

COMMENTARY FROM THE EXECUTIVE DIRECTOR

In 2008 opium has become less important to the Afghan economy. Our summary report, released in August, showed a sharp drop in its physical dimensions: cultivation and production. This final *Afghan Opium Survey 2008* assesses the complex nature of the opium economy in Afghanistan this year and prospects for 2009.

The Afghan drug economy. In 2007 the (farm gate) value of opium cultivation was one of the largest ever, at about \$1 billion. In 2008 it dropped by more than a quarter, to \$730 million. In 2007 the (potential) export value of opium, morphine and heroin (at border prices in neighbouring countries) was \$4 billion. This year's drug export was valued at \$3.4 billion. (Note that these export amounts are *potential* as they do not account for changes in domestic stocks, unknown to us).

The Taliban war economy. In many parts of Afghanistan, authorities impose a charge (called ushr) on economic activity, traditionally set at 10% of income. Thus, opium farming may have generated \$50-\$70 million of such tax income in 2008. Furthermore, opium processing and trafficking may have raised an additional \$200-\$400 million. Who collects this money? Local strong men. In other words, by year end, war-lords, drug-lords and insurgents will have extracted almost half a billion dollars of tax revenue from drug farming, production and trafficking. Not surprisingly the insurgents' war machine has proven so resilient, despite the heavy pounding by Afghan and allied forces.

The downturn in the opium economy. Since 2007 opium cultivation declined by 19% to 157,000 hectares this year, for several reasons. *First*, as shown in our August Report, restraint at planting (but not eradication), has been successful. Pressure by governors, shuras and village elders has kept cultivation down in many provinces. *Second*, and most importantly, the dynamics of farm prices. As (Afghan) supply has once again exceeded (world) demand, prices for opium (both fresh and old) are down 20% in nominal terms (and much more at constant prices). *Third*, the terms of trade effect. While opium farmers' income has declined, the revenue from wheat has tripled since 2007 (partly due to drought). The gross income ratio of opium to wheat (per hectare) in 2007 was 10:1. This year it narrowed to 3:1. The net income ratio is down to 2:1. The Afghan government, and its international partners face a unique opportunity to reinforce these economic trends with counter-narcotic measures that can further reduce opium's appeal.

A smaller, more intensive drug problem. There is evidence that Afghanistan's opium problem is shrinking in size and concentrating geographically. *First*, Afghan opium is grown exclusively (98%) in seven south-west provinces, where insurgents control the territory and organized crime groups benefit from their protection. *Second*, in 2008 just 2.1% of Afghanistan's arable land was used to grow opium, as opposed to 2.5% in 2007. *Third*, opium is now cultivated by fewer, richer farmers: in 2008 opium was farmed by one million fewer people than in 2007. *Fourth*, the convergence of opium prices this year shows that the Afghan drug market is now unified. In crude medical terms, the opium chemotherapy applied throughout Afghanistan has shrunk the cancerous metastasis to the southern region, where surgery is now needed and feasible.

Prospects for 2009? The decline in opium cultivation may continue, *first* because of policy: Mohammad Gulab Mangal, Governor of Helmand, is taking a tough stance. Since his province produced 2/3 of all Afghan opium in 2008, any decline in cultivation in the districts he controls would have a major impact. *Second*, because of price trends: if food prices remain high, farmers will stick and/or shift to food crops. Of course, as high food prices impose hardship to cities (there were riots in Kabul this spring), they have to be offset by generously subsidized distribution of food in urban centres. The international community has a special responsibility and I call on all Afghan partners to be generous, and fast.

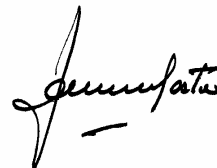
Where are the opium stocks? For a number of years now, Afghan opium production has exceeded (world) demand. The bottom should have fallen out of the opium market. It has not. Prices charged by farmers this past July (\$85/kg) were 20% lower than in 2007 and half the price in July 2005 (\$171/kg). This is significant, but not dramatic. As such price inelasticity can only be the result of stock build-ups, we should ask: where, why and by whom? *First*, our UNODC surveys show that farmers hold some stocks of dry opium, but not thousands of tons. *Second*, traders are unlikely to stock a devaluing commodity. Hence, and *third*, a non-economic

explanation: the drugs must have been withheld from the market for non-speculative considerations in areas of insurgency, on both sides of Afghanistan's southern border.

A wild card in the hands of insurgents. If the Taliban are holding major drug stockpiles, they may welcome lower opium cultivation. The resulting price increase would revalue their stocks and improve war financing. Indeed, news picked up by UNODC surveyors in a number of eastern and southern provinces confirm that the Taliban are taking a passive stance at this time of opium planting, as against past efforts to promote it. If opium prices are allowed to increase because of a moratorium on cultivation supported by the Taliban, the resulting market manipulation would spell disaster in the north-east of Afghanistan where so many provinces have abandoned opium cultivation voluntarily, enticed by expectation of development assistance and good revenues from wheat. If wheat/opium terms of trade change again in favour of the latter, this would spell trouble for Afghan counter-narcotic policy.

Keep both production and price of opium down. The laws of economics do not usually allow values and volumes to move in the same direction. Yet, in Afghanistan today there are (economic) reasons for it, and (non-economic) means to disrupt it. Opium production and prices can both be kept down by destroying high value targets like drug markets, heroin labs and trafficking convoys moving to the south-western borders. The inflow of precursor chemicals must also be reduced. If the Afghan drug economy's umbilical cord to the world (i.e. the link between the farmers in Afghanistan and the heroin addicts in the rest of the world) is cut by powerful law enforcement means, the domestic market (i.e. traders and their Taliban mentors) would remain flooded with poisonous drugs. Opium prices in Afghanistan would stay down, and so would output. The geo-concentration of opium cultivation in the southern region offers the tactical opportunity to accomplish this.

A more honest government administration and a greater/faster delivery of development assistance in opium-free provinces offer a proper context for the achievement of these results.



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