accounted around 97 percent of GDP by 2011 and it was 40 percent by 2021. The public budget during this period of time was largely depend on foreign aid. The aid funds provide the majority of the governmental expenditures from personnel trainings to maintenance, equipment spends and almost all costs. As a result the economy grown and domestic purchasing raised artificially without developing competitive firm and sustainability. The economy shifted from agriculture-based to service-based and most of jobs within services were in government around half were in defense and security which completely relayed on aid. Agriculture, natural resources and transit are the great zones of economic development in Afghanistan none of which have grown. Investment in natural resources, agriculture and infrastructure as key revenue generators was neglected in the last twenty years. The economic progress has been relatively notable, but restricted to unsustainable service sector rather than agriculture, natural resources and trade transition. Further economic agenda did not make based on long term strategic vision, and there was not a strong political commitment to effective economic and political integration to ensure inclusive economic growth. The regional and global economic integration did not develop and expanded to guarantee long-term economic stability. The domestic productive economic drivers remain undeveloped.

Economic diversification did not take place, an unsustainable foreign-funded service-based economy was seeming threatening but unfortunately, the Afghan authority ignored it. Ultimately, Afghanistan remained the poorest country in the world, as the U.S. and NATO withdrew; the Afghan economy and government collapsed, and it could not happen if a strong economy was built. The prevailing poverty, weak economy and state failure now indicate that Afghanistan is at the status that it was in 2000. The economic growth and development was unsustainable.

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