

Public Disclosure Authorized

Public Disclosure Authorized

Public Disclosure Authorized

closure Authorized

# AFGHANISTAN DEVELOPMENT UPDATE



August 2018

## **Disclaimer:**

This volume is a product of the staff of the International Bank for Reconstruction and Development/The World Bank. The findings, interpretations, and conclusions expressed in this paper do not necessarily reflect the views of the Executive Directors of The World Bank or the Governments they represent. The World Bank does not guarantee the accuracy of the data included in this work. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgment on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries

## **Copyright Statement:**

The material in this publication is copyrighted. Copying and/or transmitting portions or all of this work without permission may be a violation of applicable law. The International Bank for Reconstruction and Development/The World Bank encourages dissemination of its work and will normally grant permission to reproduce portions of the work promptly.

For permission to photocopy or reprint any part of this work, please send a request with complete information to the Copyright Clearance Center, Inc., 222 Rosewood Drive, Danvers, MA 01923, USA, telephone 978-750-8400, fax 978-750-4470, <http://www.copyright.com/>.

All other queries on rights and licenses, including subsidiary rights, should be addressed to the Office of the Publisher, The World Bank, 1818 H Street NW, Washington, DC 20433, USA, fax 202-522-2422, e-mail [pubrights@worldbank.org](mailto:pubrights@worldbank.org).

## **Photo Credits:**

Cover: ©The World Bank, 2018

# AFGHANISTAN DEVELOPMENT UPDATE

August 2018

## 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 the medium-term outlook for Afghanistan. Each edition includes more in-depth analysis on specific focus topics.

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

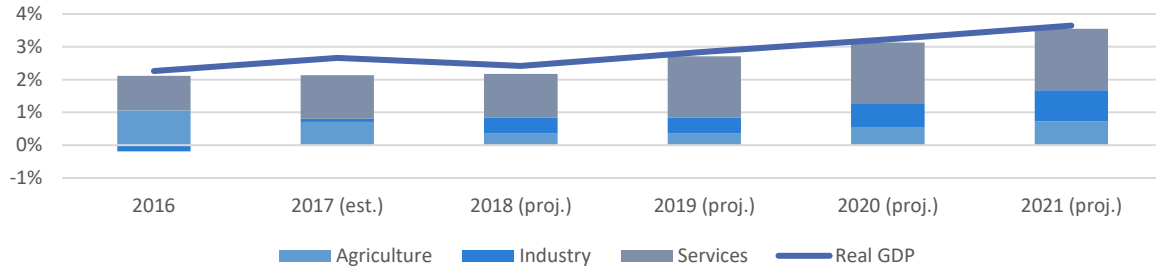
This report was prepared by Tobias Haque with Habiburrahman Sahibzada, Saurabh Shome, Bernard Haven, and Taehyun Lee. Special topic sections were provided by Nandini Krishnan and Christina Wieser, Nathalie Lahire, and Alvaro Espitia and Nadia Rocha. The report was prepared under the overall guidance of Manuela Francisco (Manager for South Asia, Macroeconomics, Trade, and Investment) and Shubham Chaudhuri (Country Director).

The authors are grateful for the cooperation received from Government officials in sharing data and statistics and providing comments on draft versions of the report. The authors also gratefully acknowledge the comments and suggestions received from the International Monetary Fund.

# Key Messages in Charts

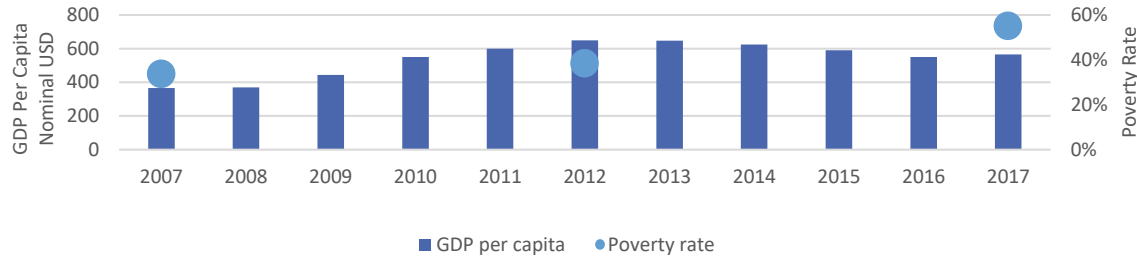
## Economic growth is gradually gaining pace, but is expected to remain sluggish.

Real GDP Growth by Sector (Percent)



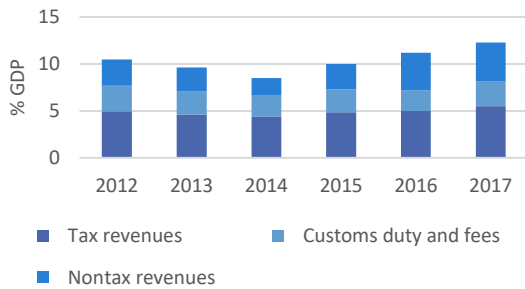
## Poverty has increased, reflecting declining per capita incomes.

Poverty Rate and Per Capita Income

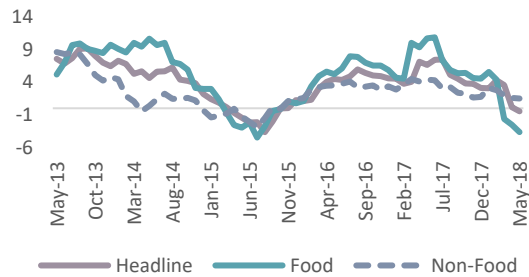


## Macroeconomic management remains sound, with sustained strong revenues and moderate inflation.

Revenue by source as % GDP

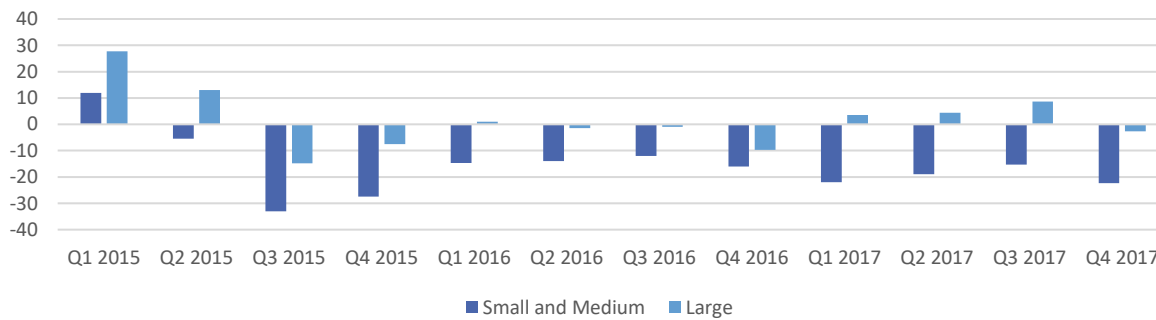


CPI Inflation (12 month percent change)



## Some indicators suggest that recent recovery may be at risk with declining confidence in the context of upcoming elections.

Business Sentiment Index



## Executive summary

### **Action is required to sustain the gradual recovery Afghanistan has seen since 2015**

Afghanistan has experienced slow growth since 2014, with the draw-down of international security forces, accompanying reductions in international grants, and a worsening security situation (growth has averaged 2.3 percent between 2014-2017). Following a period of political instability after the 2014 elections, the economy has slowly regained momentum as reforms have been implemented and confidence restored. From a low of 1.5 percent in 2015, real GDP growth accelerated to 2.3 percent in 2016, and is estimated at 2.7 percent for 2017.

Building momentum now appears to be at some risk, with increasing election-related violence, declining business confidence, worsening drought conditions, and some apparent slowing of economic activity. Growth is projected at 2.4 percent in 2018, with substantial downside risks arising from the prospects of political instability around upcoming parliamentary and presidential elections. Risks can be partly mitigated and recent momentum maintained through: i) continued reform progress, demonstrating to investors that the deterioration in governance seen in 2014 will not be repeated; and ii) continued donor commitment to sustained grant support.

### **Poverty has increased and humanitarian pressures remain**

Reflecting slow recent growth, the new Afghanistan Living Conditions Survey (ALCS) shows a significant increase in the proportion of Afghans living below the national poverty line from 38 percent in 2011/12 to 55 percent in 2016/17. Living standards are also threatened by continued drought conditions which are negatively impacting wheat harvests, generating food insecurity in many areas of the country. The displacement crisis also continues, with more than 1.7 million Afghans internally displaced, and more than 2 million returning to Afghanistan – mostly from Pakistan and Iran – since 2015.

### **Inflation was moderate through most of 2017**

Period-average inflation for 2017 reached 5 percent. Inflation peaked in June (7.5 percent), driven by food prices which moderated later in the year. Inflation in 2018 is projected to remain stable, at around 3 percent, with continued weak food price inflation offsetting increasing international energy prices.

### **Export performance is strong and the external position is comfortable**

Exports grew by around 28 percent during 2017, driven by new air corridors for exports to India and resolution of border issues that constrained trade with Pakistan in 2016. Exports remain low in absolute terms at around 6 percent of GDP. The trade deficit remained stable at around 40 percent of GDP reflecting offsetting import growth driven by higher energy prices and increased food imports in the context of drought. The current account remained in surplus at end-2017, reflecting large aid inflows. Foreign exchange reserves now stand at more than US\$8.2 billion, or more than one year of merchandise import cover.

Rapid export growth continued into the first quarter of 2018, but the trade balance is expected to remain unchanged, reflecting offsetting import growth driven by continuing high energy prices and drought-induced food imports. The current account surplus is expected to turn into a small deficit in 2019, reflecting declining

aid inflows. Foreign exchange reserves will decline slightly while remaining at comfortable levels.

The exchange rate depreciated gradually over 2017 reflecting the resumption of inflation. Depreciation accelerated in the first half of 2018, driven mostly by general strengthening of the US dollar.

**Budget reforms have had a positive impact**

The 2017 budget outturn saw a deficit of around 0.5 percent of GDP, with rapid revenue growth (15 percent in nominal terms) offset by a shortfall of grant revenues. Reforms to the 2018 budget process, including ending the practice of automatically carrying over the balance of unspent development project funds into the next budget, have seen project execution rates improve for both discretionary and non-discretionary development budget expenditures.

Revenue growth is expected to moderate in 2018. This mostly reflects the exhaustion of opportunities for revenue growth from strengthening administration and enforcement after several years of improvement. Customs control may come under pressure in the context of upcoming elections. Revenue data for the first half of 2018 shows collections at roughly the same level as for this period in 2017.

Amendments to the 2018 budget saw additional allocations for development expenditures, financed partly through reductions in recurrent allocations and partly through an additional ‘unfunded’ budget deficit of around AFS14.3 billion (US\$209 million). These revisions doubled the projected deficit after grants to around 2 percent of GDP. With domestic revenues and grants now projected to exceed budgeted levels, the deficit is now expected to be restrained to around 0.5 percent of GDP.

**Financial sector activity remains subdued**

Credit to the private sector grew by around 3 percent over 2017, after remaining flat through 2016. Credit to the private sector declined rapidly over the first four months of 2018 before recovering in May, but is still around 2 percent lower than end-December 2017. Total credit to the private sector remains well below 2014 levels.

**Over the medium-term, a step-change in growth performance is required to significantly reduce poverty**

Under current projections, Afghanistan is unlikely to make major progress in reducing poverty. Growth is expected to accelerate to around 3.7 percent by 2021. But with a current population growth rate of around 2.7 percent, a much faster growth rate will be required to significantly improve incomes and livelihoods for most Afghans, or provide jobs for the approximately 400,000 young Afghans entering the labor force every year.

In the short term, improved rates of economic growth could be driven by: i) careful prioritization of public investment towards sectors where the direct economic impacts are highest; and ii) addressing avoidable constraints to private investment, including unnecessary regulatory barriers. Over the medium-term, economic development progress will depend on mobilizing the sectors with greatest capacity to support increased growth, job creation, exports, and government revenues. This is likely to require a balanced growth strategy, including increased investment in agricultural productivity (including through expanded irrigation), increased investment in human capital, and the realization of Afghanistan’s substantial extractives potential.

## Table of contents

<b>A. RECENT ECONOMIC DEVELOPMENTS .....</b>	<b>1</b>
1. Political and Security Context .....	1
2. Real Sector Activity .....	2
3. External sector .....	7
4. Fiscal sector.....	9
5. Monetary and financial sector developments .....	12
<b>B. OUTLOOK AND MEDIUM-TERM PROSPECTS .....</b>	<b>14</b>
<b>C. FOCUS SECTION I: AFGHANISTAN’S TRADE POTENTIAL.....</b>	<b>17</b>
<b>D. FOCUS SECTION II: POVERTY AND WELFARE.....</b>	<b>25</b>
<b>D. FOCUS SECTION III: PROMOTING EDUCATION UNDER FRAGILITY.....</b>	<b>31</b>



## LIST OF FIGURES

Figure 1: Growing insecurity poses risks to growth and investment .....	1
Figure 2: Services drove growth in 2017 .....	3
Figure 3: Business climate perceptions improved through most of 2017 but business registrations were down .....	3
Figure 4: Consumer prices are declining, despite increasing international energy prices .....	4
Figure 5: Opium production reached record highs in 2017 .....	5
Figure 6: Poverty has increased substantially .....	5
Figure 7: The number of urban poor is increasing, while employment outcomes deteriorate .....	6
Figure 8: The trade balance deteriorated, despite surging exports .....	7
Figure 9: Imports in 2017 were dominated by food, energy, and machinery .....	8
Figure 10: Import growth in 2017 was driven by increased food, fuel, and machinery imports .....	8
Figure 11: Export growth in 2018 was driven by high-value fruit exports, mostly to India.....	8
Figure 12: The afghani continues to depreciate, while foreign exchange reserves build.....	9
Figure 13: Revenue growth has been strong for several years, but is now slowing .....	10
Figure 14: Execution of the development budget has improved .....	11
Figure 15: Money demand declined through 2017 even as credit to the private sector expanded.....	13
Figure 16: Budgets will remain highly dependent on aid inflows .....	16
Figure 17: Trade-to-GDP ratio in Afghanistan, 2012–16 (%) .....	18
Figure 18: Average Applied Tariffs on country exports, 2016.....	18
Figure 19: Time to export, Afghanistan and comparators, 2005-14 .....	21
Figure 20: Logistical Performance Index for Afghanistan and neighboring countries, 2016.....	23
Figure 21: Timeline of key events and GDP per capita .....	26
Figure 22: GDP per capita – Afghanistan and Comparators .....	26
Figure 23: Refugees and battle-related deaths by country.....	27
Figure 24: GDP growth, insecurity, and investment trends .....	28
Figure 25: Conflict and displacement trends .....	28
Figure 26: Poverty rate and number of poor.....	29
Figure 27: Timeline of key events and GDP per capita .....	33
Figure 28: Timeline of key events and GDP per capita .....	34
Figure 29: Public education expenditure as a share of GDP and government expenditure.....	35
Figure 30: Contributions by international donors through the national budget and directly to projects, 2011 to 2015 .....	36

## A. Recent Economic Developments

### 1. Political and Security Context

**Conflict and instability continue to profoundly influence Afghanistan's economy and economic development prospects**

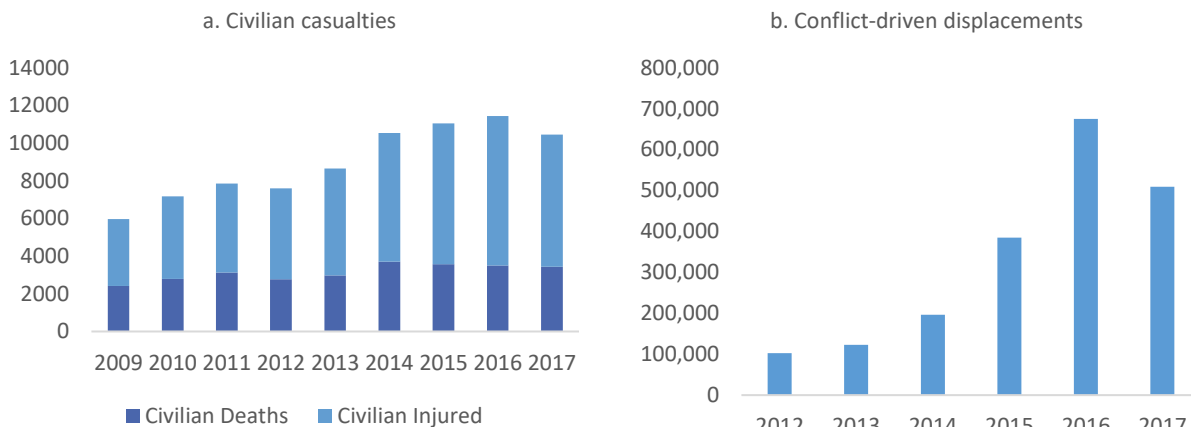
Conflict negatively impacted economic activity in 2017, and prospects for 2018 and beyond will be heavily influenced by political and security developments.

During 2017, civilian casualties reached similar levels to the previous year, with 10,451 civilians killed or wounded (down slightly from the peak of 11,418 in 2016). The slight decline in civilian casualties was due to reduced harm to civilians from ground fighting, while the number of casualties from suicide and complex attacks continued to increase. Violence remained intense throughout the early period of 2018, with 763 civilian deaths and 1,495 wounded in the period to March, similar to record-high casualty levels sustained during the same period in the previous two years. Internal displacement driven by conflict remains at extremely high levels, with 509,075 conflict-induced internally displaced recorded in 2017 (substantially above historical average levels, but well below the peak of 674,698 seen in 2016).

**Upcoming elections present risks to reform and economic management**

Parliamentary and district council elections are scheduled for October 2018 and Presidential and provincial council elections are scheduled for April 2019. Anti-government elements have already begun election-related attacks, targeting civilians in 23 election-related incidents up to April 2018. Prospects for increasing election-related violence, as accompanied the 2014 presidential elections, present a significant risk for confidence and investment. Disruption to reforms, revenue collection, and expenditure discipline are possible in the context of political instability in the lead-up to and aftermath of elections. On the other hand, recent movements towards a negotiated peace agreement with the Taliban, including an unprecedented mutual ceasefire over Eid al-Fitr in June, provide some cause for cautious optimism regarding prospects for an improvement in the security situation over coming years.

**Figure 1: Growing insecurity poses risks to growth and investment**



Source: United Nations Assistance Mission in Afghanistan (UNAMA) and UNHCR

## 2. Real Sector Activity

**Real sector activity remains muted, but there were some signs of returning confidence during 2017**

Afghanistan has recently experienced a sustained economic slowdown. Having maintained an average growth rate of 9 percent between 2003 and 2013, economic growth slowed to 2.7 percent in 2014, declining further to 1.5 percent in 2015. This decline was driven by a range of factors, including: i) declining aid levels associated with the drawdown of international security forces (from US\$12.5 billion in 2009 to around US\$8.8 billion in 2015); ii) increasing violence and insecurity; and iii) political instability associated with the 2014 elections.

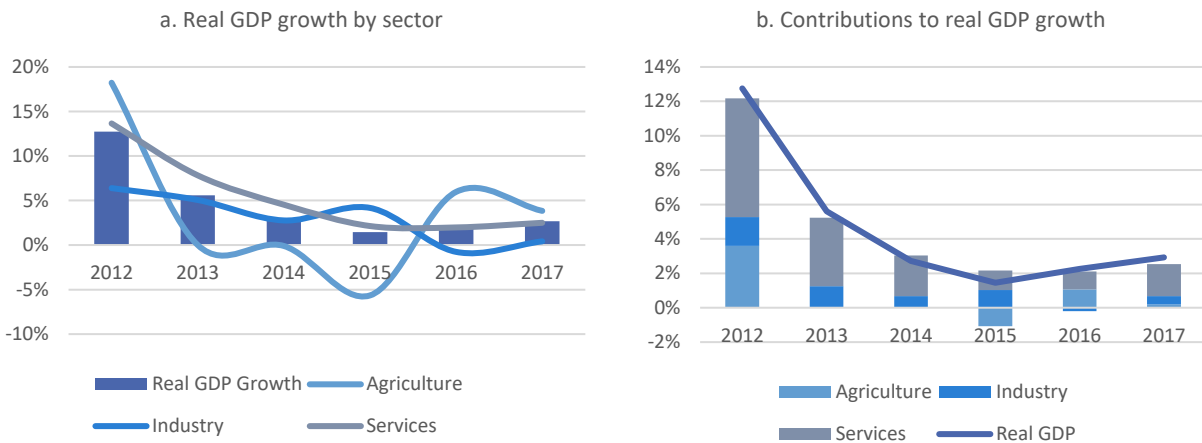
Since 2015, there has been a slight recovery, with growth accelerating slightly to 2.3 percent in 2016, reflecting increased investment and business confidence compared to 2015, in the context of relative political stability and strong progress against a range of reforms and infrastructure initiatives, including WTO accession, rollout of electronic taxpayer systems, progress with the CASA-1000 electricity transmission project, and opening of the Chabahar port.

Recovery continued in 2017, with the economy growing by 2.7 percent. Growth was driven mostly by the services sector, which expanded by 2.5 percent. Growth of the service sector partly reflected improved investor confidence through most of 2017. Investor perception surveys showed improving investor sentiment through the first three quarters of 2017, including improved perceptions of the security situation (despite continuing elevated levels of violence). For the first time since 2014, more than half of businesses responding to the ACCI Bottleneck Survey reported that security conditions had improved. Large businesses reported positive sentiment, on average, through the first three quarters of 2017, while small-and-medium enterprises reported net negative sentiment, but remained more positive than during the trough of late 2015.

The agriculture sector grew by around 3.8 percent despite drought conditions. Major declines in cereal production (down 10 percent) were offset by increased production in fruit. Rainfed wheat production was only 43 percent of the five-year average for 2012-2016 - the third worst year on record since 2005.

Overall new business license applications declined slightly in 2018, down 20 percent from 2016. New business registrations continued to be concentrated in the services sector. Service and manufacturing sector registrations were down by around 20 percent while construction sector registrations increased by around 40 percent.

**Figure 2: Services drove growth in 2017**  
(percent)

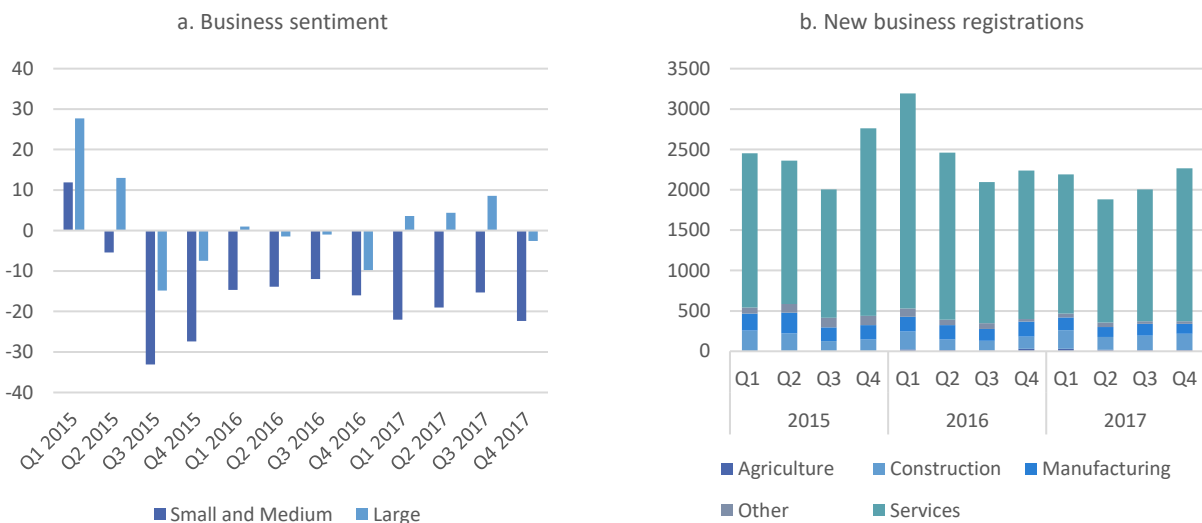


Sources: Central Statistics Organization (NSIA) and Bank staff projections

**Available indicators suggest a slowing of recent momentum in the first half of 2018**

Business sentiment across nearly all indicators and business types deteriorated in the last quarter of 2017, potentially reflecting expectations of political instability and violence associated with upcoming elections (Figure 3). Continued violence in early 2018 and the large number of election-related incidents may reinforce negative sentiment. While precipitation improved late in the October 2017-May 2018 wet season, seasonal totals in some areas remained below 50 percent of the historical average. Overall rain and snowfall was well below average levels, and wheat production in 2018 is projected at the lowest level since 2011.

**Figure 3: Business climate perceptions improved through most of 2017 but business registrations were down**  
(percent)



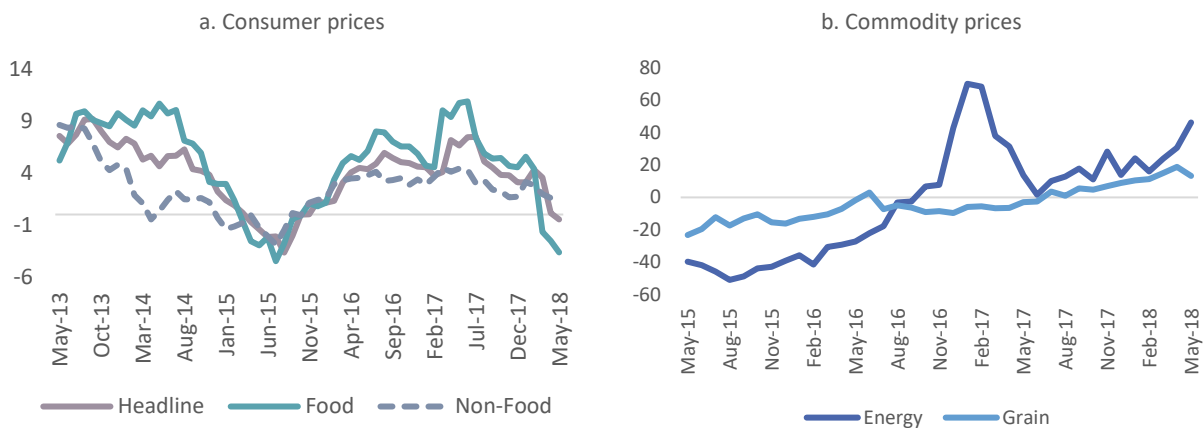
Sources: Afghanistan Chamber of Commerce and Industry Business Sentiment Survey, Government of Afghanistan

**Consumer prices increased moderately through 2017**

The annual inflation rate remained moderate through 2017, with period-average inflation of 5.0 percent for the year. Inflation peaked during the second quarter of 2017, reaching 7.5 percent in June, driven by food price increases, particularly for fruit and vegetables. Inflation moderated later in the year, declining to 3.1 percent by December, as price increases for both food and non-food items slowed. Slowing food price inflation later in the year reflected moderation of fruit and vegetable prices and weakening international prices for imported grains.

Inflation during 2018 has remained moderate to date, despite recent depreciation of the afghani against major trading currencies, peaking at 4.3 percent in in January and declining steadily to -1.0 percent by May. Recent deflation has been led by food prices, and more specifically vegetable prices, despite increasing international energy prices. Food price inflation reached -3.6 percent in May 2018. Recent drought is not expected to have a major impact on food prices, with Afghanistan already heavily reliant on imported wheat and facing relatively stable world prices.

**Figure 4: Consumer prices are declining, despite increasing international energy prices**  
(12-month percentage change)



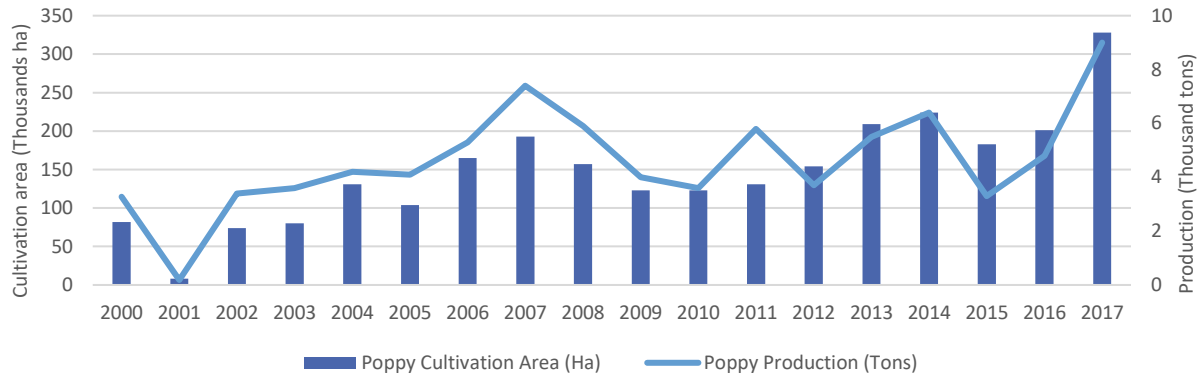
Source: Central Statistics Organization, and World Bank Global Economic Monitor (GEM)

**Opium production and the area under poppy cultivation increased dramatically in 2017**

Opium production reached a new peak in 2017, with production reaching nearly 9,000 tons with 328,000 hectares of land under cultivation. This represented a 90 percent increase in production and a 60 percent increase in land under cultivation relative to 2016 levels. The UNODC estimates that the value of the overall opium economy is now between US\$4.1-US\$6.6 billion, or around 20 percent to 30 percent of GDP. This is a substantial increase over 2016, when the value of the opium economy was estimated at around 15 percent of GDP. The value of licit agriculture, by comparison, is around 18 percent of GDP in 2018.

Strong growth of the opium economy was due to the absence of diseases that affected the 2016 crop, reduced government control in some opium-growing areas, and increased uptake of fertilizer and pesticides by opium farmers. More generally, the opium economy has benefited from continued weak rule of law, easy access to trade routes, and the continued decline in availability of alternative livelihood opportunities.

**Figure 5: Opium production reached record highs in 2017**  
(units)

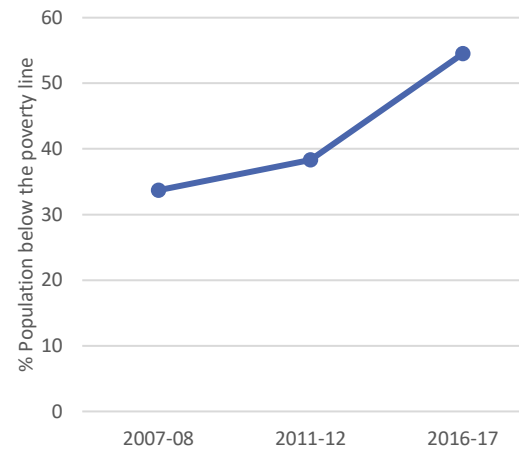


Sources: UNODC

**Poverty has increased markedly, due to slowing real economic growth**

The newly-released 2016/17 Afghanistan Living Conditions Survey shows that 54.5 percent of the Afghanistan population now live below the national poverty line, relative to 38.3 percent in 2011/12.<sup>1</sup> This equates to roughly an additional five million Afghans living below the poverty line. This rapid increase in poverty reflects economic growth lagging population growth in the context of ongoing insecurity, with declining per capita incomes since 2012. Additional pressure has arisen from internal displacement and the large number of returnees. Urban poverty has become more widespread, with the number of urban poor doubling since 2007, with 18 percent of Afghanistan’s poor now living in urban areas. Food insecurity has increased from 30 percent in 2011/12 to 45 percent in 2016/17. Vulnerability to poverty is extremely widespread, with simulations showing that a 30 percent reduction in incomes would lead to a poverty rate exceeding 80 percent.

**Figure 6: Poverty has increased substantially**  
(poverty headcount, in percent of population)



Source: Afghanistan Living Conditions Survey, 2007/08, 2011/12 and 2016/17 surveys

**Poverty is subject to regional variation and closely correlated with demographic factors**

Poverty has increased in all regions between 2011/12 and 2016/17, but regional disparities have become more pronounced. The largest increases in poverty between 2011-12 and 2016-17 were in the Central, East, North and North-East regions, between 17 and 20 percentage points. The South West region recorded the highest poverty rate in 2016-17, at 72 percent. Larger households are more likely to live in poverty. While a third of households with 1 to 5 members live below the poverty line, roughly 60 percent of households with 8 members or more are poor. Poverty is also

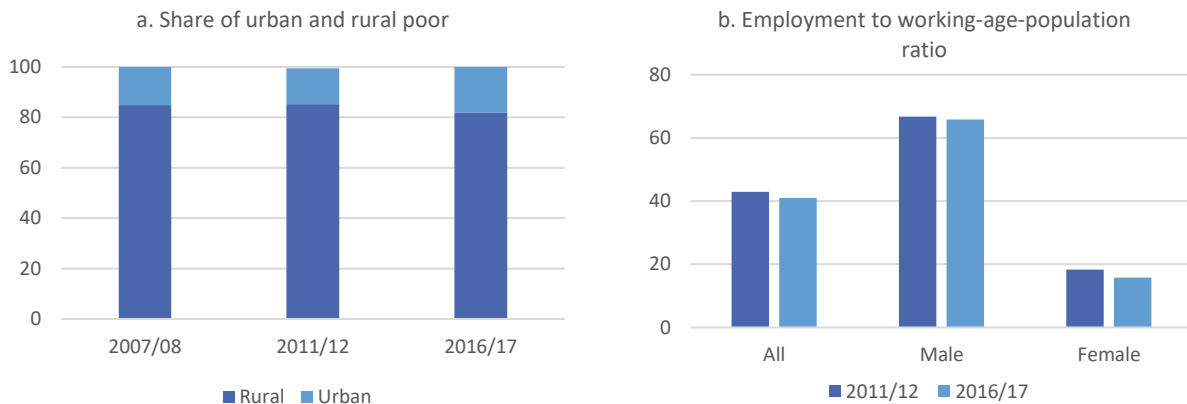
<sup>1</sup> The poverty line represents the national norm for the cost of covering basic needs including a set of food items that deliver 2,100 kilocalories per person per day as well as necessary non-food expenditures on housing, clothing, education and transportation. In 2016-17, the poverty line was 2,064 Afghani per person per month, around \$1 a day in current exchange rate terms.

correlated with education levels. 73 percent of the population belong to households where the household head has no education, but these households account for 82 percent of the poor. Households who derive their main source of income from agriculture, livestock or non-formal employment (such as wage or day labor) have high poverty rates of 65, 66 and 68 percent respectively. Almost 60 percent of poor Afghans live in such households.

**Unemployment has increased**

Employment and labor force participation has fallen between 2013 and 2017. The employment to working age population ratio fell from 42.9 percent in 2013/14 to 41 percent in 2016/17. This decline was most pronounced among rural women, where employment to working age population ratio declined from 21.2 percent to 18.3 percent, equivalent to the loss of nearly 130,000 jobs. The labor force participation rate fell from 55.4 percent in 2013/14 to 53.9 percent in 2016/17, equivalent to an increase in discouraged workers (i.e. those that are of working age, not currently employed and not seeking employment) of around 118,000. Employment of working age males between the ages of 25 and 50 declined from 93.4 percent in 2011/12 to 84.3 percent in 2016/17, equivalent to a reduction in employment by around 176,000 jobs.

**Figure 7: The number of urban poor is increasing, while employment outcomes deteriorate**  
(Percent)



Source: *Afghanistan Living Condition Surveys 2007/2008, 2011/12, 2016/17*

**Continued displacement and drought are leading to humanitarian pressures**

Afghanistan continues to face a humanitarian crisis arising from large numbers of returning migrants (more than 2 million since 2015) and a large and growing internally displaced population (1.7 million). Displacement and a large internally displaced population presents both a risk and an opportunity for Afghanistan. Successful integration into productive employment of generally better-educated returnees could provide a boost to productivity and growth. On the other hand, concentration of returnees and the internally displaced in urban centers risks overwhelming services and generating large humanitarian needs. Drought conditions are contributing to humanitarian needs. Poor households that are dependent on rainfed wheat production are expected to face difficulty in meeting consumption requirements in northern, northeastern, and northwestern Afghanistan.

### 3. External sector

**2017 saw a surge in exports, but the trade deficit continues to grow**

Exports increased from US\$614 million in 2016 to US\$784 million in 2017, representing growth of 28 percent. Export growth was driven by the establishment of new air corridors to India, the resolution of border issues that constrained trade with Pakistan during 2016, and continued gradual depreciation of the afghani relative to major trading currencies. Total exports remain very limited however, concentrated in a narrow range of commodities (dried fruits, nuts, and textiles) and with a value equal to around 6 percent of GDP.

Imports also grew substantially from US\$6,636 million in 2016 to US\$7,355 million in 2017. Import growth reflected the overall pick-up in economic growth, resolution of the disruptions at the Pakistani border that had contributed to a decline in trade during 2016, increasing energy prices, and increased grain imports driven by drought conditions. With the increase in import values outstripping increased export values, the merchandise trade deficit widened from 31.6 percent of GDP in 2016 to 33.6 percent of GDP in 2017. The service trade deficit also increased during 2017, expanding from 4.2 percent to 5.6 percent of GDP.

The trade deficit was financed almost entirely by foreign aid inflows, which remained roughly stable, at around 40 percent of GDP. Capital account and financial account flows remained modest.

In the first quarter of 2018, rapid import and export growth continued. Exports for first quarter 2018 were up by nearly 50 percent on the same period in 2017, while imports were 28 percent higher than during the same period in 2017. Export growth was concentrated in high-value fruit products, reflecting improved market access to India via air corridors. Import growth was driven by the continued depreciation of the afghani, increased energy prices, and high grain imports in the context of continuing drought conditions.

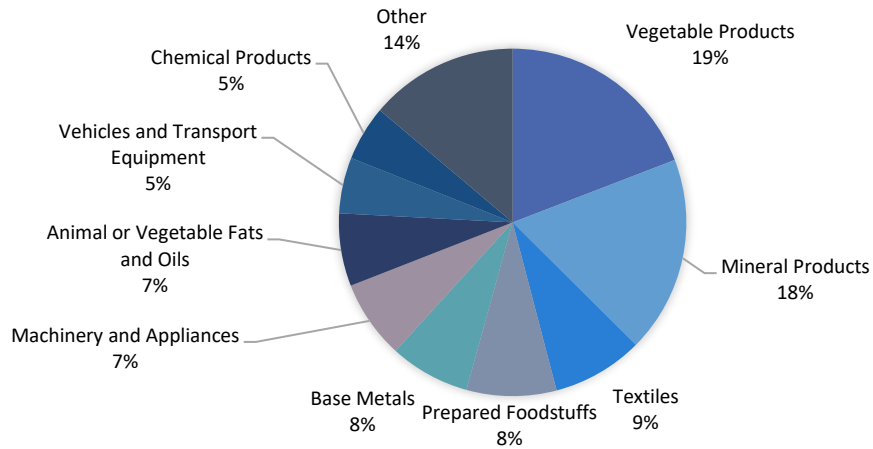
**Figure 8: The trade balance deteriorated, despite surging exports**  
(units)



Sources: NSIA

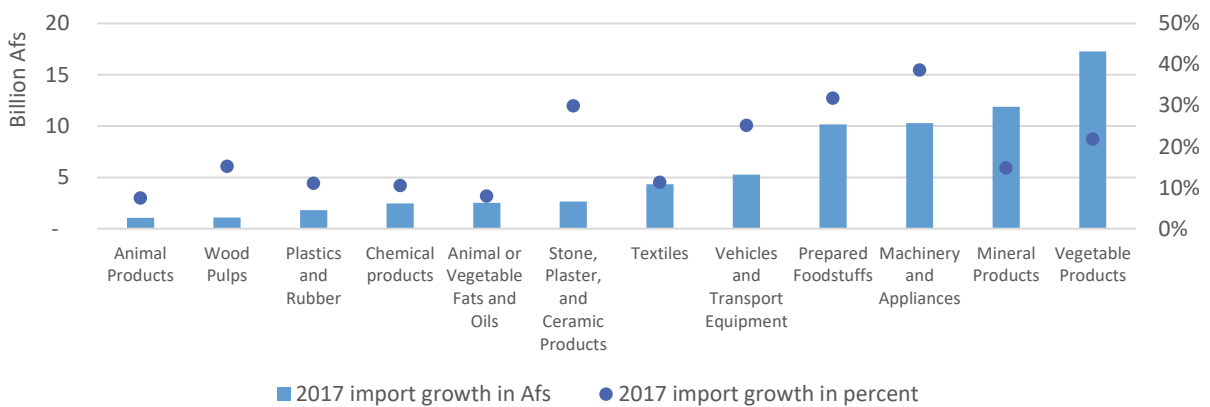


**Figure 9: Imports in 2017 were dominated by food, energy, and machinery**  
(Percent)



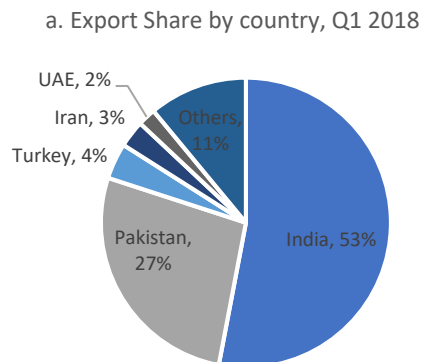
Sources: Afghanistan Customs Department

**Figure 10: Import growth in 2017 was driven by increased food, fuel, and machinery imports**  
(Change from 2016 to 2017)



Sources: Afghanistan Customs Department

**Figure 11: Export growth in 2018 was driven by high-value fruit exports, mostly to India**



Source: Afghanistan Living Condition Surveys 2007/2008, 2011/12, 2016/17

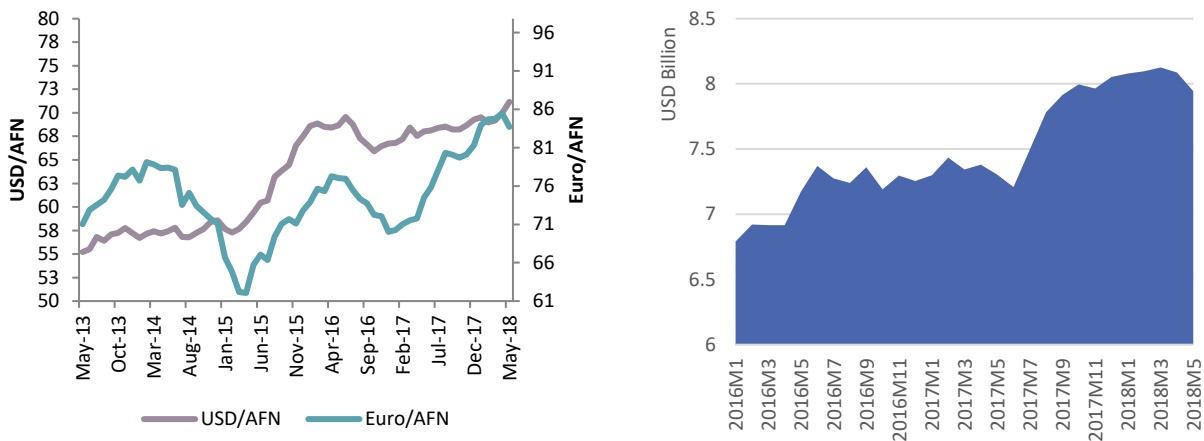
**The afghani gradually depreciated over 2017 and into the first quarter of 2018**

After appreciating slightly at the end of 2016, the afghani depreciated steadily by around 4 percent against the US dollar during 2017 (end period). Depreciation against the Euro was more pronounced, reaching 16 percent over 2017. In contrast, the afghani remained stable against the Pakistani Rupee. Despite increased US dollar sales by Da Afghanistan Bank, aimed at stabilizing the currency, depreciation against the US dollar accelerated in the first half of 2018, driven mostly by general strengthening of the US dollar but potentially reflecting capital outflows associated with political uncertainties. The afghani fell by 6 percent against the US dollar between end-December 2017 and end-June 2018. As of end-June, 2018, the afghani exchange rate stood at 73.6 per US dollar and 85.6 per Euro.

**Foreign exchange reserves continue to accumulate**

The current account remained in surplus through 2017, at approximately 1.6 percent of GDP. The continued current account surplus in the context of a wide trade deficit reflects continued large aid inflows. Driven by the current account surplus, foreign exchange reserves continued to accumulate, reaching an estimated US\$8.2 billion at end-2017, equivalent to more than one year of merchandise import cover. This represents an 11 percent increase in reserves over end-2016 levels. In the three months to March 2018, foreign exchange reserves increased slightly with slowing imports offsetting declining exports, before declining in the first two months of the second quarter.

**Figure 12: The afghani continues to depreciate, while foreign exchange reserves build**  
(Percent)



Source: *Afghanistan Living Condition Surveys 2007/2008, 2011/12, 2016/17*

**4. Fiscal sector**

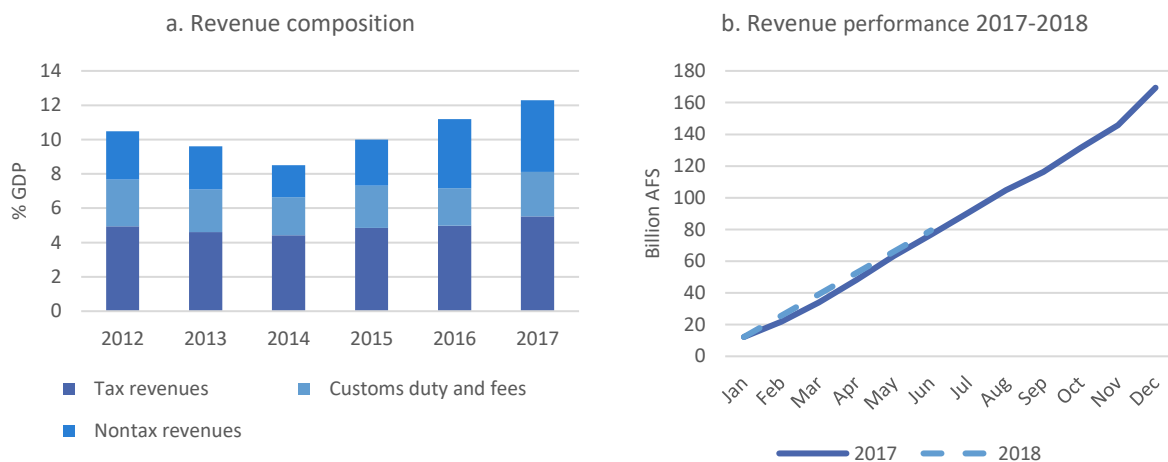
**Revenue collection remained strong in 2017**

Domestic revenues grew strongly for the third consecutive year in 2017, reaching AFS169 billion. This exceeded budgeted revenues of AFS160.6 billion by around 5.5 percent. Nominal revenue growth in 2017 was around 15 percent, following total revenue growth of 20 percent in 2016 and 22 percent in 2015. In the absence of major tax policy changes, the improvement is largely attributable to tax and customs administration and enforcement and increased non-tax revenues associated with new fees and charges. These improvements led to increases in the average value of customs declarations by around 6 percent, reflecting a reduction in under-valuation of imports. Revenue performance is now at a record high for Afghanistan. As a share

of GDP, domestic revenues reached 12.3 percent of GDP in 2017, exceeding the previous peak of 11.7 percent achieved in 2011/12.

Revenue growth is expected to moderate in 2018. Following consecutive years of rapid revenue growth within a slow-growing economy, the potential to further achieve revenue improvements from administration and enforcement improvements is near exhaustion. Customs control may come under pressure in the context of upcoming elections based on the experience of past election periods. Revenue data for the first half of 2018 shows only a slight improvement over collections for the same period in 2017, with the difference only slightly exceeding the rate of inflation.

Figure 13: Revenue growth has been strong for several years, but is now slowing



Source: Ministry of Finance data

**Expenditures increased only slightly in 2017**

Total expenditure growth in 2017 reached only 0.5 percent. An 8 percent reduction in security expenditure drove a 2.5 percent decline in overall recurrent spending. Reduced security expenditures reflected reduced allocations for goods and services in Ministry of Defense and Ministry of Interior. Declines in security expenditures largely offset growth in civilian spending, especially in the discretionary development budget.<sup>2</sup> Civilian expenditure growth was led by a large jump in discretionary development expenditures (nearly 40 percent, or around AFS 11.6 billion) and strong growth in wage and salary expenditure (7.4 percent, or around AFS 4.4 billion). Increased discretionary development expenditure was supported by improvements in execution of the development budget, which increased from 55 percent in 2016 to 68 percent in 2017.

**The 2017 budget delivered a modest deficit**

Despite improved revenue performance and declining expenditure, the 2017 fiscal deficit was equal to around 0.5 percent of GDP, up from a roughly balanced budget in 2016. This outcome reflected declines in both discretionary and non-discretionary on-budget grants, with discretionary grants declining by more than 2 percent of GDP in 2017. Total grants in the 2017 budget fell short of budgeted levels by around US\$600 million, reflecting both a shortfall of discretionary grants and weak execution of development projects.

<sup>2</sup> The development budget is divided between ‘discretionary’ and ‘non-discretionary’ categories. The discretionary budget is used for government projects while the non-discretionary portion is used for on-budget donor projects.

**Execution of the development budget continues to improve**

Reforms introduced through the 2018 budget process laid the foundation for continued improvements in budget execution. Formulation of the budget saw an end to the practice of automatically rolling over unspent balances allocated to development projects into the following year, with 2018 allocations subject to careful review based on project quality and execution performance. The 2018 budget also introduced a medium-term framework at the project/program level to make the ongoing costs of budgeting decisions transparent and to enforce consistency between aggregate macro-fiscal projections and expected expenditures at the program level.

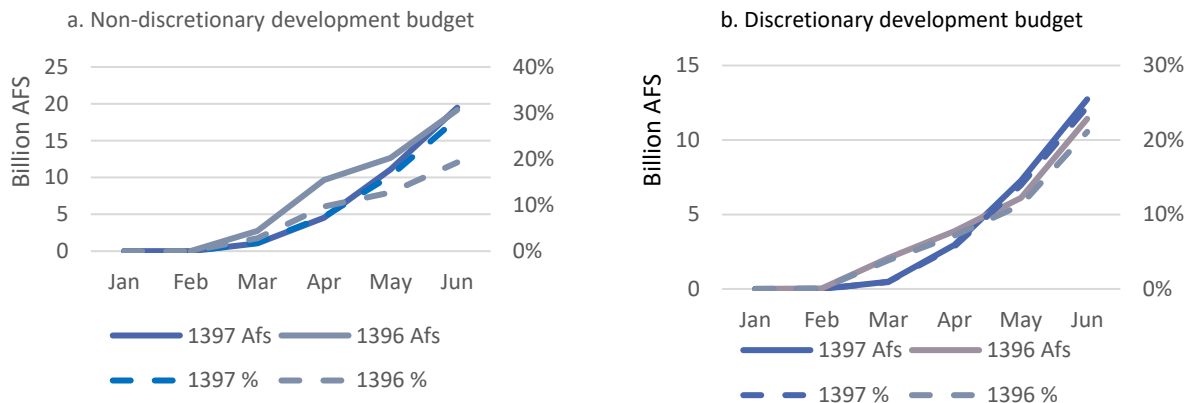
Partly because of the elimination of automatic carry-overs, project execution has strengthened in 2018, likely supporting an improvement in the overall budget execution rate for the year. As of end-June 2018, execution of the non-discretionary development budget was at 29 percent, relative to 19 percent in 2017. Execution of the discretionary development budget was at 24 percent relative to 21 percent in 2017. Improved execution rates are generally driven by reduced budgeted expenditures rather than improved execution capacity, with actual execution in afghani terms tracking close to 2017 levels.

**The mid-year budget review projects a deficit of around 0.5 percent of GDP**

Amendments to the 2018 budget saw additional allocations for development expenditures, financed partly through reductions in recurrent allocations and partly through an additional ‘unfunded’ budget deficit of around AFS14.3 billion (US\$209 million). These revisions to the budget more than doubled the projected deficit after grants from around 0.8 percent of GDP to around 2 percent of GDP.

Government, through its mid-year budget review, is now seeking to restrict the deficit to around 0.5 percent of GDP. Some development expenditure has been restrained through a review of project performance and the identification of savings through reallocation away from poorly-performing projects. Discretionary grants and revenues are also expected to exceed budgeted levels, supporting a reduction in the deficit to within targeted levels. The deficit will be financed mostly from cash reserves, which remain at comfortable levels (around AFS 40 billion).

**Figure 14: Execution of the development budget has improved**  
(Execution rate in percent, and total cumulative expenditures to date)



Source: Ministry of Finance data

## 5. Monetary and financial sector developments

### Money demand declined slightly in 2017

Da Afghanistan Bank targets monetary aggregates. The broad money (M2) growth rate, which include currency-in-circulation and deposits in commercial banks, increased during 2017 (4 percent year-on-year, at end-December in nominal terms). This represented a much slower growth rate than during 2016 (9.7 percent over the previous period). The year-on-year currency-in-circulation growth rate also slowed during 2017 to 2 percent (year-on-year at end-December) from 10 percent in the previous period. Growth in commercial bank deposits was similarly subdued. Commercial deposits in afghanis grew by only around 11 percent in 2017, relative to 21 percent in 2016, while deposits in US dollars grew by just 1 percent, relative to 8 percent in the previous year. This partly reflected a reduction in Da Afghanistan Bank's capital notes rate.

### Credit growth resumed in 2017

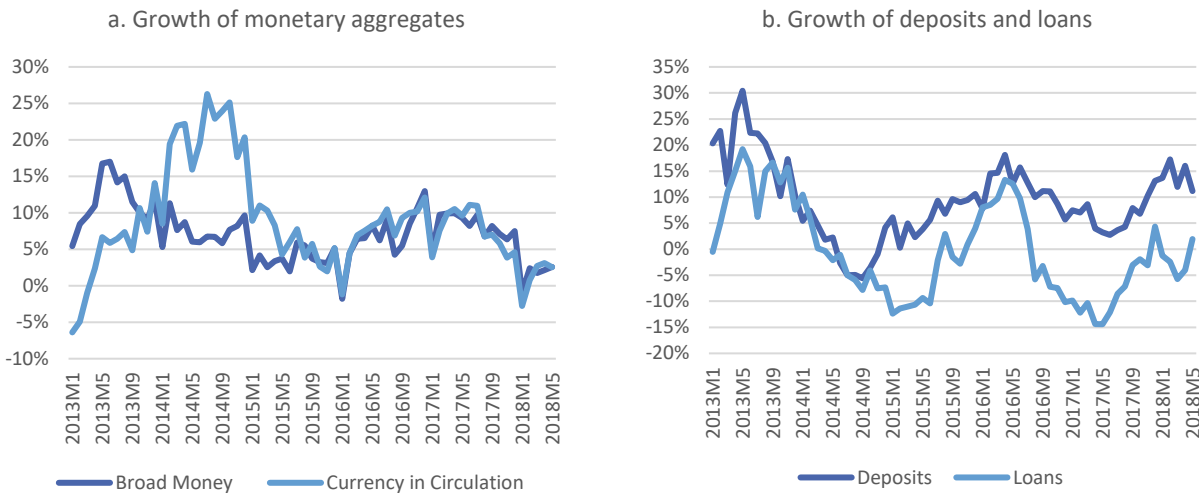
Credit to the private sector resumed gradual growth in 2017, increasing by 3 percent over the year to December, 2017, after remaining flat through 2016. Growth in credit to the private sector is consistent with the recent uptick in economic activity and improvement in investor sentiment observed through the first three quarters of 2017, but was supported by exchange rate effects, with depreciation of the afghani driving an increase in the value of USD-denominated loans in local currency terms. Local currency credit to the private sector grew by around 2.4 percent from 2016, while credit denominated in USD grew by around 3.8 percent. Total credit to the private sector, however, remains well below 2014 levels.

Reflecting high dollarization of the Afghan economy, the shares of foreign-denominated loans and deposits remain substantial, at 58 percent and 68 percent respectively at end-2017. In both cases, this is a slight decline from the previous year (59 percent and 70 percent respectively). The quality of bank assets improved slightly, with non-performing loans declining to 12.2 percent at end-2017, from 12.7 percent at end-2016. Banks remained profitable through 2017, with most profit being derived from non-interest income.

### Available financial sector indicators suggest declining confidence in the first half of 2018

Broad money and currency in circulation year-on-year growth rates to May 2018 slowed significantly relative to the same period the previous year (currency in circulation grew by just 1.5 percent, relative to 8 percent the previous year). Deposits in afghanis increased, while foreign exchange deposits declined over the five months to May 2018 (21 percent increase compared to 25 percent decrease), potentially indicating transfer of assets overseas. Dollar outflows may be driven by the informal currency trade in Iran, which is facing a shortage of US dollars in the context of international sanctions. Credit to the private sector declined rapidly over the first four months of 2018 before recovering in May, but is still around 2 percent lower than end-December 2017. Da Afghanistan Bank is expected to continue to reduce the capital notes rate in an effort to stimulate increased lending to the private sector.

**Figure 15: Money demand declined through 2017 even as credit to the private sector expanded**  
*(year-on-year percent change)*



Source: Da Afghanistan Bank

**The financial sector remains underdeveloped, constraining investment and growth**

Assets of the banking sector totaled 23 percent of GDP in 2018. The value of credit intermediated to the private sector by banks, however, remains at around 3.3 percent of GDP (down from around 3.6 percent of GDP in 2016). Consequently, bank asset-to-deposit ratios remain extremely high, at around 74 percent at end-2017. Weak intermediation reflects under-development of the financial sector, including limited access to financial services for many Afghans, as well as weak confidence constraining credit demand and difficult economic conditions constraining the number of viable projects.

## B. Outlook and Medium-Term Prospects

### **Growth is expected to remain sluggish over coming years**

Growth over 2018 is expected to reach 2.4 percent, a slight decline from 2.7 percent growth in 2017, reflecting continued drought conditions and investor uncertainty in the lead-up to parliamentary and presidential elections. Government consumption and investment is expected to increase only slightly. Private consumption is expected to be depressed by continued drought conditions, while private investment will likely be adversely impacted by uncertainty approaching the elections. International sanctions on Iran are expected to negatively impact the Afghan economy given Iran's role as a trading partner and source of remittances. Over the medium-term, growth is expected to gradually accelerate as drought conditions abate and confidence picks up. Growth is expected to reach 2.8 percent in 2019, and increase gradually to 3.6 percent by 2021.

### **A small deficit is expected in 2018**

Reflecting current strong performance against revenue targets and the expectation of additional discretionary grants, the budget deficit for 2018 is projected at 0.4 percent of GDP. Revenues are expected to remain constant in percentage GDP terms, with a nominal increase of around 2 percent. Expenditures are projected to grow by around 5.2 percent, driven mostly by security and non-discretionary development project expenditures. Security expenditure increases are driven by Government taking on greater responsibility for provision of security services, while growth of the development budget reflects continued efforts by development partners to move aid on-budget. On-budget donor grants are expected to reach around 13.7 percent of GDP.

Over the medium-term, revenues are expected to remain stable as a proportion of GDP over 2019-2021. Revenue projections do not currently include the potential impacts of the proposed VAT, which is scheduled to be implemented in 2021. This policy reform could have a significant impact on domestic revenue performance.

### **The current account surplus will evaporate as grants decline**

The trade balance is expected to widen to around 40 percent of GDP. While the pace of export growth will exceed import growth, absolute increases in imports will continue to outstrip absolute increases in exports. The current account balance will remain in slight surplus (around 0.2 percent of GDP) supported by aid inflows. As aid declines over the medium-term, the current account is expected to move into deficit, reaching a deficit of 4.1 percent of GDP by 2021.

As the current account surplus narrows, foreign exchange reserves will stabilize in 2018, before beginning to decline from 2019. Reserves are expected to remain at comfortable levels, however, equal to more than 10 months of merchandise import cover by end-2021.

Consumer price inflation is expected to slow to 3 percent in 2018, reflecting the slight decline in economic activity, credit growth, investment, and money demand. As growth picks up slightly, over the medium-term inflation is expected to accelerate to around 5 percent. This assumes continued stability of international commodity prices, as currently predicted, and gradual depreciation of the afghani against major trading currencies.

	2015	2016	2017	2018	2019	2020	2021
	Actuals/Estimates			----Staff projections----			
<i>Growth and prices</i>							
Real GDP growth (%)	1.5	2.3	2.7	2.4	2.8	3.2	3.6
Nominal GDP (Af billion)	1,223	1,314	1,376	1,450	1,564	1,693	1,839
CPI Inflation (period average, %)	-0.7	4.4	5.0	3.1	5.0	5.0	5.0
<i>Fiscal</i>							
	% GDP						
Revenues and grants	25.3	26.9	25.3	25.4	26.0	26.5	26.4
Domestic Revenues	10.0	11.2	12.3	12.3	12.3	12.3	12.3
Foreign grants	15.3	15.8	13.0	13.1	13.7	14.2	14.1
Total expenditures	26.0	26.9	25.8	25.8	26.2	26.6	26.6
Recurrent expenditures	19.3	19.8	18.4	18.4	18.6	18.9	18.9
Development expenditures	6.7	7.1	7.4	7.4	7.5	7.7	7.7
Overall balance (incl. grants)	-0.7	0.0	-0.5	-0.4	-0.2	-0.1	-0.2
Overall balance (excl. grants)	-16.0	-15.7	-13.5	-13.5	-13.9	-14.4	-14.3
<i>External</i>							
	% GDP						
Merchandise Trade balance	-35.8	-31.6	-33.6	-34.4	-34.2	-33.4	-32.3
Current account balance (incl. grants).	7.5	7.1	1.6	0.2	-1.2	-1.6	-4.1

**The short-term outlook is subject to significant uncertainties, given the unpredictable political and security situation**

Afghanistan faces substantial risks in the short-term arising from the possibility of political instability and violence in the context of upcoming elections. Elections of 2014 saw a major and unexplained declines in revenues (from 9.6 percent of GDP in 2013 to 8.5 percent of GDP in 2014), likely driven by increased revenue leakage in the context of election-related political economy pressures. The formation of the National Unity Government saw a disruption in reform progress as political competition came to delay the appointment and confirmation of senior officials. Political instability undermined investment confidence, with negative impacts on growth (which declined from 5.6 percent in 2013 to 1.5 percent in 2015). A similarly disruptive election period could have major negative impacts on revenues, investment, and growth over 2018, 2019, and beyond. On the other hand, progress with a negotiated peace settlement with the Taliban could have a major positive impact on investment confidence, potentially spurring accelerated growth and improved government revenues.

**Afghanistan remains heavily dependent on aid**

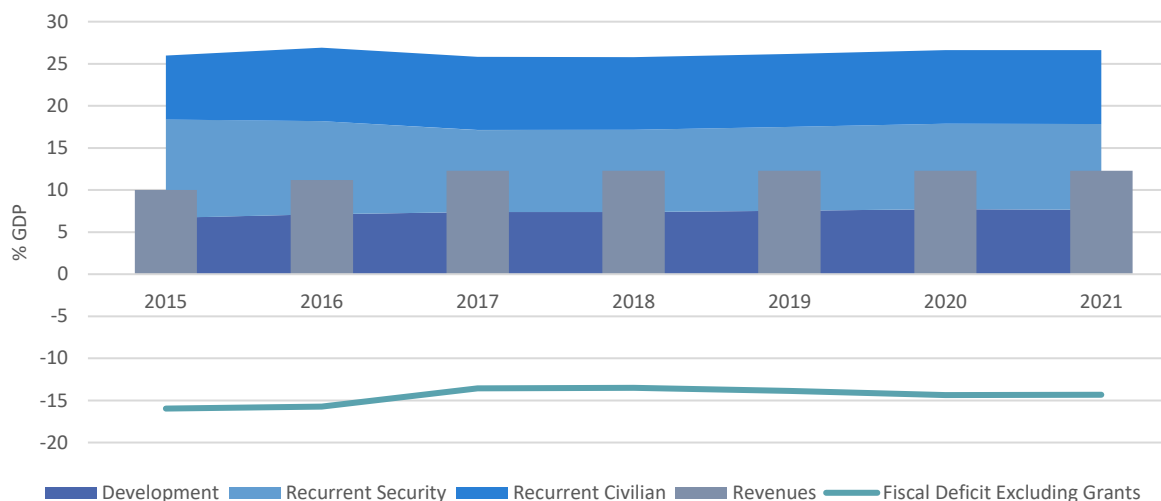
Economic projections are highly sensitive to the level and modality of aid flows. Grants to Afghanistan are currently estimated at around 40 percent of GDP. External grants are currently relied on to finance more than half of budget expenditures and vital off-budget security and service delivery functions. The substantial trade deficit (around 40 percent of GDP) is financed almost entirely by aid inflows.

Aid levels are expected to approximately halve by 2030 (to around 20 percent of GDP), remaining substantially above the average for low-income countries (around 10 percent of GDP). With the Government of Afghanistan facing major upcoming



expenditure pressures related to taking on increased responsibilities in the security sector and meeting the maintenance costs of donor-financed assets and infrastructure, any sudden reduction in aid levels below currently committed levels would have major implications for fiscal sustainability. Failure by development partners to move an increasing share of aid on to the budget over time would similarly constrain Government's capacity to meet looming expenditure pressures without major disruptive adjustments, with likely negative impacts for service delivery.

**Figure 16: Budgets will remain highly dependent on aid inflows**  
(Percent of GDP)



Sources: Ministry of Finance data, World Bank staff projections

### A step-change in growth is required for substantive poverty reduction

Under current projections, Afghanistan is unlikely to make major progress in reducing poverty. Growth is expected to accelerate to around 3.6 percent by 2021. But with a current population growth rate of around 2.7 percent, a much faster growth rate will be required to significantly improve incomes and livelihoods for most Afghans, or provide jobs for the approximately 400,000 young Afghans entering the labor force every year. In the short term, improved rates of economic growth could be driven by: i) careful prioritization of public investment towards sectors where the direct economic impacts are highest; and ii) addressing avoidable constraints to private investment, including unnecessary regulatory barriers. Over the medium-term, economic development progress will depend on mobilizing the sectors with greatest capacity to support increased growth, job creation, exports, and government revenues. This is likely to require a balanced growth strategy, including increased investment in agricultural productivity (including through expanded irrigation), increased investment in human capital, and the realization of Afghanistan's substantial extractives potential.

## C. Focus Section I: Afghanistan's Trade Potential

### 1. Background

**Trade could be an important channel for accelerating growth in Afghanistan**

Trade can promote the efficient allocation of resources; allow a country to realize economies of scale and scope; facilitate the diffusion of knowledge; foster technological progress; and encourage competition in both domestic and international markets, which leads to an optimization of production processes and the development of new products. Complementary policies—regarding infrastructure, skills, institutions—can enhance the impact of trade on growth and poverty.

This focus section answers the following questions:

- What explains Afghanistan's recent trade performance?
- What strategy should Afghanistan pursue to maximize the benefits of trade?
- What are the prospects of transit trade for Afghanistan and what are the priorities for realizing transit trade opportunities?

#### Box: Key messages for policy

- Improving productivity in high potential sectors such as agriculture will help meet domestic demand, substitute imports, and potentially promote exports in the short- and medium-term.
- In the short term, exports could be improved by tackling export delays related to customs and border procedures, or high risks during transportation in the short term. In the long run, improvements in trade facilitation and logistics coupled with Afghanistan's productivity converging to regional levels could lead to a more than six-fold increase in exports.
- Efficient logistics, well-designed and maintained infrastructure, and an adequate framework of regulation and regional cooperation are pre-requisites for Afghanistan to realize the potential benefits of transit trade in commodities and energy.

### 2. What explains Afghanistan's recent trade performance?

**Trade has played a limited role as an engine for growth in Afghanistan**

Afghanistan's recent trade performance has been driven by reconstruction and aid inflows. Large aid influx has driven high imports in a variety of consumption goods and equipment. In the last two decades, the country's trade balance has been negative. Over the period 2012-16 Afghanistan's exports of goods and services rose from US\$1.13 billion to US\$1.34 billion, an increase of only 18.5 percent. Imports grew at a similar rate (18.7 percent) from US\$8.04 billion to US\$9.54 billion. The structural trade deficit in goods and services has remained around 40 percent of GDP in recent years, reaching 42.1 percent in 2016, and exports amounted to only 6.9 percent of GDP in 2016 (Figure 17).

**Figure 17: Trade-to-GDP ratio in Afghanistan, 2012–16 (%)**

(Percent of GDP)



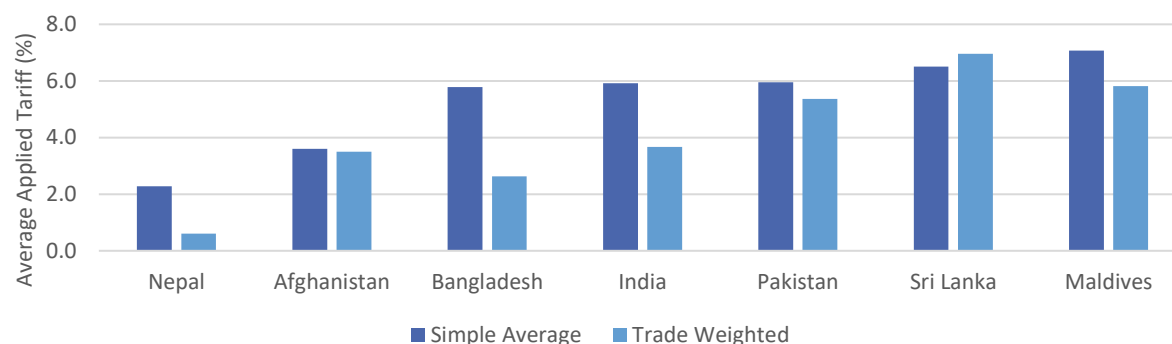
Sources: Calculations based on the World Bank’s World Integrated Trade Solutions (WITS) database.

**Afghanistan’s trade performance is weak despite relatively good access to international markets**

A gravity analysis<sup>3</sup> suggests that Afghanistan underperforms in trade, even compared to its neighbors and countries at similar levels of development. In addition, Afghanistan exports less than expected to markets where it has access, suggesting that there are barriers to trade that are common to most of the destinations instead of a lack of market access. Afghanistan faces relatively lower tariffs than its neighbors do (see Figure 18 **Error! Reference source not found.**). It also has preferential access via GSP to the EU and the United States, two of the largest markets outside its neighbors. On average, Afghan exports are benefiting from tariff rates that are 10 percent points lower than its competitors.<sup>4</sup>

**Figure 18: Average Applied Tariffs on country exports, 2016**

(Percent)



Sources: ITC/World Bank database from Espitia, Mattoo, Mimouni, Pichot and Rocha (2018)

**Afghan firms exhibit poor export performance**

The low proportion of exporters among all Afghan companies, and their poor performance in export markets, suggest low export capabilities and high barriers to trade. According to the World Bank Enterprise Survey, only 6.7 percent of the 410 surveyed Afghan firms were exporters in 2014 (see Table 1). This share is low

<sup>3</sup> Gravity analysis uses econometric techniques to evaluate individual observations on trade between countries over time, against the gravitational ‘mass’ of explanatory variables such as GDP and distance that describe the characteristics of bilateral trade between partners. Anderson and van Wincoop (2003), Feenstra (2004), and Baldwin and Taglioni (2006), among others, present exhaustive literature reviews on the gravity equation as applied to international trade.

<sup>4</sup> Calculations based on competition adjusted preference margins. See Espitia, Mattoo, Mimouni, Pichot and Rocha (2018) for reference.

compared with averages for the South Asia region (13 percent) and Organization for Economic Co-operation and Development countries (36 percent). Low export performance is associated with low levels of foreign investment, which can provide an important conduit for acquiring knowledge and technology. Foreign direct investment (FDI) flows into Afghanistan were less than 1 percent of GDP in recent years.

**Table 1: Share of firms exporting at least 1 percent of sales, Afghanistan and comparators, 2013-14**

	% of Exporter firms
Pakistan	18.60
<b>Afghanistan</b>	<b>6.70</b>
Kazakhstan	5.00
Azerbaijan	1.90
South Asia	12.9
High income: OECD	35.70

Source: World Bank Enterprise Surveys

Note: Shares for Afghanistan are from 2014; for Pakistan, Kazakhstan, and Azerbaijan are from 2013. 410 enterprises were surveyed in Afghanistan in 2014. The sectors covered are manufacturing (40 percent), retail (20 percent), and services (40 percent).

**Heavy trade concentration renders Afghanistan susceptible to external shocks**

During 2014-16, average exports were concentrated in a handful of vegetable products such as grapes, insect resins and tropical fruits, representing 17.3 percent, 8.7 percent, and 8.6 percent of total exports, respectively. The top 10 exported product categories represented more than 70 percent of Afghanistan's total exports (see Table 2). Afghanistan also exports a limited number of goods to a restricted list of destinations. The top five destinations—Pakistan, India, United Arab Emirates, United States, and Turkey—account for 94.8 percent of exports (see Table 3). On the import side, the top 10 imported goods represented 43.9 percent of the country's total imports in 2016 and 70 percent of Afghanistan's imports originated from few neighbors or war-related partners. In addition, the limited value of intermediary imported inputs suggests weak integration in GVCs and confirms that imports might not translate into productivity gains.

**Table 2: Top-10 trade sectors in Afghanistan, Average 2014-16 (HS-4)**

Industry	Exports	Share of total (%)	Industry	Imports	Share of total (%)
Grapes	137,777	17.3	Telephones	1,035,231	14.7
Coal Briquettes	70,566	8.9	Wheat Flours	489,011	6.9
Raw Cotton	70,387	8.8	Refined Petroleum	302,650	4.3
Insect Resins	68,996	8.7	Raw Sugar	290,458	4.1
Tropical Fruits	68,398	8.6	Armored Vehicles	199,679	2.8
Scrap Iron	47,003	5.9	Aircraft Parts	192,100	2.7
Other Nuts	46,436	5.8	Other Engines	173,563	2.5
Dried Legumes	28,721	3.6	Cement	171,179	2.4
Soapstone	21,648	2.7	Jewelry	128,881	1.8
Onions	19,157	2.4	Rice	117,308	1.7
<b>Top-10 Industries</b>	<b>579,089</b>	<b>72.7</b>	<b>Top-10 Industries</b>	<b>3,100,060</b>	<b>43.9</b>

Source: Calculations based on the World Bank's World Integrated Trade Solutions (WITS) database

Note: Calculations are made using mirror data. Average exports do not include 2016 gold exports as they do not reflect Afghanistan export basket and might be related with transit trade.

Table 3: Top 10 Afghanistan trade partners, Average 2014-16

Destination	Exports	Share of total (%)	Origin	Imports	Share of total (%)
Pakistan	384,069	48.2	United Arab Emirates	2,162,653	30.6
India	280,923	35.3	Pakistan	1,657,034	23.5
United Arab Emirates	17,411	2.2	United States	611,081	8.6
United States	14,908	1.9	India	479,603	6.8
Turkey	12,592	1.6	Kazakhstan	397,614	5.6
China	11,210	1.4	China	395,003	5.6
Germany	10,089	1.3	Russian Federation	246,319	3.5
Russian Federation	9,347	1.2	Azerbaijan	169,873	2.4
France	7,584	1.0	Turkey	164,385	2.3
Finland	6,807	0.9	Germany	97,944	1.4
<b>Total</b>	<b>796,693</b>		<b>Total</b>	<b>7,066,110</b>	

Source: Calculations based on the World Bank's World Integrated Trade Solutions (WITS) database

### 3. What strategy should Afghanistan pursue to maximize the benefits of trade?

#### Insufficient production capacity is Afghanistan's largest constraint for production and trade

Afghanistan's export base is still extremely narrow, reflecting the country's limited agricultural production and very small manufacturing base. The GDP share of both agriculture and industry is on average 20 percent and has not increased over time. Top exported products such as fruits and nuts represented only one-fourth of agricultural GDP in 2015. Other traded products such as textiles, wood, and paper represented less than 1 percent of manufacturing GDP.

Increased productivity in the agricultural sector is fundamental to meet domestic demand, substitute imports, and potentially promote exports in the short and medium term. Given limited government resources, intervention should focus on sectors with high potential such as agriculture and agribusiness. They all enjoy comparative advantage and could be the first movers of the agricultural sector toward substituting imports, which would assist in increased food security and open new export opportunities. Increases in competitiveness should also be coupled with action plans to enhance female participation in agricultural activities, given that they represent a significant source of income for the female population.

Three complementary actions could improve agricultural productivity in the short-medium run:

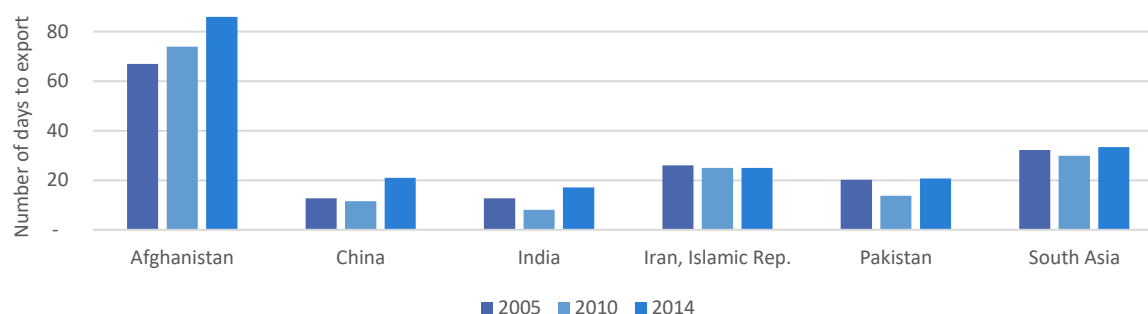
- Improvement of adequate irrigation facilities. Afghanistan's irrigated lands can be substantially increased with the rehabilitation of traditional irrigation systems. High-level coordination among line ministries and improvement of irrigation water management through definition of a legal and regulatory framework are also key.
- Better access to high-quality inputs. Efforts should focus on the creation of an effective regulatory system and on strengthening the capacity of Ministry of Agriculture, Irrigation and Livestock to enforce certification of seeds and veterinary medicines and vaccines, among others; control banned pesticides; constantly monitor domestic supplies; and prevent imports of low-quality and hazardous agricultural inputs.
- Better access to technology. To deliver better technologies for farmers and increase yields and productivity, the capacity of the national research system needs to be strengthened, for example, through the rehabilitation and strengthening of the existing networks of research stations, and

collaborations with international research centers working in similar agroecological areas.

**While productive capacity is the main constraint, trade is also impaired by logistics and infrastructure**

Afghanistan is a landlocked country with complex topography, underdeveloped road infrastructure, and high transportation costs. Firm-level surveys suggest that delays at the border, followed by domestic transportation, are the main causes of export delays. It took Afghan exporters 86 days on average to ship their goods in 2014, compared to 33 days on average for South Asia, 21 days for Pakistan, 25 days for the Islamic Republic of Iran, 21 days for China, and 17 days for India (see Figure 19). Enterprise surveys suggest that nearly half of surveyed firms see transport as a major or severe obstacle to export. In addition, there is an increasing share of surveyed firms reporting customs and trade regulations as a major or severe obstacle to export. Around 85 percent of total time spent to export is related to documentary compliance, and 15 percent is due to border compliance.

**Figure 19: Time to export, Afghanistan and comparators, 2005-14**  
(Days)



Sources: Doing Business Survey (2018)

**Improvements in trade facilitation and logistics could enhance exports in the short term**

Even with existent infrastructure, export flows could be improved by 20 percent in the short term by tackling export delays related to customs and border procedures or high risks during transportation. A simulation exercise suggests that reducing export delays to 25 days could increase overall exports in goods by 20 percent, which corresponds to US\$160 million on average per year. Three complementary methods could improve trade logistics:

- Improve efficiency of documentation requirements and processes. The number of documents and authorizing signatures required for trade operations should be reviewed for consistency with international good practices. In the medium term, the Government of Afghanistan should work to automate all trade-related requirements and procedures into a National Single Window (NSW) system.
- Reduce waiting times at the border. Opportunities exist to review and rationalize border operations to eliminate inefficiencies. These include improving cooperation and information sharing among the various government agencies mandated to operate at the border; operationalizing the ASYCUDA World's advance declaration and manifest functionalities

to allow prescreening of consignments prior to their arrival at the border; reducing congestion by separating pedestrian and truck traffic; expanding border capacity and related infrastructure; and implementing cargo tracking to better manage the risks associated with movement of goods.

- Improve interagency cooperation on trade facilitation matters. Consistent with the commitments of the World Trade Organization (WTO) Trade Facilitation Agreement (TFA), it is recommended that the Government of Afghanistan formally mandate customs and other key border management agencies to maintain a National Trade Facilitation Committee (NTFC) to provide a formal mechanism for enhanced interagency cooperation and improved dialogue with the private sector.

**In regional cooperation, existing trade agreements with regional partners can be deepened and expanded**

Strengthening trade agreements would facilitate visa processing and improve transport and logistics, and help with the harmonization and simplification of customs procedures in line with international standards and regional commitments. In the case of Pakistan, the main destination and transit country for Afghanistan's exports, a strengthening of the dialogue between the two countries to accelerate de-bottlenecking of the Afghanistan-Pakistan Transit Trade Agreement would be fundamental to reduce uncertainties related to merchandise transportation and to more broadly ensure gains from trade.

#### 4. What are the prospects of transit trade for Afghanistan and what are the priorities for realizing transit trade opportunities?

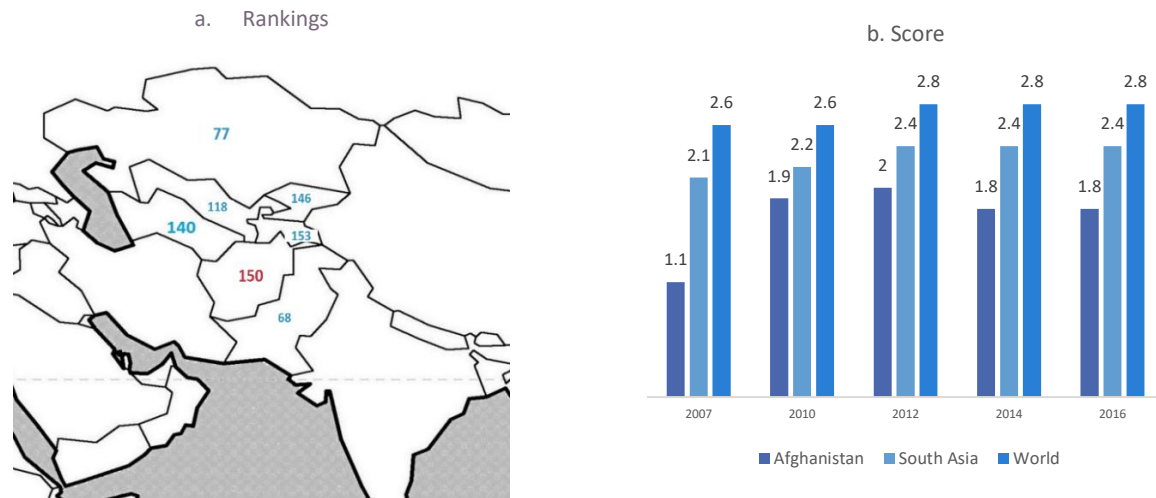
**Potential gains from merchandise transit trade may be slow to materialize**

Transit trade in goods is often emphasized as an obvious opportunity for Afghanistan, but until recently it has not been clear how large this potential is. Approximately US\$5.7 billion of trade in goods could potentially transit through Afghanistan. Gains for the country could grow to an estimated 5 percent of that amount (US\$285 million per year), around 1 percent of GDP. Gains from transit trade are realized through the collection of transit revenues, and through job creation in associated activities, such as rest stops and servicing. There could also be indirect benefits of increased transit trade, through reductions in transport costs for Afghan traders.

Realizing these benefits requires efficient logistics, well-designed and maintained infrastructure, and a propitious framework of regulation and regional cooperation. Globally and within the region, Afghanistan shows the weakest performance in the logistics and transportation category of the World Bank's Logistics Performance Index (LPI), ranking 150th out of 160 countries in 2016 (Figure 20). Logistics efficiency in Afghanistan is challenged by long waiting times at borders and complex customs procedures. Infrastructure is also likely to be a serious constraint, as Afghanistan's transportation (roads and railroads) network is currently very underdeveloped. With its challenging terrain and after decades of internal conflict, Afghanistan has consistently ranked in the lowest group of the LPI infrastructure index, well below South Asia and the world average (Figure 20). Achieving a competitive edge in transportation and logistics will require large investments in

transportation and border infrastructure, which will compete with infrastructure demands in productive sectors.

Figure 20: Logistical Performance Index for Afghanistan and neighboring countries, 2016



Source: Logistical Performance Index

Note: The infrastructure index is one of the components of the LPI. This index scores the quality of trade and transport infrastructure of countries in a scale from 1 to 5, with 5 representing the best quality.

**A sensible approach to transit trade development should also be based on careful prioritization of infrastructure investment**

A transit trade development strategy should:

- Resolve existing congestion at important trade points (see trade facilitation recommendations above).
- Meet emerging needs in domestic productive sectors such as agriculture and extractives. Implementation of plans to connect all provinces via highways should also aim to connect regional and local roads to the national transportation network. These plans include, for example, the completion of the National Ring Road which, when finished, will connect resource-rich regions in Afghanistan and neighboring countries more directly.
- Create partnerships with the private sector. Public-private initiatives aimed at improving infrastructure would decrease the weight of the infrastructure bill in the government budget.

Transit trade potential is also shaped by sensitive political and geopolitical considerations that are not entirely under Afghanistan’s control. Considering recent international and regional developments, Afghanistan should focus its effort on:

- Updating APTTA. A revised version of the APTTA should contemplate factors such as the shift to a transport trade regime based on reciprocity. The enforcement of measures aimed at minimizing the incidence of customs fraud and avoidance, and monitoring and curbing informal trade is also key.



- Deepening and expanding existing agreements with regional partners. Improvements in visa regimes, harmonization, and simplification of custom procedures would be fundamental to facilitate transit trade.
- Improving harmonization of transportation standards among countries. This has been a recurring challenge, for example, in planning new railways, since there are three different gauges in neighboring countries.

With regards to energy trade, Afghanistan has a geographic advantage for becoming an energy transit hub that would boost economic growth and revenue. Energy transit trade could add 3.1 percent to export growth annually and contribute US\$530 million to revenue by 2030 (1 percent of GDP). Building regional connectivity for energy transit trade can deliver important revenues for the country and help meet its own acute domestic shortages. Major regional energy projects like the *Turkmenistan-Afghanistan-Pakistan-India (TAPI) Pipeline*<sup>5</sup> and *CASA-1000*<sup>6</sup> are evidence of the commitment of countries in the region to integrate and will help build regional connectivity.

Full completion and operationalization of large-scale infrastructure projects such as CASA-1000, TAPI, and TUTAP are essential for Afghanistan to fully benefit from energy transit trade. Although Afghanistan is not in the lead on these projects, the government should constantly monitor the developments of the proposed energy transit projects and be prepared to respond positively if action is required. A plan to respond to partner concerns regarding security, location of offtakes, cost sharing, transit tariffs, and other matters should be implemented.

## References

Anderson, J. E. and E. van Wincoop (2003). “Gravity with Gravitas: A Solution to the Border Puzzle.” *American Economic Review*, 93(1): 170–92.

Baldwin, R. and D. Taglioni (2006). “Gravity for Dummies and Dummies for Gravity Equations.” NBER Working Paper No. 12516, National Bureau of Economic Research, Cambridge

Espitia, A, A. Mattoo, M. Mimouni, X. Pichot, and N. Rocha. (2018) “How preferential is preferential trade?”. World Bank Policy Research Working Paper forthcoming

Feenstra, R. C. (2004). *Advanced International Trade: Theory and Evidence*. Princeton, NJ: Princeton University Press.

Rocha, Nadia (2017). “Trade as a Vehicle for Growth in Afghanistan: Challenges and Opportunities”. World Bank, Washington, D.C.

<sup>5</sup> <https://www.adb.org/projects/44463-013/main>.

<sup>6</sup> <http://www.casa-1000.org/>.

## D. Focus Section II: Recent Developments in Poverty and Welfare

### 1. Background

**Afghanistan has achieved much progress over the past decade, but progress is now at risk**

From 2007 to 2012, Afghanistan witnessed unprecedented economic growth. While the benefits of growth were narrowly concentrated, the period saw major gains in health and education. Since the 2014 security transition the country has faced slow economic growth rates, a deterioration in security, and a displacement crisis, arising from both internal displacement and large numbers of returnees. As job quality remains poor and agriculture stagnant, food insecurity has risen sharply, and one in two Afghans today lives below the national poverty line. This stark deterioration in welfare poses a humanitarian crisis, and is a call for concerted action.

This focus section answers the following questions:

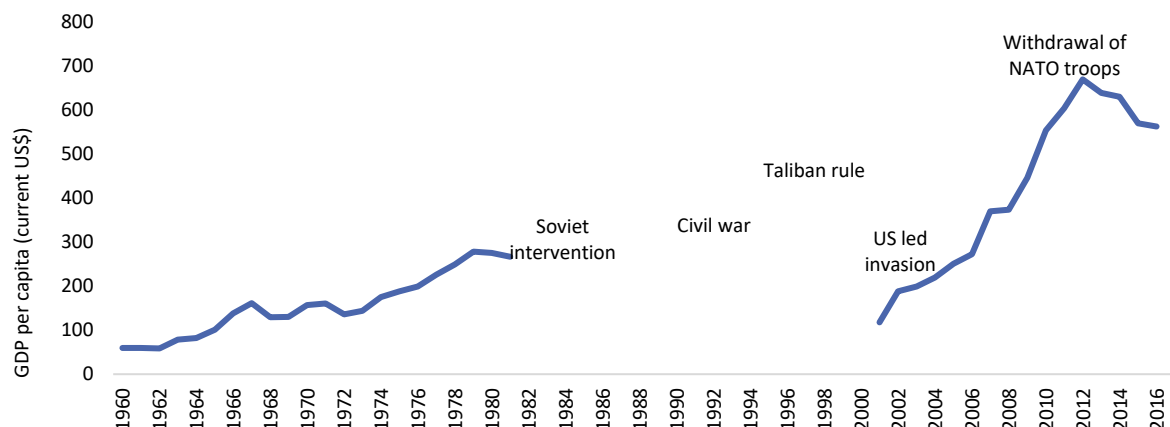
- What are the long-term patterns in income growth and population movement?
- What progress was achieved during the period of reconstruction?
- How has poverty and welfare changed since the drawdown of international security forces?

### 2. What are the long-term patterns in income growth and population movement?

**Economic growth has been repeatedly and severely disrupted over the past four decades**

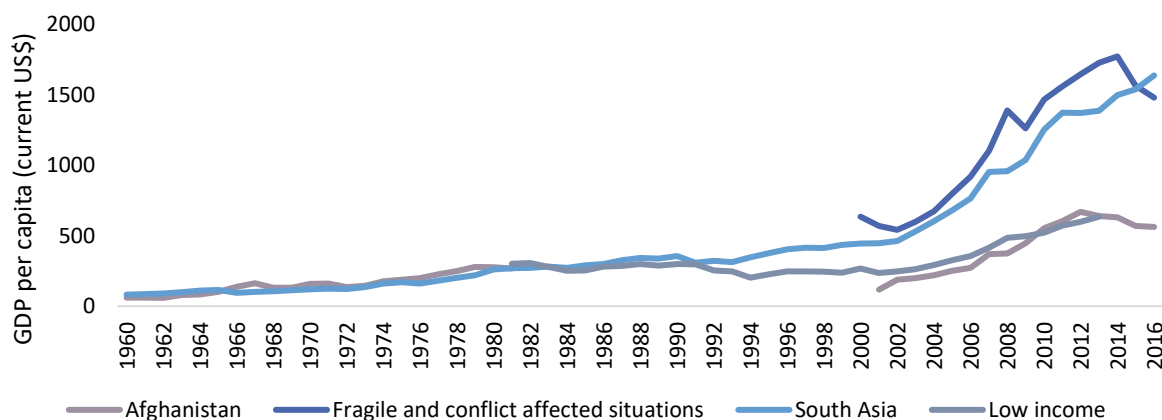
In 1960, Afghanistan was the 6th poorest country in the world in terms of GDP per capita in current US\$. By 2016, it had risen a bare 6 ranks. This bleak picture of long term stagnation masks both advancement and loss. The country's GDP per capita in 2002 was below the last recorded estimate, two decades prior. Since then, and until 2012, the economy grew at faster rates than ever before. Despite this recent growth, Afghanistan remains firmly within the group of low income countries, having been left behind by its regional neighbors, and well below the average for other fragile and conflict affected states.

**Figure 21: Timeline of key events and GDP per capita**  
(Current USD)



Sources: World Development Indicators

**Figure 22: GDP per capita – Afghanistan and Comparators**  
(Current USD)

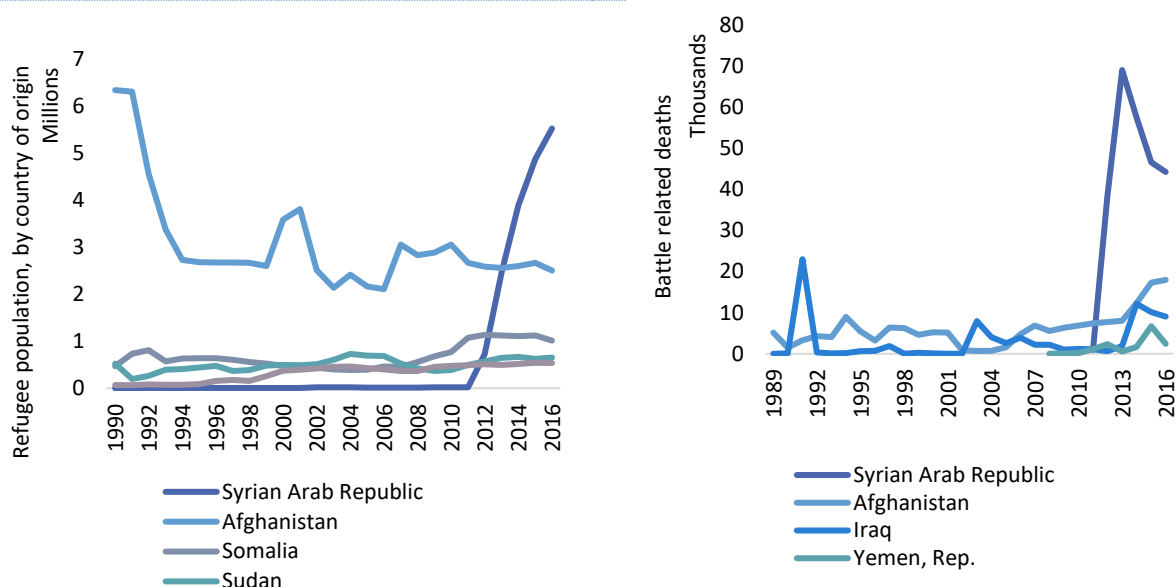


Sources: World Development Indicators

**Conflict-induced population displacements and violence have been a recurrent feature of life for ordinary Afghans**

Large scale population displacements and violence continue to characterize the country. Conflict-induced population displacements have occurred on a massive scale. After the Syrians, Afghans are the largest refugee population in the world, and with the Palestinians, among the most protracted refugee populations. Violence and risks to life have long been a feature of everyday life for Afghans. The scale of battle-related deaths is only eclipsed by the Syrian civil war, the two Gulf/Iraq wars and the IS insurgency. Nowhere has the scale been sustained in the post-World War era over so long as it has in Afghanistan.

Figure 23: Refugees and battle-related deaths by country



Source: World Development Indicators

### 3. What progress was achieved during the period of reconstruction?

**Much was achieved during reconstruction, but key vulnerabilities remained**

The 2001-2014 period was characterized by rapid economic growth and a relatively stable security situation. Over 2003-2013 the economy grew at an average rate of 9 percent per annum, while per capita incomes increased from around US\$200 to around US\$650. Huge gains were made in terms of access to services, with rapid improvements in education provision and health outcomes.

The scale of the long-term development deficits facing the country would take any country decades of sustained effort to address and reverse. Important problems, including lack of productive employment, illiteracy and low levels of education, and huge demographic pressures – remained pervasive.

Throughout the period, most of the population remained highly vulnerable. Welfare gains were limited because growth was not inclusive and broad-based. The 2013-14 Afghanistan Living Conditions Survey (ALCS) showed that poverty reduction stalled from 2007, and a large share of the population adopted negative coping strategies when faced with shocks. The progress made on human development appeared to be at risk, with growing disparities in access to services.

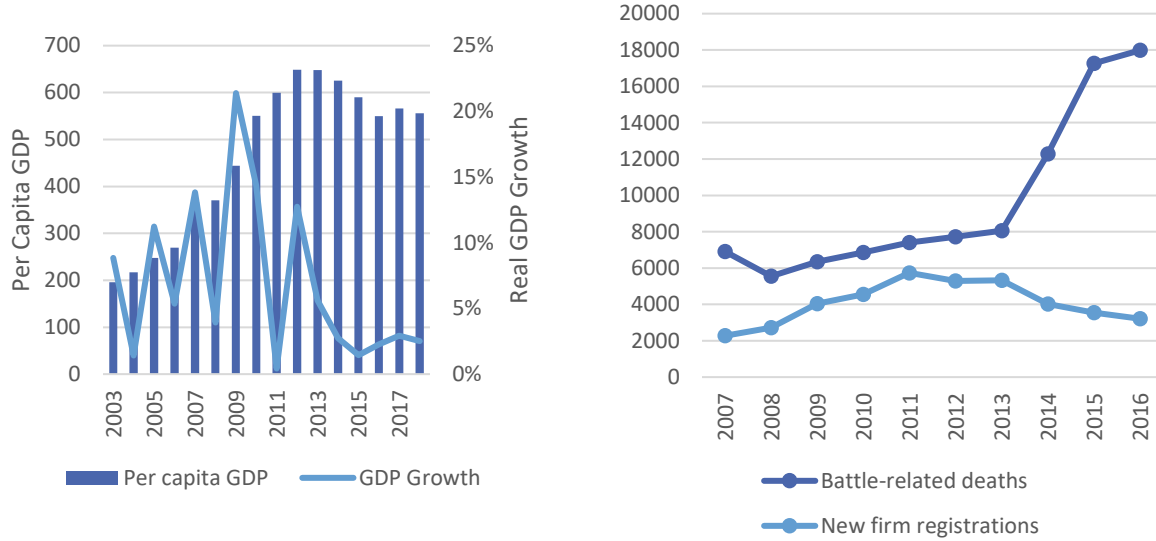
### 4. How has poverty and welfare changed since the drawdown of international security forces?

**Afghanistan has faced impossible odds since the 2014 security ‘transition’**

Afghanistan has faced almost impossible odds since the 2014 drawdown of international security forces and accompanying reduction of aid. The Afghan economy has grown at an average of 2.1 percent between 2013 and 2016, and GDP per capita in 2018 is estimated to be around \$100 below 2012 levels. As a consequence, the poverty rate is estimated to have increased from 34 percent in 2007/08 to 55 percent in 2016/17. Mirroring the increase in poverty, food insecurity has climbed from 30 percent in 2011-2012 to 45 percent in 2016-2017,

driven by an increase in the proportion of severely and very severely food insecure population.

Figure 24: GDP growth, insecurity, and investment trends

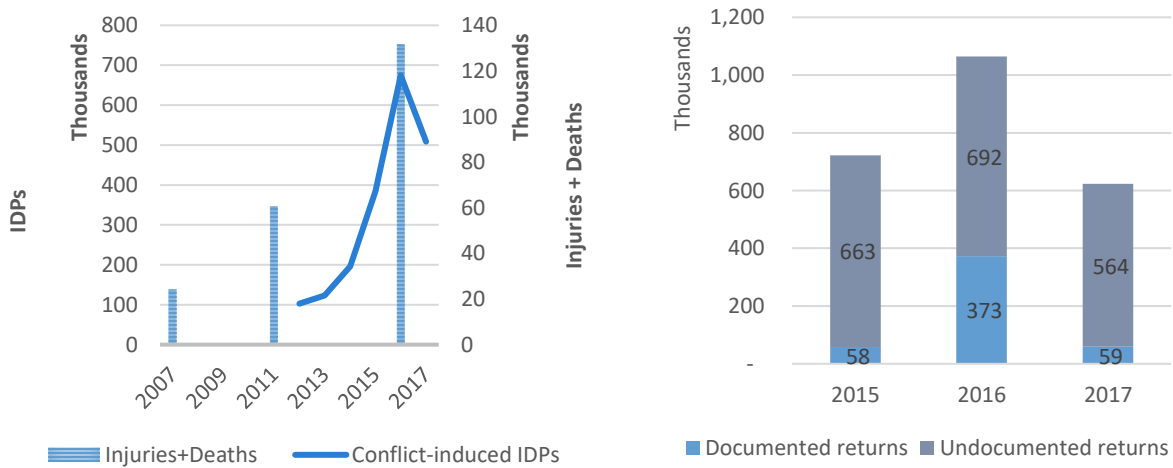


Source: World Bank, UNAMA, AISA

**The deteriorating security situation has led to large-scale population displacements**

Since 2007, the number of injuries and deaths has increased five-fold, and in 2016 and 2017, more than 1.1 million Afghans were internally displaced due to conflict. At the same time, 2016 and 2017 witnessed the return of almost 1.7 million documented and undocumented Afghan refugees, primarily from Pakistan and Iran. Internal displacement and large-scale return within a difficult economic and security context pose risks to welfare, not only for the displaced, but also for the population at large, putting pressure on service delivery systems and increasing competition for already scarce economic opportunities.

Figure 25: Conflict and displacement trends

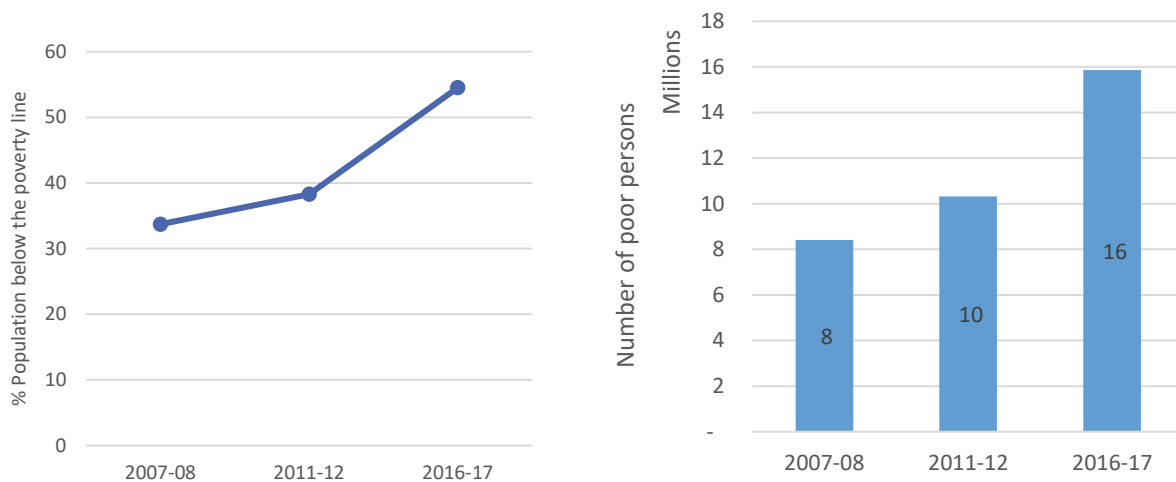


Source: UNAMA, IOM

**Slowing agricultural growth has had a negative impact on livelihoods and poverty**

Sector specific trends in growth suggest further causes for concern. While agriculture’s contribution to GDP has declined steadily from around 30 percent in 2007 to 22 percent in 2016, it remains an important sector as a source of livelihoods for the rural poor, in influencing the affordability of basic food items for the population, and its significant inputs into the manufacturing sector. Characterized by significant annual fluctuations, the agricultural sector grew, on average, 8 percent per year between 2007 and 2012. Since then, its annual growth rate has fallen sharply to 0.1 percent on average.

Figure 26: Poverty rate and number of poor



Source: ALCS (NSIA)

**Population growth far outstrips job growth, and most employment is vulnerable**

Few Afghans have access to productive or remunerative employment. Low levels of educational attainment are pervasive: adult literacy rates stand at only 35 percent, among the lowest in the world. More than four out of five Afghan adults (ages 25 and above) have not completed any level of education. A quarter of the labor force is unemployed, and 80 percent of employment is vulnerable and insecure, comprising self- or own-account employment, day labor or unpaid work.

With almost half the population below the age of 15, each year, large numbers of young Afghans continue to enter the labor market, most with little education and few productive employment opportunities. A natural consequence of the poor security situation and limited development resources, job creation has been unable to keep up with population growth, and good jobs are few and far between. Almost three-quarters of the population are below the age of 30, and roughly 25 percent are between the ages of 15 and 30. This large youth cohort of approximately 8 million is entering the labor market with little education and few employment opportunities. Though increasing over time, just over half (54 percent) of young Afghans are literate. Labor force participation rates of young Afghan women are particularly low due to higher rates of inactivity and unemployment among young women. Young Afghans (ages 15-24) have high unemployment rates of 31 percent and 42 percent are neither in employment, education or training (NEET). Progress with education is threatened by the security situation. Net attendance rates in

secondary education fell from 37 to 35 percent between 2013 and 2016, driven by declining attendance among girls.

**Neither jobs nor education are enough to assure a decent standard of living**

Neither education nor employment are a guarantee out of poverty, as poor job quality and insecure employment is widespread. The lack of a strong link between higher education, employment and lower poverty reflects the pervasive lack of productive employment opportunities. The employment status of the head of the household does not sharply differentiate poor households from non-poor households. While poverty rates are highest among households with heads who are unemployed, they remain high irrespective of the employment status of the head.

**These findings are a call to action**

These findings demonstrate the need to maintain progress and carefully manage risks associated with the upcoming election period. For Government, maintaining services and building private sector confidence is vital if investment and employment opportunities are to expand. This will require continued sound macroeconomic and fiscal management, continued reform progress, and avoiding any repeat of the disruptive political transition that followed the 2014 elections. For development partners, continuation of aid support is vital to both service delivery and overall economic performance in an economy that remains heavily reliant on aid. Continued support is vital if gains of the past 15 years are to be maintained and any further deterioration of living conditions is to be avoided.

## D. Focus Section III: Promoting Education Under Fragility

### 1. Background

**Population growth far outstrips job growth, and most employment is vulnerable**

The Afghanistan government has achieved substantial improvements in the education sector over the past decade, though significant challenges remain. The government is committed to tackling issues of security, poverty reduction, governance and shared and inclusive growth. It sees service delivery as playing a dual role in Afghanistan: promoting social cohesion and trust in public institutions while laying the foundation for job creation and growth. Afghanistan, is however, again experiencing increasing conflict and fragility. Attacks against students and schools continue to be major threats and causes for closing of schools or low rates of attendance.

This focus section answers the following questions:

- What is the current status of education in Afghanistan?
- Is there a learning crisis?
- Are there structural issues in education financing that are holding the sector back?

### 2. What is the current status of education in Afghanistan?

**Afghanistan has achieved rapid expansion in enrollment, especially at the primary level**

In 2016, more than 9.2 million students were enrolled in school, regardless of level; this represents a 9-fold growth from 13 years earlier. Since 2005, enrollment at the primary level grew every year, sometimes by more than 10 percent annually. Expansion at the lower secondary level has been more erratic; with growth rates of 1-2 percent in one year followed by a 50 percent growth the next year. Since 2008, this growth has plateaued and is now at the 2-4 percent range. Upper secondary enrollment has mostly not experienced such levels of growth, but since 2002, TVET enrollment has increased substantially.

However, the overstatement of actual schooling and the existence of “permanently absent students” presents a misleading picture of enrollment. There has been a rapid increase in gross enrollment ratios (GER) since the early 2000s; primary GER is now at 111.7 percent compared to 73 percent in 2002. GER for lower and upper secondary levels stand at 66 percent and 43 percent respectively, whereas tertiary GER was 12 percent in 2013. Household data shows that GERs greatly overstate actual schooling. Only 43 percent of children and youth under the age of 24 actively attend schools – the GER for this group is estimated at 95 percent. One of the reasons for the gap between enrollment and attendance is the policy of keeping children on the enrollment logs for up to three years after a student stops attending school.

**Gender, regional inequalities and socioeconomic status are prominent in keeping school**

Many school age children in Afghanistan are out of school. In fact, the gap in access between male and female students starts in early grades and widens as students move up to higher grades. In 2014 alone, 51 percent of girls and 19 percent of boys at the lower secondary level were out of school. In fact, boys are 1.5 times more likely to attend middle school than girls; at the upper secondary level, boys’ access is twice the rate of girls. Provincial analysis shows that in 15 provinces, proportion



**age children out of school**

of children out of school exceeds 50 percent, ranging from 51 percent in Ghor to 88 percent in Urozgan. Children and youth from the lowest income quintile are nearly half as likely to attend school compared to children from the highest income quintile (33 percent v. 59 percent). Children of literate parents are three times more likely to attend than children of illiterate parents (57 percent v. 19 percent). School attendance is 61 percent in urban areas, 39 percent in rural areas and under 9 percent among the Kuchi.

**Work is a common feature of life for Afghan children and youth**

29 percent of children between the ages of 7 and 12, and nearly half the youth between the ages of 13 and 17 work; incidence of work is much higher among males across both cohorts and among rural children. Domestic and agricultural activities – either helping on the family plot or with family animals or working for someone else – is likely to be the most common type of work children do. For Kuchi children, work is a part of life, with over 70 percent of children and 85 percent of youth engaged in some kind of work activity.

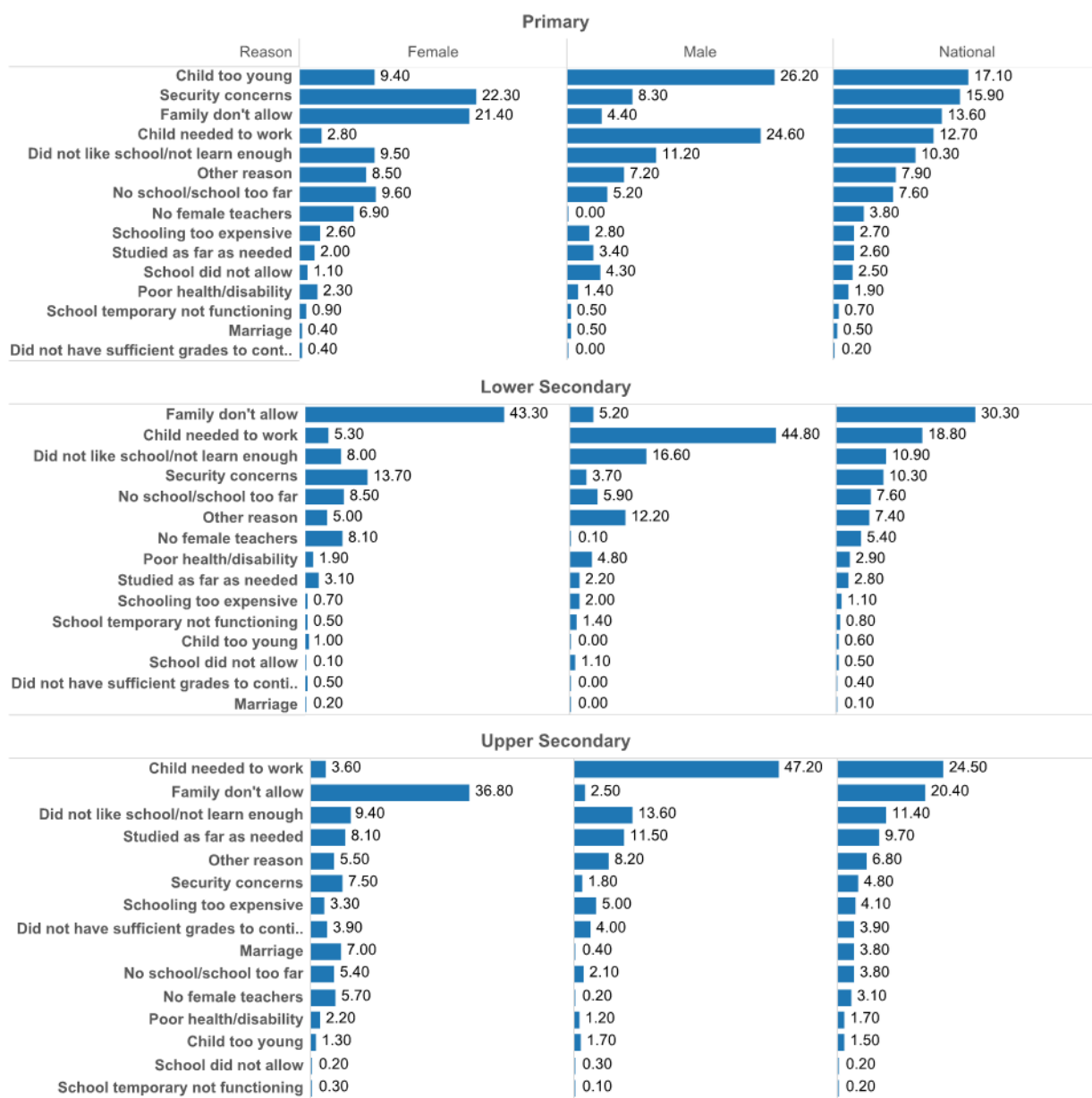
**Conflict and family approval are major sources of decline in girls' access to education**

For girls, security concerns, family approval and distance/lack of schools are major factors in why they do not go to school. Worsening conflict and increasing insecurity tended to affect girls' school attendance the most. In 2013-14, for every ten boys, seven girls attended primary school in low-conflict areas, but only five girls attended school for every ten boys in high-conflict areas.

**3. Is there a learning crisis in Afghanistan?****Student learning outcomes are low and represent a real crisis**

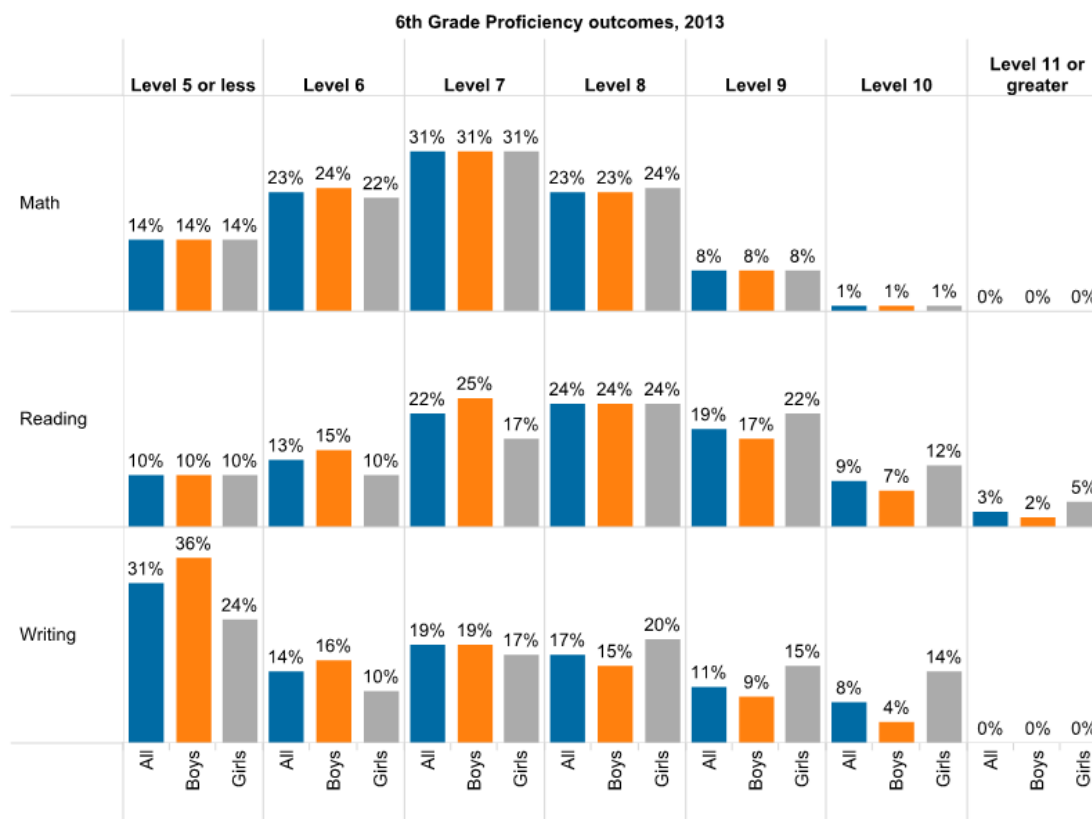
Limited data that exists on learning outcome show that only a small share of grade 6 students from 13 provinces achieve proficiency in math, reading and writing. A 2013 assessment showed that only 9 percent of students mastered proficiency levels of 9 and above, and 37 percent of the students scored at a level corresponding at level 6. In both reading and writing, girls appear to be better than boys.

Figure 27: Reasons for staying out of school



Sources: ALCS (NSIA) and author calculations

Figure 28: Grade six proficiency



Sources: ACER 2015

**School supply indicators and quality and availability of teachers are significant drivers of the learning crisis**

Student learning is negatively impacted by the uneven prevalence of school supply indicators and the general under-qualification and irregular distribution of the teacher force. Analysis of scores among grade 6 students along various school characteristics show that availability of textbooks and strong monitoring of teacher absenteeism make the greatest difference in learning outcomes. Furthermore, there are 45.6 students per teacher in general education and 44.5 teachers across all sectors. In 2011, 68 percent of general education teachers did not meet the minimum standard of qualifications for trained professional teachers. Only one quarter (approximately) have completed Grade 14 (level equivalent to an associate’s degree), less than 10 percent hold an undergraduate degree and 19 percent have not even completed high school. Of the 14,252 general education schools, 44 percent did not have any buildings, instead operating out of makeshift places or rented locations. Over a third of all general education schools have two or more shifts. In 2012, only 10 percent of all general education schools had biology labs, 9 percent had chemistry and physics labs and only 6 percent had mathematics labs.

**Inequities impact learning outcomes**

Learning outcomes are affected not just by supply side variables and teacher workforce, but also by social inequalities. Comparing the school performances of 15-year-olds enrolled at lower secondary schools – household wealth is positively correlated with learning outcomes: youth from the lowest two wealth quintiles consistently underperform in all subjects. The gap is largest in writing, where youth

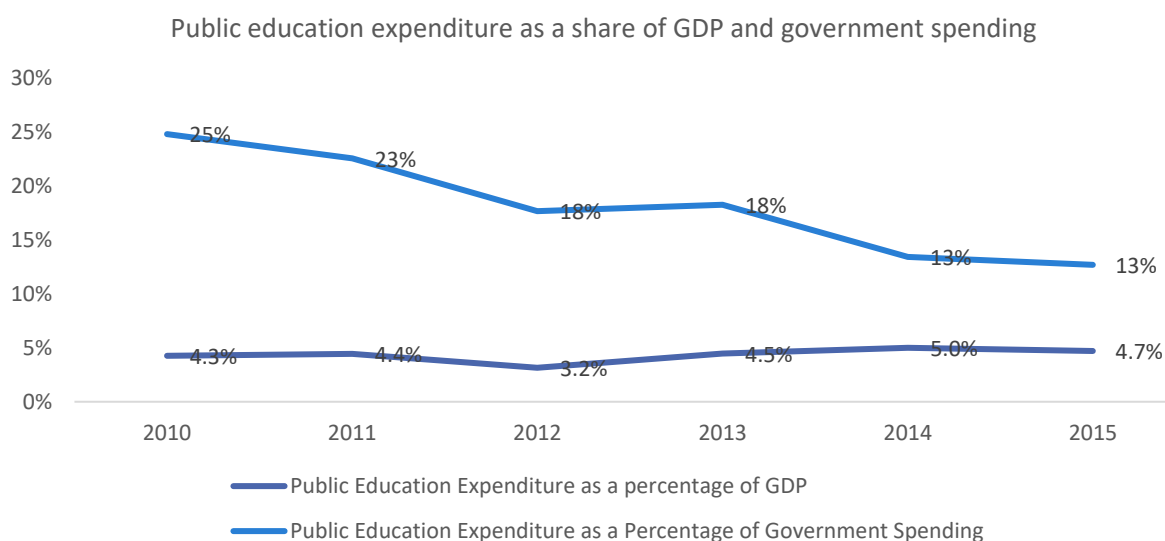
from the least wealthy households score nearly one standard deviation below the mean.

#### 4. Are there structural issues in education financing that are holding the sector back?

##### Education financing has not kept up with student growth

If Afghanistan is going to strengthen the education sector, then the above findings indicate that the education sector needs to bolster its financing. Education financing has not kept up with student growth given the multiple demands on the government budget. Between 2010 and 2015, the sector received AFS312 billion in funding, but the bulk of financing has come from international donors. Between 2011 and 2015, Afghanistan spent in total approximately AFS251.9 billion on the education sector, on average 4.4 percent of its GDP.

Figure 29: Public education expenditure as a share of GDP and government expenditure (Percent)

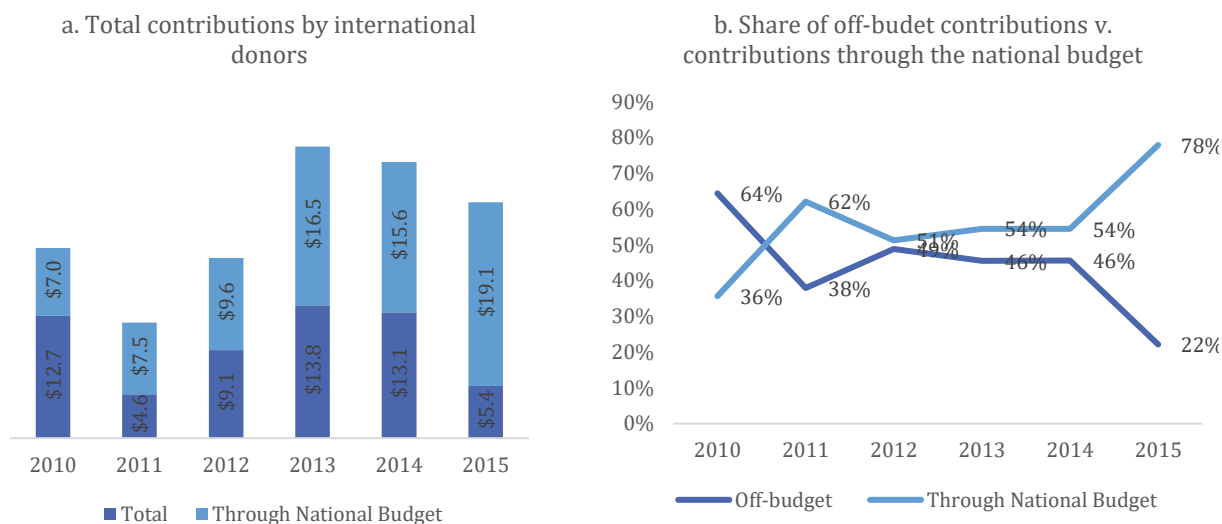


Sources: World Bank and Ministry of Finance data

##### Aid support to education has declined

International donors have financed almost half of all education expenditures to make up for the government shortfall, but over time, their contributions have declined. Afghanistan remains reliant on international donors to make up the government shortfall in education expenditures and even though international donors have financed almost half of all education expenditures over the years, over time, their contributions have declined. Donors are now more likely to channel funds through the national budget as opposed to direct financing of projects. Total international funding peaked in 2013 with contributions over AFS30 billion, but since then this has declined to about AFS24 billion. In 2013, nearly half the total contributions were directly given to projects, but in 2015, this share fell to 22 percent.

Figure 30: Contributions by international donors through the national budget and directly to projects, 2011 to 2015 (in AFS billions)



Source: Ministry of Finance data and author calculations

**Security is the primary reason for the decline in international funding to the education sector**

Interviews with donors reveal that they have some shared concerns and face similar challenges. The most commonly cited concern is security, which limits their ability to find partners to implement projects and limit project staff’s ability to travel. Insecurity also hampers the success of existing projects. For example, Germany, which has been investing in adult literacy programs, reported that in several provinces, these courses were cancelled because facilitators, monitoring officers and provincial advisors were no longer able to attend. Similarly, Finland-supported projects could not find international consultants willing to work in various regions.

At first glance, no significant waste appears within any particularly subsector, however when taking into consideration attendance, Afghanistan spends more per capita than other low-income countries. Afghanistan spends approximately AFS5,966 per student across all levels of education that is equivalent to almost 16 percent of its per-capita income on per-pupil spending. At the primary and secondary levels combined, per pupil spending has equaled about 11 percent of per capita income. This puts Afghanistan on the higher end of spending across other low-income countries.

**5. Recommendations**

**Afghanistan has a window of opportunity to improve education outcomes**

Afghanistan has a demographic opportunity because population among younger people is growing at a rate slower than working age adults. This trend, which is expected to continue over the foreseeable future, will ease pressure on the government to expand services and lead to decline in dependency rates due to which parents might not need to depend on the labors of their children. To make this happen, the country must improve the equity of its education sector.

The following specific policy recommendations are suggested:

- Target investments towards improving quality. Assessment data suggest that the presence of teachers and learning materials have the biggest impact on learning. Poor learning conditions are linked to repetition, attrition, and dropping out. Afghanistan must invest in improving the quality of education by increasing spending on teaching and learning materials and making sure that there are enough learning materials for students and teachers. Given low literacy and poor learning outcomes in the 6th grade national assessment, importance of reading and writing in the early grades should be a key emphasis.
- Expand/stabilize access and attendance through community-based education, especially in rural and conflict affected areas where school attendance comes at a considerable risk. However, given the variety in approaches and costs, designing a harmonized and cost-effective package of services should be a priority.
- Develop a system for more equitable distribution of resources to schools and hold provincial education directorate accountable for their effective use. There are great disparities in the distribution of school supplies, infrastructure and teachers. Per capita operating expenditures in recent years have more heavily targeted provinces with low levels of schooling, but teacher deployment and school supplies remain in severe shortages in remote areas. At the provincial level, allocation to schools do not follow a systematic procedure. In fact, distribution to districts and schools are at the discretion of the PED with no accountability or reporting requirements. Deconcentrated structures should be required to report on the use of public resources and reporting outputs.
- Involve communities in making education attractive. School Shuras need to be further strengthened, especially in the hard to reach areas, as they can play an important role in increasing retention and encouraging parents to send their children to school, especially girls. They have also served as local negotiators in conflict affected areas to re-open schools. The Citizen's Charter is a promising platform for strengthening community engagement in education management and monitoring teacher absenteeism and learning time
- Develop a long-term needs projection for the education budget. Afghanistan must focus on developing multi-year budget projections adjusted for the current and future needs of the education system. As the pressure for expanding school infrastructure at the national level slows down over time with the eventual reduction in the school age population, long term budgeting should take into account an increasing need for school repairs and maintenance as well as much needed school materials and supplies. New school construction in the short term should focus on the remote and underserved areas.
- Make better use of the existing budget structure and the information systems for more transparency on allocation and use of public resources. Analyses of education sector performance and its financing point to the necessity to strengthen the comprehensiveness of data provided through the multiple management information systems. Institute integrated information management systems for better monitoring and reporting on outcomes and evaluation. The systems could be strengthened, starting with better projections of student and teacher requirements and instituting biometric IDs for student and teacher tracking. Integrated data collection systems of EMIS, Human Resources Management Information System, and payroll would also allow for closer and rigorous monitoring.

Appendix Table 1: Standard Economic Indicators

	2015	2016	2017	2018	2019	2020	2021
<b>Output/Income</b>							
Nominal GDP (billion Af)	1,223	1,314	1,376	1,450	1,564	1,693	1,839
Nominal GDP (billion US\$)	19.9	19.0	19.5	19.9	20.5	21.1	21.8
GDP Per Capita (US\$)	590	550	550	548	550	555	561
Population (million)	33.7	34.7	35.5	36.4	37.2	38.1	38.9
<b>Real Economy</b>							
Real GDP Growth	1.5	2.3	2.7	2.4	2.8	3.2	3.6
Agriculture	-5.7	6.0	3.8	2.0	2.0	3.0	4.0
Industry	4.2	-0.8	0.4	2.0	2.0	3.0	4.0
Services	2.1	2.0	2.5	2.5	3.5	3.5	3.5
<b>GDP Composition (% GDP)</b>							
Agriculture	17.7	18.4	18.6	18.5	18.3	18.3	18.4
Industry	25.2	24.5	24.0	23.9	23.7	23.6	23.7
Services	53.3	53.1	53.1	53.1	53.4	53.6	53.5
<b>Prices (12 month % change)</b>							
CPI Inflation (period average)	-0.7	4.4	5.0	3.1	5.0	5.0	5.0
CPI Inflation (end-period)	1.1	4.5	3.1	..	..	..	..
Core Inflation (Excl. fuel and cereals)	0.3	5.6	3.4	..	..	..	..
<b>External Sector</b>							
Exports of goods (million US\$)	556	614	784	862	949	1063	1222
Imports of goods (million US\$)	7,679	6,636	7,355	7,722	7,954	8,113	8,275
Merchandise trade balance	-35.8	-31.6	-33.6	-34.4	-34.2	-33.4	-32.3
Net current transfers	36.2	39.6	40.4	40.6	39.6	38.4	34.5
Current account balance	7.5	7.1	1.6	0.2	-1.2	-1.6	-4.1
Foreign exchange reserves (Million USD)	6,752	7,330	8,129	8,163	7,915	7,573	6,681
Gross foreign exch. res. (months of merchar	10.6	13.3	13.3	12.7	11.9	11.2	9.7
External debt	6.2	6.5	6.6	6.8	7.0	7.2	7.4
Exchange rate (Af/US\$, period average)	61.4	69.0	70.4	..	..	..	..
Exchange rate (Af/US\$, end-period)	67.5	66.7	69.3	..	..	..	..
<b>Monetary and Financial Statistics</b>							
Broad money (M2)	33.9	34.6	34.5	30.7	32.3	33.9	35.6
Total deposits (% GDP)	17.7	20.1	19.9	18.0	18.4	18.8	19.1
Total deposits	3,514	3,819	3,882	3,596	3,776	3,965	4,163
Share of dollar deposits (%)	71.8	69.5	67.5	..	..	..	..
Credit to private sector, commercial banks	3.4	3.6	3.5	3.3	3.3	3.4	3.4
Loan-to-deposit ratio (%)	19.4	18.1	17.7	18.1	18.1	18.1	18.1

Appendix Table 2: Selected Fiscal Indicators

	2015	2016	2017	2018	2019	2020	2021
<i>In billion Afghanis unless otherwise stated</i>				<i>Est.</i>	<i>Proj.</i>	<i>Proj.</i>	<i>Proj.</i>
Domestic revenues	122.2	147.0	169.1	178.2	192.2	207.7	226.2
Tax revenues	59.2	65.4	75.9	80.0	86.3	93.1	103.0
Customs duty and fees	30.2	28.6	35.7	37.7	40.6	44.0	47.8
Nontax revenues	32.8	53.0	57.4	60.6	65.3	70.7	75.4
Donor grants	186.6	207.0	179.2	190.4	213.9	240.6	258.8
Discretionary grants	122.8	143.1	118.4	125.8	141.3	159.0	171.0
Nondiscretionary grants	63.8	63.9	60.8	64.6	72.5	81.6	87.8
Total expenditures	317.4	353.6	355.4	374.0	409.2	450.7	489.3
Recurrent expenditures	235.7	260.1	253.6	266.8	291.6	319.9	348.4
Security	143.1	145.6	133.9	141.9	156.1	171.7	187.2
Civilian	92.6	114.6	119.7	124.9	135.5	148.2	161.3
Wages and salaries	54.8	58.6	63.0	65.5	72.0	79.2	87.2
Operations and maintenance	17.4	29.7	29.1	30.2	32.0	34.6	37.7
Capital expenditure	2.3	2.3	2.8	2.9	3.1	3.3	3.4
Social transfers	17.0	22.3	23.0	24.4	26.4	29.0	30.7
Interest payments	1.2	1.6	1.8	1.9	2.0	2.1	2.2
Discretionary development	17.3	29.2	40.9	42.5	45.1	49.1	53.1
Nondiscretionary development	64.4	64.3	60.9	64.6	72.5	81.6	87.8
Discretionary balance	-8.0	0.8	-7.0	-5.4	-3.2	-2.3	-4.3
Overall balance	-8.6	0.4	-7.2	-5.4	-3.2	-2.3	-4.3
Overall balance excluding grants	-195.2	-206.6	-186.3	-195.7	-217.0	-242.9	-263.1
Revenues to recurrent spending ratio (%)	51.9	56.5	66.7	66.8	65.9	64.9	64.9



Appendix Table 3: Selected Fiscal Indicators

	2015	2016	2017	2018	2019	2020	2021
<i>In % GDP unless otherwise stated</i>				<i>Est.</i>	<i>Proj.</i>	<i>Proj.</i>	<i>Proj.</i>
Domestic revenues	10.0	11.2	12.3	12.3	12.3	12.3	12.3
Tax revenues	4.8	5.0	5.5	5.5	5.5	5.5	5.6
Customs duty and fees	2.5	2.2	2.6	2.6	2.6	2.6	2.6
Nontax revenues	2.7	4.0	4.2	4.2	4.2	4.2	4.1
Donor grants	15.3	15.8	13.0	13.1	13.7	14.2	14.1
Discretionary grants	10.0	10.9	8.6	8.7	9.0	9.4	9.3
Nondiscretionary grants	5.2	4.9	4.4	4.5	4.6	4.8	4.8
Total expenditures	26.0	26.9	25.8	25.8	26.2	26.6	26.6
Recurrent expenditures	19.3	19.8	18.4	18.4	18.6	18.9	18.9
Security	11.7	11.1	9.7	9.8	10.0	10.1	10.2
Civilian	7.6	8.7	8.7	8.6	8.7	8.8	8.8
Wages and salaries	4.5	4.5	4.6	4.5	4.6	4.7	4.7
Operations and maintenance	1.4	2.3	2.1	2.1	2.0	2.0	2.1
Capital expenditure	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social transfers	1.4	1.7	1.7	1.7	1.7	1.7	1.7
Interest payments	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Discretionary development	1.4	2.2	3.0	2.9	2.9	2.9	2.9
Nondiscretionary development	5.3	4.9	4.4	4.5	4.6	4.8	4.8
Discretionary balance	-0.7	0.1	-0.5	-0.4	-0.2	-0.1	-0.2
Overall balance	-0.7	0.0	-0.5	-0.4	-0.2	-0.1	-0.2
Overall balance excluding grants	-16.0	-15.7	-13.5	-13.5	-13.9	-14.4	-14.3
Revenues to recurrent spending ratio (%)	51.9	56.5	66.7	66.8	65.9	64.9	64.9

Appendix Table 4: Selected Fiscal Indicators

	2015	2016	2017	2018	2019	2020	2021
<i>In billion USD unless otherwise stated</i>				<i>Est.</i>	<i>Proj.</i>	<i>Proj.</i>	<i>Proj.</i>
Domestic revenues	2.0	2.1	2.4	2.5	2.5	2.6	2.7
Tax revenues	1.0	0.9	1.1	1.1	1.1	1.2	1.2
Customs duty and fees	0.5	0.4	0.5	0.5	0.5	0.5	0.6
Nontax revenues	0.5	0.8	0.8	0.8	0.9	0.9	0.9
Donor grants	3.0	3.0	2.5	2.6	2.8	3.0	3.1
Discretionary grants	2.0	2.1	1.7	1.7	1.9	2.0	2.0
Nondiscretionary grants	1.0	0.9	0.9	0.9	0.9	1.0	1.0
Total expenditures	5.2	5.1	5.0	5.1	5.4	5.6	5.8
Recurrent expenditures	3.8	3.8	3.6	3.7	3.8	4.0	4.1
Security	2.3	2.1	1.9	2.0	2.0	2.1	2.2
Civilian	1.5	1.7	1.7	1.7	1.8	1.8	1.9
Wages and salaries	0.9	0.8	0.9	0.9	0.9	1.0	1.0
Operations and maintenance	0.3	0.4	0.4	0.4	0.4	0.4	0.4
Capital expenditure	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social transfers	0.3	0.3	0.3	0.3	0.3	0.4	0.4
Interest payments	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Discretionary development	0.3	0.4	0.6	0.6	0.6	0.6	0.6
Nondiscretionary development	1.0	0.9	0.9	0.9	0.9	1.0	1.0
Discretionary balance	-0.1	0.0	-0.1	-0.1	0.0	0.0	-0.1
Overall balance	-0.1	0.0	-0.1	-0.1	0.0	0.0	-0.1
Overall balance excluding grants	-3.2	-3.0	-2.6	-2.7	-2.8	-3.0	-3.1
Revenues to recurrent spending ratio (%)	51.9	56.5	66.7	66.8	65.9	64.9	64.9



