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# AFGHANISTAN DEVELOPMENT UPDATE



November 2017

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# AFGHANISTAN DEVELOPMENT UPDATE

November 2017



## 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, Saurabh Shome, Taehyun Lee, Bernard Haven, Christina Wieser, and Aman Farahi. The authors gratefully acknowledge the useful inputs provided by other members of the Afghanistan country team. Claudia Nassif provided helpful comments and suggestions. 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

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Afghanistan's security environment is continuing to deteriorate. The increased conflict appears to be holding back business and consumer confidence from recovering fully from the impact of the security transition in 2014. Economic growth has increased moderately from 2014-15, when the lowest growth rate was recorded since 2003. Proxy data for the first half of 2017 indicates that economic activity is continuing to languish, while business sentiment, gauged from the quarterly business perception surveys, appears to have improved slightly between the first and second quarters of 2017, though it remains lower than in the second quarter of 2016.

The annual economic growth rate is projected to reach 2.6 percent in 2017, increasing very slightly from the figure of 2.2 percent recorded in 2016. Industry is projected to grow by two percent, while services is projected to grow at 3.3 percent. Following a substantial increase last year (six percent), growth in agricultural output is expected to decelerate significantly to around 1.5 percent.

Following an increase from 4.5 percent in December 2016 to 7.5 percent in May 2017, the consumer price inflation rate dropped to 3.8 percent year-on-year (y-o-y) in September. The marginal increase in the inflation rate in the first five months of the year was driven by an increase in food prices, particularly of fruits and vegetables. Given that Afghanistan imports fuel and part of its cereals requirement, global fuel and grain prices have a substantial impact on domestic prices. The slowdown in the domestic inflation of energy and food prices since May could be due to the fact that while world commodity prices have remained roughly stable, the exchange rate has ceased to depreciate.

The merchandise trade deficit widened in the first half of 2017, largely due to surging imports. Imports increased by nearly 9 percent (y-o-y), following the 2.2 percent appreciation of the Afghani against the US dollar between December 2016 and September 2017. On a year-to-year basis, however, the average exchange rate was stable in the first nine months of the year. This marked a reversal from the previous trend, with the Afghani depreciating by around 15 percent in the period from 2015 to 2016. The increase in imports may also reflect a pick-up in domestic demand. Gross foreign exchange reserves increased by around 7 percent between December 2016 and August 2017, reaching US\$ 7.8 billion, equivalent to around 12 months of import cover. The current account is expected to remain in a surplus of about 3 percent of GDP in 2017.

Revenue collection remained strong for the third year in a row, following the abrupt decline in 2014. In the first eight months of 2017, domestic revenues amounted to Af 104 billion, almost a 13 percent increase y-o-y. This increase was driven by both tax revenues and customs duties, which went up by around 13 percent and 15 percent respectively. The strong revenue performance so far in 2017 is largely attributed to continued improvements in tax and customs administration and enforcement.

Public spending in the first eight months of the year remained at around the same level as in 2016. Total expenditure amounted to around Afs 195 billion, of which nearly Af 150 billion (77 percent) was for recurrent spending. Donor grants are expected to come in as planned and revenue collection is on track to reach the annual budgeted target. Hence a balanced budget is expected by the year's end.

Growth is projected to edge up to 3.2 percent in 2018, assuming no further deterioration in the security environment. While this constitutes a moderate improvement compared to 2014 and 2015, it is still significantly below the 9.6 percent average annual rate recorded in the period from 2003 to 2012. Weaker domestic demand and subdued investment sentiment, in the context of the increased violence and political uncertainty since 2014, have resulted in the lower growth trajectory. However, anecdotal evidences indicate that overall confidence is moderately improving, as the uncertainty around the US troop presence in Afghanistan is likely to be resolved following the latest announcement of the US strategy in Afghanistan.

Growth is expected to remain muted in the medium term, increasing modestly to 3.6 percent by 2020. Stronger growth in out-years is predicated on improvements in security, political stability, steady progress with reform, and continued high levels of aid flows. Growth could also be enhanced with the right combination of fiscal and policy reforms, including improving budget execution, and reorienting budget expenditures towards labor-intensive and community-based programs that directly reach the population with the greatest needs and with the highest marginal propensity to consume. The poverty rate is expected to remain high in the medium-term, driven by weak labor demand (despite an increasing labor force) and security-related constraints on service delivery.

The Focus Section in this edition discusses the level of resilience of Afghanistan's health service delivery in the context of the ongoing conflict and insecurity. Public health services are provided using two delivery models, one in which health services are contracted out to non-governmental organizations (NGOs), and the other in which the Government directly provides health care. Our analysis suggest that there is not significant difference between the two models; both models appear to be working well. The section shows that: i) health service delivery has been resilient to the conflict, and ii) it has been largely equitable across provinces. This resilience to conflict is likely due to the close ties that the NGOs delivering the health services – the larger model – have established with the communities they serve. In addition, given that the NGOs usually employ people from local communities and given the nature of the services delivered, they are better able to negotiate within local power structures. More analysis using complementary data sources, improved survey methodologies and better controls are required to fully establish the relative merit of the two delivery mechanisms.



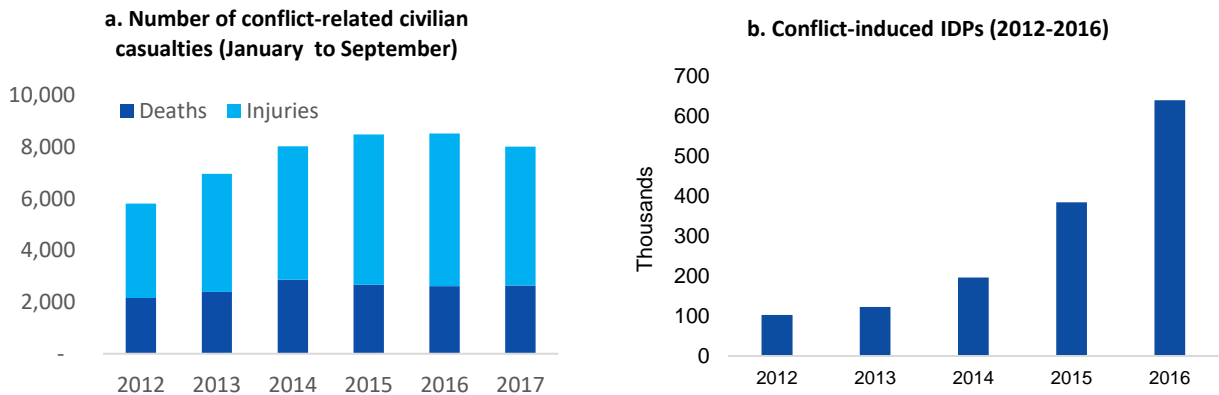
## A. Recent Economic Developments

### 1. Background

#### The security context continues to be challenging

Safety and security are vital conditions for any nation to develop. Insecurity and conflict have a significant negative impact on economic activity and on the ability of the state to deliver services to its citizens. Insecurity is on the rise in Afghanistan. In 2016, Afghanistan recorded more civilian casualties than at any point since 2002. The number of civilian casualties only slightly declined in the first 9 months in 2017 compared to the same period in 2016. Between January and September 2017, 2,640 people were killed and around 5,380 injured. The number of Internally Displaced People (IDP) has increased at an alarming pace, going up from approximately 200,000 in 2014 to 640,000 in 2016. In the first six months of 2017 alone, more than 202,000 people have been displaced internally due to conflict. This has affected the vast majority of provinces, with people in 30 of Afghanistan's 34 provinces fleeing their homes due to violence and conflict. Adding to the existing humanitarian challenges, more than 296,000 refugees have returned from neighboring Iran and Pakistan since the beginning of 2017.

Figure 1: Civilian casualties have increased



Source: UNAMA, UNHCR, and UNOCHA

### 2. Real Sector Activity

#### Economic recovery has been slow, as the deteriorating security continues to constrain private investment and consumer demand

With the commencement of the withdrawal of international security forces in 2012, followed by the security and political transition in 2014, economic growth in Afghanistan has declined significantly. The average annual economic growth rate has plummeted from 9.4 percent in the period from 2003 to 2012 in the pre-transition period to a meagre 2.1 percent since 2013. There was a weak rebound in 2016, with the rate increasing from 1.1 percent in 2015 to 2.2 percent<sup>1</sup> in 2016, primarily due to the strong growth of the agriculture sector in that year. The significant decline since 2012 primarily reflects the impact of reduced aid, the low levels of investor confidence, and

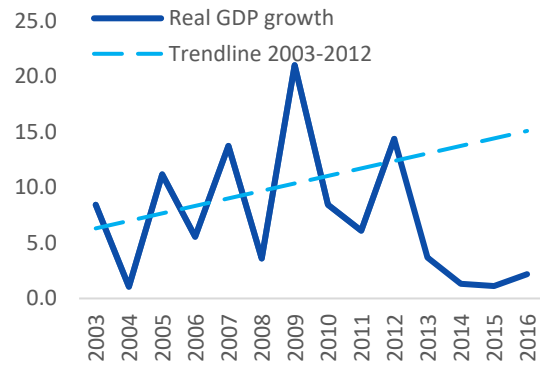
<sup>1</sup> The GDP growth numbers reported in this report exclude the value-added generated from the opium production. The official growth numbers (for instance, 3.6 percent for 1395) reported by the Central Statistics Organization include the opium value added, and is based on the Persian Solar Hijri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

continued political uncertainty in the challenging security environment. Overall aid is estimated to have declined from an annual average of US\$ 12.5 billion in the period from 2009 to 2012 to around US\$ 8.8 billion in 2015. On-budget aid has increased from around US\$ 2 billion in 2012 to more than US\$3 billion in 2016, while off-budget aid has decreased.<sup>1</sup>

**Economic activity in the first half of 2017 continues to languish**

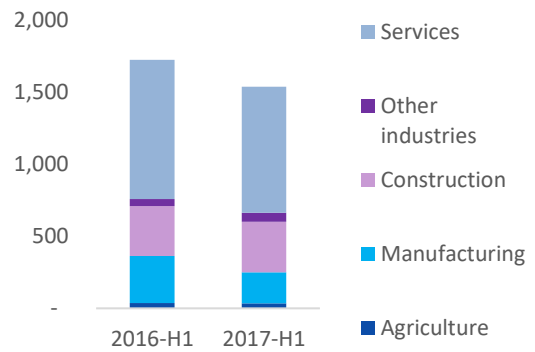
In the first half of 2017, proxy data indicate that economic activity is continuing to languish, although negative sentiment appears to have bottomed out. The number of new firm registrations in the first half of the year was slightly lower than the number recorded in the same period in the previous year. Around 1,500 new firms were registered in the first half of 2017 (excluding firms in trade sector), with the number in the first half of 2016 standing at 1,700. The number of new firm registrations is not fully indicative of overall private investment trends though, failing in particular to capture business fixed investments by existing firms. Nonetheless, in view of the lack of comprehensive data, this number still provides a reasonably good proxy measure for new investment activities. However, gauged by the quarterly business perception surveys conducted by the Afghanistan Chambers of Commerce of Industry (ACCI), business sentiment appears to have improved slightly, although it remains weak. The survey indicates that while business sentiment improved to some extent between the first and second quarters of 2017, it remains lower than in the same quarter in the previous year.

**Figure 2 : Real GDP growth, 2003-2016 (percent)**



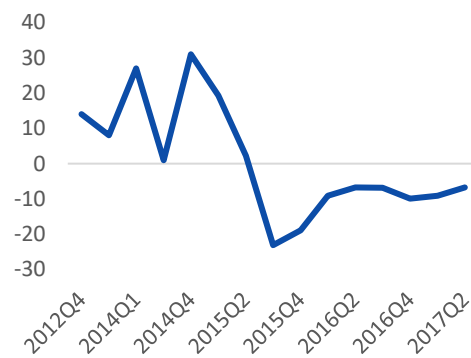
Source: Central Statistics Organization, and World Bank staff calculations

**Figure 3 : Number of new firm registrations in the first half of 2016 and 2017**



Source: Ministry of Commerce of Industries  
Note: The data exclude the registrations in trade sector.

**Figure 4: ACCI's business sentiment indicator**



Source: Afghanistan Chambers of Commerce and Industry

<sup>1</sup> 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.

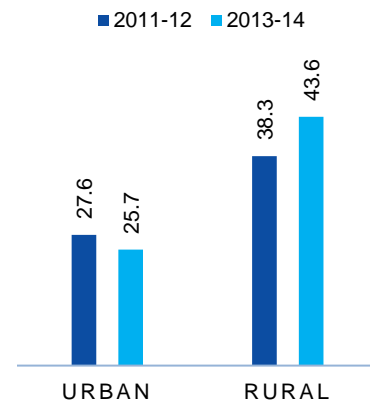
**A number of on-going initiatives have the potential to improve investment prospects**

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, with the potential to become the most important and cost-efficient transit port for Afghanistan’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.

**Poverty increased following the commencement of the withdrawal of international troops in 2011 and the following sharp decline in economic growth**

As a result of the sluggish economic growth and the deteriorating security situation, the poverty rate increased from 36 percent in 2011/12 to 39.1 percent in 2013/14. With this increase, 1.3 million additional people fell below the poverty line, defined in terms of 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 expenditure 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 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 has increased in recent years**

The 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 economic growth rates are required to improve per capita incomes and to provide quality employment opportunities for the expanding workforce.

**The growing number of returnees has led to mounting**

More than 296,000 Afghan refugees have returned from Iran and Pakistan alone since the start of 2017. The recent large influx of returnees poses significant challenges to host communities already living in difficult economic conditions, in

**humanitarian pressures**

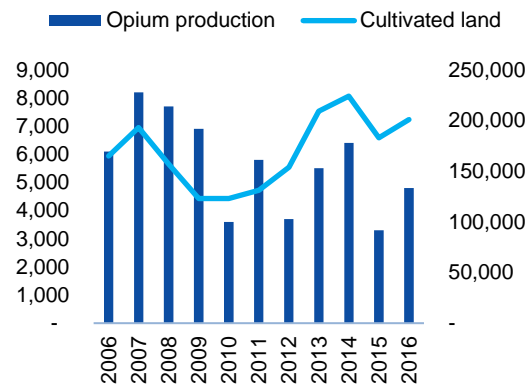
a deteriorating security situation, with scarce human and physical capital, and with a demographic imbalance in which the job creation rate lags far behind the growth in the size of the working age population. In this context, lack of meaningful livelihoods, land, shelter, and extremely limited access to basic services could exacerbate pre-existing causes of conflict. With limited economic growth, the ongoing deterioration in the security situation, and the increased number of displacements, significant improvements to Afghanistan’s poverty rate are unlikely until these issues are resolved. In this context, the appropriate targeting of the country’s extremely limited humanitarian and development resources is vital.

**The gross value of opiates has increased to around 15 percent of GDP**

In 2016, the gross value of opiates is estimated to have reached around US\$ 3 billion, equivalent to 15 percent of GDP. This is twice the estimated figure for 2015, which stood at US\$ 1.5 billion, or around 8 percent of GDP. The increase in the value of opium in 2016 was the result of increases in both the production output and the prices of opium. The United Nations Office on Drugs and Crime’s (UNODC) survey showed an increase of about 10

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

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



Source: UNODC

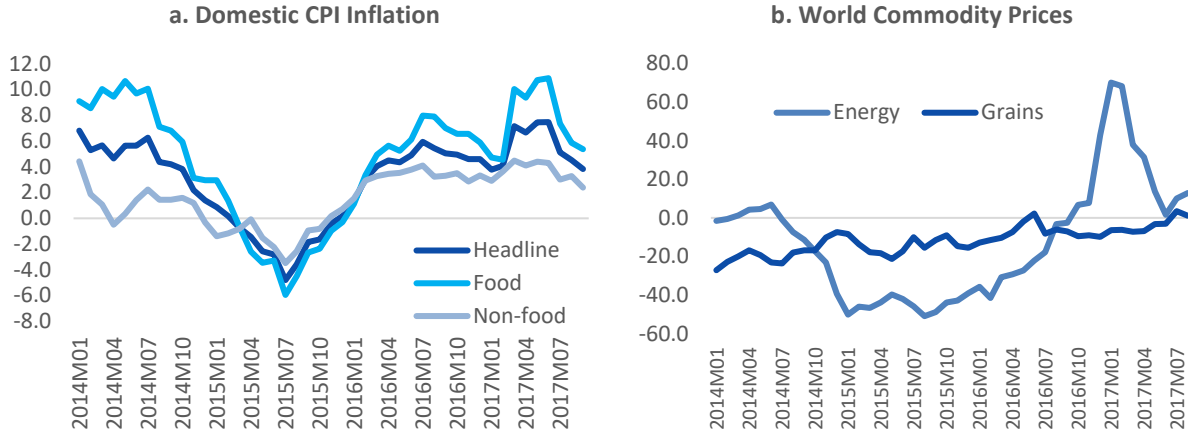
percent in the area utilized for the cultivation of poppies, as well as an increase of about 30 percent in per hectare opium yields in 2016. In marked contrast to the decline in licit cereal production in 2016, opium production expanded significantly in all regions across the country, increasing by around 43 percent in total. This increase was due to the absence of diseases that affect production in 2016. This was a contrast to previous years, when such diseases had a significant impact. The farm gate value of opium in 2016 was estimated at nearly US\$ 900 million, showing nearly 60 percent growth over the previous year.

**Inflation, while volatile, has remained in single digits**

Following an increase from 4.5 percent in December 2016 to 7.5 percent in May 2017, the consumer price inflation rate dropped to 3.8 percent in September. The slight increase in the rate in the first five months of 2017 was driven by an increase in food prices, particularly for fruit and vegetables. The food price inflation climbed to 10.7 percent year-on-year (y-o-y) in May, before declining to 5.4 percent in September. Over the same period, the non-food inflation remained relatively stable, falling moderately from 4.1 percent to 2.4 percent. Given that Afghanistan imports fuel and part of its cereals requirement (wheat, wheat flour, and rice), global fuel and grain prices have a substantial impact on domestic prices. Cereals and energy represent respectively around 18 percent and 20 percent of household consumption in Afghanistan. The slowdown in the domestic prices of energy and food since May could therefore be due to the fact that while world commodity prices have remained roughly stable, the exchange rate has ceased to depreciate. While global energy prices increased by an average of around 30 percent (y-o-y) in the first eight months of 2017, it seems that this was merely a base effect, resulting

from a rebound from unusually low prices in the previous year. The global price of grains declined by an average of 3 percent (y-o-y) in the first eight months of 2017.

**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)

### 3. External sector

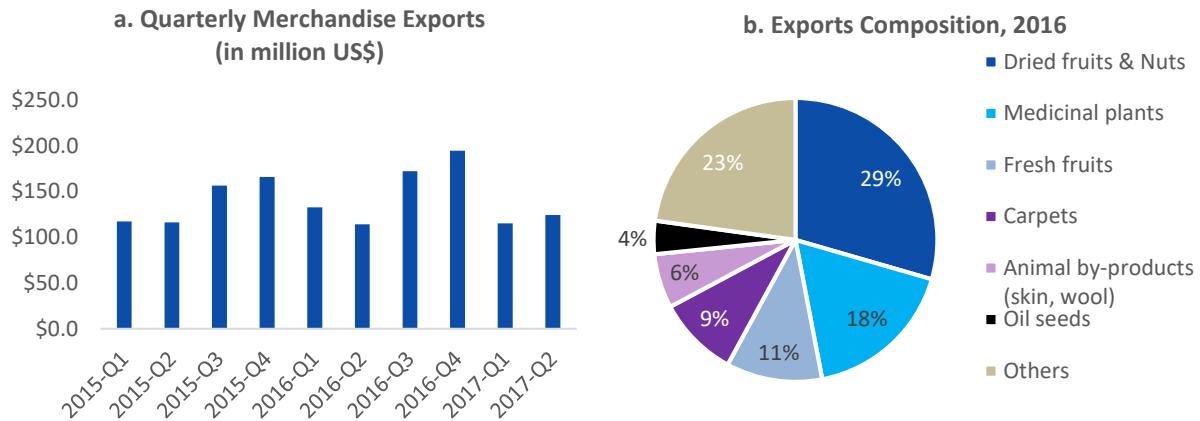
#### Exports decreased slightly in the first half of 2017

In the first half of 2017, official exports decreased marginally by around 3 percent (y-o-y). Over the same period, the real effective exchange rate (REER), which adjusts the average exchange rate between the Afghani and the currencies of Afghanistan’s major trade partners by the relative price differences, appreciated by 4.3 percent. An appreciation in the REER implies a decline in Afghanistan’s export competitiveness, as the price of Afghanistan’s exports become relatively more expensive in trade partner countries. In the three years prior to 2017, the REER was on a depreciating trend, which supported Afghanistan’s exports. On average, the REER depreciated by 3 percent annually in the period from 2013 to 2016, over which time the annual value of exports increased from US\$ 500 million to US\$ 614 million. Nonetheless, other factors such as domestic supply-side constraints, access to international markets, and tariff changes in partner countries may play more an important role. For instance, preferential tariff treatment by India supported the surge in Afghanistan’s fruit exports to India in 2016.

#### The merchandise trade deficit has widened as imports have increased

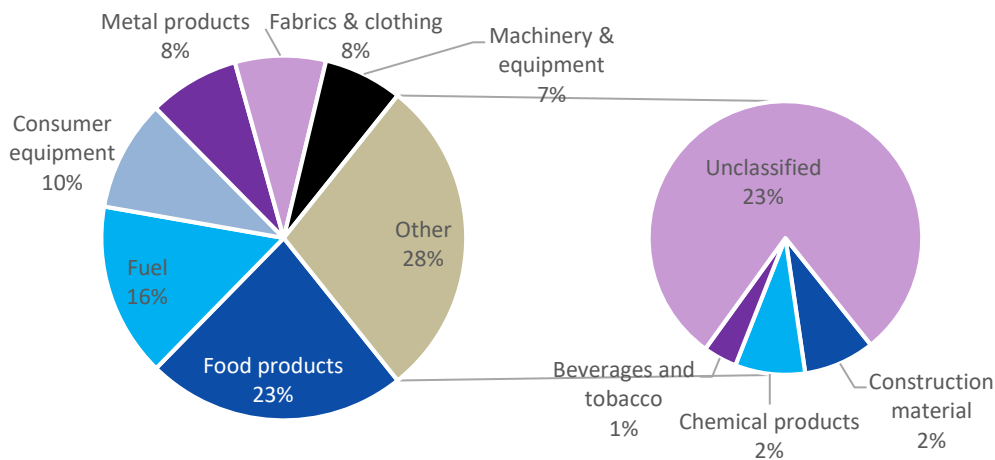
In the first half of 2017, official imports increased by nearly 8 percent (y-o-y), widening the merchandise trade deficit. The annual trade deficit, including estimated unofficial trade, is projected to reach around 33 percent of GDP, financed by foreign aid inflows. The current account is projected at a surplus of 3.2 percent of GDP in 2017, including foreign aid flows.

Figure 8: Exports were slightly lower in the first half of 2017 compared to the same period in previous year



Source: Central Statistics Organization

Figure 9: Food and fuel are the largest import items (as of 2016)



Source: Central Statistics Organization

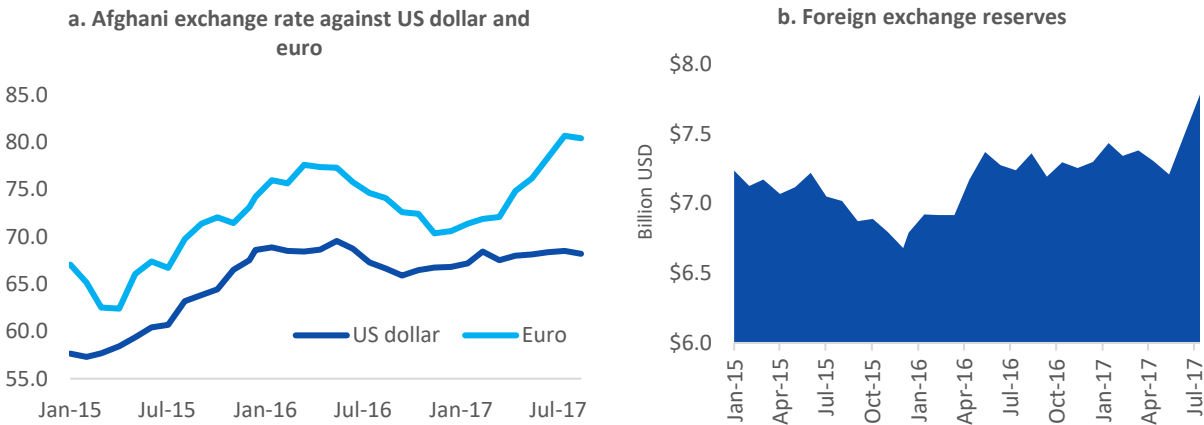
**The exchange rate remained relatively stable in the first nine months of 2017**

After depreciating for nearly two years, the nominal currency exchange rate stabilized against the US dollar in 2017. The Afghani appreciated by 2.2 percent against the US dollar in the period from December 2016 to September 2017. On a year-to-year basis, however, the average exchange rate in the first nine months was stable. This marks a reversal from the previous trend, with the Afghani depreciating by around 15 percent in 2015-16, an average of 8.7 percent annually. As of October 31, 2017, the exchange rate stood at Af 68.2 against the US dollar and at Af 80.3 against the Euro.

**Foreign exchange reserves stood at US\$ 7.8 billion at the end of August 2017**

After having declined throughout most of 2015, gross international reserves increased by around 8.5 percent in 2016. In the first eight months in 2017, gross foreign exchange reserves increased further by around 7 percent, standing at US\$ 7.8 billion at the end of August. The current level of gross reserves is equivalent to around 12 months of import cover.

Figure 10: The value of the Afghani: Depreciation in the first two quarters, appreciation in the third quarter



Source: Da Afghanistan Bank

#### 4. Fiscal developments

**Revenue collection remained strong in the first eight months of the year**

Revenue collection performance remained strong for the third year in a row, following an abrupt decline in 2014. In the first eight months of 2017, domestic revenue collection amounted to Af 104 billion, an increase of almost 13 percent y-o-y.<sup>1</sup> Tax revenues increased by almost 20 percent (y-o-y) and customs duties increased by around 15 percent (y-o-y) over the same period, while non-tax revenues remained flat. After stagnant growth last year amid declining imports, stronger import growth led to a stronger customs duties collection in the first eight months of the year.

**Improvements in administration and enforcement have driven strong tax revenue collection**

In the absence of new tax policy measures and currency depreciation, which were the main drivers of tax revenue growth in the previous two years, the strong revenue performance recorded so far in 2017 can be largely attributed to continued improvements in tax and customs administration and enforcement. For instance, the average value of customs declarations increased by six percent (y-o-y) in the first seven months of the year, most likely reflecting a reduction in the under-valuation of imports.<sup>2</sup> Even though Afghanistan’s tax base remains limited and is not expanding, the authorities have concentrated their efforts on strengthening compliance within the existing taxpayer base to achieve improved levels of revenue collection.

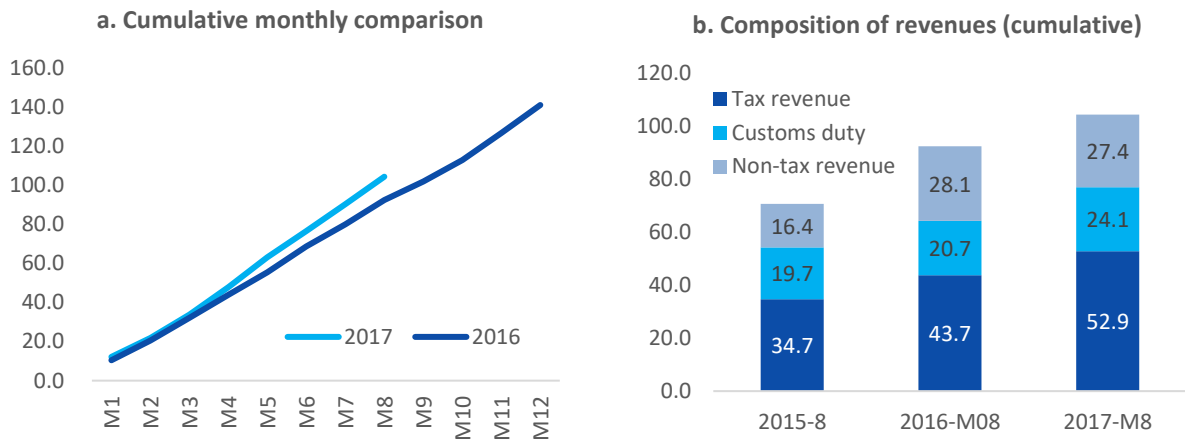
**Revenues are likely to slightly exceed the budget target by end-year**

Domestic revenues are projected to slightly exceed the annual budget target of Af 152.5 billion by the end of the fiscal year. The annual revenues outturn is projected to reach 10.9 percent of GDP, only a marginal increase from the figure of 10.5 percent recorded in 2016. Although the Parliament suggested the suspension of the 10-percent tax on mobile telecommunications on October 11, 2017, this measure is unlikely to derail the revenue collection from meeting the end-year budget target. Although the suspension was not immediately made effective by the Government, given the small monthly collection of about Af 350 million (corresponding to Af 4 billion a year) through this tax, the suspension will not derail the revenue target.

<sup>1</sup> Revenue numbers for 2016 exclude one-off transfers by the Central Bank (about Af 10 billion) and two line ministries (about Af 2 billion in total) which were received in the first 8 months of 2016.

<sup>2</sup> Byrd, B. and K. Payenda. “Afghan Government Revenue Continues to Grow: A bright spot in a weak economy.” Sep 27, 2017. Afghanistan Analysts Network

**Figure 11: Revenue collection increased for a second year in a row**  
(billion AFS)



Source: Ministry of Finance

**Box 1. Revenue measures to improve business climate**

The authorities are implementing measures to address tax policy and administration issues that have a negative impact on the business climate while at the same time striving to protect the revenue base. While corporate tax rates are low by international standards, unexpected audit results, high penalties and strict enforcement have created friction with the business community. Key challenges identified through discussions with taxpayers and taxpayer representatives and measures to address these challenges are presented in Box 1.1. The adverse effect of these measures on revenue collection is not expected to be significant.

Administrative measures have been implemented to improve filing speed and accuracy. A fast track electronic filing system has been developed and is being piloted, with this system expected to be rolled out to large taxpayers over the coming year. This hybrid system can be implemented before the passage of legislation related to electronic governments, as a final statement is certified by taxpayers. The roll-out of the system to medium and small taxpayers will follow. This system will eliminate paper forms, thus reducing data entry errors and instances of document loss. Thus, it will reduce the application of administrative penalties applied as a result of calculation errors and processing delays. Additionally, a new taxpayer service center is under construction, to provide one-stop service to large taxpayers as a means to reduce the number of required visits to individual offices to resolve taxation payment issues.

**Box 1.1. Tax-related challenges faced by the private sector**

- Outdated paper filing, document loss, routine data entry errors.
- Weaknesses in audit reports, including legal and accounting problems, results in inaccurate assessments.
- Legal ambiguity and limited taxpayer understanding of tax laws.
- High penalties, including a 200% penalty for evasion and 0.10% daily late payment penalty.
- Non-refundable 50% payments required to pursue objections to avoid severe enforcement action (such as bank account freeze, travel ban, arrest).

The authorities also plan to reduce administrative penalties and to cap late payment penalties. Before the implementation of this measure, in some cases, the value of penalties significantly exceeded that of the original liabilities. The authorities plan to amend the Tax Administration Law to implement a system of penalties that conforms to international good practice. Additionally, the authorities will conduct an ongoing communication campaign to build awareness of taxpayers’ obligations and of the penalties associated with failure to meet them.



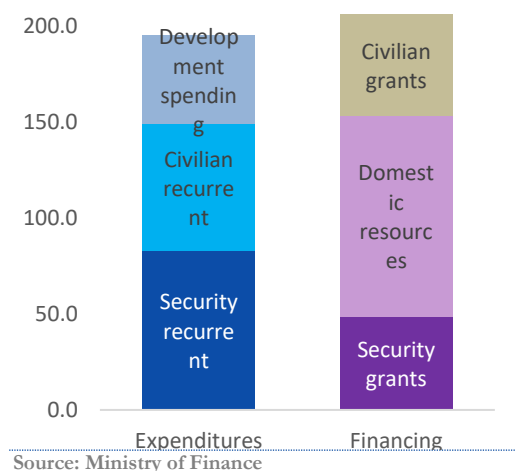
**In addition, taxpayers will have increased opportunities to appeal audit results and payment requirements will be reduced.** The legal issues related to the staffing and implementation of the Taxpayer Disputes Resolution Board will be finalized in 2017, with this board expected to commence operations in 2018. The board will provide an additional level of appeals mechanisms to enable taxpayers to resolve questions of fact before resorting to adjudication before the court system. It will include private sector representation to ensure that the views of the private sector are adequately reflected. The authorities also plan to reduce payment requirements from 50 percent of liability to 30 percent during the objections process by the end of 2017.

**Longer-term measures include measures to enhance training and to improve internal controls to reduce opportunities for corruption.** The adoption of electronic filing systems will reduce the level of contact between taxpayers and officials, while additional taxpayer appeals mechanisms and the application of risk-based audit and audit review will reduce incentives and opportunities for abuse and will enable the internal review of audit outcomes. Strong leadership and improved internal control structures will be required to ensure the successful implementation of these reforms.

**Expenditures were around the same level as in the previous year**

In the first eight months of 2017, total government expenditure amounted to Af 195 billion. This level is close to that in the same period last year, despite the smaller total budget envelope planned for this year compared to the previous year. Recurrent security expenditures declined by four percent (y-o-y), while recurrent civilian spending rose by about six percent, driven by an increase in the civilian wage bill from Af 35 billion to Af 39 billion over the same period. Development spending, including both discretionary and non-discretionary expenditures, declined by about three percent. With stronger domestic revenue growth and flat expenditure outturn, an overall budget surplus of about Af 11 billion was recorded in the first 8 months of the year. Donor grants financed 52 percent of budget expenditures (Af 102 billion or US\$ 1.5 billion) during this period.

**Figure 12: Expenditures and financing in the first 8 months of 2017**  
(Af billion)



**Table 1: Public expenditure: 2016 and 2017 comparisons (cumulative 8 months)**  
(Af million)

Expenditures	2016-M8	2017-M8
Recurrent expenditures	148.8	149.0
Security	86.5	82.8
Civilian	62.3	66.1
Wages and salaries	35.2	39.0
Operations and maintenance	9.7	9.3
Capital expenditures	1.2	0.9
Social transfers	15.2	15.7
Interest payment	0.8	1.2
Discretionary development	13.5	18.5
Non-discretionary development	34.2	27.7
<b>Total expenditures</b>	<b>196.6</b>	<b>195.2</b>

Source: Ministry of Finance (AFMIS)

**Execution of the development budget improved in the first eight months of 2017**

The execution rate for both the recurrent and development budgets improved in the first eight months of 2017. The overall budget execution rate increased to 48 percent, up from 45.5 percent in the same period last year. The execution rate for the development budget rose from 26 percent to 33 percent over this period, while the execution rate for the recurrent budget increased from 51 percent to 54 percent. Despite the improvement, this rate is still low, particularly in the case of the development budget. Protracted procurement procedures, low implementation capacity in the provinces, carryforward of unspent resources from previous year leading to unrealistic budget formulation, and the overall deterioration in the security environment all contribute to the poor execution rates. To address this poor performance, measures to improve the public investment management framework throughout the project life cycle are required.

**Reforms are underway to improve budget execution**

To improve the budgeting process, the Government introduced a number of measures in the FY 1397 (2018) budget cycle, which include: i) enhancing the quality of project concept notes in the Budget Circular 1; ii) requesting full economic appraisals for all large projects (larger than US\$ 5 million) in the Budget Circular 2; and iii) applying a strategic fit analysis for all large projects, which will be presented to the recently established Development Councils for discussion and approval. These changes are expected to help improve the quality of the budget, and thereby to improve the execution rate as budget formulation becomes more realistic. A comprehensive public investment management assessment is under way to further address weaknesses in the budget process.

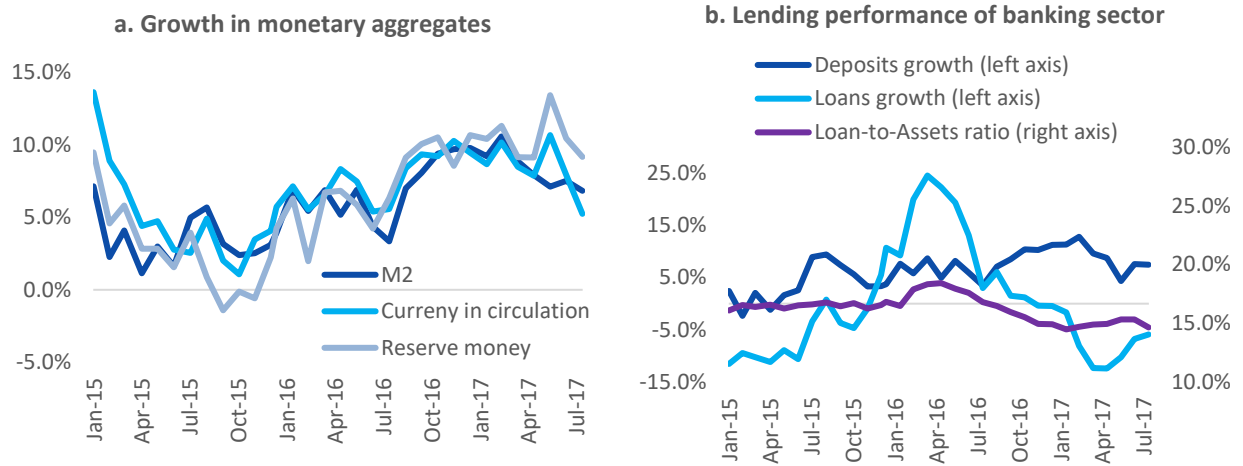
**5. Monetary and financial sector developments****Money demand grew moderately in the first eight months of 2017**

The growth in broad money (M2), which includes currency-in-circulation and deposits in commercial banks, slowed from 9.8 percent (y-o-y) in December 2016 to 6.8 percent (y-o-y) in August 2017. Slower growth in monetary aggregate can be attributable to: (i) the sluggish growth of transferable deposits in commercial banks (deposits in current and checking accounts), with the rate declining from 7.3 percent in December 2016 to 4 percent in August 2017, and (ii) a deceleration in the growth of currency-in-circulation from around 10 percent (y-o-y) to 5 percent over the same period.

**Commercial banks' performance has been poor**

The total value of commercial bank loans to the private sector declined slightly from around Af 46 billion in December 2016 to Af 45 billion in August 2017, likely reflecting the private sector's lack of willingness to undertake new investments and commercial banks' weak appetite for lending. In light of increased uncertainty and heightened perceptions of political instability, businesses usually reduce their investments due to the perceived high risks. Uncertainty also influences the lending behavior of the banking sector. Over the year, the quality of banks' assets deteriorated, with the proportion of non-performing loans (NPLs) increasing from around 12 percent in December 2016 to nearly 18 percent in June 2017, with this increase weighing on banks' profitability. The banking sector posted net profits of almost Af 600 million (or a return on assets of 0.35 percent) in July 2017, a sharp decline from the figure of Af 3.5 billion (or return on assets of 2.2 percent) recorded for the same period last year. The decline in banking profitability has been due to a decrease in non-interest income and an increase in banks' operating expenses.

**Figure 13: Growth in monetary aggregates and commercial bank loans**  
*(year-on-year percent change, unless otherwise indicated)*



Source: Da Afghanistan Bank

**The financial sector remains underdeveloped, with low levels of financial intermediation**

Commercial banks dominate the financial sector in Afghanistan, but the financial intermediary function of the banking system remains extremely limited. While the total value of bank assets amounted to around 20 percent of GDP in August, the total value of credit intermediated from banks to the private sector stood at only 3 percent of GDP. The system-wide liquid assets ratio reaches around 70 percent, indicating that the banking system remains highly liquid due to its weak financial intermediation function.

## B. Outlook and Medium-Term Prospects

**The economic growth rate is projected to reach 2.6 percent in 2017 and 3.2 percent in 2018**

The annual Real GDP growth rate is expected to reach 2.6 percent in 2017, increasing slightly from the figure of 2.2 percent recorded in 2016. Industry is projected to grow by 2 percent, and services by 3.3 percent. Agricultural output is forecast to grow by 1.5 percent, facilitated mainly by an increase in fruit and other horticulture production. This rate, however, reflects a slowdown in the agriculture output growth recorded at 6 percent last year. In 2016, the strong growth was largely driven by a substantial increase in fruit production (about 30 percent) as a result of favorable and timely rainfall. This year, however, despite reasonably good precipitation, substantial growth of that magnitude is unlikely to recur, as last year's production levels were already close to the full potential. Next year, assuming no further deterioration in the security environment, the economic growth rate is projected to increase slightly to 3.2 percent. While the baseline growth projection is for a moderate increase from the level recorded in 2014, it is still significantly lower than the average annual rate of 9.6 percent recorded in the period from 2003 to 2012. Weaker domestic demand and the subdued investment sentiment, largely driven by the increased violence and political uncertainty since 2014, have resulted in the decline in the growth trajectory. However, anecdotal evidence indicates that overall confidence is now improving slightly, with the uncertainty regarding the US troop presence in Afghanistan being addressed to an extent by the most recent announcement of US strategy in Afghanistan.<sup>5</sup> A number of reforms and measures aimed at improving the business climate, facilitated through the PriSEC (Private Sector Executive Committee), are planned for implementation by 2018.

**Growth is expected to remain modest in the medium-term**

The economic growth rate is projected to remain constant at 3.2 percent in 2018 and 2019, before increasing to 3.6 percent by 2020. The constant growth projection in 2019 is based on the assumption that increased political uncertainty related to the upcoming presidential elections will likely have an adverse effect on economic activities and new private investments. Stronger growth in out-years is predicated on the achievement of improvements to security, increased political stability, a successful reform process, and continued high levels of aid flows. The poverty rate is expected to remain high due to the weak labor demand, despite increasing labor force and security-related constraints on service delivery.

**A balanced budget is expected in 2017**

Domestic revenues are projected to increase moderately in proportion to GDP, from 10.5 percent of GDP in 2016 to 10.9 percent in 2017. Total budget expenditure is projected to reach 25.9 percent of GDP in 2017, slightly higher than the figure of 25.5 percent recorded last year. Slower growth in expenditure is due to slower on-budgeting of security costs that are assumed off-budget, and cost-savings in security spending. With donor grants budgeted at 15.3 percent of GDP, the overall fiscal balance will be in a minor surplus of about 0.2 percent of GDP.

**Over the medium term, fiscal outcomes are highly sensitive to the level and**

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 29.4 percent in 2020, assuming that security spending previously undertaken directly by international partners will be brought on budget.

<sup>5</sup> President Trump's speech on the US strategy in Afghanistan and South Asia on August 21, 2017

**modality of aid commitments.**

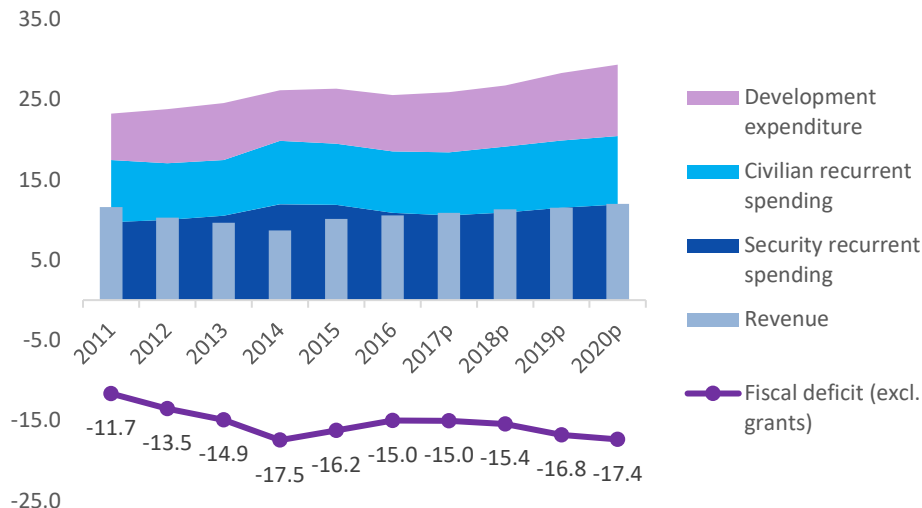
The growth of civilian expenditure reflects the need to maintain current levels of service delivery to the increasingly large population, to develop essential infrastructure and to maintain aid-financed assets recently transferred to the Government. Domestic revenues are projected to increase to 12 percent of GDP by 2020, assuming that the Government can sustain recent improvements to tax compliance and administration. Despite the improved performance, domestic revenues will only be able to cover around 40 percent of budgeted expenditures. The fiscal financing gap is significant, currently standing at 15 percent of GDP and projected to widen to 17.4 percent by 2020. Thus, Afghanistan will continue to need substantial on-budget civilian aid to maintain basic social services and to implement essential development programs over the coming years. Projected public spending increases also reflect the transfer of previously off-budget spending to the Government budget, which implies that an equivalent amount of donor grants should be delivered on-budget to meet the spending needs that have been previously financed outside the budget. Shortfalls in the on-budget donor financing of donor grants will likely significantly constrain Afghanistan's fiscal space and jeopardize its fiscal sustainability.

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

	2014	2015	2016	2017	2018	2019	2020
	<i>Actuals/estimates</i>			<i>--- Tentative staff projections ---</i>			
<b>Real GDP growth (%)</b>	1.3	1.1	2.2	2.6	3.2	3.2	3.6
<b>Nominal GDP (Af billion)</b>	1,151	1,210	1,338	1,449	1,580	1,718	1,866
<b>CPI inflation (period average, in %)</b>	4.6	-1.5	4.4	5.5	5.0	5.0	5.0
<i>Fiscal</i>	<i>In Percent of GDP</i>						
<b>Revenues and grants</b>	24.4	25.1	26.2	26.1	27.1	28.0	29.0
Domestic revenues	8.7	10.1	10.5	10.9	11.3	11.5	12.0
Foreign grants	15.7	15.0	15.6	15.3	15.8	16.5	17.0
<b>Total expenditures</b>	26.2	26.4	25.6	25.9	26.7	28.3	29.4
Recurrent expenditures	19.8	19.5	18.5	18.4	19.1	19.9	20.5
Development expenditures	6.3	6.9	7.0	7.5	7.6	8.4	8.9
<b>Overall balance (incl. grants)</b>	-1.8	-1.3	0.6	0.2	0.3	-0.3	-0.4
<b>Overall balance (excl. grants)</b>	-17.5	-16.2	-15.0	-15.0	-15.4	-16.8	-17.4
<i>External</i>							
<b>Trade balance</b>	-39.6	-36.6	-33.3	-32.0	-31.9	-32.5	-31.8
<b>Current account balance (incl. grants)</b>	8.0	6.2	5.0	3.2	2.6	0.4	-1.0

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

**Figure 14: 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 reach 5.5 percent (12-month average) and to remain at around 5 percent in 2018, assuming the absence of domestic supply shocks that could exert upward pressure on prices. With domestic demand remaining subdued and the global prices of fuel and grains projected to remain stable in 2018, it is forecast that domestic price levels will remain stable. The merchandise trade deficit is expected to grow by around US\$ 300 million in nominal terms as imports are projected to increase. However, in proportion to GDP, this deficit will narrow from 33.3 percent of GDP in 2016 to 32 percent in 2017. Imports increased in the first half of the year and are expected to continue to increase through to the end of the year. However, the increase in imports is lower than the increase in nominal GDP, thus resulting in a narrowing of the trade deficit in proportion to GDP. Continued foreign aid inflows will maintain a surplus in the current account, with this surplus amounting to 3.2 percent of GDP in 2017.

**Medium-term prospects are subject to substantial downside risks**

The baseline macroeconomic framework remains heavily exposed to a range of downside risks, with the most significant of these being: i) an unanticipated decline in aid, which could undermine fiscal sustainability and require difficult expenditure adjustments; ii) a further deterioration in the security environment, which could erode confidence and dampen growth; and iii) heightened political instability, which could result in unpredictable adverse impacts on the security situation, business confidence, and external support. Continued reform to improve governance, to increase revenue mobilization and to improve its administration, and to establish a conducive environment for private sector growth is critical to the achievement of sustainable growth. The mobilization of sufficient aid flows to maintain the delivery of essential services and development outcomes will also depend to a significant extent on the progress towards the structural reforms mandated by the Afghanistan National Development and Peace Framework.

**Growth can be enhanced in the medium-term with the right combination of fiscal and policy reforms**

Institutional reforms and infrastructure investments aimed at driving increased growth usually take time to produce results and to deliver an impact. In the short to medium term, however, growth can be enhanced by boosting aggregate demand. Afghanistan's fiscal space is limited, which makes expansionary fiscal policy based on increasing public expenditure challenging. Nonetheless, the right combination of fiscal and policy measures may help to boost growth in the short-run. These measures

may include: i) improving budget execution; ii) reorienting budget expenditures towards labor-intensive and community-based programs that directly reach the population with the greatest needs and with the highest marginal propensity to consume; iii) improving the quality of expenditure on basic service delivery; iv) promoting private investment and strengthening the confidence of business community by forcefully implementing the reforms and measures to reduce risks and costs of doing business; and v) moving from narrowly-focused revenue collection to broader revenue mobilization by expanding the tax base.

**Structural transformation is required for long-term macroeconomic sustainability**

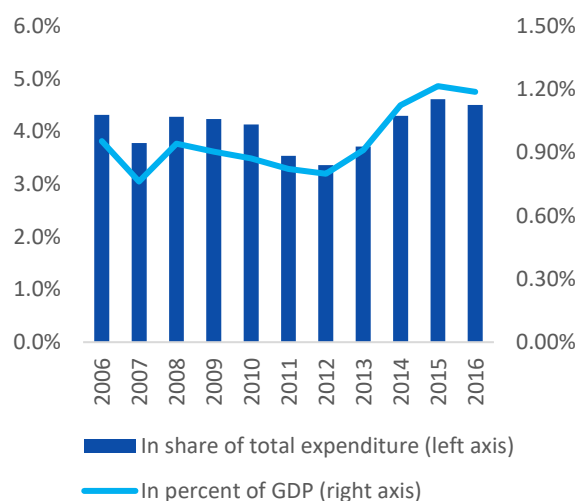
With an average annual population growth rate of 3 percent and an estimated 400,000 individuals entering the labor market each year, much higher growth rates are needed to improve per capita incomes and to provide quality employment opportunities for the expanding workforce. The Government should explore new sources of growth to increase its revenues and to generate foreign exchange earnings needed to maintain external balance, particularly in the context of the expected normalization of aid levels over the longer-term. Even with optimal revenue policies and administrative settings, Afghanistan's upper-bound revenue potential is currently estimated to stand at only around 17 percent of GDP, due to the narrow base of the economy and heavy reliance on subsistence agriculture. These levels fall far short of projected expenditure needs. Low levels of human capital, substantial infrastructure deficits, and weak institutions make it challenging to achieve structural transformation in the short term. Over the medium term, however, increased investment in human capital and in measures to improve agricultural productivity could result in significantly higher economic growth rates and increased employment opportunities. In particular, the development of the extractives sector has significant potential to stimulate growth and to generate increased revenues and foreign exchange earnings.

## C. Focus Section: Resilient despite challenges: Experience from more than a decade of health service delivery

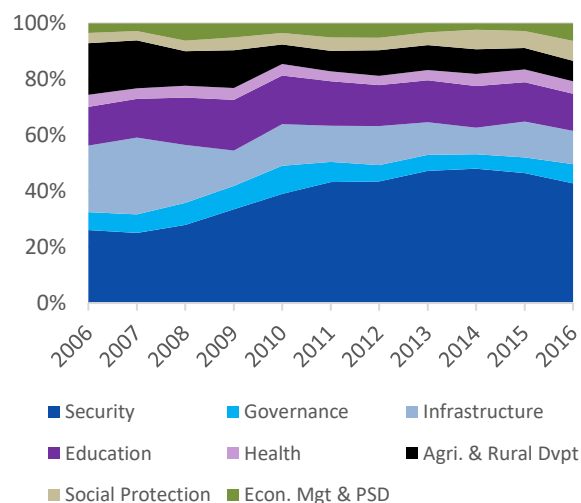
### Background

Despite the protracted conflict, Afghanistan has achieved impressive gains in some sectors of development, particularly the health sector. Historically, health service provision has been poor and heavily dependent on the efforts of non-government organizations (NGOs). In the past, the activities of these NGOs have tended to be uncoordinated and unfocused. In the 1980s and 1990s, the Government had little capacity, inclination and interest to coordinate the activities of these NGOs. This situation has changed gradually since 2003 as the Government began to adopt a more systematic approach. Significant initial measures to coordinate the poorly performing health care system included defining a basic package of health services for all citizens and establishing systems for the regular monitoring and evaluation of the health sector. Since then, impressive gains in health outcomes and health care service delivery have been achieved, despite the volatility of the security situation. Moreover, improvements have been equitable across the different parts of the country, irrespective of the different levels of conflicts that they face.

**Figure 15: Health expenditures, in percent of total expenditures and of GDP**



**Figure 16: Sectoral expenditures, percentage share of total**



Source: MoF, CSO, and author's calculations

Afghanistan has been gradually increasing public expenditure on health, with these expenditures increasing from 0.8 percent of GDP in 2011 to 1.2 percent in 2016. As a share of aggregate on-budget government expenditures, health expenditures remain low compared to other sectors, but they have nonetheless increased from 3.5 percent of total government expenditures in 2011 to 4.5 percent in 2016 (see Figures 15 and 16). In this context, this note focusses on how health outcomes and service delivery have performed in the period since 2003. Health service delivery is further evaluated to determine the extent of improvements to service coverage and the performance of the health system. The following three questions relating to health outcomes and health services delivery in Afghanistan are addressed in this focus section:

1. Is the current health services delivery system facilitating good health outcomes?

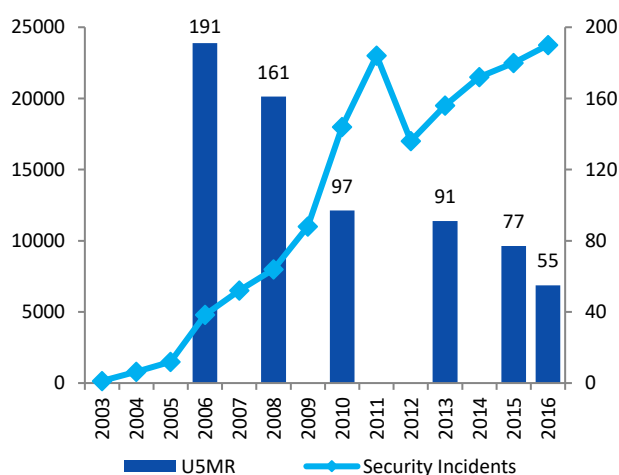


2. How have changes in the conflict conditions affected trends in health service delivery in terms of service coverage and performance of the health system?
- 3.
4. How can health service delivery be made more resilient to conflict?

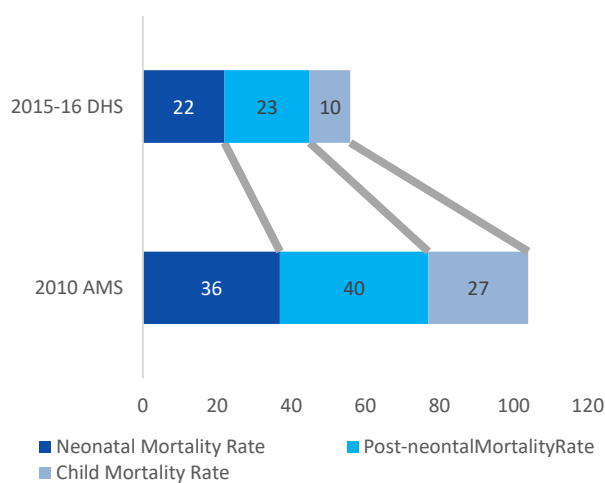
**Is the health service delivery system achieving good health outcomes?**

Afghanistan’s progress towards improved health outcomes has been notable, with better progress than in many comparator countries. Significant progress has been made towards the achievement of Millennium Development Goals (MDG) related to maternal health (MDG5) and child health (MDG4). The maternal mortality ratio has declined from 1,100 deaths per 100,000 live births in 2000 to 396 deaths in 2015. Between the same points, the under-5 mortality rates (U5MR) have declined from 137 per 1000 live births to 91 deaths, while new-born mortality rates (NMR) have declined from 53 deaths per 1000 live births to 36 deaths. The latest Afghanistan Demographic and Health Survey (DHS) 2017 indicates further reductions in the U5MR (to 55) and NMR (to 22) (see Figure 17). Significantly, the improvements in the U5MR and NMR have been equitable across gender. Even though in absolute terms, these health outcomes remain less impressive than in comparator countries,<sup>1</sup> Afghanistan has recorded relatively greater improvements, indicating that it has progressed towards closing the outcome gap with comparators.

**Figure 17: U5MR (columns) and incidents, persons per 1000 (RHS), number of incidents (LHS)**



**Figure 18: Change in U5MR, person per 1000**



Source: UNDSS, AHS (2006, 2015), NRVA (2008, 2013), AMS (2010), DHS (2015-16)

This note assesses two aspects of the performance of the health service delivery system: (i) improvements in service coverage and (ii) improvements in performance. This note refers to these two aspects as ‘coverage’ and ‘quality’ respectively. Improvements in coverage are measured using indicators and a Composite Coverage Index (CCI)<sup>2</sup> across the complete continuum of Maternal and Child Healthcare (MCH) interventions, from contraceptive coverage to use of oral rehydration salts among children. To assess quality, the note utilizes the standard Balanced Scorecard survey methodology, which classifies performance-related issues into six broad domains. Table 3 presents a selected list of the coverage indicators and quality domains against which the coverage and quality of the health services have been measured.

<sup>1</sup> Afghanistan is compared against the global median, Pakistan and provinces in Pakistan such as Khyber Pakhtunkhwa and Baloch, given their geographic proximity and similar context.

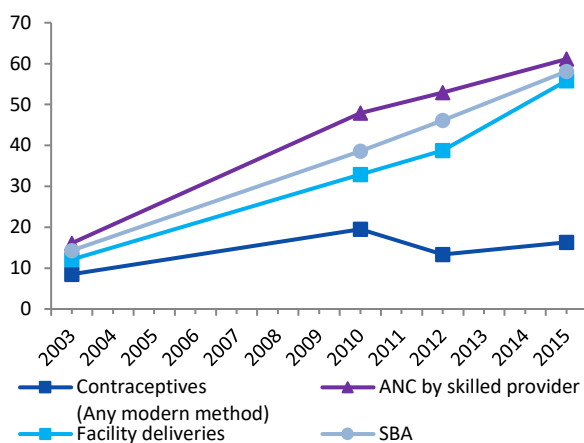
<sup>2</sup> The Composite Coverage Index is based on a weighted coverage mean of eight essential Maternal and Child Health interventions (both curative and preventive) organized into four categories along the continuum of care (Boerma, B.J., Kinfu, Axelson, & Victora, 2008).

**Table 3: Selected coverage indicators and quality domains**

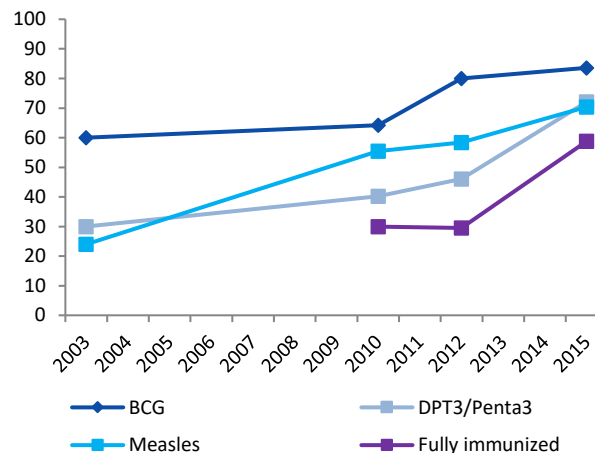
Coverage Indicators	Quality Domains
Contraceptive coverage (modern and traditional)	Client and community
Antenatal care	Human resources
Skilled birth attendance and facility births	Physical capacity
Immunization	Quality of service provision
Acute Respiratory Infection (ARI)	Management systems
Oral Rehydration Therapy (ORT)	Ethics
Composite Coverage Index	Overall score

Afghanistan’s coverage has increased at a faster pace than comparators, with the pace of improvement increasing over time. The coverage rate for most MCH interventions increased over the two periods for which comparable statistics are available, these being 2003 to 2010 (MICS) and 2011 to 2015 (AHS). There are two encouraging aspects of this improvement. Firstly, the pace of improvement was significantly higher in the latter period (2011 to 2015) than in the former period (2003 to 2010). Secondly, the improvement in coverage indicators was similar for boys and girls. However, there were some exceptions. For example, the coverage rate for contraceptives improved in the first period, but declined in the second. Most importantly, the pace of improvement in coverage (annual percentage point change) has exceeded the rate recorded by comparators.

**Figure 19: Coverage maternal indicators, percentage**



**Figure 20: Coverage child indicators, percentage**



Source: AHS (2012, 2015), MICS (2003, 2010-11), AMS (2010), DHS (2015-16)

Almost all provinces recorded improvements in coverage, based on observed changes in the Composite Coverage Index, but over time the pace of improvement was slower in provinces with larger populations. If provinces are classified according to improvements to their pace of coverage during each of the two time periods and compared to their populations, it reveals that in 2015, a larger proportion of the population (39 percent) resided in provinces with the slowest pace of improvement than in 2010 (23 percent).

Most quality domains improved, but the pace of improvement has abated with time. There was considerable improvement in almost all quality domains in the period from 2004 to 2010, particularly in terms of physical capacity, although in terms of the overall perception of service quality, performance remained largely unchanged. In the next time period (2011 to 2016), the pace of improvements slowed, although physical capacity continued to improve at a robust pace. Improvement in quality was broad-based across almost all provinces in both the time periods. Encouragingly, it was also accompanied by a steady increase in the relative number of female health workers.

Figure 21: Quality domains (2004 to 2010), score/100

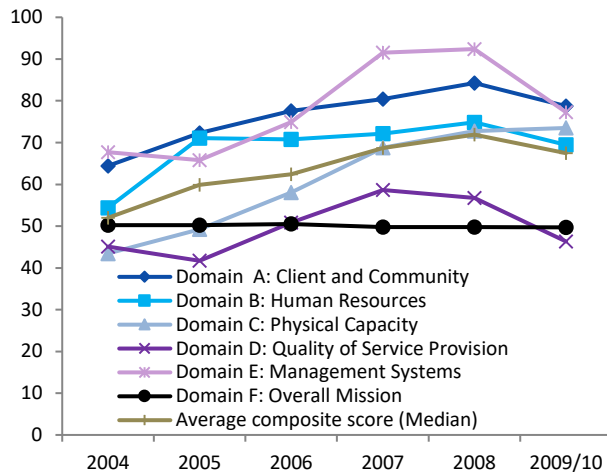
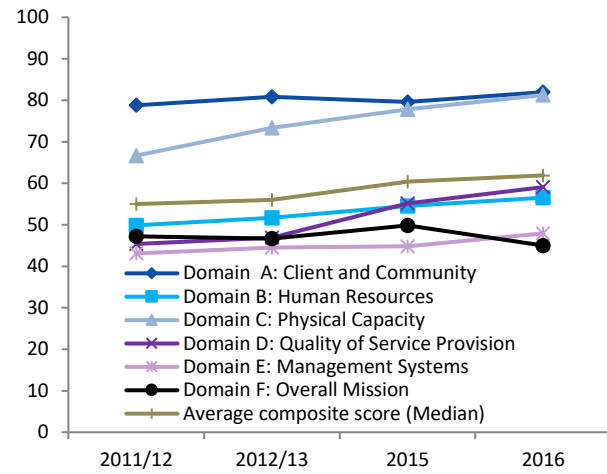


Figure 22: Quality domains (2011 to 2016), score/100



Source: BSC (2004 to 2010), BSC (2011 to 2016)

Has conflict affected health service delivery?

Health service delivery performance has been resilient to conflict, both in terms of coverage and quality. An analysis of the survey data shows that after adjusting for other drivers of improvements, there was not much difference in improvements to coverage and quality across provinces, despite the varying levels of conflict. While it was established that provinces with relatively higher levels of conflict achieved a lower level of improvement, the differences were small. This resilience of health service delivery against conflict is the single most impressive achievement in the health sector.

Figure 23: Difference in improvement of coverage indicators between severe and minimal conflict provinces (2003 to 2010), annualized percentage points

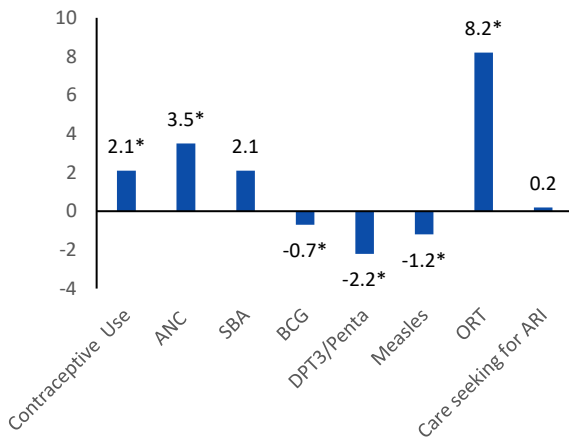
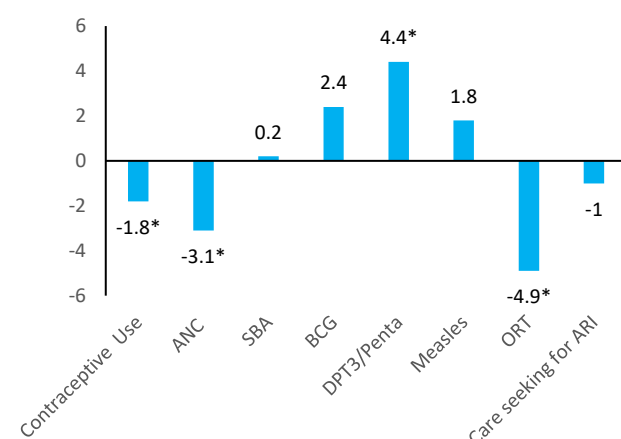


Figure 24: Difference in improvement of coverage indicators between severe and minimal conflict provinces (2010 to 2015), annualized percentage points



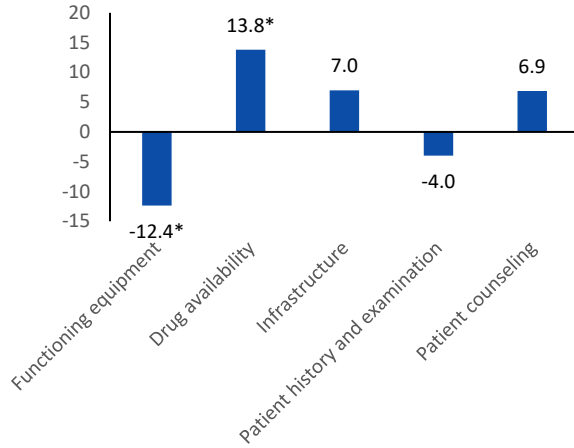
Source: AHS (2012, 2015), MICS (2003, 2010-11), AMS (2010), DHS (2015-16)  
 Note: Figures marked with \* are statistically significant differences

Although the levels of coverage remain lower in provinces affected by severe conflict, the improvement in coverage in higher conflict provinces was not much significantly different than in lower conflict provinces, after adjusting for other factors, such as maternal literacy, the contracting modality of health services, and their rural residence. In fact, provinces facing severe conflict achieved greater improvements in terms of many of the coverage indicators than did minimal conflict provinces. For example, in the period from 2003 to 2010, high conflict provinces recorded more significant gains in terms of indicators relating to contraceptive use,

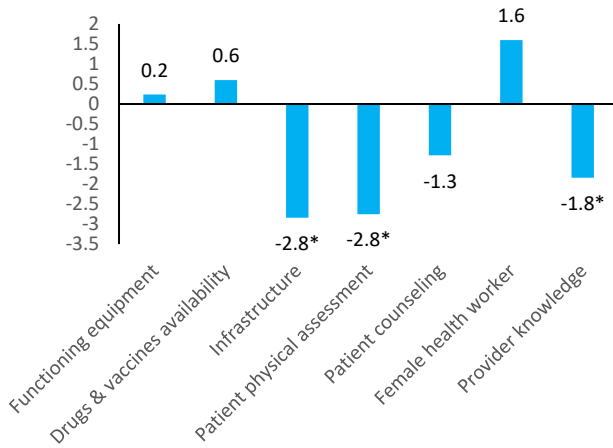
antenatal care, skilled birth assistance, oral rehydration therapy and acute respiratory infection care than did lower conflict provinces (see Figure 23).

Improvements in quality – after controlling for other factors – achieved by lower conflict provinces were generally greater than by higher conflict provinces, although the differences in the pace of the quality improvements were minor. These findings were consistent in both the time periods over which improvements in quality were evaluated.

**Figure 25: Difference in improvement of quality domains between severe and minimal conflict provinces (2004 to 2010), annualized percentage points**



**Figure 26: Difference in improvement of quality domains between severe and minimal conflict provinces (2011 to 2016), annualized percentage points**



Source: BSC (2004 to 2010), BSC (2011 to 2016)

Note: Figures marked with \* are statistically significant differences

Resilience against conflict is likely due to the strong links between service providers and local communities. With the exception of three provinces (Parwan, Panjshir and Kapisa), health service delivery in all other provinces is provided by government-contracted NGOs. Interviews and focus group discussions with stakeholders indicate that the resilience against conflict is likely due to NGO strategies that result in the establishment of strong links with local communities. This resilience is particularly remarkable given that security challenges severely constrain the identification and retention of suitable human resources, supply management, operational coordination, and the supervision and monitoring of health facilities.

However, other data sources and strategies should be used to further validate these findings and to provide additional insights. This analysis presented in this note relies on survey data. Since health facilities in the most insecure areas were not surveyed, the statistics for high conflict areas may be biased favorably. One way to improve the validity of the findings would be to improve the sampling frames to ensure that the statistics are more representative. Another way could be to use data from other sources, such as from health management information systems, to validate the findings.

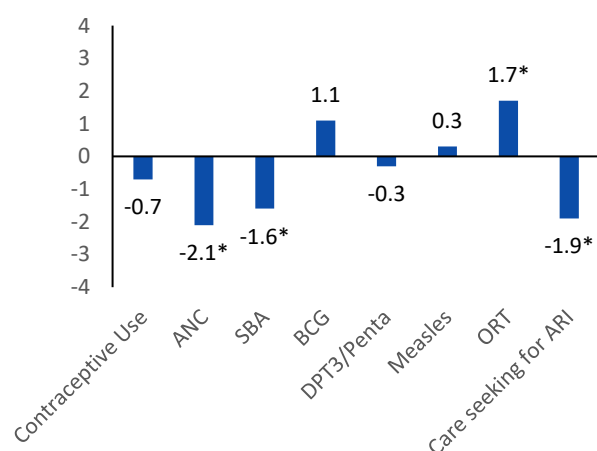
### How effective are the models of health service delivery?

Public health services are provided by the Government using two delivery models: (i) the Contracting-Out model and (ii) the Contracting-In model. This note refers to these two models simply as the ‘contracted-out’ and the ‘Government-delivered’ models, respectively. The use of the contracted-out model is more prevalent. With the contracted-out model, the Ministry of Public Health (MoPH) enters into service delivery contracts with NGOs, which are responsible for final frontline service delivery. The MoPH defines the standardized package of health services to be provided, assigns clear geographical areas of responsibility for the NGOs, and monitors and evaluates the quality of services delivered. NGOs are selected through a competitive bidding process conducted by the MoPH. Overtime, an increased proportion of contracts have been awarded to Afghan NGOs with a strong local presence. Out of the 49 contracts currently in place, almost three quarters

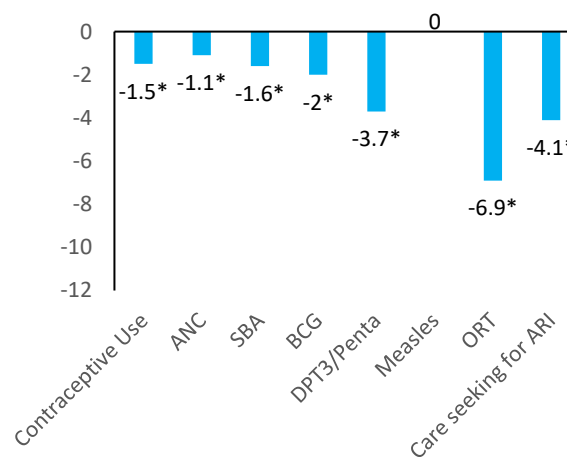
(72 percent) are with local NGOs. The Government-delivered model involves the direct delivery of health services by the Government, although these services are managed by contracted private individuals. The Government-delivered model is used in three provinces near Kabul (Parwan, Panjshir and Kapisa), where the Government exercises a much higher level of control than in other provinces. The MoPH awards contracts to qualified individuals to manage and strengthen health service delivery by MoPH staff. The contracted managers are selected through a competitive recruitment process and are paid prevailing market-based salaries. Funding for both these models is provided using identical norms, with the same standards used to evaluate and monitor them.

Provinces using the Government-delivered model achieved a greater level of improvement in terms of most coverage indicators in both time periods than did provinces using the contracted-out model. In the period from 2003 to 2010, provinces using the Government-delivered model achieved a greater statistically significant level of improvement in terms of most coverage indicators, except the indicator relating oral rehydration therapy. However, the difference in the pace of improvement was small, with the most significant gap amounting to a mere 2.1 percentage points over the seven-year period. In the 2010-2015 period, coverage also improved at a greater rate provinces using the Government-delivered model in terms of almost all indicators. Though small in magnitude, these differences were statistically significant for most indicators.

**Figure 27: Difference in improvement of coverage indicators between contracted-out and Government-delivered (2003 to 2010), annualized percentage points**



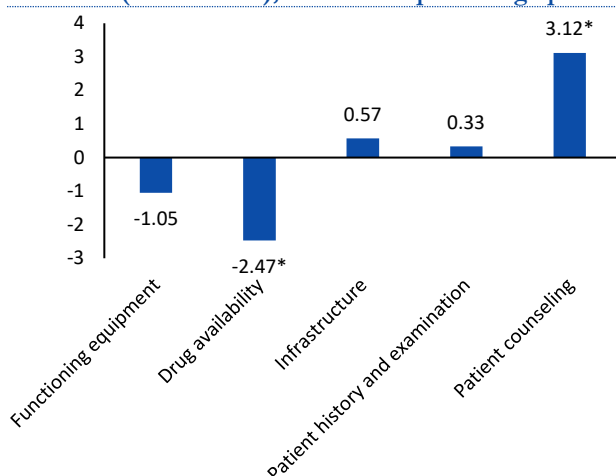
**Figure 28: Difference in improvement of coverage indicators between contracted-out and Government-delivered (2010 to 2015), annualized percentage points**



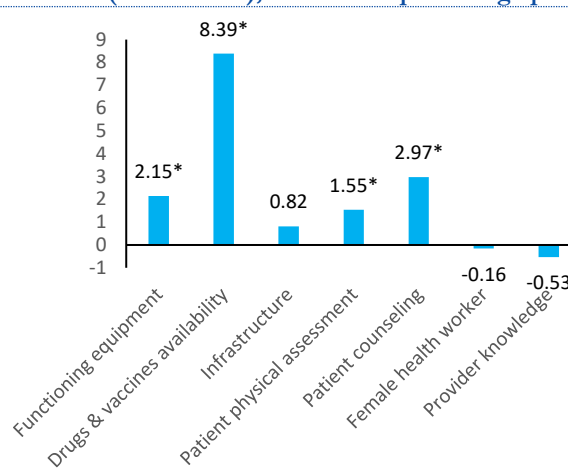
Source: AHS (2012, 2015), MICS (2003, 2010-11), AMS (2010), DHS (2015-16)  
 Note: Figures marked with \* are statistically significant differences

Provinces using the Government-delivered model achieved greater quality improvements during the first time period, but contracted-out provinces performed better during the second period. In the period from 2004 to 2010, provinces using the Government-delivered model achieved greater improvements for most quality domains, with improvements in patient counselling being statistically significant (see Figure 29). However, in the period from 2011 to 2016, quality improvements were greater in provinces using the contracted-out model. But again, the difference in the pace of improvements between the service delivery models was not large, except in the case of the availability of drugs. The pace of improvement in terms of the availability of drugs in the contracted-out provinces exceeded that in the Government-delivered provinces by a substantial 8.4 percentage points.

**Figure 29: Difference in improvement of quality domains between contracted-out and Government-delivered (2004 to 2010), annualized percentage points**



**Figure 30: Difference in improvement of quality domains between contracted-out and Government-delivered (2011 to 2016), annualized percentage points**



Source: BSC (2004 to 2010), BSC (2011 to 2016)

Note: Figures marked with \* are statistically significant differences

These findings may be biased in favor of provinces using the Government-delivered model. The analysis does not take into consideration the relative size of the provinces (smaller the better) nor the geographic proximity to the capital region. Both these factors favor government-provided provinces, which are both smaller and closer to Kabul than the contracted-out provinces. Despite these caveats, the improved performance in terms of drug availability in contracted-out provinces reflects the importance of decentralized supply chains and drug procurement strategies in the quality of service provision.

### How can health service delivery be made more resilient to conflict?

Stronger community links and simpler processes improve resilience to conflict. Most conflict affected provinces use the contracted-out model to deliver health services. These services are delivered by local Afghan NGOs with locally recruited staff, who have a relatively good understanding of the context in which they operate. Stakeholder consultations and studies show that as a result, these NGOs are better received by local communities and better able to negotiate with local powerbrokers. Other studies have shown that the contracted-out approach bypasses administrative and political economy bottlenecks that a more centrally controlled system faces (World Bank, 2014).

Measures to enhance provider autonomy and to ensure the robust independent monitoring of results improves health service delivery. International reviews of the contracted-out model of service delivery shows that this model is effective in low and middle income countries with weak capacities. This is particularly true in conflict and post-conflict contexts, where the ability of the state to reach all populations is relatively weak and uneven. Studies on Afghanistan confirm that granting a greater degree of autonomy to service providers improve service delivery (Arur, 2008). For example, in the contracted-out model, NGOs are currently granted lump sum contracts. However, in practice, NGOs report that they have to seek permission from MoPH to transfer funds between line items. This is both cumbersome and time consuming. A model focused on outputs and outcomes, instead of inputs, would result in greater autonomy and more simple administration. However, in such a system, the independent, robust and regular monitoring of outputs and outcomes would be of paramount importance.

### Conclusion

Afghanistan has recorded impressive improvements to health service delivery, despite the ongoing conflict. The two major findings regarding the delivery of these services are that: i) health service delivery has been resilient to the conflict; and ii) it has been largely equitable across provinces. As a result, Afghanistan's

improvements to health outcomes have outpaced those of comparators. Both the both the contracted-out and Government-delivered models work almost equally well in Afghanistan. The resilience to conflict is likely due to the close ties that the NGOs delivering health services have established with the communities they serve. In addition, given that the NGOs usually employ people from the local communities and given the nature of the services delivered, these NGOs are better able to negotiate within local power structures. The two delivery systems exhibit different strengths across the spectrum of quality and access, and more analysis using other data sources, improved survey methodologies and better controls are required to fully establish their relative effectiveness.

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## 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 \$4.05 billion for development and emergency reconstruction projects, and five budget support operations in Afghanistan. This support comprises over \$3.37 billion in grants and \$666,5 million in no-interest loans known as 'credits'. The Bank has 18 active IDA projects in Afghanistan with net commitment value of over \$1.26 billion. In addition, the Afghanistan Reconstruction Trust Fund (ARTF) has generated US\$ 10 billion of funding from 34 donors, and committed US\$ 4.6 billion for the Government's recurrent costs and US\$ 4.6 billion for government investment programs. As of July 2017, 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\$ 100 million, and additional financing to Citizens' Charter for Emergency Regional Displacement Response in the amount of US\$ 127.7 million under the IDA portfolio. The Bank also approved an additional financing to the Financial Sector Rapid Response Project in the amount of US\$ 20 million. Moreover, in June 2017, the following four projects were approved: Inclusive Growth Development Policy Grant, Afghanistan Strategic Grain Reserve (SGR), Urban Development Support, and Herat Electrification for a total of US\$ 200.3 million. Under the ARTF, Citizens' Charter project was approved by the ARTF Management Committee (MC) in the amount of US\$ 400 million and additional financing for Emergency Regional Displacement Response in the amount of US\$ 44.3 million. The MC also approved additional financing of US\$ 105 million to Afghanistan Rural Access Roads Project (ARAP). In addition, additional financing for existing projects include US\$ 4.7 million for the Afghanistan Rural Enterprise Development Project, and a 2<sup>nd</sup> additional financing was approved in September for US\$ 5 million. 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, US\$ 6.5 million Mazar-e-Sharif Gas to Power project, and US\$ 5 million Women Economic Empowerment National Priority Program.
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 financing 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. The International Financial Corporation (IFC), a member of the World Bank Group, is working to strengthen the environment for private sector investment. IFC is actively supporting the private sector in Afghanistan in the areas of renewable energy, infrastructure, financial sector, and agriculture. IFC provides a mix of investment and advisory services in Afghanistan. IFC's cumulative committed investment portfolio stood at \$52 million as of end-FY17, and its advisory services portfolio stood at \$8.8 million. At present, IFC's Investment portfolio includes investments in the telecommunication sector and financial markets, while investments in the pipeline include investments in the power sector and agribusiness.
7. IFC offers its Advisory Services in the areas of access to finance, Small and Medium Enterprises (SMEs) capacity development, job creation, strengthening horticulture export, access to renewable energy, corporate governance structure enhancement, and investment climate reform interventions. IFC is also working with the Ministry of Commerce and Industries (MoCI) in improving the investment climate and bringing reforms that are conducive to private sector growth.
8. The Multilateral Investment Guarantee Agency (MIGA) has US\$ 116.5 million of gross exposure in Afghanistan as of 31 August 2017, related to three projects. Of these, 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, in dairy and cashmere production. Among MIGA's global priorities is support for FDI with high developmental impact into IDA countries and Fragile and Conflict-affected Situations, and Afghanistan is a key country for MIGA in terms of delivering on this objective. In 2013, MIGA launched its Conflict Affected and Fragile Economies Facility, which provides an initial loss layer to help insure investments in difficult situations. Moving forward, the Agency will seek, including in collaborations with the World Bank and IFC, further entry points for supporting investments into Afghanistan, including via the new Private Sector Window under IDA18.

Appendix Table 1: Selected economic indicators

	2014	2015	2016	2017	2018	2019	2020
<b>Income Levels</b>				Proj.	Proj.	Proj.	Proj.
Nominal GDP (billion Af) /1	1,151	1,210	1,338	1,449	1,580	1,718	1,866
Nominal GDP (billion US\$) /1	20.0	19.7	19.7	21.6	23.0	24.6	25.9
GDP per capita (US\$)	611	584	569	607	632	660	679
Population (million)	32.8	33.7	34.7	35.5	36.4	37.2	38.1
<b>Real Economy (% growth)</b>							
Real GDP growth /1	1.3	1.1	2.2	2.6	3.2	3.2	3.6
Agriculture	-0.1	-5.7	6.0	1.5	2.0	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	3.7	3.8	4.1
<b>GDP Composition (% of GDP)</b>							
Agriculture	23.5	21.7	21.6	19.5	19.2	19.1	19.5
Industry	22.3	23.3	21.1	25.5	25.4	25.3	25.0
Services	54.2	55.0	52.2	55.0	55.4	55.6	55.5
<b>Prices (% , 12-month percent change)</b>							
CPI inflation (period average)	4.6	-1.5	4.4	5.5	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	6.0	..	..	..
<b>External Sector (% of GDP, unless otherwise indicated)</b>							
Exports of goods (million US\$) /2	783	667	720	756	870	957	1,052
Imports of goods (million US\$) /3	8,711	7,867	7,284	7,648	8,222	8,839	9,281
Trade balance	-39.6	-36.6	-33.3	-32.0	-32.0	-32.1	-31.8
Net current transfers	38.0	38.2	39.0	34.4	31.4	29.9	28.3
Current account balance	8.0	6.2	5.0	3.2	2.6	0.4	-1.0
Gross foreign exchange reserves (million US\$)	7,158	6,682	7,255	7,800	7,900	7,950	7,930
Gross foreign exch. res. (months of imports)	9.9	10.2	12.0	12.2	11.5	10.8	10.3
External debt /4	6.5	6.3	6.4	6.2	6.1	6.0	6.0
Exchange rate (AFN/USD, period average)	57.4	61.4	67.9	68.0	..	..	..
Exchange rate (AFN/USD, end period)	58.1	68.1	66.7	68.6	..	..	..
Real effective exchange rate /5	103.0	99.0	92.6	95.2			
<b>Monetary and Financial Statistics (% of GDP)</b>							
Broad money (M2)	35.0	34.3	34.0	33.0	34.5	35.0	35.0
Total deposits	17.7	17.4	17.3	17.0	18.0	17.5	19.0
Share of dollar deposits (%)	66.0	71.5	68.0	..	..	..	..
Credit to private sector, commercial banks	3.8	3.9	3.4	3.2	3.5	3.0	4.0
Loan-to-deposit ratio (%)	21.6	22.2	19.7	18.8	19.4	17.1	21.1

## 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
<i>In Billion Afghanis, unless otherwise indicated</i>				Proj.	Proj.	Proj.	Proj.
Domestic revenues	100.1	122.4	141.2	157.7	178.5	197.5	223.9
Tax revenue	51.8	59.5	69.5	77.3	87.1	94.0	108.8
Customs duty and fees	26.0	30.4	31.3	36.0	40.3	46.4	51.0
Nontax revenues	22.3	32.4	40.4	44.4	51.1	57.2	64.1
Donor grants	180.7	181.1	209.2	221.0	248.8	283.4	317.1
Discretionary grants	119.1	123.7	148.5	152.2	169.8	192.4	214.5
Nondiscretionary grants	61.6	57.4	60.1	68.8	79.0	91.0	102.6
Total expenditures	301.0	318.8	341.9	375.6	422.4	486.1	547.5
Recurrent expenditures	228.3	235.9	248.0	267.0	302.4	341.8	381.5
Security	137.4	143.6	145.5	152.8	172.2	197.5	222.0
Civilian	91.0	92.3	102.5	114.2	130.2	144.3	159.5
Wages and salaries	52.7	54.5	58.6	65.2	72.7	79.0	85.8
Operations and maintenance	16.3	17.3	18.6	20.3	23.7	27.5	29.8
Capital expenditures	1.9	2.3	2.3	2.9	4.7	5.2	7.5
Social transfers	19.2	17.0	22.2	24.6	27.6	30.9	34.5
Interest payment	0.9	1.2	0.8	1.2	1.4	1.7	1.9
Discretionary development	9.9	18.0	29.0	36.2	41.1	44.7	54.1
Non-discretionary development	62.8	64.9	64.9	72.5	79.0	99.6	111.9
Discretionary balance (Recurrent + Disc dev.)	-19.0	-7.8	12.7	6.7	4.9	3.4	2.8
Overall balance	-20.2	-15.3	8.5	3.1	4.9	-5.2	-6.5
Overall balance excluding grants	-200.9	-196.4	-200.7	-218.0	-243.9	-288.6	-323.7
Revenues to recurrent spending ratio (%)	43.8	51.9	56.9	59.1	59.0	57.8	58.7

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

Appendix Table 3: Selected fiscal indicators

	2014	2015	2016	2017	2018	2019	2020
<i>In Percent of GDP, unless otherwise indicated</i>				Proj.	Proj.	Proj.	Proj.
Domestic revenues	8.7	10.1	10.5	10.9	11.3	11.5	12.0
Tax revenue	4.5	4.9	5.2	5.3	5.5	5.5	5.8
Customs duty and fees	2.3	2.5	2.3	2.5	2.6	2.7	2.7
Nontax revenues	1.9	2.7	3.0	3.1	3.2	3.3	3.4
Donor grants	15.7	15.0	15.6	15.3	15.8	16.5	17.0
Discretionary grants	10.3	10.2	11.1	10.5	10.8	11.2	11.5
Nondiscretionary grants	5.4	4.7	4.5	4.8	5.0	5.3	5.5
Total expenditures	26.2	26.4	25.6	25.9	26.7	28.3	29.4
Recurrent expenditures	19.8	19.5	18.5	18.4	19.1	19.9	20.5
Security	11.9	11.9	10.9	10.5	10.9	11.5	11.9
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	2.5	2.6	2.6	2.9
Nondiscretionary development	5.5	5.4	4.8	5.0	5.0	5.8	6.0
Discretionary balance (Recurrent + Disc dev.)	-1.7	-0.6	0.9	0.5	0.3	0.2	0.1
Overall balance	-1.8	-1.3	0.6	0.2	0.3	-0.3	-0.4
Overall balance excluding grants	-17.5	-16.2	-15.0	-15.0	-15.4	-16.8	-17.4
Revenues to recurrent spending ratio (%)	43.8	51.9	56.9	59.1	59.0	57.8	58.7

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

Appendix Table 4: Selected fiscal indicators

	2014	2015	2016	2017	2018	2019	2020
<i>In Billion USD, unless otherwise indicated</i>				Proj.	Proj.	Proj.	Proj.
Domestic revenues	1.7	2.0	2.1	2.3	2.6	2.8	3.1
Tax revenue	0.9	1.0	1.0	1.1	1.3	1.3	1.5
Customs duty and fees	0.5	0.5	0.5	0.5	0.6	0.7	0.7
Nontax revenues	0.4	0.5	0.6	0.7	0.7	0.8	0.9
Donor grants	3.1	2.9	3.1	3.3	3.6	4.0	4.4
Discretionary grants	2.1	2.0	2.2	2.2	2.4	2.7	3.0
Nondiscretionary grants	1.1	0.9	0.9	1.0	1.1	1.3	1.4
Total expenditures	5.2	5.2	5.0	5.5	6.1	6.9	7.6
Recurrent expenditures	4.0	3.8	3.7	3.9	4.4	4.8	5.3
Security	2.4	2.3	2.1	2.2	2.5	2.8	3.1
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	0.7
Nondiscretionary development	1.1	1.1	1.0	1.1	1.1	1.4	1.6
Discretionary balance (Recurrent + Disc dev.)	-0.3	-0.1	0.2	0.1	0.1	0.0	0.0
Overall balance	-0.4	-0.2	0.1	0.0	0.1	-0.1	-0.1
Overall balance excluding grants	-3.5	-3.2	-3.0	-3.2	-3.5	-4.1	-4.5
Revenues to recurrent spending ratio (%)	43.8	51.9	56.9	59.1	59.0	57.8	58.7

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





