AFGHANISTAN DEVELOPMENT UPDATE

May 2017

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Preface

The Afghanistan Development Update, which is published twice a year, provides a comprehensive report of the state of the Afghan economy. It covers recent economic developments and outlines the medium-term outlook for Afghanistan. Each edition includes a section that provides in-depth analysis on one or more specific focus topics. The lack of high-frequency data in Afghanistan makes it difficult to track economic activities on a monthly or quarterly basis. Thus, proxy indicators are utilized when their quality is deemed satisfactory. Efforts are made to ensure that key analysis and forecasts are based primarily on reliable sets of data.

The Afghanistan Development Update is intended for a wide audience, including policy makers, the donor community, the private sector, the community of analysts and professionals engaged in monitoring the economy and Afghanistan's citizens at large.

This report was prepared by Omar Joya, Aman Farahi, Christina Wieser, and Claudia Nassif. The authors gratefully acknowledge the useful inputs provided by other members of the Afghanistan country team. Ehsanullah Nasiree assisted with the design and formatting of the document. Irfan Kortschak provided copyediting assistance. The report was prepared under the overall guidance of Manuela Francisco (Manager for Macroeconomics and Fiscal Management, South Asia) and Shubham Chaudhuri (Country Director).

The authors are grateful for the cooperation provided by Government officials who shared valuable data and statistics. The authors also gratefully acknowledge the comments and suggestions received from staff of the International Monetary Fund.

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Executive summary

In 2016, violent unrest continued to have a negative impact on the security of livelihoods in Afghanistan. The number of civilian casualties increased to unprecedented levels, with intensified internal conflict adding to the political uncertainty. Business sentiment remained suppressed, with the number of new firm registrations having continued to decline over the past four years. Real GDP growth increased from 1.1 percent in 2015 to 2.2 percent in 2016, mainly driven by strong growth in the agriculture sector. However, the non-agriculture sectors continued to exhibit sluggish growth. With Afghanistan's population growth rate at nearly 3 percent, an economic growth rate of 2.2 percent implies a decline in per capita income.

The inflation rate increased from –1.5 percent in 2015 to 4.4 percent in 2016, driven by the lagged effects of currency depreciation and by a recovery in global food prices. As most consumer goods in Afghanistan are imported, global prices and exchange rate movements tend to have a significant impact on domestic prices.

Revenue collection performance has improved significantly over the past two years, a reversal from the abrupt decline recorded in 2014. Domestic revenues increased by nearly 15 percent in 2016, exceeding the budget target by around 5 percent. However, in proportion to GDP, revenues still remain relatively low, at 10.5 percent.

With an increase in exports and a decrease in imports (due to weaker domestic demand), the merchandise trade deficit is estimated to have improved from –36.6 percent of GDP in 2015 to –33.3 percent in 2016. The large trade deficit continues to be financed by foreign aid, with a small surplus expected to be recorded in the current account balance in 2016, at around 4 percent of GDP.

2016 also presented an increase in Afghanistan's humanitarian challenges. Over this year, more than 800,000 Afghan refugees returned from Pakistan and Iran. Displacements resulting from internal conflict have also sharply increased. With the likelihood of continued repatriation and internal displacement in 2017, this situation creates an urgent need for the Government to protect and provide basic services to these vulnerable individuals.

In 2017, the economic growth rate is projected to increase modestly to 2.6 percent and is expected to gradually increase to around 3.6 percent by 2020. Stronger growth in out-years is predicated on improvements in security, the achievement of political stability, the successful implementation of reforms, and continued high levels of aid.

Domestic revenues are projected to increase to 10.8 percent of GDP in 2017. While public spending is also projected to increase by a proportionate amount in relation to GDP, a nearly balanced fiscal budget may be achieved in 2017 if donor grants come in as planned.

Over the medium term, the Government will continue to face significant fiscal challenges. Development and security expenditures are expected to increase, while resources are likely to remain tight. Thus, the strategic allocation of these resources and their efficient use is critically important.

In this issue of the Update, the Focus Section discusses how economic stimulus can be provided in Afghanistan's resource-constrained environment. In the context of the economic slowdown, Afghanistan faces the difficult dilemma of balancing measures to stimulate the economy while at the same time avoiding a further weakening of its fiscal position. The fiscal space is already extremely limited, with no room to increase public expenditure or to lower taxes. Thus, the Government must implement initiatives to maximize the growth impact of fiscal expenditure. First, policies to encourage government spending on non-tradable goods from local suppliers will ensure that demand taps domestic production, rather than imports. Second, policies to improve absorptive capacity will increase the quality, speed of execution and value for money of public investments. Third, policies to promote contestable markets in banking and construction will stimulate the entry of small and medium-sized firms in both sectors. Fourth, polices to increase fiscal space should include measures to improve revenue mobilization and to use existing resources more effectively, which will release additional resources.

A. Recent Economic Developments

1. Background

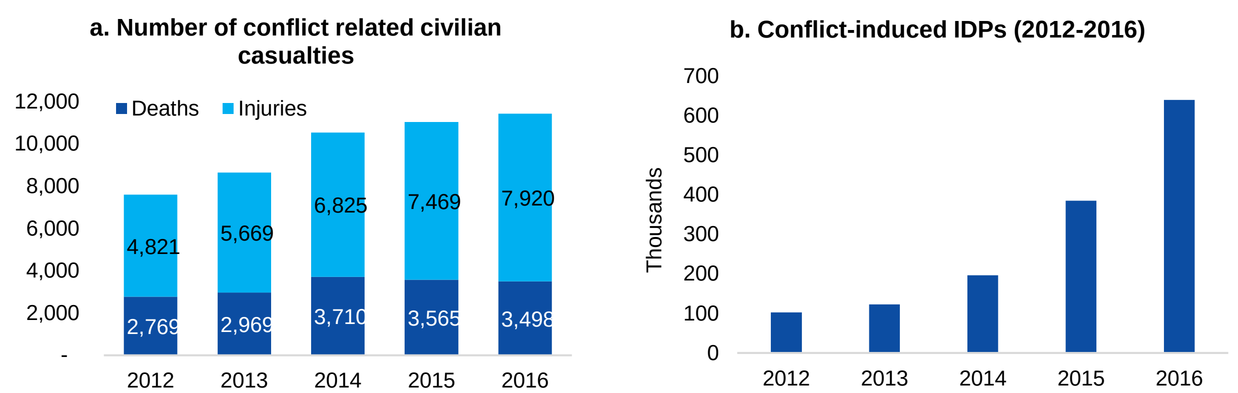
The political and security context continues to affect Afghanistan's economic and social outcomes

The overall security environment continued to deteriorate in 2016. Taliban, ISIS and other armed groups have significantly intensified their attacks, with these groups operating in a number of districts across Afghanistan. As a result, the number of reported civilian casualties has also increased to record levels. Around 11,400 civilian casualties, including nearly 3,500 deaths and nearly 8,000 injuries, were reported to have occurred in 2016. Increasing insecurity further compounds the fragile context in which basic services and development initiatives are delivered and implemented.

The deteriorating security conditions and the increased repatriation of Afghans from Europe, Iran and Pakistan have increased pressures related to internal displacement. In 2016, over 800,000 Afghan refugees returned from Pakistan and Iran. An estimated 1.2 million Afghans remain in Pakistan, with a further 3 million in Iran, including registered and unregistered refugees. A significant proportion of these individuals could be subject to repatriation in 2017 if regional relations deteriorate. At the same time, the number of displacements resulting from the internal conflict has increased significantly due to the escalation of this conflict, with more than 640,000 people being internally displaced in 2016. Thus, the total number of internally displaced people currently stands at 1.4 million. Given that repatriation and internal displacement are expected to continue in 2017, this situation creates an urgent need for the Government to protect and provide basic services to these vulnerable individuals.

In this difficult context, Afghanistan's National Unity Government ("the Government") continued to pursue its ambitious reform agenda. On October 4, 2016, the Government presented the new Afghanistan National Peace and Development Framework (ANPDF) at the Brussels Conference on Afghanistan (BCA), which was attended by representatives of around 70 countries and 30 international organizations. At this conference, development aid of US$ 3.8 billion per year was pledged for the next four years. In addition, at the NATO Warsaw Summit in July 2016, security funding of US$ 4.5 billion per year was pledged for the same time period.

Figure 1: Civilian casualties have increased



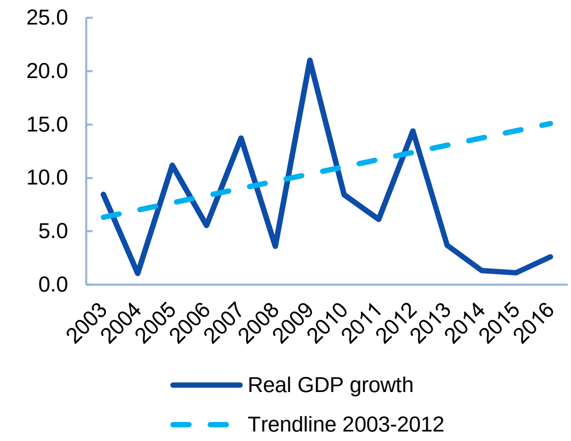
Source: UNAMA, UNHCR, and UNOCHA

2. Real Sector Activity

Economic recovery has been slow, as insecurity continues to curtail private investment and consumer demand

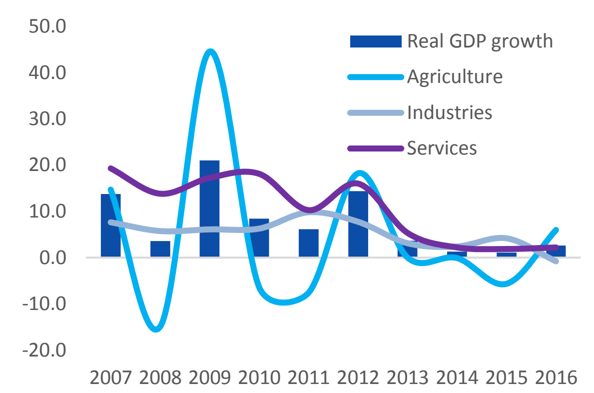
With the withdrawal of international security forces starting in 2011 and with the subsequent security and political transition in 2014, Afghanistan's growth trajectory has declined significantly. Mean growth plummeted from an average annual rate of 9.4 percent in the period from 2003 to 2012 to 2.1 percent in the period from 2013 to 2016. In 2016, the growth rate increased to 2.2 percent,[1] up from 1.1 percent[2] in 2015, principally due to the strong growth of the agriculture sector. The significant decline in growth since 2012 reflects the impact of reduced aid and weak investor confidence in the context of increasing insecurity and continued political uncertainty. While on-budget aid increased from around US$ 2 billion in 2012 to more than US$ 3 billion in 2016, the proportion of aid delivered off-budget has declined.[3] The total value of all aid, including both security and civilian aid and both on- and off-budget aid, is estimated to have declined from an annual average figure of US$ 12.5 billion in the period from 2009 to 2012 to around US$ 8.8 billion in 2015.

Figure 3: Real GDP growth, 2003-2016
(percent)



Source: Central Statistics Organization, and World Bank staff calculations

Figure 2: Real GDP and sector output growth
(percent)



Source: Central Statistics Organization (CSO)

Economic growth in 2016 was principally driven by agriculture

Agriculture accounted for around half of economic growth in 2016. Over the year, agricultural output increased by six percent, making it the largest contributor to Real GDP growth. The strong growth in agriculture was primarily driven by an increase in fruit production of more than 30 percent. Favorable precipitation and rainfall throughout the year supported the remarkable increase in the

[1] The GDP numbers reported in this report exclude the value-added generated from the opium production. The official growth numbers (for instance, 3.6 percent for 1395) reported by the Central Statistics Organization include the opium value added, and is based on the Persian Solar Hijri year. Growth numbers in this report are converted from the Persian Solar Hijri to the Gregorian calendar.

[2] The initial estimate for growth in 2015 was 0.8 percent, as also reflected in the October 2016 edition of the Afghanistan Development Update. The estimate was revised recently by the Central Statistics Organization to 1.1 percent.

[3] On-budget aid refers to the grants that are disbursed to the Government as 'discretionary' (i.e., budget support funds) or 'non-discretionary' resources (project-specific funds) , while the off-budget aid is directly executed by the donors and is not accounted in the budget.

horticultural output. However, the production of cereals declined by 4.8 percent, with the production of wheat dropping by 2.5 percent. This decline was primarily due to pests and diseases that negatively affected cereal harvests.

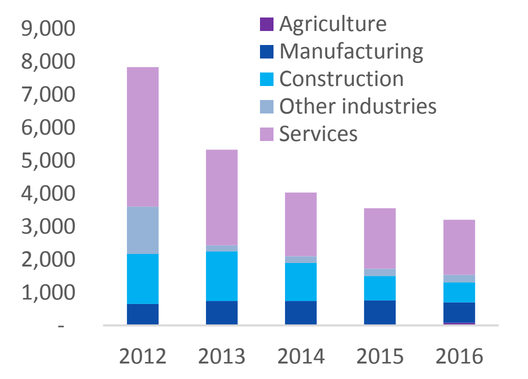
Industry contracted, while services recorded positive growth

The output of the industry sector declined by 0.8 percent, largely due to a decline in construction activities of 2.6 percent. This represents a reversal from previous years, with construction maintaining strong growth in the period from 2012 to 2015, even when the output of most other sectors was decelerating. In 2016, manufacturing grew by around 1 percent, while the services sector grew by around 2.2 percent. These growth rates for both manufacturing and services are substantially lower than the average historical growth rates for these sectors.

Proxy indicators do not indicate a pick-up in private investments

In 2016, the number of registrations of new firms (excluding those in wholesale and retail trade) decreased by around 9 percent. Given the lack of high frequency data on private investment, the number of new firm registrations is the only available data suitable for use as a proxy to track investment activities. In 2016, the number of new vehicle registrations increased by only 3.9 percent, also indicating a low level of economic activity.

Figure 4: New firm registrations continue to decline



Source: Afghanistan Central Business Registry (ACBR) Excluding the wholesale and retail trade sector.

A number of on-going initiatives have the potential to improve investment prospects

Afghanistan was formally admitted to the World Trade Organization (WTO) on July 29, 2016. This creates a number of potential benefits for Afghanistan, providing a means to facilitate transit, to resolve trade disputes, and to gain access to global markets, thus improving prospects for foreign direct investment over the medium-term. In May 2016, Iran and India signed an agreement to develop the Chabahar seaport, located in southeastern Iran on the Persian Gulf. This port will open a new transit route for Afghanistan, having the potential to become the most important and cost-efficient transit port for the country's trade. While both the accession of Afghanistan to the WTO and the opening of the Chabahar port could improve the country's investment prospects, the security environment will determine the extent to which it will be able to reap the full benefits of these developments.

Opium production and the area under poppy cultivation increased in 2016

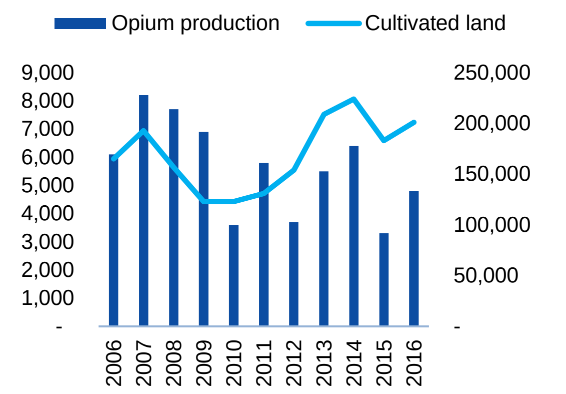
Opium production increased in 2016. The United Nations Office on Drugs and Crime's (UNODC) latest survey shows an increase of about 10 percent in the area utilized for the cultivation of poppies, as well as an increase of about 30 percent in per hectare opium yields. In marked contrast to the decline in licit cereal production over the year, opium production expanded significantly in all regions across the country, increasing by around 43 percent in total, from around 3,300 metric tons in 2015 to an estimated 4,800 tons in 2016. This increase was due to the absence of diseases that did not affect production this year, in contrast to previous years, when such diseases had a significant impact.

Poverty increased following the start of the international troops withdrawal in 2011 and the accompanying sharp decline in economic growth

As a result of the sluggish economic growth and the deteriorating security situation following the start of the withdrawal of international troops in 2011, the poverty rate increased to 39.1 percent in 2013-14, up from 36 percent in 2011-12. This meant that 1.3 million additional people fell into poverty over this period, being unable to satisfy basic food and non-food needs. The increase in poverty was especially severe in rural areas, where most of the population live. In rural areas, the poverty rate increased by 14 percent in the period from 2011-12 to 2013-14, going up from 38.3 percent to 43.6 percent (see Figure 6). On the other hand, the poverty rate in urban areas did not change over this period, despite substantial migration flows from rural to urban areas. Deteriorating living conditions in rural areas were mostly due to the deteriorating security situation and the decline in international spending associated with the withdrawal of international military forces. As a result, labor demand in the off-farm sector declined, with most of the jobs created in the service sector during the pre-transition phase being lost.

Figure 6: Opium output and area under cultivation increased in 2016

(left axis: metric tons; right axis: hectares)



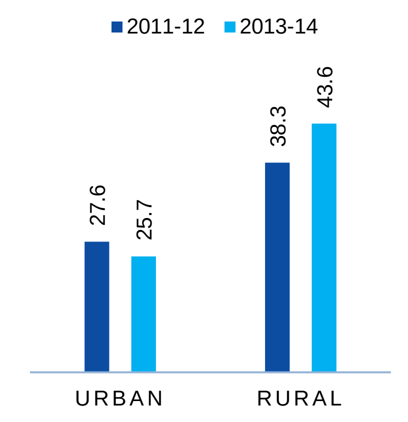
Source: UNODC

Geographical disparities exist

Poverty in the Southwest region increased dramatically in the period from 2011/12 to 2013/14, but otherwise the regional poverty profile did not change. Geographical variations in welfare are a distinguishing feature in Afghanistan. The lagging East, Northeast, and West Central regions are generally considerably more vulnerable to poverty than the other regions. In the period from 2011/12 to 2013/14, there were generally no significant changes to the relative gaps between the regions, with the lagging regions remaining poorer than the rest of the country. The notable exception to an otherwise unchanged profile involves the Southwest region, where poverty increased from 28 to 56 percent. The Southwest region, which includes the Nimroz, Helmand, Kandahar, Zabul and Uruzgan provinces, has historically been characterized by high conflict levels and high international spending on both civilian and military operations. As such, it is not surprising that poverty increased most in this region, due to the relatively high decline in international spending during the transition phase.

Figure 5: Increase in poverty in rural areas

(poverty headcount, in percent of population)



Source: Afghanistan Living Conditions Survey, 2007/08, 2011/12 and 2013/14 surveys

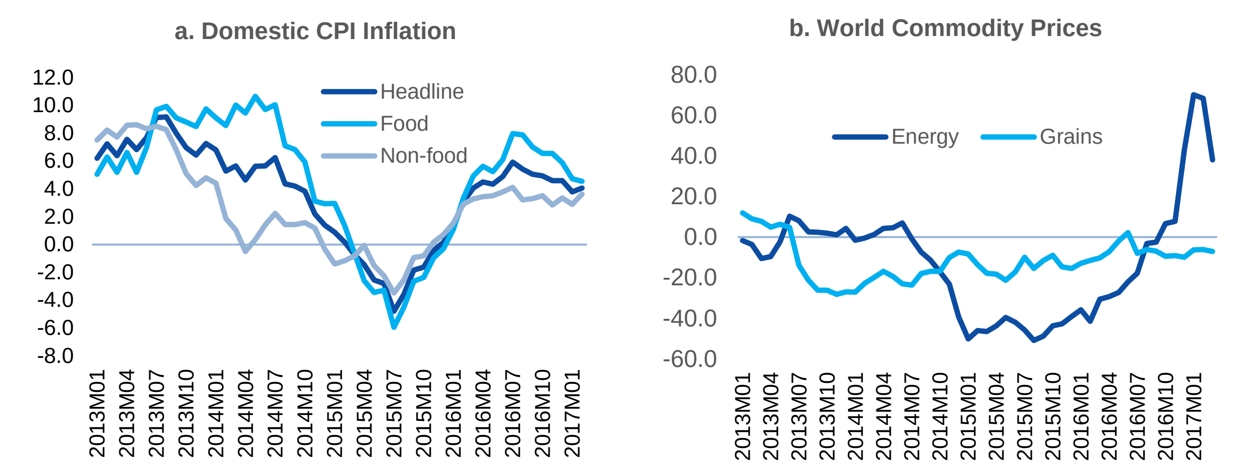
Unemployment increased in recent years

Mid-term results from the most recent household survey (ALCS 2016-17) show an increase of about 1 percentage point in the unemployment rate over the past two years. In 2013/14, the unemployment rate stood at 22.6 percent, with the female unemployment rate two and half times higher than the male rate. Unemployment is particularly severe amongst low skill, illiterate workers, who historically are at the greatest risk of falling into poverty. Sluggish economic growth and continued demographic pressures exacerbate Afghanistan's unemployment situation. With an average annual population growth rate of 3 percent and with an estimated 400,000 Afghans entering the labor market each year, much higher growth rates are required to improve per capita incomes and to provide quality employment opportunities for the expanding workforce.

The impact of returnees on domestic demand is expected to be minimal

Afghanistan is now facing a sharp increase in displacement due to the escalation in the level of internal conflict, exacerbated by a new wave of often involuntary refugee returns. Despite potential positive economic impacts, the return of refugees is not expected to have a significant stimulating effect on domestic demand in the short term. Most returnees in the rural areas engage in subsistence activities, while settlers in urban or peri-urban areas are often low-income earners who will depend on the provision of public assistance, straining public service delivery. Further, given the high import content of expenditures on food in Afghanistan, any increase in household consumption might be partially offset by increased imports. Thus, the net effect on real GDP growth is expected to be minimal.

Figure 7: Consumer prices increase as global commodity prices rebound
(12-month percentage change)



Source*:* Central Statistics Organization, and World Bank Global Economic Monitor (GEM)

Consumer prices increased in 2016

After falling for most of 2015, consumer prices increased significantly in 2016. The consumer price inflation rate increased from –1.5 percent (period average) in 2015 to 4.4 percent in 2016. Increases to both food- and non-food prices have contributed to inflationary pressures. Food prices increased from –1.9 percent to 5.7 percent between 2015 and 2016, while the increase in non-food prices was less steep, rising from –1.2 percent to 3.2 percent over the same period.

The surge in prices is likely to have been caused by the lagging effects of the currency depreciation

The surge in prices is likely to have been caused by the lagging effects of the currency depreciation. This depreciation began in mid-2014, with the value of Afghanistan's currency declining by nearly 20 percent against the US dollar in the period from January 2015 to March 2017. Given that most of Afghanistan's consumer goods are imported, with merchandise imports constituting around 40 percent of GDP, exchange rate movements have a significant impact on domestic prices. The effects of the currency depreciation on domestic prices was initially offset by the decline in global energy and food prices in 2015. However, as global energy and food prices recovered in the first half of 2016 (see Figure 7), domestic prices also started to rise, increasing from 0.2 percent in December 2016 to 4.9 percent in June 2016. In the second half of 2016, however, both world food prices and domestic inflation declined. Thus, the inflation rate dropped from 5.9 percent in July 2016 to 4.5 percent in December 2016.

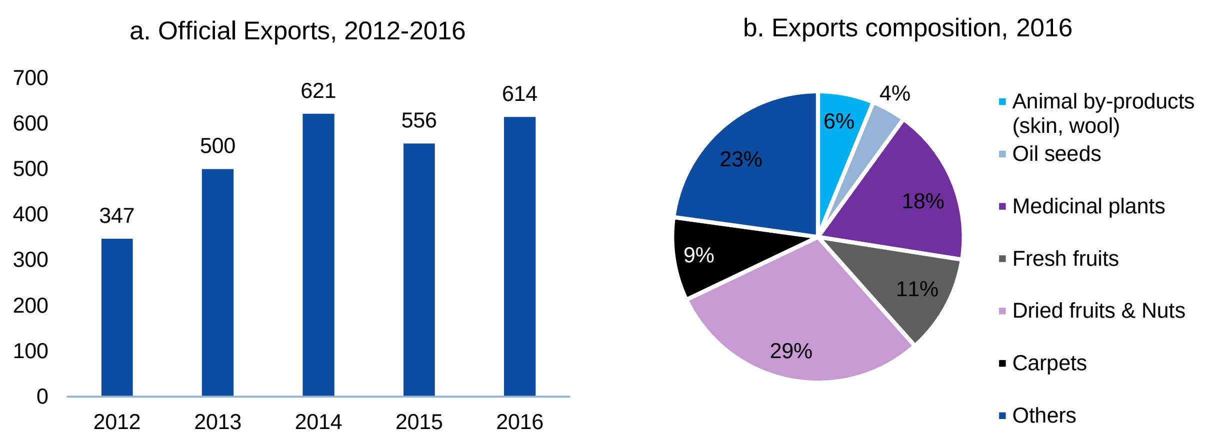
3. External sector

Merchandise trade balance improved in 2016

The exports of goods increased by around 10 percent in 2016, with their total value reaching US$ 614 million[1] over the year. Exports of fruits, including fresh and dried fruits, which together account for almost a third of exports, were the main driver of the growth in official exports. Improved horticultural performance has resulted in increases to fruit production over the past two years. While the level of fresh fruit exports depends on horticultural performance in the current year, the exports of dried fruits typically depends on the performance in the previous year, due to the time required for food processing (drying).

On the other hand, the value of imports declined by 13.5 percent in 2016, down to US$ 6.6 billion. The decline since 2013 is likely due to weakened domestic demand and to the currency depreciation, which has increased the costs of imported goods. As a result, the merchandise trade balance (including estimated unofficial trade) improved, with the deficit shrinking from 36.6 percent of GDP in 2015 to 33.3 percent in 2016.

Figure 8: Exports increased in 2016
(US$ million)



Source: Central Statistics Organization

Box 1. Afghanistan's trade structure, across partner, has diversified in recent years

In the earlier decade, Afghanistan's trade structure was highly concentrated around only a few trading partners. Afghanistan's largest trade partner, Pakistan, contributed to more than half (56.5 percent) of Afghanistan's trade, including both exports and imports. In terms of Afghanistan's exported products, the trade structure also remains highly concentrated, with the exports basket consisting of only a few products, all of which are either agricultural products, or agriculture-related products, such as carpets and rugs.

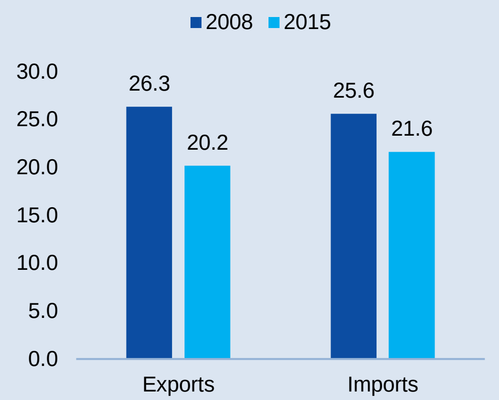
[1] The figure refers to "official" trade only. Unofficial exports, including smuggling, are not incorporated.

A highly concentrated trade structure, in terms of products and/or partners, makes countries more vulnerable to external trade shocks. Empirical studies show that countries with a less diversified trade structure experience higher levels of growth volatility, and risk lower growth rates and higher levels of inequality and poverty in the long-run.

The trade structure in Afghanistan is now less concentrated in terms of its trade partners than it was in the previous decade. Pakistan's contribution to total trade in Afghanistan declined from 56.5 percent in 2008 to 38.9 percent in 2015. Iran is now the largest provider of Afghanistan's imports (14.5 percent), while India is the largest destination for Afghan exports (31.3 percent). Afghanistan's level of trade partner concentration, as measured by the Herfindahl index, declined for both exports and imports in the period from 2008 to 2015 (see Figure 9).

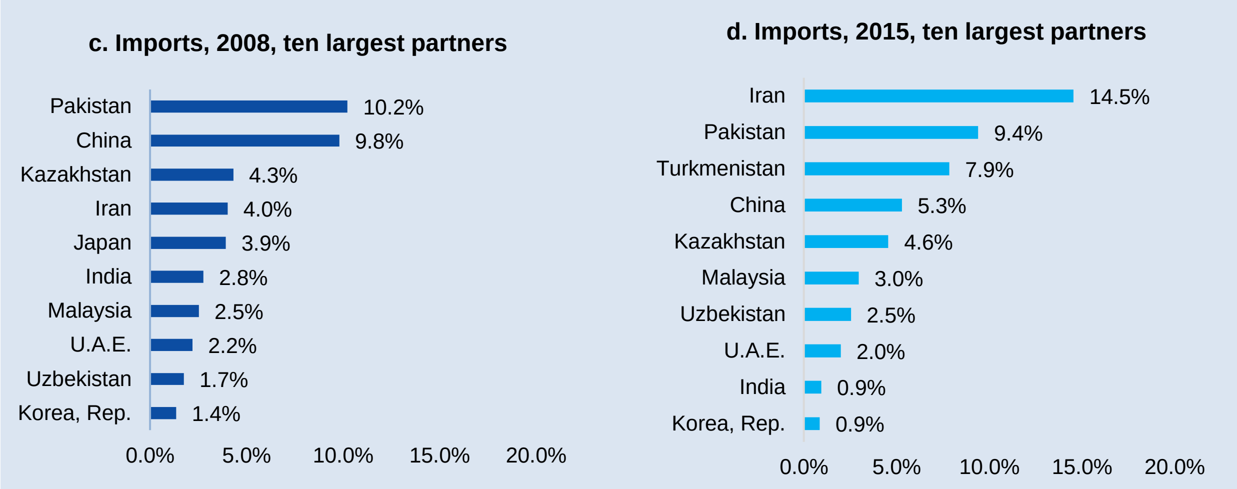
An increase in the number of trade routes through Central Asia and Iran has diversified the movement of goods to and from Afghanistan and will likely improve the country's resilience to external shocks. For example, the recent closure of the Torkham gate on the border with Pakistan in February 2017 may have had a relatively smaller impact on domestic prices than similar incidences in the past.

Figure 9: Trade partner concentration, measured by Herfindahl index



Source: World Bank staff calculation based on data from WITS/ World Integrated Trade Solution (World Bank)

Figure 10: Afghanistan's top trade partners, 2008 and 2015
(Percentage share)

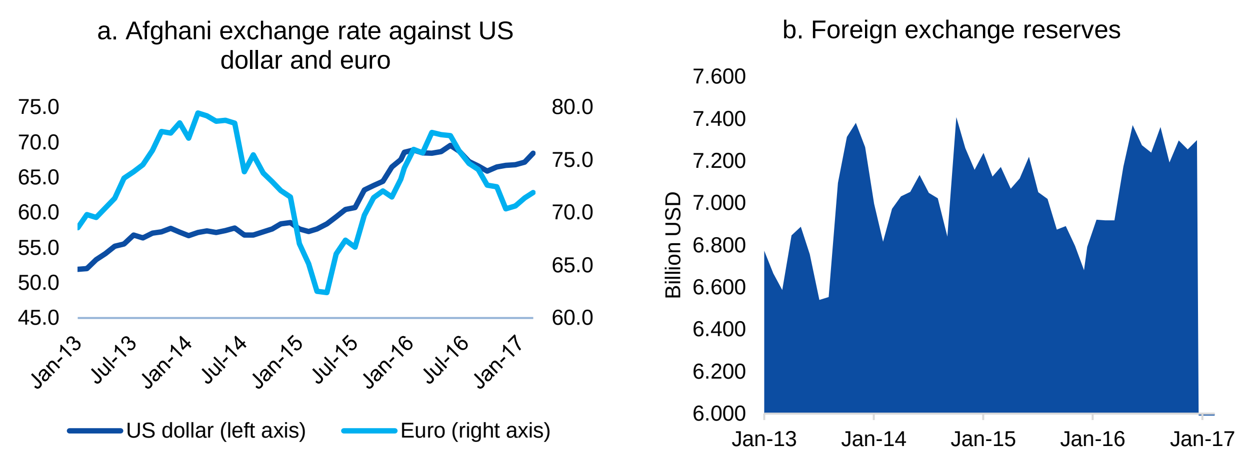


Source: WITS/ World Integrated Trade Solution (World Bank) based on UN COMTRADE data

Exchange rate has been volatile, and depreciated in 2016

On average, Afghanistan's currency depreciated by 10.5 percent against the US dollar in 2016. However, the end-year exchange rate depreciated by only 1.2 percent. Throughout the year, the exchange rate was volatile, depreciating in the first half and gaining value in the second half. The overall depreciation (period average) could be due to the lower net inflow of capital into the economy and to the increased tendency for households to hold their savings in US dollars, which result in a decreased demand for Afghani. The Afghani traded against the US dollar at Af 68.4 and against the euro at Af 71.9 in March 2017.

Figure 11: The value of the Afghani: Depreciation in the first two quarters, appreciation in the third quarter



Source: Da Afghanistan Bank

Foreign exchange reserves increased in 2016

After having declined throughout most of 2015, gross international reserves increased by around 8.5 percent in 2016. In December 2016, foreign exchange reserves stood at US$ 7.3 billion, up from US$ 6.7 billion recorded in December 2015. The increase in the reserves is mostly attributable to the decline in imports. The current level of gross reserves is sufficient to cover around 11 months of imports.

4. Fiscal developments

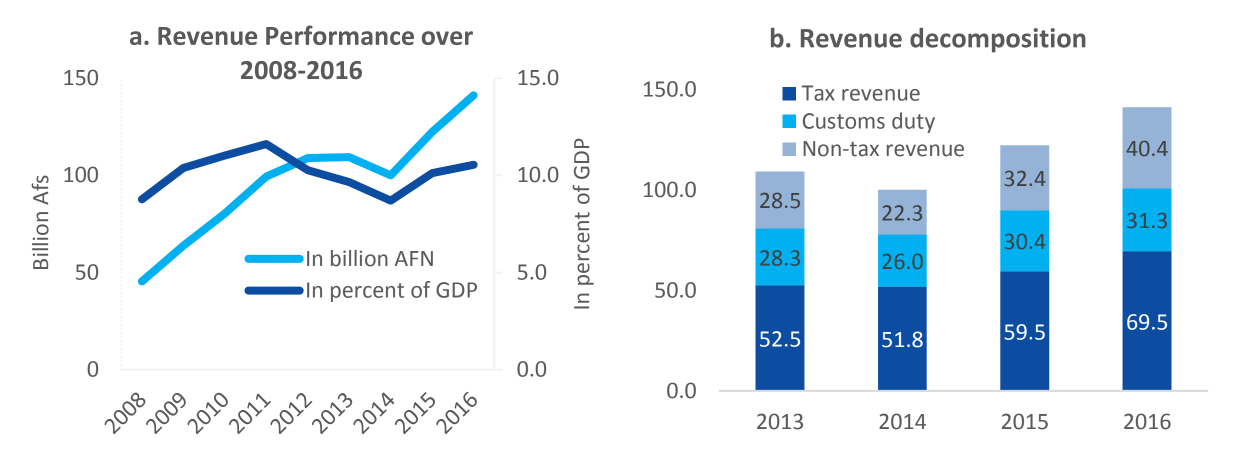
Revenue collection has remained strong in 2016, with a 15 percent increase compared to 2015

The Government maintained its strong revenue collection performance in 2016. It collected a total of Af 141.2 billion,[1] an increase of about 15.3 percent compared to the previous year. Compared to 2014 levels, when the value of collected revenue declined by 9 percent, revenues have increased by about 41 percent. Both tax revenue (excluding customs duty) and non-tax revenues contributed to the increased revenues in 2016. Tax revenue, which constitutes slightly less than half of total revenues, increased by nearly 17 percent. Non-tax revenue, which constitutes less than a third of total revenues, increased by 25 percent. However, customs duties increased by only 3 percent over the year, due to the decrease in imports. Since 2011, the growth of customs duty has been lower than for any other source of revenue, increasing by only 2 percent in the period from 2011 to 2016. As a result, the contribution of customs duty to total revenues declined from 31 percent in 2011 to 22 percent in 2016.

New tax measures introduced in 2015 and improvements in compliance and enforcement have contributed to increased revenue

The improvement in revenue performance in 2016 can be explained by both new tax policy measures, which were introduced towards the end of 2015, and by improvements in compliance and enforcement. In the third quarter of 2015, a number of new tax measures were introduced, including an increase in the business receipts tax (BRT) rate from 2 percent to 4 percent; the introduction of a 10 percent telecommunications fee on mobile phone top-ups; an increase in the fuel excise rate from Af 1 per liter to Af 2 per liter; and an increase in over-flight fees for traffic passing through Afghanistan's airspace. The value of revenues generated from these new measures amounted to around Af 17 billion in 2016. However, part of the increase can also be attributed to recent improvements to revenue administration and enforcement.

Figure 12: Revenue collection increased for a second year in a row
(billion AFS)



Source: Ministry of Finance

In ratio to GDP, the revenue collection performance is less impressive

The total value of collected revenues in 2016 amounted to 10.5 percent of GDP, which is slightly higher compared to 10.1 percent of GDP recorded in 2015. This is still lower than the figure of 11.6 recorded in 2011, the year with the highest revenue-to-GDP ratio.

[1] The figure excludes the transfer of about Af 10 billion from the Central Bank (Da Afghanistan Bank) to the Treasury due to profits realized on foreign exchange assets as a result of currency depreciation, and one-off transfers of about Af 2 billion from two state-owned enterprises operating under Ministry of Urban Development and Ministry of Agriculture, Irrigation and Livestock.

Expenditures increased, driven by higher civilian recurrent and development spending

Public expenditures increased by 7.5 percent in nominal values in 2016, reaching Af 343 billion (or US$ 5.1 billion).[1] Civilian wages increased by 7.5 percent, due to the introduction of a qualification allowance, or education premium, for civil servants. Expenditure on civilian operations and maintenance increased by nearly 13 percent, from Af 17 billion in 2015 to Af 19.5 billion in 2016. Finally, expenditure on social benefits increased by around 30 percent as a result of increased expenditure on benefits to the families of martyrs and disabled. The Government also expanded its discretionary development[2] budget in 2016. Discretionary development expenditure grew by around 60 percent, with the increase in discretionary resources (such as domestic revenues and discretionary donor grants) enabling the Government to finance a larger number of discretionary development programs. On the other hand, security expenditure, which constitutes more than half of the recurrent budget, remained at similar levels as in 2015. Nevertheless, in proportion to GDP, public spending decreased slightly, declining from 26.4 percent in 2015 to 25.6 percent in 2016.

Table 1: Public expenditure: 2015 and 2016 comparisons
(Af million)

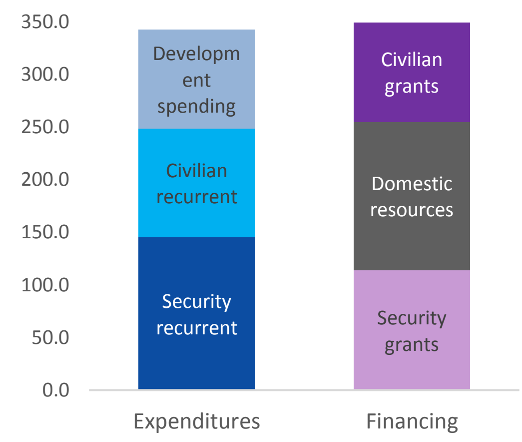
Expenditures	2015	2016
Total recurrent	235.9	248.9
Security	143.6	145.5
Civilian	92.3	103.4
Wages & salaries	54.5	58.6
O&M	17.3	19.5
Capital expenditures	2.3	2.3
Pension and social transfers	17.0	22.2
Discretionary development	18.0	29.0
Recurrent + Discretionary development	253.9	288.1
Nondiscretionary development	64.9	64.9
Total core expenditures	318.8	342.8

Source: Ministry of Finance (AFMIS)

Execution of the development budget did not improve in 2016

The execution rate for the overall budget (including recurrent and development budgets) improved marginally, increasing from 73 percent in 2015 to 76 percent in 2016. This was primarily due to the improved execution of the recurrent budget, with the rate increasing from 80 percent to 90 percent between the two years. However, the execution rate for the development budget has continued to stagnate at around 54 percent for a second consecutive year. Protracted

Figure 13: A balanced fiscal budget was achieved in 2016
(Af billion)



Source: Ministry of Finance

[1] The figure does not includes a Af 10.2-billion recapitalization of the Da Afghanistan Bank by the Ministry of Finance for the Kabul Bank Receivership.

[2] Discretionary development refers to the development projects over which the Government has full control, unlike non-discretionary projects which are designed and implemented together with the donors and each project has its own earmarked donor funds.

Cash reserves were rebuilt to pre-2014 levels

procurement procedures, low capacity in the provinces, and the overall deterioration in the security environment are the main causes for this.

During the 2014 fiscal crisis, Afghanistan's revenues declined, arrears accumulated, and spending cuts were enforced. Two years since, the Government has been able to achieve a fiscal balance, with a small surplus, and to rebuild its cash reserves. This has been largely due to improved revenue collection and to the regular disbursement of on-budget donor grants, which increased by nearly 16 percent, to US$ 3.1 billion in 2016. In the case of its discretionary budgets, namely the recurrent and discretionary development budgets, the Government recorded a surplus of Af 11.8 billion (or 0.9 percent of GDP) in 2016, compared to the deficit of Af 19 billion (or -1.7 percent of GDP) in 2014. The 2014 fiscal crisis led to a depletion of cash reserves, which declined from an opening balance of Af 21 billion to a closing balance of Af 8.7 billion over the course of the year. The improved management of expenditure and increased discretionary resources (revenues and grants) in the past two years enabled the Government to increase its cash reserves to around Af 21 billion by the end of 2016.

5. Monetary and financial sector developments

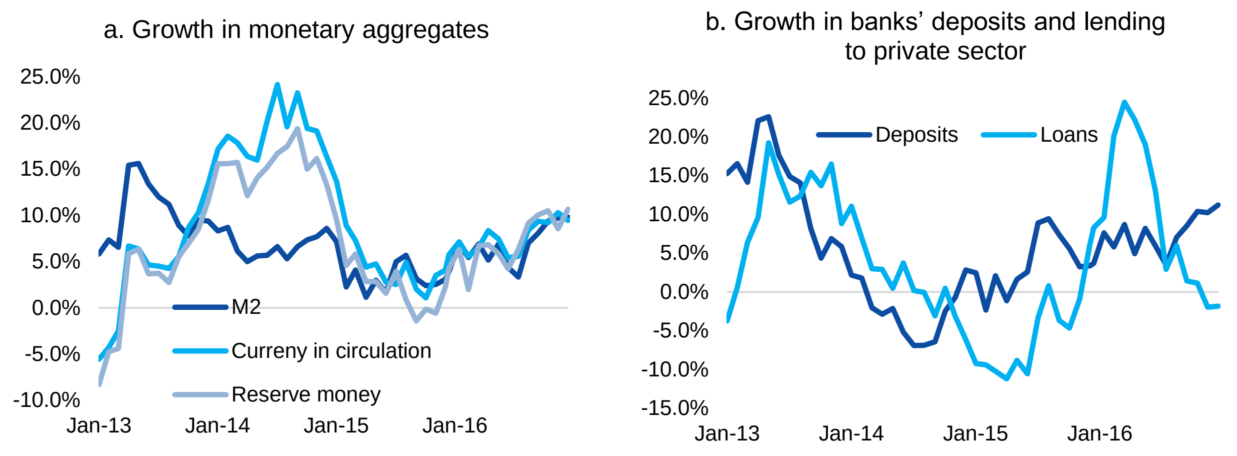
Money demand has increased, likely due to higher prices

The broad money (M2) growth rate, which includes currency-in-circulation and deposits in commercial banks, increased to 9.7 percent in December 2016 (year-on-year), up from the figure of 3.1 percent recorded in the previous year. The year-on-year currency-in-circulation growth rate also increased, from 4.1 percent to 10.3 percent, over the same period. The increase in money demand is probably the result of increasing inflationary pressures. In December 2016, deposits in commercial banks grew at an annualized rate of 10.3 percent. Although this is higher than the rate of 3.4 percent recorded in December 2015, it remains significantly lower than the rates recorded in the years prior to 2013.

Commercial banks' performance has been mixed

Commercial bank loans to the private sector remained flat at around Af 46 billion in the period from December 2015 to December 2016. The absence of growth in private sector credit may indicate either a slowdown in private investments, banks' weak appetite for lending, or both. While the data shows an increase in lending in the first half of 2016, this increase was primarily due to the effects of currency depreciation, which inflated the value of assets held by commercial banks. Given the high degree of dollarization in the Afghan economy, the shares of US denominated deposits and loans are substantial, standing at 68 and 63 percent respectively. However, the quality of banks' assets improved in 2016. The ratio of non-performing loans (NPLs) decreased from 12.1 percent in December 2015 to 10.8 percent in December 2016, largely due to collateral repossessions. The banking sector remained profitable in 2016, with most profit being derived from non-interest incomes.

Figure 14: Growth in monetary aggregates and commercial bank loans
(year-on-year percent change)



Source: Da Afghanistan Bank

The financial sector remains underdeveloped and is characterized by low level of financial intermediation

Commercial banks dominate the financial sector in Afghanistan. Other financial services remain underdeveloped, contributing only modestly to financial intermediation. While the banking sector's assets amounted to 23 percent of GDP in December 2016, the value of credit intermediated from banks to the private sector stood at only 3.4 percent of GDP. The banking system remains highly liquid, with the liquid assets ratio standing at more than 70 percent for the past two years, reflecting the low level of intermediation. The Government has been intensifying its efforts to develop and improve the oversight of the banking sector and to adopt prudential measures to assess its soundness.

B. Outlook and Medium-Term Prospects

Growth is projected to increase to 2.6 percent in 2017

The economic growth rate is projected to accelerate modestly to 2.6 percent in 2017. While this shows a slight acceleration since 2014, it is still significantly lower than the average growth rate recorded in the period from 2003 to 2012, which stood at 9.6 percent. The weaker domestic demand and subdued investment sentiment caused by the increased violence and political uncertainty have resulted in lower growth since 2014. Industry and services are expected to grow by 2.5 and 2.4 percent respectively in 2017, while agricultural output is projected to grow by 1.5 percent.

WTO accession and infrastructure projects could significantly improve prospects for private investment and business activities

Afghanistan's accession to the World Trade Organization, the opening of the Chabahar port in Iran (with this port serving as an alternative, low-cost transit route), the initiation of the Trans-Hindukush road connectivity project, and a number of other national and regional projects could significantly improve Afghanistan's prospects for private investment and business activities. In addition, a number of important Government reforms in the areas of anti-corruption, revenue collection, and private sector development could help build confidence in the economy in the longer term, although their impact in the short term is likely to be limited. However, unless security challenges and political uncertainty are addressed, these reforms will bear little impact on growth.

Growth is expected to gradually increase over the medium-term

The growth rate is expected to gradually increase to around 3.6 percent by 2020. Stronger growth in out-years is predicated on the achievement of improvements in security, political stability, a successful reform progress, and continued high levels of aid. The poverty rate is expected to remain high due to weak labor demand and security-related constraints on service delivery, despite some positive offsetting impacts from improvements to the performance of the agriculture sector and lower food prices.

A balanced budget is expected in 2017

Domestic revenues are projected to increase only marginally in proportion to GDP, increasing from 10.5 percent of GDP in 2016 to 10.8 percent in 2017. While this represents a growth of nearly 12 percent in nominal terms, these increases are much lower than those achieved in 2015 and 2016. Expenditures, too, are expected to increase. Total expenditure is expected to increase to around 27 percent of GDP in 2017, up from 25.6 percent in the previous year, driven by higher recurrent security spending and higher development expenditure. With donor grants budgeted at 16.8 percent of GDP, the overall fiscal balance will be in a minor surplus of about 0.4 percent of GDP.

Over the medium term, fiscal outcomes are highly sensitive to the level and modality of aid commitments.

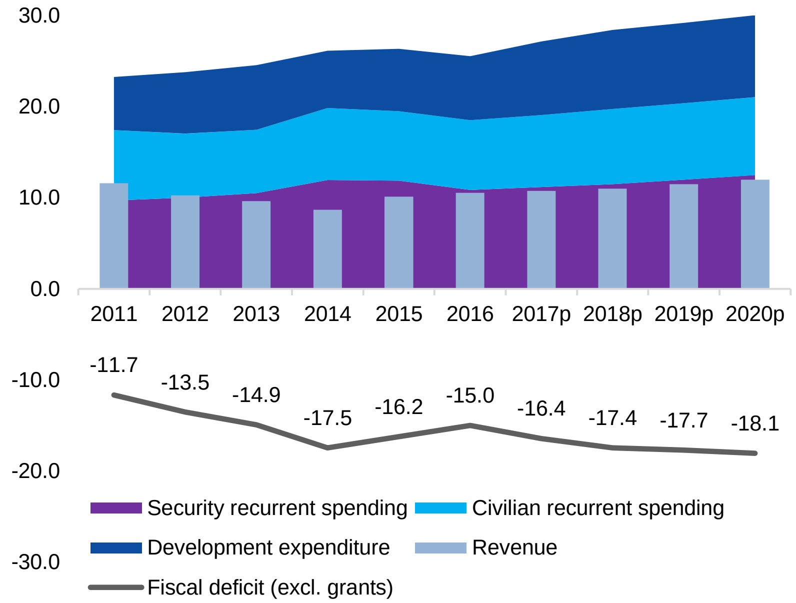
Over the medium term, fiscal outcomes are highly sensitive to the level and modality of aid commitments. Total budget expenditures are projected to increase from 25.6 percent of GDP in 2016 to 30.1 percent in 2020. This increase largely reflects the fact that security spending previously undertaken directly by international partners is being moved on budget. The growth of civilian expenditure reflects the maintenance of current service levels to an increasingly large population and the expenditure on essential infrastructure and the essential maintenance of aid-financed assets recently transferred to the Government. If the Government can sustain recent improvements to compliance and administration, domestic revenues are projected to increase to 12 percent of GDP by 2020, although these domestic revenues will still only cover around 40 percent of budgeted expenditures. Thus, Afghanistan will need on-budget civilian aid to a value of about 18 percent of GDP to fund basic social services and development programs over the coming years. Given that part of the increase in public spending is due to the on-budgeting of expenditures that have been funded off-budget, a proportional amount in donor grants should also be delivered on-budget. However, any shortfall in the on-budget delivery of donor grants will exacerbate fiscal pressures and put Afghanistan in an extremely difficult position.

Table 2: Medium-term macroeconomic framework, 2014–20

	2014	2015	2016	2017	2018	2019	2020
		Actuals/estimates			*---- Tentative staff projections ----*		
Real GDP growth (%)	1.3	1.1	2.2	2.6	3.4	3.1	3.6
Nominal GDP (Af billion)	1,151	1,210	1,338	1,466	1,603	1,736	1,885
CPI inflation (period average, in %)	4.6	−1.5	4.4	6.0	5.0	5.0	5.0
Fiscal				*In Percent of GDP*			
Revenues and grants	24.4	25.1	26.2	27.6	28.3	28.8	29.5
Domestic revenues	8.7	10.1	10.5	10.8	11.0	11.5	12.0
Foreign grants	15.7	15.0	15.6	16.8	17.3	17.3	17.5
Total expenditures	26.2	26.4	25.6	27.2	28.4	29.2	30.1
Recurrent expenditures	19.8	19.5	18.5	19.1	19.7	20.4	21.1
Development expenditures	6.3	6.9	7.0	8.1	8.7	8.8	9.0
Overall balance (incl. grants)	-1.8	-1.3	0.6	0.4	-0.1	-0.4	-0.5
Overall balance (excl. grants)	-17.5	-16.2	-15.0	-16.4	-17.4	-17.7	-18.1
External							
Trade balance	-39.6	-36.6	-33.3	-32.5	-32.3	-33.1	-32.1
Current account balance (incl. grants)	8.0	5.4	4.4	3.4	1.0	-1.0	-2.7

Source: World Bank staff estimates, tentative and subject to revision

Figure 15: The fiscal deficit (excluding donor grants) is projected to continue to grow
(Percent of GDP)



Prices are expected to remain stable and the current account to remain in surplus.

In 2017, the inflation rate is expected to increase to around 6 percent, with this increase driven by the lagging effect of currency depreciation, which persisted throughout the first half of 2016. Despite the increase, at this rate, inflation remains within the Da Afghanistan Bank's target range. The current account balance is expected to remain in a surplus equivalent to 3.4 percent of GDP as a result of the continued influx of foreign aid. With a projected increase in both exports and imports, the merchandise trade deficit is expected to remain at around 33 percent of GDP in 2017. The trade deficit is principally financed by foreign aid inflows.

Medium-term prospects are subject to substantial downside risk

Afghanistan's macroeconomic framework remains heavily exposed to a range of downside risks, including: i) an unanticipated decline in aid, which would undermine fiscal sustainability and force difficult adjustments on the expenditure side; ii) a further deterioration in the security environment, which would undermine confidence and further slow growth; and iii) increased political instability, which would have highly unpredictable impacts on the security situation, business confidence, and external support. Continued progress with efforts to strengthen governance, to improve revenue mobilization and administration, and to establish a conducive environment for private sector growth underpin the achievement of longer-term sustainability. The mobilization of the required aid will continue to depend on adequate performance in implementing the structural reforms mandated by the Afghanistan National Development and Peace Framework.

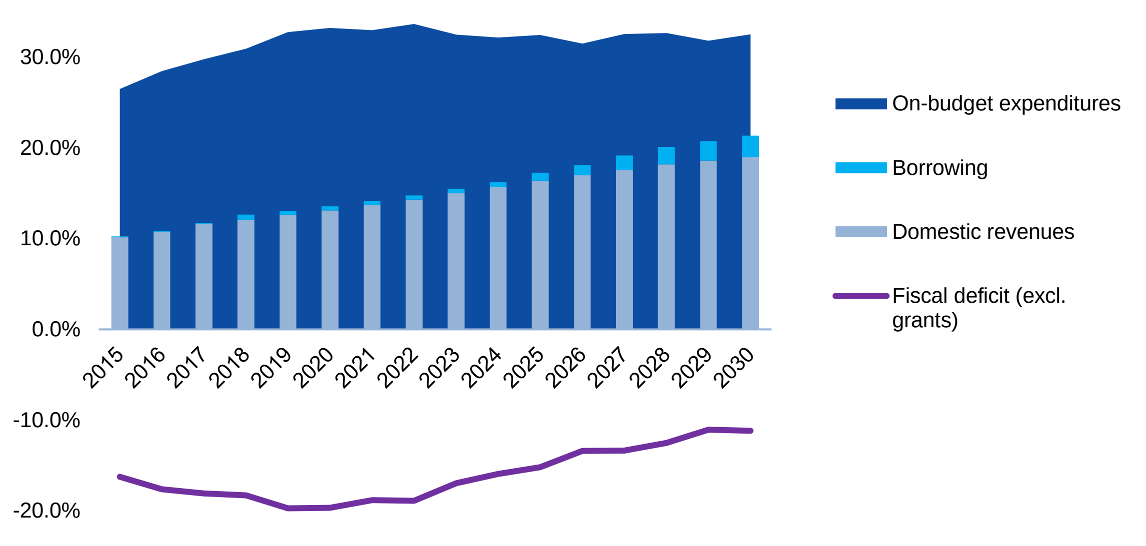
Structural transformation is required for long-term macroeconomic sustainability

With an average annual population growth rate of 3 percent and an estimated 400,000 individuals entering the labor market each year, much higher growth rates are required to improve per capita incomes and to provide quality employment opportunities for the expanding workforce. New sources of growth are needed to increase government revenues in the context of the expected normalization of aid levels over the longer-term and to generate the foreign exchange required to finance Afghanistan's large import bill. Even with optimal revenue policies and administrative settings, Afghanistan's upper-bound revenue potential stands at only around 17 percent of GDP, due to the undiversified economy and the continued heavy dependence on subsistence agriculture. At this level, this revenue is well short of projected expenditure needs. Given low levels of human capital, substantial infrastructure deficits, and weak institutions, opportunities for structural transformation are limited in the short term. Over the medium term, increased human capital investment and improved agricultural productivity could drive significantly higher economic growth and increase employment opportunities. The development of the extractives sector offers important opportunities for the generation of government revenues and of foreign exchange earnings to replace the expected decline in aid.

C. Focus Section I: How to provide economic stimulus in a resource-constrained environment

Afghanistan faces dire prospects in its struggle to achieve fiscal sustainability. The long-term fiscal outlook is discouraging, with current analysis by the World Bank showing that Afghanistan will not be able to meet its public spending needs without substantial donor funding for the foreseeable future, even in the best-case scenarios for economic growth. As discussed in the previous Afghanistan Development Update (October 2016), total expenditures are projected to reach a value of at least twice that of projected domestic revenues by 2030, with the potential for domestic borrowing and external concessional borrowing continuing to be limited. Even in a high-growth scenario involving the development of the extractives sector; the generation of natural resource rents; a reduction in security costs as a result of improvements to the security situation; and the implementation of critical reforms to provide cost savings, domestic revenues are forecast to reach only 19 percent of GDP. Even in this scenario, the financing gap (after borrowing) would still only decline to around 12 percent of GDP by 2030 (see Figure 16).

Figure 16: Projected revenues, expenditure, and fiscal deficit, in a High-Growth scenario
(percent of GDP)



Source: World Bank staff projections

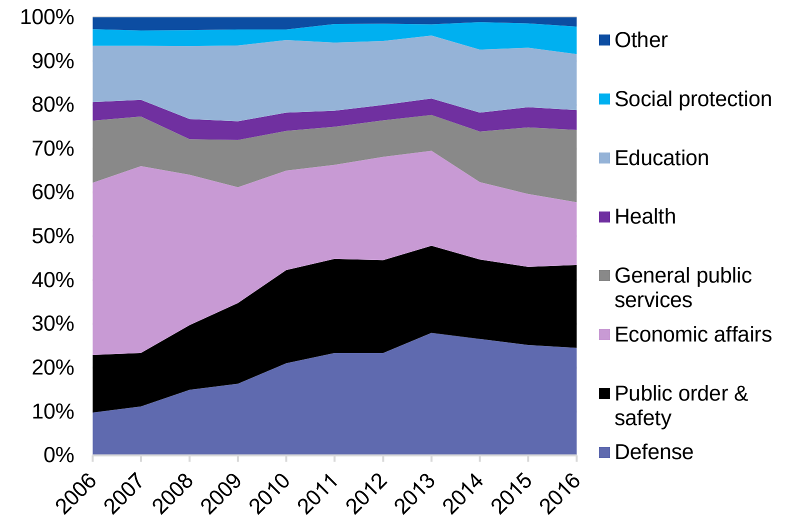
Afghanistan also faces the challenge of managing a significant economic slowdown. The withdrawal of international security forces commenced in 2011, with the subsequent security and political transition occurring in 2014. Since then, the average economic growth rate has declined from 9.4 percent in the period from 2003 to 2012 to around 2.1 percent in the period from 2013 to 2016. With business and consumer confidence suffering due to the deterioration in the security and political environment, domestic demand weakened, leading to a deceleration in real GDP growth and an increase in unemployment.

In this context, the typical fiscal policy response would be to implement measures to stimulate the economy by increasing domestic demand, either by increasing public expenditure (or transfers) or reducing taxes. However, deficit financing is not an available option. Given the limited fiscal space and the extraordinary pressure on fiscal sustainability in Afghanistan, economic stimulus measures will be practically impossible to implement. Thus, the dilemma that Afghanistan (and many other low-income countries) faces relates to the need to provide economic stimulus in an environment where resources are extremely limited and/or the current fiscal trajectory is not sustainable. Obviously, in this situation, increasing the overall level of spending is impossible. Nevertheless, even in these circumstances, the Government could reshuffle the *composition* of public spending to achieve a similar set of objectives, by:

(i) prioritizing resources for the most important spending needs;
(ii) increasing the impact of public expenditure by investing resources in sectors where they can have maximum impact; and
(iii) improving the efficiency of public expenditure to achieve cost-savings.

This Focus Section presents a discussion of the manner in which the Government can enhance public spending by prioritizing public expenditures to maximize their impact on growth. Prioritizing public expenditures should not only be viewed as the strategic allocation of resources across sectors in the economy, but also as an element of a spending-based fiscal consolidation plan to strengthen fiscal sustainability over the medium term. The key to achieving this successfully is to determine which expenditures can be reduced with as little negative impact as possible on economic growth, and which expenditures can be increased in order to achieve the desired growth outcome.

Figure 17: Composition of total on-budget expenditure, by functional categories as defined by COFOG
(percent)



Source: World Bank staff calculations

In order to make informed decisions regarding the prioritization of public expenditure and/or maximizing the impact of this expenditure, assessment of the **fiscal multipliers** for the functional categories[1] of public spending may be a useful analytical tool. A determination of the magnitude of the fiscal multiplier for each functional category of expenditure will assist the Government to better understand the sectors in which the growth impact of public expenditure will be highest. The Government can take this information into account when prioritizing expenditure and/or when preparing a fiscal consolidation plan for the medium-term in the context of its financing constraints.

What is a fiscal multiplier?

The Government spending multiplier quantifies how strongly output or components of aggregate private activity increase when the Government temporarily increases its purchases or transfers. An extra dollar spent on goods and services can generate more than one dollar's worth of additional activity, as a portion of the expenditure will be re-spent by those who benefited from the original outlay. The key element is that households respond to having additional disposable income by spending at least a part of it on additional consumption. The fraction of an additional dollar of disposable income that is spent on additional consumption is called the "marginal propensity to consume." In economics, the term "marginal" refers to the response to an incremental change.

[1] Functional categories of public expenditure are classified according to the "purpose" of spending, such as: security, education, health, etc.

When an economy is faced with decelerating growth, increases in public expenditure can play a role in filling the gap caused by reduced outlays by businesses and households. These expenditures, if appropriately timed and focused, and of the appropriate magnitude, can stimulate demand and economic activity and thereby reduce the likelihood and extent of job losses, thus facilitating economic recovery.

When an economy is on an unsustainable fiscal path, a fiscal consolidation or adjustment may be required. Fiscal adjustments can be achieved either through reductions in spending across the board or in specific sectors. Fiscal adjustments can also be achieved by reallocating spending to one or another sector; by increasing taxes; or by some combination of spending and taxation adjustments. Fiscal adjustments are only appropriate if they have the lowest possible negative impact on economic growth; if they prioritize growing spending needs; and if they ensure that scarce resources are spent efficiently. Of course, fiscal adjustments may be justified if these adjustments promote growth or, at the very least, if they do not lead to a net decline in aggregate demand. Therefore, making informed decisions related to the size, timing and nature of the fiscal adjustment requires precise estimates of the *functional fiscal multiplier*, which determines *the response of output to changes in the functional components of public spending.*

The size of the multiplier in low-income countries

The estimates for the magnitude of fiscal multipliers vary considerably from one country to another: it is increasingly clear that there is no single immutable multiplier. Rather, the magnitude of the multiplier is determined by a range of factors, including the structure of the underlying economy, the nature and the duration of the fiscal change (expansion or consolidation), the composition of the fiscal change (level of expenditures and/or revenues change), the level of public debt, the propensity to consume and import, other monetary and financial conditions, the exchange rate, and the type of the econometric model used in the study.

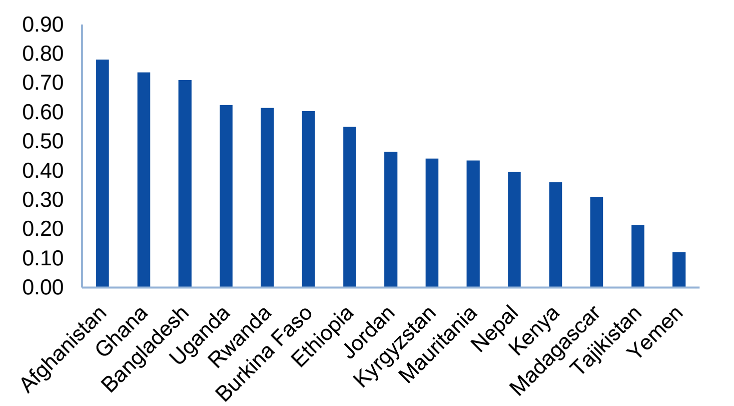
In low-income countries, estimates for the magnitude of fiscal multipliers range from 0.25 to 0.70 in the short term, and cumulatively from 0.5 to 0.9 over the medium term. Studies also show that fiscal multipliers are much weaker in countries that have high levels of debt, low average incomes, flexible exchange rates, and higher levels of international openness.

Functional fiscal multipliers in Afghanistan

Afghanistan's economy has many features that greatly complicate attempts to estimate the magnitude of the Government spending multiplier. The Afghan economy is a complex mix of formal/informal activities, with illicit crops, war-driven spending, and aid-sustained enclaves. This situation is the result of more than 30 years of protracted conflict that has resulted in low state capacity, a high level of dependence on external aid, and a stunted private sector. In addition, statistical problems of measurement and data availability (standard econometric methods require long quarterly data and sufficiently long-term series) make the challenges seem almost insurmountable.

A recent study commissioned by the World Bank[2] attempts to address several of these challenges. The study compiled data for 34 countries for the period from 1984 to 2013. The results show that the multiplier for total government spending in Afghanistan is

Figure 18: Size of fiscal multiplier in selected countries
(percent)



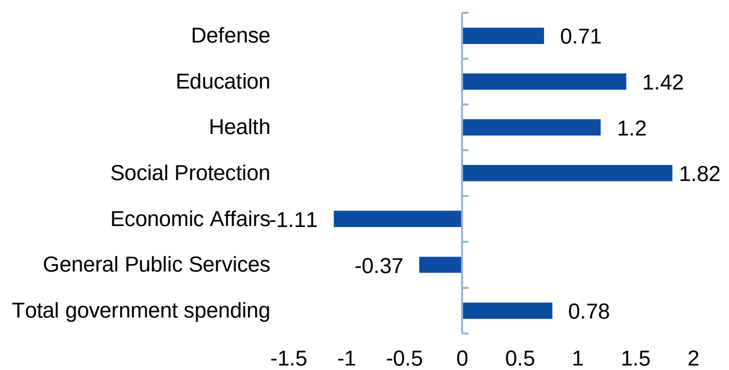
Source: Asea (2016)

[2] Asea, P. 2016. "Estimating conditional functional multipliers." November 2016. Background paper produced for forthcoming report: *Navigating Risk and Uncertainty in Afghanistan* (forthcoming July 2017). The World Bank

0.78, meaning that a 1-percentage point of GDP increase in public spending leads to a 0.78 percent increase in output, all other things being equal. Compared to a range of other low-income countries (see Figure 18), the fiscal multiplier in Afghanistan is apparently the highest, with the average multiplier for the group standing at 0.69. One possible explanation for Afghanistan's relatively high fiscal multiplier is the large share of security spending, which has a positive multiplier effect (see Figure 19). Security spending in Afghanistan is exceptionally high, with one of the highest proportions relative to GDP in the world.

Multipliers for the different functional categories of expenditure[3] in Afghanistan vary considerably (see Figure 19). Social protection is the largest multiplier, with a value of 1.82. This means that government spending on social protection has a significantly expansionary impact. In a resource-constrained environment, where expenditures must be carefully prioritized, it is imperative to maintain and, if possible, increase spending on social protection. However, social assistance should be targeted to the poor and better tailored to combat poverty in the country.

Figure 19: Functional fiscal multipliers in Afghanistan
(percent)



Source: Asea (2016)

Education (1.48), followed by health (1.20), are the two next largest multipliers. Taken together with the multiplier on social protection, the size of these estimators demonstrates the significant positive impact that social protection programs (such as through cash transfers) can have on output and poverty reduction. This result conforms with the findings of a number of theoretical studies that demonstrate that well-targeted transfers can have an expansionary effect on output. Analysis of cash transfer programs in a number of countries has also found that cash transfers result in increased investment in household economic activities and increased social capital. They also enable beneficiaries to re-enter existing social networks, and/or to strengthen informal safety nets and risk-sharing arrangements.

The key message is that investments in health and education and cash transfer programs generate both short and long-term economic benefits through improvements to human capital. In turn, this leads to an increase in labor productivity and employability. However, the large size of the multipliers suggest that cash transfer programs also influence the productive dimension of beneficiary households.

Unsurprisingly, spending on defense has a positive multiplier effect (0.71) on real GDP growth in Afghanistan, as is the case in many other countries. Given the size of the Afghan army, military spending eventually increases household income through wages and through the local procurement of goods and services.

Finally, the multiplier for expenditure on economic affairs, which include expenditures on infrastructure, energy and agriculture, is negative (-1.11). The key determinant for the growth effects of public spending on infrastructure is the degree of efficiency of the expenditure, which can be determined by the extent to which it results in the production of service-yielding assets. However, the evidence shows that the link between expenditure on infrastructure and the production of services/assets is weak, particularly in the case of developing countries. Two factors could account for low efficiency. First, weak technical capacity leads to poor project selection, cost overruns and implementation delays, and poor project management. All these factors are

[3] The study uses functional categories of expenditure as classified in the COFOG (Classification of the Functions of Government) system, developed by the Organization for Economic Cooperation Development (OECD) and the United Nations. The COFOG classified public spending into: General public services, Defense, Public order and safety, Economic affairs, Environmental protection, Housing and community amenities, Health, Recreation, culture and religion, Education, and Social protection.

more significant in the case of expenditure on infrastructure than in the case of other types of expenditures. Second, poor fiscal governance, poor procurement practices, political favoritism, and corruption substantially affect the efficiency of public infrastructure expenditures. Both these factors have an impact in the case of Afghanistan, as they do in many other developing countries. Corruption, which is a particular concern in Afghanistan, drastically increases the unit cost of infrastructure projects, which in turn translates into poor value for money and poor quality of assets/services.

The import content in the case of infrastructure spending in Afghanistan is also high. Almost all inputs and materials for infrastructure projects are imported. This means that all financial resources expended on infrastructure translate into an increase in imports, which in turn may more than offset any potential positive effects on domestic demand. Thus, it is not surprising to see that the multiplier effect in the case of expenditure on economic affairs, most of which consists of expenditure on infrastructure, is negative in Afghanistan.

It should be noted that fiscal multipliers are time-variant. When public spending changes dramatically, the multipliers are unlikely to remain constant. For instance, if defense spending increases following a deterioration in the security environment, the multiplier effect could be much higher.

What can be done to maximize the multiplier?

We now return to the fundamental question: *How is the Government to provide economic stimulus in a resource constrained environment?* This question can be broken down into two parts. The first part relates to measures to maximize economic stimulus, which relates to the empirical question of the magnitude of the multiplier effect in Afghanistan. The second part of the question relates to measures that could be taken to relax the resource constraint.

1. **Increasing the size of the multiplier**

Generally, the size of the spending multiplier is dependent on factors such as:

- The extent of underutilized capacity in an economy (the multiplier effect will be smaller the closer an economy is to full capacity);
- People's and businesses' marginal propensity to save out of increased income (the higher the proportion of income that is re-spent, the greater the multiplier effect);
- The import content of people and business' spending (funds used to pay for imported goods achieve a once-only local stimulus); and
- How quickly the money is spent (projects that require lots of planning before most spending occurs will not provide much stimulus when most needed).

The World Bank study found that, in practice, two characteristics of low-income countries are likely to mediate the effect of government spending on real GDP growth, these being: (i) **absorptive capacity**; and (ii) **market contestability**, particularly in the construction and banking sectors. The study commissioned by the World Bank found that a one standard deviation change in absorptive capacity yields an 18 percent larger multiplier effect compared to the average level of absorptive capacity. Similarly, a one standard deviation change in contestability yields a 14 percent larger multiplier effect.

Absorptive capacity is the ability of the Government to identify, attract and efficiently use financial resources (domestic and external). Key to this concept is the extent to which modern management practices and skilled manpower are present in the public sector. The lack of these skills can severely limit the volume of productive investments that can be planned, organized and executed. Absorptive capacity is thus conceptualized as the Government's latent ability to marshal, develop, direct, and control its human, physical and information capital to support the discharge of its policy directions.

Governments with a high absorptive capacity are characterized by a combination of strong policy formulation capacities and by the presence of skilled technocrats. These characteristics enable these governments to be adaptable, effective and efficient in their endeavors to utilize financial resources to produce tangible public investments. By contrast, governments with a low absorptive capacity are unable to utilize financial resources to produce tangible public investments efficiently and effectively.

Market contestability is another important factor. In low-income countries, the conditions for perfect competition are often unfulfilled. Thus, these countries do not always reap the potential benefits of competition, such as lower prices, better quality goods, job creation and faster economic growth. At the same time, efforts to deregulate markets do not always benefit consumers. For example, the experience of many low-income countries shows that in the absence of rules to manage competition and of a supporting institutional infrastructure, consumer welfare does not always benefit from trade and investment liberalization and privatization.

Recent developments in Afghanistan underscore this predicament. According to the Asia Foundation's Survey of the Afghan People, the public increasingly links the worsening economy with the Government's policies on free markets and/or with its inability to perform. While the National Unity Government has prioritized the achievement of economic growth in its policy reform agenda, popular expectations regarding the putative impact of a free market economy have yet to be matched by the creation of a significant number of productive jobs and by the delivery of high quality goods at low prices. Further, a survey by the American University of Afghanistan in October 2016 found that 78 percent of the respondents believed that the private sector has failed to deliver jobs, and that privatization and free trade has killed small local businesses while protecting larger, politically important businesses.

Contestability is absent in Afghanistan. According to the Doing Business indicators, Afghanistan ranks in 177th place in terms of regulatory quality and efficiency for investment, with no improvements during 2015. The number of new firm registrations in 2016 remains well below that recorded in 2012/13, illustrating the difficulty of launching new businesses in the country.

In Afghanistan, the construction industry could play a critical role in the transformation of the Government's financial resources into tangible public investments. The construction industry delivers the roads, rails, bridges, dams, airports and housing that are the critical components of the infrastructure required to support a modern economy. In addition to delivering critical infrastructure, the construction industry plays its role by creating jobs at scale, because the industry is labor intensive. However, if the construction is not contestable but rather dominated by a few large international firms, with small local firms excluded, then the impact of government spending will be muted at the national level and totally absent in local economies.

The same is true of the banking sector. Competition in the banking industry matters for a number of reasons. As in other industries, the degree of competition in banking matters for the efficiency of the production of financial services, the quality of financial products and the degree of innovation in the sector.

Banking markets are already moving towards a higher level of contestability. Digital technology has had the effect of lowering entry barriers into some sub-markets in the banking industry, with services such as mobile money payments and cross-border transfers. Modern digital technology has lowered the marginal cost of transactions, it has made distance and location increasingly less significant, it has lowered consumer search costs, it has increased the availability of information, and it has lowered the cost of price discovery. A contestable banking sector has the potential to better serve the needs of low-income economies.

However, some caution is required in the promotion of contestability in financial markets. Many of the relationships and tradeoffs between competition, financial system performance, access to financing, stability, and finally growth, are complex from a theoretical perspective. Also, empirical evidence related to competition in the financial sector is scarce and, to the extent that it is available, produces unclear conclusions. However, both theory and empirics indicate that with these tradeoffs, it is not sufficient to analyze competitiveness on the basis of a narrow concept or to focus on one effect only.

Rather, it is necessary to consider competition in the context of a broad set of objectives, including the efficiency of the financial sector, access to financial services for various segments of users, and systemic financial sector stability, and to consider possible tradeoffs between these objectives. And since competition depends on several factors, it is necessary to consider a broad set of policy tools in endeavors to increase competition in this sector.

(i) Increase absorptive capacity

Policies to increase absorptive capacity will help to strengthen the productivity of public investment and to enable high growth returns from investment projects, thus maximizing the spending multiplier. As discussed above, the concept of absorptive capacity refers to the sum total of individual actions of government employees operating within various practical and political constraints, which are in large part set by the policies and resources provided to the agency or ministry by elected officials. Initiatives to increase absorptive capacity should therefore be two-pronged, including both initiatives that target individual government employees and those that target government-wide policies.

Polices to increase the absorptive capacity of Afghanistan public sector agencies include:

- Providing skilled civil servants with merit pay and bonuses;
- Allowing skilled civil servants greater input into policy formulation and implementation processes;
- Allowing agencies greater flexibility to respond to best practice and project peculiarities;
- Providing better, more relevant and more rigorous training to deliver stronger medium-term budget frameworks;
- Improving public investment management by streamlining the project appraisal process and budgeting cycle;
- Providing better, more relevant and more rigorous training to enable bureaucrats to deliver more thorough appraisal and selection of investment projects;
- Providing better, more relevant and more rigorous training to enable bureaucrats to monitor and deliver high quality systematic ex-post evaluations;

(ii) Improve contestability in construction and banking sectors

As discussed previously, promoting contestable markets in the construction and banking sector is important if government spending is to have a significant positive impact on economic outcomes. Policies to ensure that markets are contestable will play a role in strengthening the private sector response to increased government spending, thus maximizing the size of the spending multiplier effect. Such policies include both those targeting competition policy and those targeting procurement policy. Thus, they should include:

- Improving and strengthening the competition law, and empowering the national competition authority with a clear mandate;
- Simplifying legal procedures and providing working capital grants to facilitate the entry of new small and medium-sized construction firms that will create jobs;
- Simplifying legal procedures to facilitate start-ups and entry in the financial sector.

These policy reforms are aimed at ensuring that markets function better, delivering lower prices, enabling the entry of small- and medium-size firms, and creating jobs. The reforms aim to ensure that public funds are used in the most efficient manner possible, with greater transparency, probity and accountability. This will ensure that the system delivers value for money. Further, studies on the effect of reforming procurement processes provide evidence that competitive and transparent procurement processes play a role in enabling public authorities to acquire better quality goods and services at lower costs. It is essential to include provisions to promote transparency to ensure that the opening up of procurement is effective.

2. Relaxing the resource constraint

This report now returns to the second part of question posed at the beginning of this section: *How is the Government to provide economic stimulus in a resource-constrained environment?*

One means to overcome the constraints of a resource-constrained environment is to increase the fiscal space. It is useful to think of fiscal space as having three components: government revenues, internal financial resources (domestic borrowing), and external resources (grants, external borrowing). Also included are the domestic resources that would become available as a result of more effective public expenditure.

The following policy measures can increase the internal finance resources of a low-income country:

- Extending the range of financial services (creation of 'basic' bank accounts suitable for poor households);
- Increasing contestability in the banking industry with a view to improving financial products in order to retain the savings of high-income households and to facilitate transfers from migrant workers;
- Facilitating the introduction of electronic payment systems such as mobile money systems to bank the unbanked and to deepen financial coverage;
- Improving the financial literacy of the poorest households;
- Strengthening the regulation of the financial system (to ensure that regulations are respected, to introduce transparency in rules by which loans are granted, and so on) in order to develop a climate of trust in the formal banking system.

The following policy measures will play a role in channeling financial savings to enable the mobilization of domestic resources, which can then be utilized to finance government spending:

- Introducing a vibrant Sukuk public bond market (improvement in issuance procedures, standardization of bonds, training of specialist intermediaries);
- Devolving budget responsibility to local authorities (channeling savings into the public sector, as supply of public services would be closer to local communities);
- Improving budget practices in order to increase the public's trust in the Government.

Conclusion

In the context of the economic slowdown, Afghanistan faces the difficult task of balancing measures to stimulate the economy while at the same time avoiding a further weakening of its fiscal sustainability. Fiscal space is already extremely limited, with little room to increased public expenditure or to lower taxes. In this context, the Government must implement initiatives to maximize the growth impact of fiscal expenditure. First, policies to encourage government spending on non-tradable goods from local suppliers will ensure that demand stimulates domestic production, rather than imports. Favoring local suppliers in procurement processes will not raise domestic prices or reduce welfare if markets are competitive and contestable. Second, policies to improve absorptive capacity will increase the quality, speed of execution and value for money of public investments. Third, policies to promote contestable markets in banking and construction will stimulate the entry of small and medium-sized firms in both sectors. In the banking sector, the new firms will strengthen financial markets by introducing innovative financial products. In the construction sector, the new firms will play a role in the creation of jobs in this labor-intensive sector. Fourth, polices to increase fiscal space should include measures to better mobilize domestic resources and to use existing resources more effectively, which will release additional resources.

D. Focus Section II: Movement patterns of returns and internal displacement in 2016: An analysis based on a variety of data sources

There is currently no system by which migration flows and, in particular, displacement can be tracked in a timely manner. This poses a significant challenge to the design and targeting of humanitarian and development interventions in the context of recurring episodes of forced displacement. Information regarding undocumented returns, documented returns,[1] and internal displacement are collected by three different humanitarian agencies (IOM, UNHCR, and UN-OCHA) at the border, encashment centers, or at the place of displacement respectively. While these systems compile data related to the numbers of returnees and internally displaced, there is a lack of accurate information on: (i) the actual destination of return (as opposed to the intent of return); (ii) community-level pressures (in terms of hosting displaced populations); (iii) and community needs, in order to support the targeting and/or redirection of humanitarian assistance, and the design and implementation of appropriate development interventions. Monitoring returns has not been systematic and existing efforts have not proven easy.

Data sources

The starting point for assessing the spatial distribution of internally displaced people and returns in 2016 is based on information collected by IOM, UNHCR, and OCHA. The databases of these agencies provide the most accurate available data related to the size of each of these groups (reference year: January to December 2016). This combined database suggests that the 1.5 million individuals fall into one of three categories: (i) undocumented returnees (31 percent of all displaced people in Afghanistan); (ii) documented returnees (25 percent); and (iii) internally displaced (44 percent).

Even though data related to the numbers of returns are readily available from IOM and UNHCR, the database contains information on the *intended* place of return and not the *actual* place of return. To better understand the spatial distribution of displaced populations, it is essential to complement and verify these numbers with other data sources. However, other data sources are not readily available and, where they exist, cover the country only partially. For example, the Independent Directorate of Local Governance (IDLG) collected information for 31 out of 34 provinces.[2] The IOM's Displacement Tracking Matrix (DTM) compiled by the IOM to track and monitor population displacement during crises includes information for Nangarhar, Kunar, and Laghman only.[3]

What we currently know

Total displacement

The recent Return Monitoring Update by UNHCR, which was based on interviews conducted to track returnees over time, does not fully represent the documented returnee population. It also suggests that there are meaningful differences between the *intended* destinations and the *actual* destinations of returnees.[4]

[1] Documented returnees are issued a proof of registration (PoR) card by the UNHCR in neighboring countries, while undocumented returnees do not have a PoR.

[2] IDLG data collection was collected as a one-time effort rather than a recurring or regular data collection process.

[3] IOM plans to expand the DTM into an additional 6 provinces (Baghlan, Balkh, Kabul, Kunduz, Paktya, and Takhar) in the next months.

[4] UNHCR, "Return to Afghanistan: A challenging Year", January 2017.

Table 3: Top 10 provinces by displaced population (returns and internally displaced), by data source in 2016

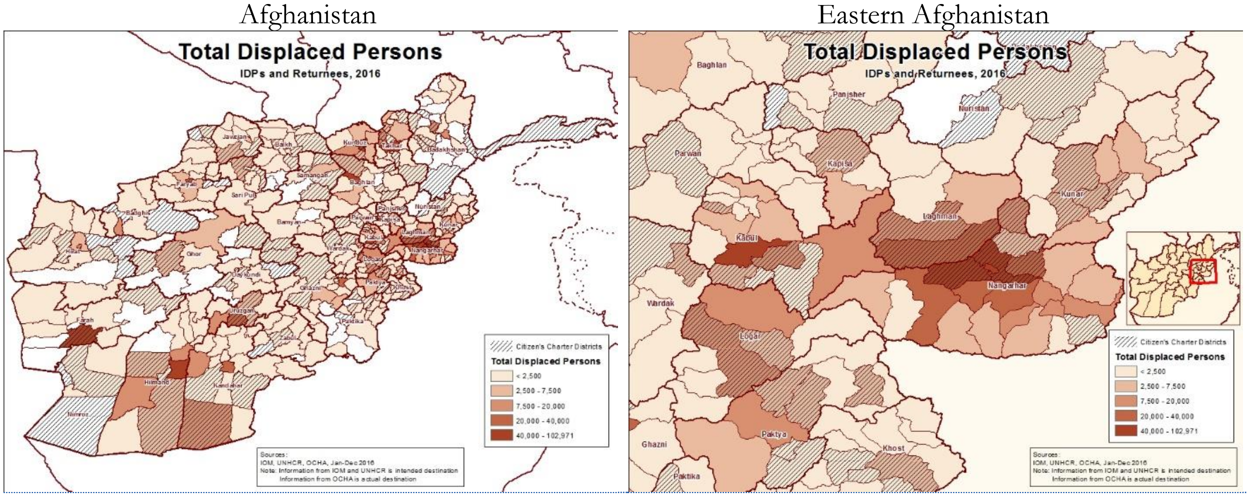
Province	IOM undocumented returnees	UNHCR documented returnees	OCHA internally displaced	Total of displaced populations	Displaced relative to host pop	Displaced relative to all displaced
Nangarhar	299,694	115,528	33,771	448,993	29.1	30.4
Kabul	26,175	81,092	15,504	122,771	2.7	8.3
Kunduz	6,456	25,526	63,420	95,402	9.9	6.5
Takhar	787	2,783	85,307	88,877	8.9	6.0
Baghlan	5,512	28,035	38,549	72,096	7.8	4.9
Hilmand	1,572	1,634	68,743	71,949	8.0	4.9
Kandahar	15,006	5,591	50,548	71,145	6.0	4.8
Uruzgan	275	158	57,007	57,440	16.7	3.9
Farah	136	154	51,380	51,670	10.0	3.5
Laghman	20,887	24,649	1,599	47,135	10.6	3.2
Totals	**462,810**	**372,574**	**643,442**	**1,478,826**		

Table 3 shows the scale of displacement in proportion to the host community population. A large influx of displaced compared to host communities poses stark challenges to communities already living under difficult economic conditions. Nangarhar currently carries the heaviest burden, with the number of displaced people relative to host communities standing at almost 30 percent.[5] Displaced people account for almost 17 percent of the total population in Uruzgan and 10 percent in Laghman, Farah, and Kunduz.

Returns and internal displacement follow distinct geographic patterns, with clustering in certain districts. Map 1 shows the total number of displaced people (returnees and IDPs) by district in Afghanistan (left panel) and in Eastern Afghanistan (right panel). It can be observed that displaced populations tend to cluster in the South, North and East of Afghanistan.

Map 1: Displaced population (returns and internally displaced) by district, 2016

Afghanistan Eastern Afghanistan



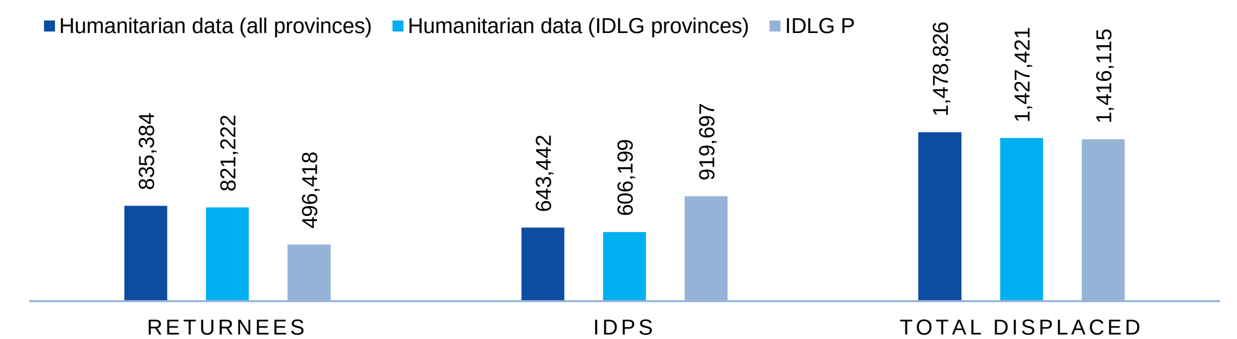
Source: World Bank, based on information provided by IOM, UNHCR, and OCHA from January to December 2016

To better gauge the reliability of data collected by humanitarian agencies, the data can be triangulated with the IDLG province-level data and the IOM-DTM. IDLG's province-level data provides estimates of IDPs and returnees for 31 of the 34 provinces of Afghanistan, excluding Balkh, Hirat and Panjsher. These 31 provinces account for 96 percent of the population of interest in the humanitarian database. It can be observed that the total number of displaced people is strikingly similar, with a total of 1.4 million displaced people (returnees and IDPs) in the humanitarian and IDLG sources (see Figure 20). However, as discussed in more detail below, the distribution of returns and IDPs in proportion to the population of interest is different. There are at least a couple of explanations for this apparent discrepancy: (i) it is difficult to

5 Official population estimates of 2016/17 from the Central Statistics Organization (CSO) of Afghanistan were used.

distinguish between returns and IDPs in the field through administrative channels; (ii) some returnees may have been displaced subsequent to entering Afghanistan.

Figure 20: Comparison of IDLG province-level data with humanitarian sources



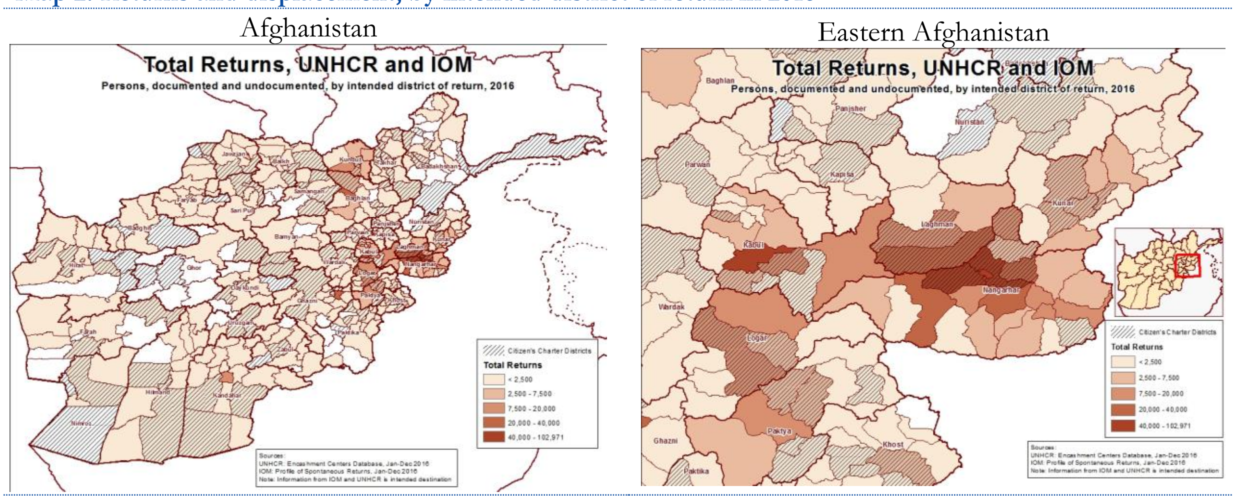
Source: World Bank staff calculation based on data from IDLG, IOM, UNHCR, and OCHA on returns and IDPs from January to December 2016

This distribution of the IDLG province-level data suggests that the top seven provinces of concern, in descending order, are Kunduz (dominated by IDPs), Nangarhar (majority returns), Kabul (majority returns), Takhar, Faryab, Urozgan, and Helmand. Taken together, these account for more than 70 percent of the total number of displaced people according to these provincial estimates.

Returnees

Data on returnees from IOM and UNHCR (documented and undocumented) show that the intended destination of returnees is concentrated towards the East of Afghanistan. About 50 percent of all returnees intend to return to Nangarhar, 13 percent to Kabul, 6 percent Laghman, and 5 percent to Kunar (see Map 2). Within provinces, returnees show a preference for urban and peri-urban areas as their intended destination and often intend to move to district centers or adjacent districts.

Map 2: Returns and displacement, by intended district of return in 2016



Source: World Bank, based on information provided by IOM, UNHCR, and OCHA from January to December 2016

The data compiled by the humanitarian agencies (IOM, UNHCR, and UNOCHA) show a strikingly similar number of displaced people. However, the distribution of returnees in proportion to the population of interest is different according to the IDLG province-level database (see Figure 20). According to the IDLG province-level data, 35 percent of the total number of displaced are returnees (less than 500,000), compared to the figure of 58 percent according to the humanitarian agencies (over 820,000 returnees). This distribution of IDLG province-level data suggests that the top six provinces of concern, in descending order, are Nangarhar, Kabul, Helmand, Baghlan, Laghman, and Kunduz, four of which (Nangarhar, Kabul, Baghland,

and Laghman) are also among the top provinces according to the humanitarian database. Together, these account for more than 80 percent of all returnees according to these provincial estimates.

Another source of comparison is IOM's Displacement Tracking Matrix (DTM) which is currently available for three provinces in Eastern Afghanistan, these being Nangarhar, Kunar, and Laghman. At the province level, in Nangarhar, there is a large variation between the number of returnees according to the IOM-DTM and according to other UN databases, even though the total number of all displaced is strikingly similar. The DTM reports 276,275 returnees in Nangarhar, while IOM's and UNHCR's intent of return report 415,222 returnees.

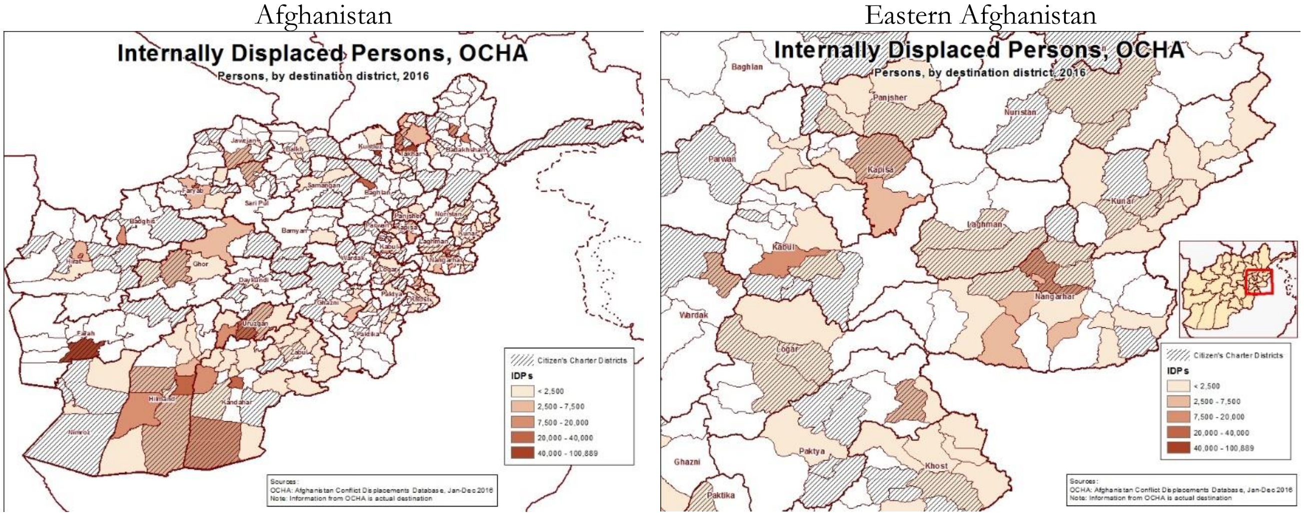
Province	IOM & UNHCR # returns	DTM # returns
Nangarhar	415,222	276,275
Laghman	45,536	36,092
Kunar	37,273	38,763

Internally displaced persons (IDPs)

According to data from humanitarian sources, the geographic profile for internal displacement is more dispersed and follows different patterns than for returnees. According to data from UN-OCHA, there are IDPs in all 34 provinces and in about one third of all districts in Afghanistan. However, the bulk of the IDP population is located in the South and North of Afghanistan (see Map 3). IDPs tend to move within the province, with the majority of IDPs settling in provincial centers. Takhar province hosts the largest number of IDPs (85,000), followed by Hilmand (69,000), Kunduz (63,000), Uruzgan (57,000), Farah (51,000), and Kandahar (51,000). Internally displaced persons tend to move to the nearest secure area, where they have some form of social network, typically in the provincial or district center. The figure for within-province displacement stands at more than 90 percent in half of all provinces, while the figure for within-district displacement stands at more than 90 percent in one third of the districts.[6] IDPs tend to settle in the provincial centers. In the case of all of the top six provinces, the provincial center district is the primary destination for displaced people.

Map 3: Internal displacement, by district of displacement in 2016

Afghanistan | Eastern Afghanistan



Source: World Bank, based on information provided by UN-OCHA on conflict-induced internal displacement from January to December 2016

Data from the IDLG province-level database show that the distribution of IDPs in proportion to the population of interest varies from that according to humanitarian sources. According to IDLG province-level data, 65 percent of total displacement are internally displaced, compared to 43 percent as reported by humanitarian agencies. IDLG province-level data shows almost 920,000 IDPs while the humanitarian

[6] In addition to conflict induced IDPs, there were almost 70,000 natural disaster induced IPDs in 2016 (data collected by OCHA).

database contains 606,000 records. As mentioned above, these discrepancies could stem from: (i) the difficulty of distinguishing between returns and IDPs in the field through administrative channels; (ii) information at the district level may be quite different from that at the provincial level; (iii) some returnees may have been displaced subsequent to entering Afghanistan.

When comparing results from the humanitarian database with those from the IOM's DTM, significant differences in the number of IDPs can be observed. These variations need to be further investigated. For example, according to the DTM, the number of IDPs in Nangarhar stands at 182,162, while according to OCHA, it stands at only 33,771. However, on the basis of district-level information, the IOM-DTM does confirm that displaced people tend to settle in and around district centers. In addition, the ranking of districts within provinces is fairly consistent between the varying sources.

Province	OCHA # IDPs	DTM # IDPs
Nangarhar	33,771	182,162
Laghman	1,599	19,079
Kunar	3,656	31,567

APPENDIX I: WORLD BANK GROUP PROGRAM IN AFGHANISTAN

1. The World Bank Group's program in Afghanistan is guided by the Country Partnership Framework (CPF) for FY 2017–FY 2020, which focuses on three strategic areas: (i) build strong and accountable institutions to support the Government's state-building objectives, enable the state to fulfil its core mandate to deliver basic services to its citizens, and create an enabling environment for the private sector; (ii) support inclusive growth, with a focus on lagging areas and urban informal settlements; and (iii) deepen social inclusion through improved human development outcomes and reduced vulnerability amongst the poorest sections of society, including the large numbers of internally displaced persons and returnees.

2. Since April 2002, the World Bank's International Development Association (IDA) has committed over $3.46 billion for development and emergency reconstruction projects, and five budget support operations in Afghanistan. This support comprises over $3.02 billion in grants and $436.4 million in no-interest loans known as 'credits'. The Bank has 15 active IDA projects in Afghanistan with net commitment value of over $1.1 billion. In addition, the Afghanistan Reconstruction Trust Fund (ARTF) has generated US$ 9.2 billion of funding from 34 donors, and committed US$ 4.2 billion for the Government's recurrent costs and US$ 4.45 billion for government investment programs. As of May 2017, the active IDA portfolio was worth US$ 1.06 billion and the active ARTF investment portfolio was worth US$ 3.3 billion

3. The Bank also administers the ARTF, the World Bank Group's largest single-country multi-donor trust fund. The ARTF provides grant support to Afghanistan based on a three-year rolling financing strategy. Together, the IDA and the ARTF provide close to US$ 1 billion per year in grant resources (about US$ 200 million from IDA and about US$ 800–US$ 900 million from the ARTF). The ARTF is a key vehicle for providing the Government with predictable and transparent on-budget financing, providing a platform for policy dialogue between the Government and donors.

4. Since September 2016, the World Bank Board has approved the Citizens' Charter Afghanistan Project to the amount of US$ 300 million, as well as an additional financing to an existing project, the Financial Sector Rapid Response Project, to the amount of US$ 20 million. Under the ARTF, Citizens' Charter project was approved by the ARTF Management Committee (MC) in the amount of US$ 300 million, which is jointly financed by the ARTF and IDA. Besides this, a number of project preparation grants (PPGs) were approved since September 2016 to lay the necessary ground work. The approved PPGs include: US$ 2 million for Urban National Priority Program; US$ 5 million for the Afghanistan International Labor Mobility and Domestic Labor Market Insertion Project; US$ 7.3 million for the Afghanistan Extractives for Development project. Additional Financing for existing projects include US$ 4.7 million for the Afghanistan Rural Enterprise Development Project.

5. The World Bank continues to engage in rigorous analytical work and to place a significant emphasis on policy dialogue. These non-lending activities have supported the World Bank's lending program and played a crucial role in informing the Government of its strategic choices and in advancing dialogue between the Government and its international development partners. In the last fiscal year, the ARTF Steering Committee endorsed the Research and Analysis Program (RAP), which aims to support the Government policy reform agenda and decision-making processes. The program creates an opportunity to introduce innovative ways of working with the Government, universities and local research institutions to introduce analysis and generate knowledge. As part of the RAP, the World Bank is currently engaged in a series of analytical works to enhance understanding of Afghanistan's growth and fragility challenges and to inform the development response of the Government and international development partners. The initial results of this work were presented at the Brussels Conference on Afghanistan in October 2016.

6. IFC's committed investment portfolio in Afghanistan has more than doubled between FY08 and FY14 – from around $58 million to about $135 million in FY14 – but this strong growth could not be maintained due to a worsening of security, political uncertainty, and operating conditions. At present, IFC's committed investment portfolio in Afghanistan stands at about US$50 million and includes: one investment in the

telecommunication sector (Roshan) and two operations in financial markets (First Microfinance Bank, Afghanistan International Bank—trade facility).

7. IFC's strong Advisory Services program has been supporting the private sector in the areas of access to finance, horticulture/agribusiness, and investment climate. IFC's investments have had a transformational impact (in terms of access to finance and outreach), particularly in the microfinance and telecommunication sectors – providing phone connections to 7.2 million customers, increasing access to SME loans (43,572 loans outstanding worth $48 million), and supporting around 2,500 jobs.

8. The Multilateral Investment Guarantee Agency (MIGA) has US$ 154 million of gross exposure in Afghanistan, supporting telecommunications and agribusiness projects. In 2013, MIGA launched its Conflict Affected and Fragile Economies Facility, which is supports the agency's exposure in Afghanistan. MIGA currently supports three projects in Afghanistan, of which one is a joint effort with IFC in the telecommunications sector to support the telecom operator MTN. The other two operations are MIGA-only projects related to dairy and cashmere production.

Appendix Table 1: Selected economic indicators

	2014	2015	2016	2017	2018	2019	2020
Income Levels			Prel. Est.	Proj.	Proj.	Proj.	Proj.
Nominal GDP (billion Af) /1	1,151	1,210	1,338	1,466	1,603	1,736	1,885
Nominal GDP (billion US$) /1	20.0	19.7	19.7	21.2	22.7	24.1	25.6
GDP per capita (US$)	633	606	590	619	650	675	718
Population (million)	31.6	32.5	33.4	34.2	34.9	35.7	35.7
Real Economy (% growth)							
Real GDP growth /1	1.3	1.1	2.2	2.6	3.4	3.1	3.6
Agriculture	−0.1	−5.7	6.0	1.5	2.5	2.0	2.5
Industry	2.4	4.2	−0.8	2.0	3.0	2.5	3.5
Services	2.2	1.6	1.9	3.3	3.8	3.7	4.1
GDP Composition (% of GDP)							
Agriculture	23.5	21.7	21.6	20.7	20.4	20.5	21.0
Industry	22.3	23.3	21.1	20.3	20.1	19.9	21.5
Services	54.2	55.0	52.2	53.4	53.5	53.6	57.5
Prices (%, 12-month percent change)							
CPI inflation (period average)	4.6	−1.5	4.4	6.0	5.0	5.0	5.0
Core inflation (excl. fuel & cereals; p.a.)	2.4	−1.3	4.0	..	..	..	..
CPI inflation (end period)	1.4	0.2	4.6	..	..	..	..
External Sector (% of GDP, unless otherwise indicated)							
Exports of goods (million US$) /2 /3	783	667	720	769	888	1,059	1,269
Imports of goods (million US$) /3	8,711	7,867	7,284	7,648	8,222	9,044	9,497
Trade balance	-39.6	-36.6	-33.3	-32.5	-32.3	-33.1	-32.1
Net current transfers	38.0	38.2	39.0	34.4	31.4	29.9	28.3
Current account balance	8.0	5.4	4.4	3.4	1.0	-1.0	-2.7
Gross foreign exchange reserves (million US$)	7,158	6,682	7,255	7,500	7,600	7,700	7,800
Gross foreign exch. res. (months of imports)	9.9	10.2	12.0	11.8	11.1	10.2	9.9
External debt /4	6.5	6.3	6.4	6.4	6.1	5.9	5.6
Exchange rate (AFN/USD, period average)	57.4	61.4	67.9	..	..	..	..
Exchange rate (AFN/USD, end period)	58.1	68.1	66.8	..	..	..	..
Real effective exchange rate /5	103.4	98.5	92.5	98.2			
Monetary and Financial Statistics (% of GDP)							
Broad money (M2)	35.0	34.3	34.0	34.4	34.7	34.9	35.1
Total deposits	17.7	17.4	17.3	17.7	18.2	19.2	20.0
Share of dollar deposits (%)	66.0	71.5	68.0	..	..	..	..
Credit to private sector, commercial banks	3.8	3.9	3.4	3.8	4.3	4.5	5.5
Loan-to-deposit ratio (%)	21.6	22.2	19.7	21.2	23.9	23.6	27.5

Notes:
1/ National Accounts data exclude opium value added. The official NA numbers, originally based on the Solar Hijri year (Mar 20 – Mar 21) have been re-estimated for the calendar year (Jan-Dec).
2/ Exclude sales of goods to nonresidents in the country. 3/ Include estimated unofficial trade or smuggling.
4/ Incorporates committed but not yet delivered debt relief; excludes Russian Federation's loan.
5/ A decrease in index shows depreciation. Based on a weighted basket of currencies corresponding to nine major trading partners, incl. Pakistan, Iran, India, Euro area, Russia, UAE, Turkey and China. The weight for the US dollar is the residual trade share. Q2 2015 = 100.
Sources: Central Statistics Organization, Central Bank, World Development Indicators, IMF staff estimates, and Bank staff projections.

Appendix Table 2: Selected fiscal indicators

	2014	2015	2016	2017	2018	2019	2020
In Billion Afghanis, unless otherwise indicated				Proj.	Proj.	Proj.	Proj.
Domestic revenues	100.1	122.4	141.2	157.7	176.3	199.6	225.9
Tax revenue	51.8	59.5	69.5	73.9	77.7	84.3	99.6
Customs duty and fees	26.0	30.4	31.3	37.9	41.5	46.5	52.1
Nontax revenues	22.3	32.4	40.4	45.9	57.1	68.8	74.2
Donor grants	180.7	181.1	209.2	246.7	277.3	300.3	329.4
Discretionary grants	119.1	123.7	148.5	160.9	181.1	197.9	216.5
Nondiscretionary grants	61.6	57.4	60.1	85.8	96.2	102.4	112.9
Total expenditures	301.0	318.8	341.9	398.5	455.8	506.8	565.6
Recurrent expenditures	228.3	235.9	248.0	279.7	316.4	354.1	396.2
Security	137.4	143.6	145.5	164.2	184.3	208.3	235.3
Civilian	91.0	92.3	102.5	115.5	132.1	145.8	160.9
Wages and salaries	52.7	54.5	58.6	66.0	73.7	79.8	86.6
Operations and maintenance	16.3	17.3	18.6	20.5	24.0	27.8	30.1
Capital expenditures	1.9	2.3	2.3	2.9	4.8	5.2	7.5
Social transfers	19.2	17.0	22.2	24.9	28.0	31.2	34.8
Interest payment	0.9	1.2	0.8	1.2	1.4	1.7	1.9
Discretionary development	9.9	18.0	29.0	33.7	40.1	43.4	47.1
Non-discretionary development	62.8	64.9	64.9	85.0	99.4	109.3	122.4
Discretionary balance (Recurrent + Disc dev.)	-19.0	-7.8	12.7	5.1	1.0	0.0	-0.9
Overall balance	-20.2	-15.3	8.5	5.9	-2.2	-6.9	-10.4
Overall balance excluding grants	-200.9	-196.4	-200.7	-240.8	-279.5	-307.2	-339.8
Revenues to recurrent spending ratio (%)	43.8	51.9	56.9	56.4	55.7	56.4	57.0

Sources: Ministry of Finance (AFMIS), and Bank staff projections

Appendix Table 3: Selected fiscal indicators

	2014	2015	2016	2017	2018	2019	2020
In Percent of GDP, unless otherwise indicated				Proj.	Proj.	Proj.	Proj.
Domestic revenues	8.7	10.1	10.5	10.8	11.0	11.5	12.0
Tax revenue	4.5	4.9	5.2	5.0	4.8	4.9	5.3
Customs duty and fees	2.3	2.5	2.3	2.6	2.6	2.7	2.8
Nontax revenues	1.9	2.7	3.0	3.1	3.6	4.0	3.9
Donor grants	15.7	15.0	15.6	16.8	17.3	17.3	17.5
Discretionary grants	10.3	10.2	11.1	11.0	11.3	11.4	11.5
Nondiscretionary grants	5.4	4.7	4.5	5.9	6.0	5.9	6.0
Total expenditures	26.2	26.4	25.6	27.2	28.4	29.2	30.1
Recurrent expenditures	19.8	19.5	18.5	19.1	19.7	20.4	21.1
Security	11.9	11.9	10.9	11.2	11.5	12.0	12.5
Civilian	7.9	7.6	7.7	7.9	8.2	8.4	8.6
Wages and salaries	4.6	4.5	4.4	4.5	4.6	4.6	4.6
Operations and maintenance	1.4	1.4	1.4	1.4	1.5	1.6	1.6
Capital expenditures	0.2	0.2	0.2	0.2	0.3	0.3	0.4
Social transfers	1.7	1.4	1.7	1.7	1.8	1.8	1.9
Interest payment	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Discretionary development	0.9	1.5	2.2	2.3	2.5	2.5	2.5
Nondiscretionary development	5.5	5.4	4.8	5.8	6.2	6.3	6.5
Discretionary balance (Recurrent + Disc dev.)	-1.7	-0.6	0.9	0.4	0.1	0.0	0.0
Overall balance	-1.8	-1.3	0.6	0.4	-0.1	-0.4	-0.5
Overall balance excluding grants	-17.5	-16.2	-15.0	-16.4	-17.4	-17.7	-18.1
Revenues to recurrent spending ratio (%)	55.3	43.8	51.9	52.3	54.6	55.7	57.0

Sources: Ministry of Finance (AFMIS), and Bank staff projections

Appendix Table 4: Selected fiscal indicators

	2014	2015	2016	2017	2018	2019	2020
In Billion USD, unless otherwise indicated				Proj.	Proj.	Proj.	Proj.
Domestic revenues	1.7	2.0	2.1	2.3	2.5	2.8	3.1
Tax revenue	0.9	1.0	1.0	1.1	1.1	1.2	1.4
Customs duty and fees	0.5	0.5	0.5	0.5	0.6	0.6	0.7
Nontax revenues	0.4	0.5	0.6	0.7	0.8	1.0	1.0
Donor grants	3.1	2.9	3.1	3.6	3.9	4.2	4.5
Discretionary grants	2.1	2.0	2.2	2.3	2.6	2.7	2.9
Nondiscretionary grants	1.1	0.9	0.9	1.2	1.4	1.4	1.5
Total expenditures	5.2	5.2	5.0	5.8	6.5	7.0	7.7
Recurrent expenditures	4.0	3.8	3.7	4.0	4.5	4.9	5.4
Security	2.4	2.3	2.1	2.4	2.6	2.9	3.2
Civilian	1.6	1.5	1.5	1.7	1.9	2.0	2.2
Wages and salaries	0.9	0.9	0.9	1.0	1.0	1.1	1.2
Operations and maintenance	0.3	0.3	0.3	0.3	0.3	0.4	0.4
Capital expenditures	0.0	0.0	0.0	0.0	0.1	0.1	0.1
Social transfers	0.3	0.3	0.3	0.4	0.4	0.4	0.5
Interest payment	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discretionary development	0.2	0.3	0.4	0.5	0.6	0.6	0.6
Nondiscretionary development	1.1	1.1	1.0	1.2	1.4	1.5	1.7
Discretionary balance (Recurrent + Disc dev.)	-0.3	-0.1	0.2	0.1	0.0	0.0	0.0
Overall balance	-0.4	-0.2	0.1	0.1	0.0	-0.1	-0.1
Overall balance excluding grants	-3.5	-3.2	-3.0	-3.5	-4.0	-4.3	-4.6
Revenues to recurrent spending ratio (%)	55.3	43.8	51.9	52.3	54.6	55.7	57.0

Sources: Ministry of Finance (AFMIS), and Bank staff projections