

# Causes of Deficit in Trade Balance and Its Effects on the Economy of Afghanistan

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**Abstract:-** The deficit in the trade balance is the major problem for Afghanistan. The purpose of this article is to identify the causes of deficit in the trade balance of Afghanistan and develop effective policies to reduce, prevent and eliminate the deficit in the trade balance. For this study, we use primary data as well as secondary data collected from the world bank, IMF, ministry of finance, ministry of economics, NSIA, and some national and international organizations.

**Our finding is that lower tariffs, low productivity, insecurity, warlord and mafia, stabilization of taxes, lack of good management, and culture of exemption are the major causes of trade balance deficit in Afghanistan. Deficit of trade balance has negative effects on the economy of Afghanistan.**

**Keywords:-** Trade Balance Deficit, Unemployment, Money Outflow, Afghanistan economics, Instability.

## I. INTRODUCTION

Afghanistan has suffered from a large trade deficit for many decades as the imports have been rising faster than the exports. Afghanistan's economy faced a trade deficit that has resulted in macroeconomic instability.

Transfer of goods and services from one individual, entity, or nation to another individual, entity, or country is called trade, which often takes place in exchange for money. A trade deficit also called net exports, the difference between exports and imports of a country is called a trade deficit. A country has a trade deficit when the income of a nation's or a country's exports is less than the cost of a country's or nation's imports, or in the economic condition, a trade deficit occurs when a country is importing more goods and services than it is exporting.

On the one hand, a trade deficit can raise a country's standard of living because residents can access a wider variety of goods and services for a more competitive price, can reduce the threat of inflation since it creates lower prices and overtime it can create more job opportunities to other countries, On the other hand trade deficit has adverse effects on the economy. A persistent trade deficit can often have adverse effects on the interest rates, downward pressure on a country's currency devalues it, which can lead to inflation, out-of-country currency flows, the collapse of domestic

companies, increase of unemployment, and other such effects can be mentioned.

The increase in domestic demand because of strong economic growth improved the level of investment, which will make an opportunity for hiring new employees as well as increase the level of domestic product.

With the structural change in Afghanistan's financial system, there had been increase in demand for capital goods and industrial raw material as well as consumer goods. On the other hand, the efficiency of any country's global trade plan mostly relies upon the scale of income and price elasticities of its exports and imports as well as exchange rate and instability of exchange rate which involves the removal of trade restriction, trade liberalization, and rationalization of tariff and protectionist trade policies by developed countries.

Trade deficit could be a good signal for consumers because they can purchase more goods than their country produces. But it can have adverse effects on the national economy, employment and so on. The trade deficit is the most important issue for developing and less developed countries especially for Afghanistan, because their company's product cannot compete with foreign products, if they do not support their product, the deficit in trade balance will increase, which have negative effects on the economy and social situation in the country. It is important to know the main causes of trade deficit and its effects on the economy of a country. Prevent and detect the negative effects on the economy and society.

## II. RESEARCH PROBLEM AND OBJECTIVE

The problem of the research is the causes of the trade deficit in Afghanistan. The object of the article is to identify the causes of the trade deficit and to suggest its solution, measure the impact of the trade deficit on the economy of Afghanistan, adopted, and make recommendations on how to reduce the trade deficit. A trade deficit occurs when a country does not produce all goods and services it needs. Afghanistan must borrow and get aids from foreign states and regional and international organizations to pay for imports. Therefore, Afghanistan with a trade deficit will also have a current account deficit. Afghanistan has been facing a current account deficit and it has been struggling to reduce it through different policy initiatives.

### III. LITERATURE REVIEW

A lot of work has already been done on determining the causes of trade deficit and its effects on economy. We explored previous studies related to the topic and they are briefly stated as under In 2013 Shawa & Shen determined and examined the causes of trade balance and found the core reason of the trade deficit of Tanzania. They used the augmented Dickey-Fuller(ADF) and Phillip-Peron (PP) unit root tests to assess the nature relationship between variables. Actual GDP, real exchange rate, relative GNI, and import weighted index and open that import weighted index used as variables. The result explains that all variables contain a unit root at levels while those were found to be static at the first difference.

In 2019, Awan A. G., Mukhtar S. examined the causes of trade deficit and its impact on Pakistan's economic growth, The results reveal that foreign direct investment has a positive impact on trade deficit in long run but in short run it is insignificant. Similarly, trade volume and GNI has both negative and positive relationship with trade equilibrium in short run as well as in long run.

In 2019 Austin. K discussed trade balance especially American trade deficits and the unidirectionality error, in this article labels assertions of one-sided causality "the Unidirectionality Error. The flip side of efforts to increase trade surpluses is an effort to export or expel unwanted capital.

In 2019, Reed, M., Najarzadeh, R., & Sadati, S. Z. determine the dynamic relationships between budget deficit, current account deficit, and government debt sustainability during 1974-2015 in the Iranian economy. The result of the study shows that a long-term stable relationship among the variables of the model suggesting that to improve the government debt sustainability it has to reduce the budget deficit and current account deficit.<sup>1</sup>

In 2018 Xuan, D. T determine the exchange rate and trade balance in Vietnam. She investigates the relationship between exchange rate and trade balance in Vietnam by a time series analysis from 2001-2015. The result of the article shows that a real appreciation of dong can lead to an improvement in trade balance position, and a real depreciation can give rise to a deterioration of trade balance in the long run.<sup>2</sup>

In 2020, Ochieng, E. O., Nyongesa, D., & Obange, Nerote wrote an article which was about effect of foreign direct investment, inflation, real exchange rate and transfer payments on trade deficit in Kenya. They concluded that in

the long-run, only transfer payments and inflation have positive and negative effects respectively on both trade deficit and also foreign direct investments through there is no respective causality.<sup>3</sup>

In 2010 Ozlale and Pekkurnaz investigated the relationship between current account balance and oil prices in Turkey using VAR analysis based on data of the period between 1999 and 2008. As a result of the analysis, it was determined that oil price shocks have a significant effect on the current account balance or trade balance in the short term.

### IV. METHODOLOGY

This study is focused on Afghanistan for the period 2014–2019 and uses primary and secondary data. The selection of the years and Afghanistan is informed by the availability of data due to the year the trade deficit was introduced and because Afghanistan has land and air borders with other countries. The data for this study was obtained from primary and secondary sources, particularly from the ministry of finance, ministry of economics, World Economic Forum, Reports, Executive Opinion Survey, national, regional, and international organizations.

### V. TRADE IN AFGHANISTAN

Afghanistan is an economically downtrodden country that relies heavily on livestock and farming. In the 20th century especially in the last two decades of the 20th century, there was an astronomical decline in the gross domestic product(GDP) of Afghanistan. The economic activities were widely interrupted by the civil war and foreign countries' invasion, which were responsible for the mass destruction of the country's limited infrastructure.

The major basis of Afghanistan economy is trade with exports and imports commodities. Afghanistan predominant export commodities include, fresh and dry fruits, medical herbs, spices, seeds, skins, wool and cotton, ginseng, handwoven carpets, hides and pelts, precious and semi-precious gems. And predominant import commodities include, machinery & equipment, petroleum, chemicals, construction materials, food items, cigarettes, fabrics, clothing, & footwear, household needs & medicines.

Afghanistan signed the WTO agreement which removes the barriers that are in place for free trade to the import and export markets. According to the rules and regulation of the WTO, Afghanistan should reduce taxes and tariffs, as well as eliminate trade barriers. On the one hand Afghanistan can benefit from the various trading opportunities, on the other hand domestic products can't compete with foreign products. One of the most well-known

<sup>1</sup> Reed, M., Najarzadeh, R., & Sadati, S. Z. (2019). Analyzing the Relationship between Budget Deficit, Current Account Deficit, and Government Debt Sustainability. *Journal of WEI Business and Economics*, 8(1), 20-31.

<sup>2</sup> Xuan, D. T. (2018). Exchange rate and trade balance in Vietnam: A time series analysis. *Asian Economic and Financial Review*, 8(9), 1158.

<sup>3</sup> Ochieng, E. O., Nyongesa, D., & Obange, N. (2020). Effect of Foreign Direct Investment, Inflation, Real Exchange Rate and Transfer Payments on Trade Deficit in Kenya.

examples of this approach is the SAARC Agreement, which govern free trade across South Asia.

The WTO agreements gives an opportunity to Afghanistan to have access to more markets throughout the world. It can encourage Afghanistan's domestic industries and companies to improve their competition while relying less on subsidies from the government. This process can lead to the improvement in GDP figures, new investment opportunities, and opening of new markets.

The advantages of free trade which creates opportunities for economic growth, foreign direct investment, lowers the taxes that consumers and businesses pay and experts get to have access to the most resources<sup>4</sup>.

Moreover free trade has diverse effects on developing countries especially Afghanistan. Disadvantages of free trade for Afghanistan, which are, free trade does not create more jobs, more risks for currency manipulation, it can be fewer intellectual property protections because of free trade, environmental protections are minimal in free trade, fewer revenue generation opportunities, customers are left at the mercy of the largest providers, and can be opportunities for immigration outsourcing<sup>5</sup>.

Afghanistan is in the initial stage of development, and export mostly primary products, and cannot fetch a good price of the product in the foreign market. Afghanistan facing the problem of mounting growth of developmental imports, which include various types of machinery and equipment for the development of various types of industries.

Afghanistan also facing the problem of burgeoning imports and sluggish growth in its exports resulting in a growing deficit in the balance of payment position of Afghanistan.

As a result, Afghanistan's balance of payments deficit, especially its trade balance deficit, has a negative impact on Afghanistan's economic development, and the country will always remain an importing country if the condition of the balance of payments are not improved. The outflow of currency from Afghanistan will further complicate Afghanistan's economy.

It is important to identify the causes of the trade balance deficit and its impact on Afghanistan's economic development and develop effective policies and strategies to eliminate them.

**VI. TRADE DEFICIT OF AFGHANISTAN**

Trade deficit is described as difference between imports and exports of a nation. The trade deficit is not without risks for developing countries. In order to avoid these risks, I want to identify and discuss Afghanistan's trade deficit. From 2010 to 2020 the below data identifies Afghanistan's exports, imports, and trade deficit.

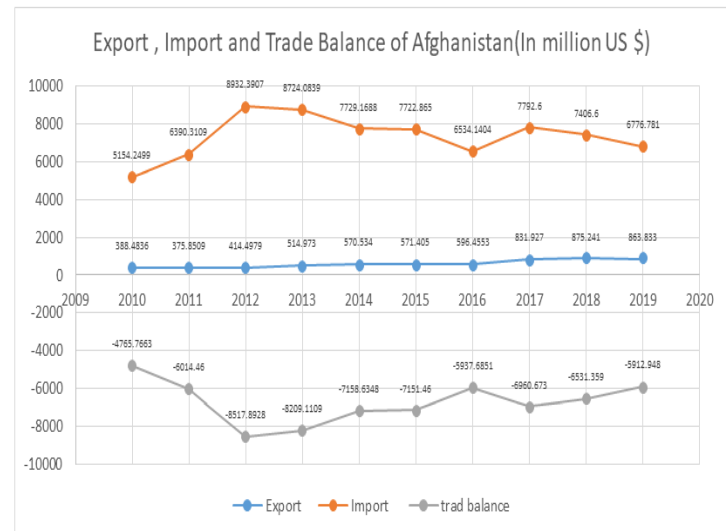


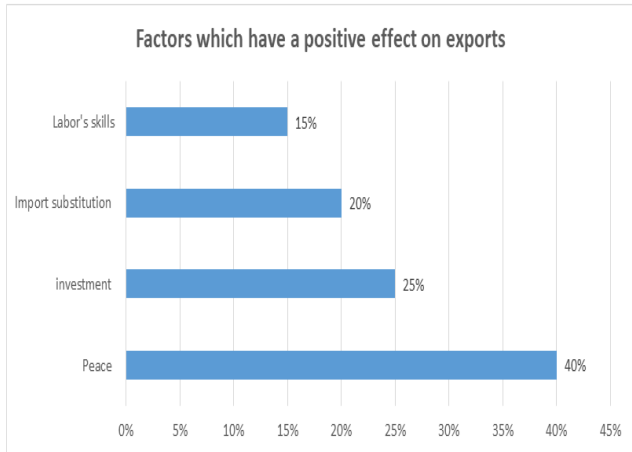
Figure 1. Export , Import and Trade Balance of Afghanistan, source: Central Statistics Organization, Afghanistan (CSO)

From the above data, it can be concluded that Afghanistan is facing a steady trade deficit from 2010-2020. It is still not known how long the deficit will last. Therefore, it is important to identify the causes of the trade deficit, and after identifying the factors and causes, effective policy can be formulated. On one hand, we will reduce the steady trade deficit, and on the other hand, we will have led the country towards economic independence. After economic independence, we will be able to make plans and strategies for the future according to our needs. Unfortunately, there are still many problems in this area.

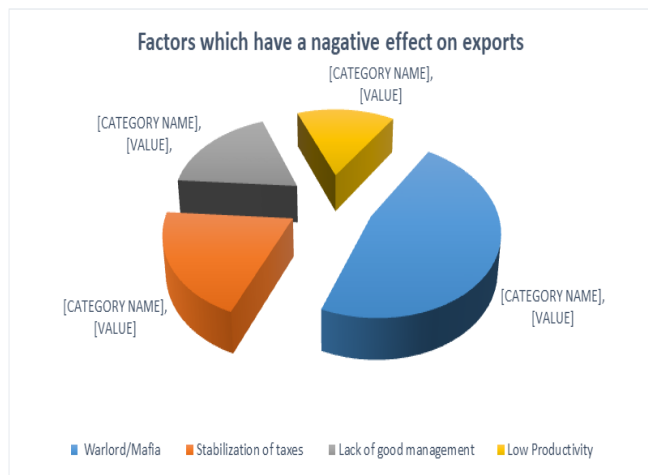
I have prepared questionnaires about how we can increase exports in Afghanistan, in which I have conducted interviews with economists. I asked them what do you think about the factors which have a positive and negative impact on the exports of Afghanistan.

<sup>4</sup> 19 Advantages and Disadvantages of Free Trade | FutureofWorking.com

According to the interview done with 200 economists, for the first question (which of the following four factors has the most positive effect on exports?), The interview analyzes that, 40% responded that peace would have a positive effect on export increasing, 25% responded that investment<sup>5</sup> would have a positive effect on exports, 20% responded that import substitution<sup>6</sup> would have a positive effect on exports, and 15% responded that labor’s skills have a positive effect on exports.



For the second question of the interview, the interview analyzes that, 47% responded that warlord/mafia would have a negative effect on the increase of the export, 20 % responded that stabilization of taxes would have a negative effect on exports, 18% responded that lack of good management would have a negative effect on exports, and 15% responded that low productivity has a negative effect on exports.



<sup>5</sup> Fakraoui, N., & Bakari, S. (2019). Tie Among Domestic Investment, Exports And Economic Growth: Empirical Analysis From India. *Journal of Smart Economic Growth*, 4(1), 1-15.

<sup>6</sup> Zobov, A. M., Degttereva, E. A., Chernova, V. Y., & Starostin, V. S. (2017). Comparative analysis of the best practices in the economic policy of import substitution. *European Research Studies*, 20(2), 507.

**VII. CAUSES OF TRADE DEFICIT**

**1. Lower Tariffs / Trade Barriers**

When the Afghan government signed some regional and international trade agreements and reduced the tariffs, it creates competition. foreign imports become cheaper and more competitive. To sum up, consumers may switch to imported alternatives. They may be cheaper and of high quality than domestic products.

**2. Low Productivity:**

Afghanistan experienced low productivity growth in relation to others, it can find itself become less competitive. Other nations become more productive, they can produce goods at a lower cost than Afghanistan. it makes their goods cheaper compared to domestic suppliers. Due to this, Afghanistan can see a trade deficit develop as consumers shift towards cheaper and more productive importers.

**3. Insecurity**

Insecurity also causes a trade deficit in Afghanistan. Due to insecurity, investors are reluctant to invest in Afghanistan and move their capital out of the country. Investors who have invested in Afghanistan have also stopped investing due to insecurity and inflows of currency to foreign countries , which has led to a decline in production in Afghanistan. As a result, insecurity is one of the main causes of the deficit in the trade balance.

**4- warlord and mafia**

The domination of those accused of the economic mafia, drugs, perpetrators of widespread corruption, land grabbers, profiteers, smugglers, warlords, compradors, outlaws, corrupt, unskilled in Afghanistan. It has caused that scientific forces and personalities, including economists, have not yet been able to plan, approve and implement economic adaptation in order to go beyond the existing rejection of the strategy with a scientific plan.

Throwing thousands of mixed production, service, commercial, government devices at a very low rate under the name of privatization, lack of support for domestic products, import of low-quality goods and materials. It caused tens of thousands of small and large companies to go bankrupt, hundreds of thousands of workers and skilled workers to migrate to countries in the region and the world.

**5- Stabilization of taxes**

The stabilization of taxes, customs products, and the unfair renting of commercial, and service markets has prevented our producers from competing fairly against foreign goods and materials

**6- Lack of good management**

Lack of good management and sound management of specialized efficiency has increased the flight of brains and capital in the country. According to the Chamber of Commerce and Industries, Afghans had invested \$ 150 billion abroad.



### 7- Culture of exemption,

The existence of a culture of impunity is also a major factor in the deficit of trade balance in Afghanistan. For example Spreading corruption in the culture of exemption, drug trafficking, influencing corrupt and foreign groups in relevant organs and departments, wasting and wanting the material and spiritual wealth of the country, including works Antiquities, forests, mines, lack of transparency in government contracts, including the purchase of oil by the Ministry of Defense, increase of the crisis, lack of fair lending resources, Putting economic pressure on donor countries, including the United States, under the pretext of corruption, etc. are factors.

### 8 - Structural and cyclical causes of a trade balance deficit

Structural causes include under-investment, relatively low productivity, persistently high relative inflation, inadequate R&D, innovation, and the emergence of lower-cost competition.

Cyclical causes of deficit of the trade balance include over-valued exchange rate, the boom in domestic demand, recession in key export markets, the slump in global prices of exports, and increased demand for imported technology.

## VIII. EFFECTS OF TRADE BALANCE DEFICIT IN AFGHANISTAN

The Afghan economy has experienced a BOT (balance of trade) deficit over the past five decades. In this part of the article I want to identify and discuss the macroeconomics variables which have influenced in such situation in Afghanistan. This part of the article is mainly focused on four exogenous variables and an endogenous factor which may affect the external balance of an economy.

Based on the economic theories relating to the BOT, it can be categorized under 3 classifications viz. (i) Absorption approach (ii) Monetary approach and (iii) Elasticity approach.

Absorption Approach reflects the national income of a country as:  $Y = C + I + G + (X - M)$  where  $Y$  = national income,  $C$  = private domestic consumption,  $I$  = private domestic investments,  $G$  = government spending,  $X$  = exports and  $M$  = imports. If it is assumed that the total domestic spending or absorption is "A" then  $A = C + I + G$ . There by;  $Y - A = X - M$ . Accordingly, if  $Y > A$ , then  $X - M > 0$  or  $BOT > 0$  and if  $Y < A$ , then  $X - M < 0$  or  $BOT < 0$ . So, when  $Y < Y^*$  (at full employment level), devaluation would improve BOT. However, when  $Y > Y^*$ , devaluation would increase  $X - M$  and lead to create inflation<sup>7</sup>.

The Monetary approach concludes that any foreign exchange intervention to the domestic market will impact on the domestic money supply and directly affect to the

domestic interest rate as well. As a result, the domestic price level will change in Afghanistan.

The elasticity approach represents the responsiveness of quantity demanded to changes in prices which is usually negative. This approach totally depends on the foreign exchange equilibrium of Afghanistan. Accordingly, any devaluation or revaluation will directly affect the BOT depending on the elasticity of such goods<sup>8</sup>.

The negative effects of imbalances on the balance of exports and imports are no less than the existence of widespread poverty and corruption in Afghanistan. Afghanistan's export and import balance has always been negative. The country imports about 95 percent and exports about 5 percent. The imbalance in exports and imports has made Afghanistan a completely consuming country. Most of the materials needed for construction, industry, food and fuel in this country are imported. But in return, it exports some other items, including fruits and some agricultural and animal products and precious stones.

The labor force in Afghanistan is increasing day by day, while the employment opportunities are decreasing day by day. Existing companies and domestic products cannot compete with foreign products, as a result, they are being driven out of the market and replaced by foreign products. This further contributes to rising unemployment in Afghanistan. Rising unemployment is root of social problems, which pose a great threat to society.

If the negative trade balance continues, it will turn Afghanistan into a permanent importer. And the inability to use its existing resources will be further lost. The fact that some regional countries and international powers have used all means to exploit Afghanistan's resources, if Afghanistan does not achieve economic independence, it will pave the way for the nefarious aims of these countries and superpowers. And our country will continue to face poverty.

## IX. RECOMMENDATION

One way to get Afghanistan out of the current state of consumption is to pave the way for investment and manufacturing companies. For example, government has offered 25 percent discounts to domestic companies to foreign companies so that they can focus more on the quality of their products and products<sup>9</sup>.

Enhance the domestic enabling environment for exporters (in terms of regulation, infrastructures, access to finance, insurance, fiscal policies).

<sup>7</sup> Sahoo, M., & Dash, U. (2016). Current account sustainability in SAARC economies: Evidence from combined cointegration approach.

<sup>8</sup> Weerasinghe, E., & Perera, T. R. (2019). Determinants of Balance of Trade in the Sri Lankan Economy. *International Journal of Trade, Economics and Finance*, 10(1).

<sup>9</sup> Successful strategies to help developing countries boost exports - IGC (theigc.org)

Foster and develop the strategic cooperation between public and private actors among domestic producers, exporters, and policymakers.

Improve the technological and productivity content of domestic products, and provide incentives to nurturing innovation. facilitate the access to credit for the investors and facilitating foreign investors to invest in Afghanistan.

Imposing higher tariffs on foreign products that use the dumping policy to drive the domestic company out of the market. Creating regional and global markets for domestic products and for balanced economic growth and development, the government must create tax exemptions.

Instead of exporting raw materials, the government should allow raw materials to be used domestically and exported in the form of semi-finished and finished goods at a higher price.

The interference of warlords and mafia rings in economic affairs should be stopped, and hired based on talent should be placed in the relevant posts.

## X. CONCLUSION

In this study, I presented causes of deficit of trade balance and its effects on the economy of Afghanistan.

Firstly, we started by introducing business in Afghanistan, secondly trade balance deficit in Afghanistan, then included causes of deficit of the trade balance in Afghanistan and recommendation which is followed by an explanation of practical and theoretical approaches. Both methodologies are altering the individual assessment of every regulation for the adoption of formalized specifications of regulations.

Our finding is that lower tariffs, low productivity, Insecurity, warlord and mafia, stabilization of taxes, lack of good management, and culture of exemption are the major causes of trade balance deficit in Afghanistan.

The trade balance deficit not only causes money to flow out of Afghanistan, but also increases unemployment, inflation, reduced GDP and makes Afghanistan a permanent importer.

This article offers various recommendation for solving this problem which are the major causes of deficit in the trade balance, as well as suggestions recommendations for increasing exports.

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