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Are Afghan riches a curse?

Valuable mineral deposits may do the country more harm than good.

By Nita Ghei

Afghanistan may have mineral deposits worth more than $900 billion, according to a recent report - a fortune for the poverty-stricken nation. It is a fortune that is unlikely to be extracted to the benefit of the Afghan people.

Without the rule of law and effective government institutions, the country will not see the massive investments in infrastructure and mining necessary to extract this mineral wealth.

As economists from Milton Friedman to Mancur Olson have pointed out, the difference between rich and poor countries is not a matter of resources; it's a matter of institutions.

Countries ruled by laws that respect property rights, and with institutions that augment and facilitate free exchange, tend to prosper. Countries where property rights are precarious, and where the risk of appropriation of property by the state is high, tend to remain poor.

If the state is likely to seize your investment or profit, why would you invest in a business in hopes of a long-term payoff? On the other hand, the higher the probability that you will be able to keep your profit and income, the greater the incentive to invest and work hard.

Many African countries, such as Nigeria and Zimbabwe, are poor despite abundant natural resources. Nigeria has large oil deposits, but it has remained poor largely due to poor governance, despite some positive changes in recent years. Zimbabwe was a relatively prosperous country that fell apart as property rights were destroyed by Robert Mugabe's forcible redistribution of land. It has since been beset by hyperinflation.

In contrast, Singapore, with few natural resources, has become wealthy over the last several decades. It has also consistently ranked as one of the world's freest countries in the Cato Institute's report "Economic Freedom of the World," which is copublished with the Fraser Institute.

What does this have to with Afghanistan? A lot. Institutions matter. Rule of law matters. Governments, by providing a framework for institutions, play an essential role in facilitating free exchange in modern markets.

This role of government is taken for granted in the West - so much so that the literature on economic growth largely seems to presume that markets will simply work. Most of the attention is on other factors that can influence economic growth, including education, technology, and, of course, natural resources.

But markets are reasonably efficient only when people are confident that contracts will be enforced, property rights will be respected, and investments will not be expropriated by the state or a local warlord. These are safe assumptions in the United States and Europe, for example, but not in many poor countries.

And not in Afghanistan. If anything, the discovery of mineral deposits worth hundreds of billions of dollars might make the country even more unstable.

Afghanistan is emphatically not a modern state. Its elected government, led by President Hamid Karzai, is limited in its reach and its ability to provide the legal amenities that most in the West take for granted.

Outside the reach of the weak central government, tribal warlords provide rough governance and a semblance of stability. The Taliban also provides a kind of governance in the areas it controls.

At present, the tribal warlords and the Taliban have, to use Olson's term, an "encompassing interest" in the areas they control. It is in their interests to maintain some degree of stability in the areas where they are in power, so there is a fragile balance. The discovery of valuable minerals might well upset that balance and set off a struggle to control the areas where the minerals are located.

At the same time, due to the country's lack of physical and legal infrastructure, it's not clear how easy it will be to extract the minerals. Mining is an expensive and time-intensive process. Roads will have to be built, and equipment and trained personnel brought in over a period of years.

In one of the rare studies on this subject that does consider the relevance of institutions, published in the American Economic Review, Henning Bohn and Robert Deacon found that an increase in investors' risks reduced the extraction of minerals. In Afghanistan, there is a physical and legal risk to any such investment, which does not make for an attractive investment opportunity.

In the end, the Afghan people may suffer more than they prosper from their country's mineral riches.

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