FOR
AGENDA

SM/76/124

CONTAINS CONFIDENTIAL
INFORMATION

June 11, 1976

To: Members of the Executive Board

From: The Acting Secretary

Subject: Afghanistan - Recent Economic Developments

This paper provides background information to the staff report on the 1976 Article XIV consultation discussions with Afghanistan, which was circulated as SM/76/102 on May 21, 1976.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL
INFORMATION

INTERNATIONAL MONETARY FUND

AFGHANISTAN

Recent Economic Developments

Prepared by a staff mission consisting of Messrs.
A.S. Ray, R. Barth, H.E. Jakubiak, J. Prust and
Ms. I-M. Bramson (all from MED), and U. Okonkwo (YPP) (FAD)

Approved by the Middle Eastern Department, the Exchange and
Trade Relations Department, and the Fiscal Affairs Department

June 9, 1976

Contents

Contents | Page

Note 1. In the text and appendix tables, components may not always add up to totals due to rounding.

Note 2. All average annual growth rates in the text refer to annual compound rates.

Afghanistan - Basic Data

Population:	18.3 million (official 1973 estimate)
IMF quota:	SDR 37 million
Fund holdings of Afghanis: (end of April 1976)	125 per cent of quota
SDR allocation	SDR 12.8 million
SDR holdings (end of March 1976)	SDR 5.3 million (41 per cent of net cumulative allocation)
Par value	0.0197482 gram of fine gold per Afghani (equivalent to Af 45.00 = SDR 1)

Year ended March 20	1972/73	1973/74	1974/75	1975/76	1976/77
	(In millions of Afghanis)				
				Revised est.	Budget estimates
Government finances					
Revenue, of which:	6,110	7,017	10,250	12,101	13,684
Tax revenue	(3,556)	(4,436)	(7,166)	(7,106)	(8,005)
Expenditures, of which:	9,609	9,471	10,892	14,020	24,217
Ordinary expenditures	(5,283)	(5,799)	(6,244)	(8,202)	(10,190)
Development expenditures	(4,326)	(3,672)	(4,648)	(5,818)	(14,027)
Overall deficit1/	-3,499	-2,454	-642	-1,919	-10,533
External financing (net)	2,634	1,377	1,645	3,410	9,333
Domestic financing (net)	39	1,046	-598	-1,491	1,200
				First eleven mos.	
Changes in money and credit					
Money and quasi-money	2,047	1,592	1,294	2,152	
Change in per cent	(19.9)	(12.9)	(9.3)	(14.2)	
Net domestic assets, of which:	2,002	1,160	369	-276	
Claims on private sector	(768)	(54)	(994)	(-100)	
Claims on public sector	(1,497)	(1,392)	(244)	(-468)	
Net foreign assets	45	432	925	2,428	
	(In millions of SDRs)				
			Prelim.	Prelim.	
Balance of payments estimates2/					
Exports, f.o.b.	110.2	132.1	178.8	191.8	
Imports, c.i.f.	-143.4	-142.5	-200.0	-218.7	
Official loans and grants (gross)	67.7	57.7	50.8	78.6	
Public debt servicing	-28.1	-29.6	-32.8	-21.3	
Other services (net)	2.2	0.5	-1.3	-2.6	
Net residual transactions (including errors and omissions)	-11.7	-6.7	14.6	25.1	
Monetary movements (increase in assets -)	3.1	-11.5	-10.1	-52.9	
Foreign assets (end of period)				Prelim.	
Da Afghanistan Bank gross international reserves	48.7	49.3	52.6	99.0	
Commercial banks	5.4	8.0	9.9	9.2	

1/ Overall deficit differs from total financing due to data discrepencies and adjustments to cash basis.

2/ Comprehensive balance of payments statistics are not available for Afghanistan.

I. The Real Sector

1. Overall economic activity

The economy of Afghanistan is predominantly agrarian; the agricultural sector is estimated to account for more than 50 per cent of gross domestic product and to provide employment to about three quarters of the labor force. The industrial sector (including manufacturing and mining) is of limited size and is believed to account for only about 10 per cent of total value-added. The manufacturing subsector is mainly engaged in processing domestically produced agricultural raw materials, and major industrial enterprises are predominantly state owned, although a number of privately owned manufacturing firms have been established since the adoption in 1967 of the Foreign and Domestic Private Investment Law. Exploitation of natural gas is of considerable economic importance as the proceeds of natural gas exports to the U.S.S.R. are a major source of budget revenue and foreign receipts. In the services sector, a large proportion of value-added derives from the transportation and marketing of agricultural produce.

Analysis of overall trends in the Afghan economy is hampered by the lack of national income accounts. Although substantial investments in infrastructure have been undertaken, Afghanistan's trend rate of economic growth appears to have remained relatively slow over the recent past, primarily as a result of only modest increases in agricultural output and limited investment in manufacturing facilities. Fluctuations in agricultural output have been the main factor explaining year to year changes in the aggregate real growth rate. Agricultural output, and consequently aggregate growth, declined in 1970/71[1/] and 1971/72 as the result of widespread drought conditions. With the return of more favorable weather in the following two years, a strong rebound in agricultural production led to an increase in the overall growth rate to an estimated 7-8 per cent. During 1974/75 and 1975/76 the growth of gross domestic product approximated 3-4 per cent reflecting mainly normal expansion rates in the agricultural sector.

2. Agriculture

The principal activities in the agricultural sector are wheat growing and animal husbandry. Production of foodgrains utilizes about 90 per cent of the total cultivable area, with wheat alone accounting for approximately 60 per cent. Cultivation of various cash crops, including cotton, sugar beet, fruits and nuts, has been encouraged by the Government due to their importance as a source of foreign exchange earnings; in 1975/76, exports of fruits, nuts and cotton accounted for about 45 per cent of total export earnings. The livestock subsector, mainly sheep raising, gives employment to about 15-20 per cent of the population and provides some major exports as well as raw materials for the handicraft industry.

1/ Afghan year ended March 20.

Fluctuations in agricultural production have been sizable in recent years and reflect continued heavy dependence on weather conditions. This was dramatically illustrated in the 1970/71-1971/72 period when production of most crops, but particularly wheat, fell sharply as a result of inadequate rainfall. In 1972/73, favorable weather conditions led to a steep recovery in the agricultural sector, and in the following year, record output levels for several crops were achieved (Table 1, below). In part, the sharp growth in agricultural output reflected the impact of a substantial expansion in the government-sponsored distribution of fertilizer. Most fertilizer consumption has been used to increase wheat and cotton yields, partially accounting for the recent production gains for these crops. Although agricultural production remained at a high level in 1974/75, somewhat less favorable precipitation than in the immediately preceding year resulted in some faltering of the agricultural rate of growth. Cotton output, however, increased substantially due, in large part, to enhanced price incentives; effective March 1974, the government-established producer price for first grade cotton was increased from Af 13 to Af 15 per kilo. During 1975/76 precipitation was satisfactory, and fertilizer usage increased further from about 62,000 tons in 1974/75 to an estimated level of over 70,000 tons last year. As a result, the relatively high level of agricultural output was sustained: the wheat crop was sufficiently large to permit the country to remain essentially self-sufficient in this commodity, and sugar beet output expanded sharply under the continuing impetus of favorable producer prices which were raised by a total of almost 50 per cent in 1973 and 1974. However, the Government was unable to execute its policy of accumulating a buffer wheat stock for the purpose of future price stabilization. Livestock numbers are now reported to have recovered fully from the drought-induced depletion of earlier years.

Table 1. Estimated Production of Principal Crops

(In thousands of metric tons)

Year ended March 20	1971/72	1972/73	1973/74	1974/75	1975/76
Foodgrain					
Wheat	1,915	2,450	2,700	2,750	2,800
Barley	295	350	360	380	380
Corn	670	720	760	770	780
Rice	350	400	420	420	435
Industrial crops					
Cotton (unginned)	63	58	108	142	150
Sugar beets	60	66	57	67	105
Sugarcane	50	55	58	60	60
Oilseeds	28	34	38	40	40
Fruits and vegetables					
Fruits	750	820	840	865	880
Vegetables	650	650	680	700	730

Sources: Central Statistical Office and Ministry of Agriculture and Irrigation.

The rate of growth in the agricultural sector has been modest over a number of years, in part due to the limited employment of modern inputs and technology. The use of fertilizers, improved seeds, pesticides and mechanical aids to expand productivity has remained at relatively low levels. Moreover, in the livestock sector, techniques of animal husbandry continue to be primitive, and large losses are occasioned by animal diseases, inadequate provision of fodder and insufficient protection against weather exigencies. Given the low level of the existent agricultural technology, there is considerable scope for increased productivity. Over past Plan periods, the bulk of government development expenditures has been concentrated on infrastructural projects in the areas of transportation and irrigation. Part of this infrastructural development has taken place within the framework of a number of regional agricultural projects. Major projects are being implemented in the Helmand Valley and in the Paktia, Kumar and Herat regions. Typically, these programs include public infrastructure investments to supply feeder roads, distribution networks for irrigation and energy along with the increased distribution of fertilizer and other modern inputs as well as improved extension services. The primary emphasis of such projects is on increasing both productivity and the cultivable land area; moreover, it is hoped that such programs will permit settlement of hitherto landless farm laborers. Although to a certain extent capital intensive infrastructural projects are a prerequisite for agricultural development, the overall impact of these projects on aggregate agricultural production has so far been limited. This has mainly resulted from limited coordination whereby initial large investments in irrigation facilities and road communications have often not been followed by investments in feeder canals and roads. Consequently, for the agricultural sector most of the benefits of the large infrastructural investments of the past two decades remain to be exploited.

In order to upgrade the technology employed by the general farm population, a number of official agencies have the responsibility to provide modern inputs and to improve agricultural methods. These programs include the distribution of fertilizers, improved seeds and pesticides, increased extension and veterinerary services and the establishment of model farms. Of these programs, the most positive impact on agricultural output has been realized by the fertilizer distribution program. Almost all fertilizer distributed to farmers is sold on credit by the Afghan Fertilizer Company (AFC) with credit provided by the Agricultural Development Bank of Afghanistan. Distribution takes place through authorized retailers and also through the cotton ginning and sugar processing companies. Although the range of other agricultural improvement programs is extensive, their quality has been constrained by the limited human and financial resources available to the relevant government agencies.

An important policy objective of the Republican Government of Afghanistan is the implementation of a land reform program, for which detailed proposals were announced in August 1975. A unit within the Ministry of Finance was charged with the responsibility for the implementation of the program, and it was intended that land reform be accompanied by a cadastral survey. However, given the paucity of land records, progress on this latter project has been slow. Although to date no land has been distributed under the program, the authorities anticipate that distribution will commence in the near future in those areas where adequate land records exist. The land reform proposals provide limits on permitted holdings: the limit on irrigated land producing two crops per annum is 20 hectares, and 30 hectares for single cropped holdings; for rainfed land, holdings are limited to 40 hectares. These limits may be exceeded if arid land is brought into cultivation, and a proprietor may hold the maximum in each land category. It is planned to redistribute to landless farm labor the land acquired by the Government through purchase of excess holdings or through return to the state of land previously misappropriated into private hands. Compensation payments to previous owners, financed primarily from payments from purchasing farmers, are to be made over 25 years at 2 per cent interest on outstanding loans; any additional financing necessary for the state's land acquisition will be provided from the central government budget.

3. Industrial production and transportation

a. Industry and mining

The industrial sector in Afghanistan is limited and is to a large extent involved in processing domestically produced raw materials; the cotton ginning, textiles, and handicrafts sectors are important users of locally produced cotton, wool and leather. As existing planning calls for synchronised expansion of agriculture and industry, this interdependency is likely to continue for some time in the future. Industrial output expanded over the past three years as a result of a number of favorable developments (Table 2, below). Gains in cotton output increased the availability of raw cotton for processing. Moreover, the rise in international cotton prices more than offset the effects of higher government-established producer prices for raw cotton and the appreciation of the Afghani; as a result the competitiveness of cotton manufactures in the domestic market as well as ginned cotton in international markets was increased. This trend was reinforced by quality improvements in the textile industry. Increased external demand contributed to the growth of cement output as well as the production of coal; the latter is employed as an input in the cement industry. As a result of an expansion in generating capacity, power production also evidenced an upward trend. The most recent major change in the composition of industrial output was the initiation of fertilizer production in 1974/75; the new fertilizer plant currently produces from natural gas about 70,000 tons of urea fertilizer per annum. Domestic and external sales of fertilizer output have been supported by government policy. In the mining sector, output has remained almost unchanged in recent years, except for the commencement on a small scale in 1974/75 of talc, fluorite and barite mining; however, surveys are underway to determine the commercial exploitability of known deposits of copper, iron and other minerals.

Table 2. Major Industrial and Mining Production

Year ended March 20	Quantity by Unit	1972/73	1973/74	1974/75	Estimate 1975/76
Mining and quarrying					
Coal	1,000 tons	70.0	116.5	153.0	154.5
Natural gas	million cub. met.	2,849.4	2,735.0	2,946.0	2,999.0
Salt	1,000 tons	31.0	42.0	48.7	60.0
Lapis lazuli	1,000 kilos	2.9	...	8.3	8.4
Marble	1,000 cub. met.	8.2	13.8	9.2	14.0
Talc	1,000 tons	--	--	3.1	6.3
Barite	1,000 tons	--	--	6.0	5.2
Food processing					
Wheat flour	1,000 tons	63.0	46.0	49.4	50.8
Bakery products	1,000 tons	16.2	17.0	17.4	17.8
Sugar	1,000 tons	7.1	7.4	8.9	10.0
Vegetable oil	1,000 tons	3.9	4.5	6.3	10.5
Ice	100 tons	3.0	10.4	5.9	6.0
Textile and leather products					
Ginned cotton	1,000 tons	15.2	25.0	44.8	49.4
Cotton yarn	1,000 bundles	162.1	179.1	243.0	270.0
Cotton textiles	million meters	60.2	71.8	68.1	76.3
Rayon textiles	million meters	14.8	16.0	20.9	25.0
Woolen textiles	million meters	0.3	0.1	0.1	0.5
Shoes	1,000 pairs	215.9	199.0	209.2	219.9
Casings	1,000 rings	375.3	238.1	218.0	230.0
Chemicals, coal and petroleum products					
Coal briquettes	1,000 tons	22.4	32.5	23.4	25.0
Soap	million cakes	4.7	3.1	4.2	4.5
Chemical fertilizers	1,000 tons	--	--	18.0	70.0
Others					
Cement	1,000 tons	90.6	135.0	144.2	139.1
Electrical power	million kwh	486.9	404.0	527.2	550.0

Sources: Central Statistical Office and Ministry of Mines and Industries.

Natural gas output has increased only slightly over the past five years, reflecting capacity limitations and more recently a government policy of limiting export volume in order to conserve energy resources for future domestic use. Although the growth of natural gas production and exports has been limited, foreign exchange receipts from this source have expanded substantially as the unit price received for exports to the U.S.S.R. was raised from US$6.70 to US$13.20 per 1,000 cubic meters in October 1974, and further to US$16.10 in January 1975. Reserves of gas fields currently being exploited are estimated to be in excess of 30 billion cubic meters, and under the on-going program for natural gas and oil exploration a second field has been located with proven reserves at least equal to this amount. Oil exploration to identify commercially exploitable fields has been conducted sporadically over an extended period of time. Following upon increased allocations for oil exploration in the 1975/76 budget, expanded efforts are being concentrated in the area north of the Hindu Kush, where oil deposits have already been located, in the south east near the Pakistan border and in Herat province.

Government industrial policy has been in a transitional phase since the change of government in 1973. This has caused uncertainties in the private sector pending official clarification of the role of the private sector with respect to the development of industry in Afghanistan. Provision for investment incentives to the private sector was made in the 1967 Foreign and Domestic Private Investment Law, and these incentives were modified under a comprehensive revision of the Law in June 1974. Under the modification, exemptions from export taxes and import duties on essential inputs were extended, and special tax benefits were given to investments outside Kabul. However, as a result of the depressed business climate prevailing in recent years, relatively few projects have been approved under the revised Law. The low level of private sector confidence has been reflected in sluggish demand for investment loans and in an essentially inactive role for the Industrial Development Bank of Afghanistan. With the exception of the handicrafts sector and a limited number of other private enterprises, including those established under the 1967 Investment Law, all other industrial concerns are publicly owned as are all enterprises engaged in mineral exploitation. Current economic planning has reserved a key role for the public sector in future industrial development: public sector participation is expected to predominate in major industries, particularly those where expansion would otherwise be inhibited by a lack of capital. Several major industrial plants, including sugar processing, leather tanning, cotton ginning, textiles, cement, glass and paper, are presently either under construction or planned for the public sector; these projects would be financed mainly by utilization of recent large aid offers. It is also intended to bring the textile industry under government control; at present the largest textile firm is privately owned.

b. Transportation

Communications within Afghanistan have been greatly improved by the major road building programs of the last two decades as a result of which the major cities are now linked by all-weather roads, and current plans envision the construction of a new major highway across the center of the country from Kabul to Herat with a view to opening up remote regions. However, the inadequacy of communications in rural areas and with other countries continues to be a major constraint to economic and social development. The flow of goods to and from rural areas is still fraught with difficulties; although the last two annual plans have enunciated a policy of concentrating on the construction of feeder roads to smaller centers of population, only moderate progress has been achieved in this area. Poor international communications have frustrated the development of foreign trade. The export of certain bulky and perishable commodities to foreign, and particularly European, markets has been adversely affected by the length of time required to make the overland journey using the existent major transportation routes through Pakistan, the U.S.S.R., and Iran. Two major initiatives are presently underway with a view to relieving the transportation constraint. The first encompasses attempts to establish joint transportation ventures with foreign interests for forwarding to the U.S.S.R. and to Western Europe. The second concerns the commencement of survey work for the construction of a railway from Kabul via Kandahar and Herat to link with the Iranian rail network near Mashad in north eastern Iran. It is anticipated that if the survey and subsequent feasibility studies prove positive, the project will be carried out within the framework of the new Seven-Year Plan and will be funded primarily through a financial commitment received from Iran.

4. Development planning

Afghanistan implemented three Development Plans between 1956/57 and 1971/72. The First and Second Plans were typified by a concentration on infrastructural development; in view of the country's poor communications network, this emphasis was particularly strong in the transportation sector to which almost 40 per cent of development expenditures were devoted in the Second Plan. The level of total investment expenditures fell sharply after completion of a number of major infrastructural projects early in the Third Plan period (Table 3, below). New infrastructural projects of comparable size were not forthcoming, and correspondingly, expenditures in the industrial and agricultural sectors became a larger proportion of reduced total development outlays in the Third Plan period. The draft Fourth Plan embodied a continuation of this trend; however, the latter Plan was never formally approved or adopted by the new government which came to power in 1973.

Table 3. Distribution and Financing of Development Expenditures

Year ended March 20	Second Plan (1962/63-1966/67)	Third Plan (1967/68-1971/72)	Actuals 1972/73	Actuals 1973/74	Revised Estimates 1974/75 1/	Revised Estimates 1975/76 2/	Budget Estimates 1976/77
Distribution of development expenditures			(As percentage of total)				
Agriculture and irrigation	18.0	33.0	38.0	29.9	33.2	...	25.0
Agriculture	...	...	16.2	12.9	14.8	...	8.0
Irrigation	...	...	21.8	17.0	18.4	...	17.0
Industry	34.0	36.0	38.1	37.4	32.9	...	40.0
Mines	...	...	18.0	20.6	15.4	...	12.3
Manufacturing	...	...	12.1	5.9	10.4	...	20.1
Energy	...	...	8.0	10.9	7.1	...	7.6
Transportation and communication	39.0	16.0	10.8	10.5	18.6	...	21.1
Surface transportation	...	...	9.6	9.4	10.7	...	16.5
Air transportation	...	...	0.7	0.8	4.7	...	1.4
Communication	...	...	0.5	0.3	3.2	...	3.2
Social services and other	9.0	15.0	13.0	22.2	15.2	...	13.9
Education	...	...	2.2	2.8	3.7	...	2.2
Health	...	...	4.0	7.7	2.3	...	2.0
Other	...	...	6.8	11.7	9.2	...	9.7
Total development expenditures			(In billions of current Afghanis)				
	25.3	20.6	4.3	3.7	4.6	5.8	14.0

Sources: Information received from the Ministries of Planning and Finance.

1/ While the figure for total development expenditures in Afghanis is an actual, the percentages showing its distribution are based on revised estimates.

2/ Revised estimates of the distribution of expenditures are not available for 1975/76.

Past five-year plans have been essentially project lists with inadequate attention paid to project evaluation and preparation, economic returns and manpower and skill constraints. Moreover, the plans related only to public sector investments, and private sector undertakings that followed upon the introduction of the Foreign and Domestic Private Investment Law were not integrated into a comprehensive development scheme. Plan expenditure has relied heavily on foreign financing which in the second and third plans accounted for about 80 per cent and 75 per cent, respectively, of total development outlays. The level of implementation of the first three Plans was closely related to the actual receipt of foreign aid which in turn was largely dependent on the availability of implementable projects. However, the non-availability of projects due to the low quality of project preparation consequent to the general weakness of public administration has been a serious constraint in Afghanistan's development effort. This is evidenced by the comparatively low level of development expenditures in real terms since the completion of the major infrastructural investments in the mid-1960's. This latter fact highlights the inherent weakness of the planning machinery and the shortage of technical skills that were partially concealed by the earlier pattern of development expenditures with its concentration on a small number of capital-intensive projects essentially planned and supervised by foreign aid donors. As there has been a widespread recognition within the Government of the disappointing impact that past large-scale capital-intensive investments have had on economic growth, current development policies have been directed toward achieving a more balanced allocation of public investment. Even though in recent years less emphasis has been placed on infrastructural investment, the difficulties of achieving a fundamental shift in the direction of investments toward quicker-yielding projects has proved intractable in part because of human resource constraints and the prerequisite of smaller-scale capital projects.

Afghanistan has recently received development aid commitments of more than SDR 1 billion, and with the assurance of a substantial amount of new project aid an acceleration in the rate of development spending was planned for 1975/76. Development expenditures were budgeted to increase by 100 per cent, and almost 85 per cent of this budgeted total was to be devoted to on-going projects with the residual employed mainly for feasibility studies in the industrial sector. Revised budget estimates indicate that actual development outlays totaled about Af 5.8 billion last year, representing a substantial shortfall from the budgeted target but a 26 per cent increase over 1974/75 actuals; the shortfall resulted essentially from a continuing shortage of new projects ready for implementation, as well as the failure of some foreign financing to materialize as planned.

Work is now at an advanced stage on drawing up the new Seven-Year Development Plan which came into effect at the start of 1976/77. The content of the Plan, its sectoral priorities, investment allocations and its financing provisions remain under review, but current planning envisions total development spending of Af 170 billion during the Plan period. The 1976/77 budget calls for a large increase in development expenditures of about 140 per cent over the revised estimates for 1975/76.

It is clear that a large proportion of projected development spending over the Plan period will be financed from the substantial foreign aid commitments available to Afghanistan. Major offers of aid have been received from the U.S.S.R. and Iran. Financial assistance from the U.S.S.R. is intended to fund a range of development projects in agriculture, industry and mining, while foreign aid from Iran will be employed mainly for industrial projects and to finance a large proportion of the cost of the proposed trans-Afghanistan railroad, if feasibility studies prove positive. Smaller aid commitments, mainly from Middle Eastern oil-exporting countries, have also been received.

5. Prices, wages and employment

The price level in Afghanistan is measured by two indices, the Kabul Price Index (Table 4, below) and the National Price Index (Appendix I, Table 15). Both indices suffer from methodological deficiencies which render them only qualified guides to true changes in the price level. The weights attached to various consumption items are based on a household budget survey conducted in 1960, and with subsequent changes in consumption patterns, the weights currently used place a disproportionate emphasis on food items. Moreover, coverage is limited to 24 consumer items. Both indices accord cereals, and particularly wheat, an excessive influence.

The variations in the indices in recent years have reflected mainly real or expected fluctuations in agricultural, and particularly cereal, production. In 1974/75, both the Kabul and National indices rose by 14 per cent largely as a result of an increase in the price of food-grains in the second half of the year occasioned by late snowfall, fears of another drought, and some speculative hoarding. Following adequate snow late in the year, cereal prices moved downward and changed only slightly during the first three quarters of 1975/76 accounting for the more moderate overall rate of price increase. Meat prices have evidenced a strong upward trend over the past two years, despite the recovery of flocks from their low drought-induced levels of 1971/72, and are believed to reflect in part the strong demand for livestock in neighboring countries. A further major trend was the decline in fruit and nut prices in 1975/76 consequent to depressed overseas markets and the diversion of a certain proportion of intended exports to the domestic market.

Table 4. Kabul Price Index

(1968/69 = 100)

Year ended March 20	General Index	General Index: Percentage change over previous year	Cereals	Meat	Fruits and Nuts	Vege-tables	Other food items	Nonfood items
(Weights)	(100.00)		(58.1)	(10.7)	(10.6)	(5.7)	(5.1)	(9.8)
Annual averages								
1971/72	143.3	(+12.7)	161.3	107.7	130.4	114.7	110.4	113.7
1972/73	122.5	(-14.5)	124.0	124.4	129.4	106.0	130.6	113.4
1973/74	115.3	(-5.9)	95.4	147.3	160.7	143.6	130.4	120.4
1974/75	131.4	(+14.0)	115.5	[illegible]	171.4	134.0	143.2	123.8
Quarterly averages								
1974/75 I	127.9	(+7.2)	100.6	177.0	200.4	181.4	136.3	121.9
II	119.3	(+9.6)	105.8	173.1	137.9	96.9	130.3	122.4
III	128.3	(+20.1)	118.9	170.2	149.7	99.2	145.2	122.7
IV	150.0	(+18.8)	136.8	191.4	197.5	158.7	152.0	128.1
1975/76 I	145.4	(+13.7)	131.1	200.1	170.3	152.6	172.9	124.8
II	132.8	(+11.3)	123.4	182.9	132.5	111.5	173.6	127.0
III	129.9	(+1.2)	124.5	174.4	132.7	109.7	175.7	134.6

Source: Central Statistical Office.

Although movements in the Afghan price indices cannot be regarded as other than a general indication of the rate of price increase, the impression conveyed is that inflation has not been a serious problem in Afghanistan in the post-drought years. Agricultural production has been buoyant, and domestic financial policies have satisfactorily contained the rate of liquidity expansion to levels that the economy has been able to absorb without generating strong upward pressures on prices. Moreover, imported inflation has not been a major problem for a number of reasons. The foreign trade sector is small, and imported goods are consumed only by a limited proportion of the urban population. The substantial appreciation of the Afghani in recent years has afforded some further measure of insulation from international price increases. In addition, for most of 1974/75, Afghanistan was able to continue importing a considerable quantity of petroleum products under contracts negotiated before the steep rise in crude oil prices at the end of 1973; however, by 1975/76 virtually all such contracts had expired. A similar, although relatively smaller, advantage was also secured from the import of sugar at prices contracted before the recent rise in the international price of this commodity. Government policy also has been explicitly aimed at limiting the impact on the cost of living of rising import prices for basic commodities through subsidization or price controls. This is particularly true in the case of sugar which is an important source of caloric intake. Although the retail price of sugar was raised from Af 16 to Af 24 per kilo at the beginning of 1974/75 and to Af 30 per kilo at the start of 1975/76, the latter price still implied a substantial government subsidy to cover the losses incurred by the Sugar Monopoly during 1975/76. While retail prices of petroleum products were also raised at the beginning of each of the years 1974/75 and 1975/76, these price increases did not fully reflect the substantial increase in the price of imported petroleum in 1975/76. The Government has also sought to limit price increases on other essential commodities through administrative price controls and through reductions in import duties on some essential items, including cotton and rayon textiles, vegetable oil and paper; the latter measures were taken in conjunction with a new export tax/import subsidy scheme, introduced at the beginning of 1974/75 and involving temporary export taxation on four commodities (cotton, oilseeds, walnuts and raisins) enjoying exceptionally favorable prices.[1/]

Comprehensive data on wages are not available in Afghanistan. A new law was promulgated with effect in 1973/74 to regulate and improve working conditions in the industrial sector and provide for an increase in the legal minimum monthly wage from Af 500 to Af 900. However, as market wages were already above the new minimum, this measure had little real impact.

1/ See SM/74/149, pp. 57-58, and Chapter III, Section 7.

Real earnings in the government sector have risen over the past two years. The 1974/75 budget provided for some increase in fringe benefits such as the creation of consumer cooperatives at which government employees could purchase commodities below market prices. In addition, the 1975/76 budget provided for a general salary increase for civil servants of about 20 per cent on average with the increases graduated to allow larger percentage increments in the salaries of lower paid workers; this was the first such increase since 1964. Certain government organizations, such as the Afghan Fertilizer Company, ADBA, and the recently created Water and Power Authority, operate outside the civil service regulations, thus allowing these bodies greater freedom in their pay and personnel policies with the intention of permitting more competitive rates of compensation and attracting higher calibre personnel.

Open unemployment is not thought to be a major problem at the present time in Afghanistan, although widespread inefficiencies in the use of manpower suggest the existence of some disguised unemployment. Reliable and comprehensive data on the distribution of the labor force are not available. An estimated 75 per cent of the population reside in rural areas, most of whom may be assumed to be employed in agricultural activities. Employment in the modern industrial sector constitutes only a small fraction of the total work force. Low levels of literacy and general education are the main factors causing Afghanistan's chronic shortage of technically skilled personnel. Progress in increasing labor force skills can be expected to occur through expansion of the educational system. However, in 1970 the primary school enrolment ratio was estimated at only 22 per cent.

II. The Financial Sector

1. Public finance

The public sector in Afghanistan consists of the Central Government, the municipalities and about 40 nonfinancial enterprises engaged in commercial, agricultural, and industrial activities. A few of the non-financial enterprises, viz., the Food Department and the government Sugar, Petroleum and Liquidation Monopolies, are closely controlled by the Central Government and are relatively important in budgetary operations. In the monetary accounts, these agencies are classified as "official entities" and included as part of the public sector, whereas the other nonfinancial public enterprises (and the municipalities) are included in the private sector accounts. As information on the financial operations of the municipalities and the public enterprises is not available, the discussion in this section will focus mainly on the budgetary operations of the Central Government.

A problem in the discussion of Afghanistan's government finances results from the lack of consistency between budgetary and monetary accounts due to timing differences in the recording of government transactions in the two sets of accounts. A large part of these timing differences can be traced to the practice of keeping the budgetary accounts open for a complementary period of two to three months after the end of the fiscal year.1/ During the complementary period, revenue and expenditure transactions relating to the budget of the year just ended are recorded in a suspense account.2/ However, as information on these transactions is not reported, it is not possible to adjust the fiscal accounts to a cash basis compatible with the monetary data. Another reason for the difference between the two accounts is that the budgetary accounts include changes in the cash balances of local treasuries held outside the banking system.

Most of the transactions made through the suspense account represent revenue transfers from the Food Department and the government monopolies. While these official entities have traditionally been regarded as sources of revenue, it should be noted that their role has changed markedly in recent years. During the severe drought of 1970/71-1971/72, when there were large commodity-aid imports of foodgrains, the Food Department generated counterpart funds which were transferred to budgetary accounts as a financing item.3/ In 1973/74, with the termination of this import program

---

1/ The fiscal year ends on March 20.

2/ See SM/73/44, p. 68.

3/ Imports under commodity-aid agreements are not subject to the customs tariff, and thus may not be accurately recorded at the customs houses. Moreover, the proceeds of sales of foodgrain imports under commodity aid are directly reflected in the bank deposits of the Food Department and have not been transferred to budgetary accounts in the same year as they have accrued. These factors have given rise to substantial differences of timing and valuation between budgetary, monetary and balance of payments accounts.

and the prospect of domestic self-sufficiency in wheat, the Food Department assumed the new function of maintaining the support price for wheat which has involved some budgetary outlays.1/ Also, for many years through 1974/75, the government Sugar and Petroleum Monopolies generated sizable revenue (both profits and taxes) from the domestic sales of monopolized imports of sugar and petroleum products. In this capacity, they played the role of fiscal monopolies, and their revenues were essentially excise taxes. However, in recent years, adjustments in domestic retail prices of these commodities have lagged behind increases in import prices and, as a result, substantial subsidies on sugar and petroleum were provided for in the 1975/76 and 1976/77 budgets. Because of the lack of detailed information on their operations, it is not possible to attempt a consolidation of the accounts of these agencies with budgetary accounts. The net impact of their operations is included in the residual item in Table 5, below.

a. Budgetary operations through 1975/76

During the period 1971/72 through 1973/74, total revenue increased at an average annual rate of about 10 per cent. Total expenditure rose by about 8 per cent, with a temporary peak in 1972/73. Over the period, the total deficit fluctuated between Af 2.3-3.5 billion, equivalent cumulatively to about 30 per cent of total expenditure. The overall deficit was financed mainly from external sources in the form of project and commodity-aid loans and grants. Domestic financing (almost entirely net borrowing from Da Afghanistan Bank) was limited to an average of less than 10 per cent of total expenditure. The residual item consisted mainly of changes in government deposits, transfers from the Food Department and the government monopolies, and other transactions undertaken during the complementary period. While it fluctuated appreciably from year to year, the net residual over the period 1971/72-1974/75 was relatively small.

In 1974/75, total revenue rose sharply by 46 per cent while total expenditure grew by 15 per cent, and the overall deficit was substantially reduced to Af 642 million or 6 per cent of total expenditure. The overall deficit was overfinanced from external sources, and the Government's net liabilities to Da Afghanistan Bank were reduced by nearly Af 600 million, the first such improvement in several years. The increase in revenue was the result of a surge in tax revenue, which increased by 25 per cent in 1973/74 and 61 per cent in 1974/75 compared with an average growth of 4 per cent in the five years ended 1972/73. The main cause of the revenue growth was the rise in the international prices of many export and import commodities, together with a recovery of the economy from the drought-induced recession and some revenue measures promulgated by the new Government after July 1973.

1/ See SM/74/149, p. 5.

Table 5. Summary Statement of Government Finances

(In millions of Afghanis)

	1971/72	1972/73	1973/74	1974/75	Approved Estimates 1975/76	Revised Estimates 1975/76 1/	Approved Estimates 1976/77
A. Total revenue	5,821	6,110	7,017	10,250	12,152	12,101	13,684
Tax revenue	3,459	3,556	4,436	7,166	7,312	7,106	8,005
Nontax revenue	2,299	2,492	2,506	2,940	4,715	4,883	5,378
Capital revenue	63	62	75	144	125	112	301
B. Ordinary expenditure	4,887	5,283	5,799	6,244	8,877	8,202	10,190
Budgetary 2/	4,723	5,104	5,600	6,024	8,877	8,202	10,190
Extrabudgetary (interest) 3/	164	179	199	220	—	—	—
C. Development expenditure	3,279	4,326	3,672	4,648	9,321	5,818	14,027
Budgetary	1,919	2,387	1,986	2,373	4,145	3,100	5,200
Project aid 4/	1,360	1,939	1,686	2,275	5,176	2,718	8,827
D. Total expenditure	8,166	9,609	9,471	10,892	18,198	14,020	24,217
Ordinary surplus (A-B)	934	827	1,218	4,006	3,275	3,899	3,494
Overall deficit (A-D)	-2,345	-3,499	-2,454	-642	-6,046	-1,919	-10,533
Financing	2,345	3,499	2,454	642	6,046	1,919	10,533
Foreign 5/	1,562	2,634	1,377	1,645	5,246	3,410	9,333
Project aid	(1,360)	(1,939)	(1,686)	(2,275)	(5,176)	(2,718)	(8,827)
Commodity aid	(929)	(1,250)	(622)	(683)	(1,048)	(1,690) 6/	(1,486)
Amortization	(-727)	(-555)	(-931)	(-1,313)	(-978)	(-998)	(-980)
Domestic							
Central Bank	1,448	39	1,046	-598	800	-1,491	1,200
Adjustment to a cash basis and statistical discrepancy 7/	-665	826	31	-405	--	--	--

Sources: Data provided by the Ministry of Finance, Da Afghanistan Bank, and the Ministry of Planning.

1/ The revised estimates for 1975/76 are based on provisional actuals for nine months.
2/ The budgetary data for ordinary expenditure have been adjusted to exclude foreign debt amortization, which is treated as a negative financing item.
3/ Represents interest payments on government domestic loans at Da Afghanistan Bank.
4/ Data on project aid expenditure are not closely integrated in budgetary accounts. They are derived from separate accountings of foreign aid valued in foreign exchange and converted into Afghanis at the official rate of Af 45 = US$1.00.
5/ Includes foreign grants. In addition to cash grants, commodity aid includes the proceeds in local currency of sales of commodity loans and grants.
6/ Includes cash grants of US$14.26 million from Iran, Iraq and Saudi Arabia converted into Afghanis at the official rate of Af 45 = US$1.00. In Afghanis, the cash grants are equivalent to Af 642 million.
7/ This item represents mainly net (revenue and expenditure) transactions made during the complementary period after the end of the fiscal year, and changes in cash balances of local treasuries held outside the banking system.

The budget for 1975/76 provided for a substantial overall deficit of Af 6.0 billion. The growth in total revenue, mainly from nontax receipts, was budgeted at 19 per cent. Total expenditure was to increase by 67 per cent due to increases in consumption subsidies and a doubling in appropriations for development. Most of the projected deficit was to be covered by foreign aid, but the budget allowed for central bank borrowing of Af 800 million. In the event, tax revenue actually declined slightly in relation to 1974/75, but nontax revenue, mainly in the form of gross proceeds of natural gas sales to the U.S.S.R. and net receipts from the newly established government fertilizer factory, increased more than expected. Thus the 18 per cent growth in total revenue was close to the approved estimates. Expenditure, however, fell well short of budgeted levels. This shortfall was especially large for development expenditure, which is estimated to have been almost 40 per cent less than the approved estimate. The reduced overall deficit of Af 1.9 billion was again overfinanced from external sources, and there was a further substantial reduction in the Government's net liabilities to Da Afghanistan Bank of about Af 1.5 billion.

b. Revenue developments 1971/72-1975/76[1/]

The revenue structure in Afghanistan is characterized by a heavy dependence on taxes on international trade. Although foreign trade taxes increased at an average annual rate of only 7 per cent in the 1971/72-1973/74 period, compared with a 14 per cent average annual increase in tax revenue, their share in tax revenue still amounted to 72 per cent in 1973/74 (Table 6, below). In 1974/75, the ratio rose to almost 80 per cent. Import duties increased by 55 per cent in 1974/75 due mainly to increases in import prices in late 1973/74 and 1974/75 but also to discretionary changes in the tax system and administrative improvements to limit smuggling.[2/] Discretionary measures included an increase in the fixed tax on imports from 4 per cent to 6 per cent in 1973/74, upward revisions of import duties in 1973/74 and 1974/75, and the introduction of a new custom tariff structure in 1974/75.[3/] Higher international prices for exports partly explain the sharp rise in export tax revenue. In addition, a selective export tax on cotton, oilseeds, raisins, and walnuts introduced in March 1974 yielded Af 893 million in 1974/75 and accounted for 36 per cent of the revenue on foreign trade.[4/] Exchange profits transferred from Da Afghanistan Bank, which represent the difference between the official rate and the Da Afghanistan Bank free market rate on net sales of government foreign exchange, have been fairly stable, averaging about Af 550 million a year since 1971/72.

1/ A description of the tax system in Afghanistan is provided in Appendix II.

2/ The effect of the appreciation of the Afghani upon dutiable base has been mitigated to a large extent by broad reliance on specific taxes on traded commodities.

3/ See SM/75/177, p. 53.

4/ On March 1, 1974, as part of a stabilization policy package, selective export taxes were levied on cotton, oilseeds, raisins, and walnuts and, at the same time, import duties on some essential imports, including vegetable oils, paper, and cotton and rayon textiles, were reduced (SM/74/149, pp 57-58).

Table 6. Central Government Revenue

(In millions of Afghanis)

	1971/72	1972/73	1973/74	1974/75	Approved Estimates 1975/76	Revised Estimates 1975/76[1]	Approved Estimates 1976/77
Current revenue	5,758	6,048	6,942	10,106	12,027	11,989	13,383
Tax revenue	3,459	3,556	4,436	7,166	7,312	7,106	8,005
Taxes on net income and profits	354	484	730	907	1,192	1,253	1,590
Corporate income taxes	138	254	367	447	640	660	776
Individual income taxes	216	230	363	460	552	593	814
Taxes on property	70	78	83	95	460	120	514
Real estate tax	70	78	83	95	360	120	455
Livestock tax	--	--	--	--	100	--	59
Taxes on goods and services	185	196	253	262	285	271	308
General sales tax	20	19	51	63	100	100	110
Selective excises	34	46	59	68	80	80	89
Licenses[2]	35	29	37	79	95	90	108
Other taxes on goods and services	96	102	106	52	10	1	1
Taxes on international trade and transactions	2,797	2,641	3,194	5,694	5,291	5,378	5,474
Import duties[3]	1,877	1,968	2,497	3,868	3,830	4,120	4,312
Export duties[3]	227	250	216	320	300	307	320
Selective export tax[4]	--	--	1	893	531	176	127
Exchange profits[5]	674	402	450	581	600	655	673
Other	19	21	30	32	30	120	42
Other taxes[6]	53	157	176	208	84	84	119
Nontax revenue	2,299	2,492	2,506	2,940	4,715	4,883	5,378
Property income	1,775	1,861	1,694	1,916	3,759	3,997	4,093
From public enterprises	(973)	(928)	(735)	(447)	(1,350)	(1,118)	(1,550)
Sales of natural gas (gross)	(587)	(727)	(690)	(1,175)	(2,025)	(2,374)	(1,823)
Other	(215)	(206)	(269)	(294)	(384)	(505)	(720)
Administrative fees, charges, etc.	292	337	363	403	506	465	561
Other	232	294	449	621	450	421	724
Capital revenue	63	62	75	144	125	112	301
Total revenue	5,821	6,110	7,017	10,250	12,152	12,101	13,684

Sources: Data provided by the Ministry of Finance and Da Afghanistan Bank.

1/ The revised estimates for 1975/76 are based on provisional actuals for nine months.
2/ Includes motor vehicle registration fees.
3/ Includes revenue from fixed import and export taxes.
4/ Data from Research Department, Da Afghanistan Bank. This item represents revenue from selective export taxes on cotton, oilseeds, raisins, and walnuts (see SM/74/149, pp. 57-58).
5/ Staff estimates based on data provided by the Research Department, Da Afghanistan Bank. This item represents profits from government foreign exchange transactions with Da Afghanistan Bank.
6/ Includes stamp taxes.

Taxes on net income and profits rose by an average annual rate of 37 per cent over the 1971/72-1974/75 period. The growth in income taxes was due to several factors including the recovery of the economy from the drought, upward revisions of income tax rates in 1973/74, improvement in income tax assessments (especially in the schedular taxes on shopkeepers) in 1974/75 and an increase in the number of licensed merchants required to file income tax returns. Despite large gains in recent years, income taxes still amounted to only 9 per cent of total revenue in 1974/75 and accounted for 13 per cent of the growth in total revenue over the 1971/72-1974/75 period. The relatively small contribution of these taxes reflects the difficulties of administering the income tax in Afghanistan. These difficulties in turn explain the need for several schedular income taxes as well as the virtual exclusion of agricultural income from the income tax base. Although it has been estimated that approximately 75 per cent of the labor force is directly engaged in agriculture and that the agricultural sector accounts for more than 50 per cent of gross domestic product, income from agriculture, including rental income from agricultural land, is not subject to income taxation. Further, revenue from the land tax (which applies only to agricultural land) has been insignificant, accounting for less than 1 per cent of total revenue in 1974/75. The livestock tax, the only other property tax, was abolished in 1965/66 and reintroduced in the 1975/76 budget. However, due to administrative difficulties, no revenue was obtained from this tax last year. Taxes on goods and services continue to yield relatively small amounts partly because of the limited range of goods subject to the tax and partly because of the use of specific rates.

Despite slow increases in the four years through 1974/75, nontax revenue remained an important source of revenue and accounted for some 36 per cent of total receipts during the period. The bulk of nontax revenue consists of net profits and taxes of the government Sugar and Petroleum Monopolies and the gross proceeds from sales of natural gas. Revenue from the Sugar and Petroleum Monopolies declined steadily from about Af 950 million in 1971/72 to Af 390 million in 1974/75. The decline in revenue from this source, despite increases in the domestic retail prices announced in 1974/75, reflected mainly the steep rise in the import costs of sugar. The gross proceeds from sales of natural gas increased moderately through 1973/74, but in 1974/75 rose sharply by 70 per cent to Af 1,175 million. Virtually all the output of natural gas is exported to the U.S.S.R. under a bilateral trade agreement and the increase in receipts reflected almost entirely the two-step increase in the agreed price from US$6.7 per 1,000 cubic meters to US$13.2 and US$16.1 effective in October 1974 and January 1975, respectively.

In 1975/76 the favorable international price developments which underlay the revenue growth of the previous year no longer operated. Revised estimates for tax revenue evidenced a slight decline in relation to 1974/75 largely on account of taxes on international trade. The increase in the international prices of dutiable imports leveled off, and the prices of several traditional export commodities (especially cotton, fresh fruits and raisins) declined significantly, leading to a drop in the revenue from selective export taxes from Af 803 million in 1974/75 to Af 176 million in 1975/76. Taxes on net income and profits increased by 38 per cent, in response to improved tax collections especially from licensed merchants and shopkeepers and from corporations whose income tax holidays under the Private Foreign and Domestic Investment Law had expired. On the other hand, nontax revenue rose by two thirds, accounting for over 40 per cent of total revenue as against less than 30 per cent in 1974/75. The gross proceeds from sales of natural gas more than doubled reflecting the full impact of the 140 per cent increase in the export price since October 1974. Largely as a result of the expanded operations of the newly-established government fertilizer factory, the receipts from public enterprises also registered a 150 per cent increase.

c. <u>Trends in expenditure 1971/72-1975/76</u>

Following an average annual increase of 10 per cent in the four-year period ended 1974/75, total expenditure rose by 29 per cent in 1975/76. During 1971/72-1974/75, stringent control on growth in ordinary expenditure limited their annual rate of expansion to 9 per cent (Table 7, below). There was no general salary adjustment for civil servants, and the average annual increase of 5 per cent in the wage bill was due entirely to the expansion in the number of employees.

In 1975/76, ordinary expenditure grew by more than 30 per cent. The improved revenue performance in 1974/75 and the expectation of more revenue in 1975/76 made it possible to finance larger appropriations for social services including education and health. Moreover, with a rise in import prices, consumer subsidies were introduced for imported sugar and petroleum products. Although retail prices of sugar and petroleum were raised substantially during 1974/75 and again at the beginning of 1975/76, the approved estimates for 1975/76 provided Af 1.2 billion to the Sugar and Petroleum Monopolies for subsidies, raising the share of subsidies and grants in ordinary expenditure from 20 per cent to 39 per cent. It should be noted, however, that since the 1975/76 revenue estimates provided for Af 700 million in revenue from these same monopolies, the net subsidy appropriated for the monopolies did not exceed Af 500 million.

Besides the subsidies on sugar and petroleum, other subsidies in the 1975/76 budget included: Af 200 million on sales of flour to civil servants; Af 633 million of exchange subsidies to exporters of cotton, karakul, and wool; and Af 585 million for unspecified purposes. The appropriation for foreign debt service in 1975/76 (including amortization payments) was Af 1.2 billion or 35 per cent less than in 1974/75, as a result of a debt rescheduling agreement concluded with the U.S.S.R. in 1974/75. No adjustment of civil servants' salaries was granted in 1975/76. On a functional basis, increases in expenditure were concentrated on defense (28 per cent), education (30 per cent), general administration (17 per cent), and health (13 per cent).

Table 7. Central Government Ordinary Expenditure

(In millions of Afghanis)

	1971/72	1972/73	1973/74	1974/75	Approved Estimates 1975/76	Revised Estimates 1975/76 1/	Approved Estimates 1976/77
Functional classification 2/							
Ordinary expenditure 3/	4,887	5,283	5,799	6,244	8,877	8,202	10,190
General administration and public order	772	791	880	887	1,094	1,041	1,215
Defense	1,359	1,460	1,545	1,608	1,909	2,050	2,500
Education	876	968	1,083	1,120	1,316	1,450	1,549
Health	165	186	192	204	243	230	273
Other community and social services	73	76	137	105	95	110	103
Economic services	474	422	449	559	513	519	531
Public debt (interest)	572	659	679	750	222	222	390
Foreign 3/	(408)	(480)	(480)	(530)	(222)	(222)	(390)
Domestic 4/	(164)	(179)	(199)	(220)	(--)	(--)	(--)
Subsidies, grants and pensions	596	721	834	1,011	3,485	2,580	3,629
Of which: exchange subsidy	(390)	(360)	(380)	(581)	(633)	(633)	(700)
Object classification							
Ordinary expenditure	4,887	5,283	5,799	6,244	8,877	8,202	10,190
Wages and salaries	2,092	2,221	2,395	2,396	2,884	2,450	3,547 5/
Materials and supplies	1,068	1,160	1,269	1,417	1,827	1,730	--
Subsidies, grants and pensions	796	865	1,017	1,279	3,506	3,400	--
Public debt (interest)	572	659	679	750	222	222	390
Foreign 3/	(408)	(480)	(480)	(530)	(222)	(222)	(390)
Domestic 4/	(164)	(179)	(199)	(220)	(--)	(--)	(--)
Other	359	378	439	402	438	400	--

Sources: Data provided by the Ministry of Finance and Da Afghanistan Bank.

1/ The revised estimates for 1975/76 are based on provisional actuals for nine months.
2/ The functional classification is based on the institutional classification used in the budget accounts.
3/ The budgetary item, "foreign debt service", in ordinary expenditure has been adjusted to exclude foreign debt amortization, which is treated as a negative financing item.
4/ Represents interest payments on government domestic loans at Da Afghanistan Bank. Data provided by the Research Department, Da Afghanistan Bank.
5/ Staff estimate.

Except for a temporary peak in 1972/73, development expenditure grew fairly steadily at an annual rate of 15 per cent during the 1971/72-1975/76 period. However, in relation to budget estimates, there were shortfalls in development expenditure almost every year. The causes of these shortfalls do not appear to have been a lack of financial resources as there were substantial inflows of foreign concessionary loans and grants; rather the operative constraints on development expenditures included deficiencies in the preparation and execution of projects and an inadequate administrative machinery and the lack of skilled manpower.1/

d. Prospects for 1976/77

The 1976/77 budget estimates were prepared in light of the overall targets of the Seven-Year Development Plan inaugurated this year. Total revenue is budgeted to increase by 13 per cent and total expenditure to rise by 73 per cent over the revised estimates of 1975/76. The overall deficit is thus projected at Af 10.5 billion, equivalent to 43 per cent of total expenditure. Of this deficit, it is estimated that Af 9.3 billion would be financed from external sources, leaving Af 1.2 billion to be financed by borrowing from Da Afghanistan Bank.

Tax revenue is estimated to rise by 13 per cent, compared with a decline of 1 per cent in 1975/76, but substantially less than the 62 per cent surge in 1974/75. While no rate changes were made, taxes on net income and profits are expected to increase by 27 per cent as a result of improved procedures for tax assessments and collections. A large increase is anticipated from taxes on property, particularly agricultural land, as the authorities believe that, despite the evidence of past performance, sufficient progress will be made with the on-going cadastral survey to generate substantial revenue from this source. Revenue from taxes on international trade is expected to increase by less than 2 per cent, partly because of the selective import tariff reductions and partly because of a general weakening in the international markets for Afghan exports. Nontax revenue is projected to increase by 10 per cent. Receipts from the government fertilizer factory and from the government monopolies are expected to register some increases but the proceeds of natural gas sales are expected to decline by almost one fourth because of a new policy to reduce gas exports and conserve energy resources for future domestic use.

Ordinary expenditure is estimated to increase by 24 per cent. The 1976/77 budget provides for a general but tapered salary increase for public sector employees, the first since 1964. The overall effect will be an increase of 45 per cent in payroll costs over the revised estimates for 1975/76. Another expenditure item in the budget is a subsidy of Af 1.0 billion on sugar and petroleum, somewhat less than the Af 1.2 billion appropriated in 1975/76. However, recent decreases in the import price of sugar suggest that a much smaller subsidy may be required to support the operations of the Sugar and Petroleum Monopolies. In any event, since the

1/ See Chapter I, Section 4.

expected revenue transfer from these monopolies is Af 773 million, the net budgetary subsidy to these monopolies may be no more than Af 230 million. The total provision for subsidies in the ordinary budget, however, is Af 3.6 billion, an increase of Af 1.0 billion over revised estimates for 1975/76. This increment is explained by the appropriation of Af 1.2 billion for unspecified contingencies.

The 1976/77 budget provides for Af 14 billion for development expenditure, representing an increase exceeding 140 per cent over the revised estimates for 1975/76. Given the past record of substantial underexpenditures in the development budget, it is not likely that this level of expenditure will in fact be attained. Shortfalls in expenditure on projects would involve an approximately commensurate reduction in the need for external project borrowing.

2. Money and credit

a. Institutional background

Afghanistan's organized banking system consists of Da Afghanistan Bank, which combines some of the functions of a central bank with those of a commercial bank, two commercial banks (the Bank Mellie and the Pashtany Tejaraty Bank) and three specialized lending institutions (the Agricultural Development Bank of Afghanistan (ADBA), the Mortgage and Construction Bank (MCB) and the Industrial Development Bank of Afghanistan (IDBA)). The Bank Mellie and the IDBA are privately owned financial institutions, while all other banks are government-owned. Da Afghanistan Bank and Bank Mellie account for about 75 per cent and 10 per cent, respectively, of total bank liabilities. In Afghanistan, the money bazaar also plays a substantial role in the financial system. There are two major money bazaars, the most important in Kabul and the other in Kandahar, while in other cities financial activities also take place outside the banking system. As a whole, the bazaar markets are estimated to finance over 50 per cent of Afghanistan's foreign trade; they also engage in some domestic lending but at nominal interest rates considerably higher than those charged by the banks. Business in the bazaar is reported to be conducted on a very informal basis with a minimum of documentation. The financial sector in Afghanistan is small as is the proportion of the population coming into direct contact with organized financial institutions; the financing requirements of the majority of the population are met primarily through the bazaar markets or other non-institutional sources of credit. The high proportion of currency in circulation to total liquidity, which has averaged about 65 per cent over the past five years, indicates that the majority of the population also hold their financial savings outside the banking system. Commercial bank lending to the private sector has been limited mainly to merchants and enterprises with long-standing banking connections; the cotton ginning companies rely mainly on bank credits and variations in cotton financing have frequently exerted the preponderant influence on year to year changes in claims on the private sector.

There are several reasons for the low state of development of the financial sector. The operations of the banks themselves have been to some extent inefficient due to a lack of qualified personnel. Among government owned banks, the major exception is the ADBA which now operates effectively under its own administrative rules. Although branch offices of the banks exist in provincial centers, all loan applications are processed by head offices in Kabul and, as a general rule, checks can only be cashed at the branch on which they are drawn. Da Afghanistan Bank has the most extensive network of branch offices, but the activities of these branches are limited almost entirely to transactions with the Government. The constraints created by deficiencies in the banks' own organization have been reinforced, and perhaps partly caused, by deeply entrenched factors militating against the establishment of a market for credit. A major difficulty has been posed by the lack of adequate security for lending. This stems from two principal factors: firstly, under Islamic law a defaulting debtor is accorded certain rights that tend to make realization of any collateral difficult, and secondly, the ownership of land, which is the most suitable form of security available, is often in doubt. Furthermore the value of land is often difficult to determine because of uncertainties as to water rights and other matters relating to its use. These problems have been faced particularly in connection with the extension of loans to the agricultural sector, but ADBA has made some qualified progress in devising legal forms that provide adequate security to the lender, including the use of cooperative promissory notes. The IDBA has also been able to propose a system for the realization of collateral that is consistent with the principles of Islamic law.

While Da Afghanistan Bank has substantial influence over the banking system, formal instruments of monetary control are rudimentary. There exist no reserve requirements for the commercial banks and only limited use of discounting facilities. The central bank relies primarily on moral suasion to control the operations of the commercial banks; it has on occasion granted advances to the commercial banks who voluntarily hold deposits with it. Da Afghanistan Bank's functions also include responsibility for the note issue, acting as banker to the Government and holding the country's official foreign exchange reserves.

A new Law of Money and Banking was promulgated on July 22, 1975. The Law provides for the nationalization of all banks within one year of promulgation. This will affect only two privately owned institutions, the Bank Mellie and the IDBA, as all other banks are already state-owned. The Law also provides for Da Afghanistan Bank to ultimately cease its commercial banking operations and act solely as a central bank, but this arrangement is not expected to become effective before 1980/81. The Law also provides the banks freedom from civil service regulations relating to personnel policies, which it is hoped will lead to an improved calibre of the banks' staffs. The banks are also required by the Law to harmonize their accounting systems, and work on this project is proceeding. In addition, monetary and banking policy has now been formally placed in the hands of a hierarchy of committees, the most senior of which is the High

Council. Its chairman is the Minister of Finance and the membership consists of the Ministers of Commerce, Planning, Mines and Industries, and Agriculture and the Governor of Da Afghanistan Bank who has no voting rights. The next committee in order of importance is the Money and Credit Committee which has been charged with the responsibility of drawing up regulations relating to the operation of the banking system, including the determination of reserve requirements and liquid assets ratios and the fixing of interest rates. The proposals of the Money and Credit Committee must receive the approval of the High Council before becoming effective. Under the Law it is also intended to create a Board of Supervisors, answerable to the Minister of Finance, to evaluate Da Afghanistan Bank's activities, and a Bank Note Reserve Control Board. While the Law establishes the institutional framework for the implementation of comprehensive monetary policies and for the authorities to have wide ranging powers over the commercial and specialized banks, the precise nature of instruments to be used remains under review. New foreign exchange control regulations are also being considered.

The other main institutional development during 1975/76 was the decision to proceed with the establishment of an Export Promotion Bank; funds to finance the loan capital of the new institution have been committed by Iran. Export financing is currencly provided by the bazaar, Da Afghanistan Bank and the two commercial banks.

Interest rate policy has not been actively used in Afghanistan for management of the economy or to mobilize domestic savings. In June 1975, interest rates were raised, after having remained unchanged for two decades despite substantial fluctuations in rates of inflation and monetary expansion. The commercial banks have tended to operate with approximately identical interest rate structures, although this has not been a formal requirement. Both Da Afghanistan Bank and the commercial banks now offer exactly the same deposit and lending rates (Table 8, below). However, these rates remain substantially below those prevailing in the bazaar money markets.

b. Recent monetary developments

The rate of growth of domestic liquidity has varied substantially over the four-year period ended 1974/75. In 1972/73, the supply of money and quasi-money rose sharply by 20 per cent compared to an increase of 8 per cent in the previous year. Over the following two years, the increase in domestic liquidity decelerated and averaged 11 per cent annually (Table 9, below). As changes in net foreign assets were moderate, except in 1972/73, variations in the growth of domestic liquidity were attributable to substantial changes in net domestic assets. Large variations in the growth of private sector credit have resulted mainly from changes in the credit requirements of the cotton ginning companies reflecting the companies' liquidity as well as the size of the cotton crop. Since the former has fluctuated considerably, there has existed no consistent relationship between the level of cotton production and changes in outstanding cotton financing. Other components of private sector credit have been more stable. The expansionary impact of public sector credit operations has also varied considerably, even though to some extent changes in the net claims on the Central Government and on the official entities have tended to be offsetting. However, in 1974/75, the expansion in credit to the official entities, principally the Sugar and Petroleum Monopolies and the Food Department, had little effect on the growth of domestic liquidity as increased claims on the entities were largely nullified by an increase in these institutions' import deposits. Changes in net unclassified assets have normally exercised a contractionary influence on money supply growth.

Table 8. Interest Rate Changes

(In per cent)

	Previous rates	Current rates 1/
Da Afghanistan Bank		
Savings deposits	6	8
Loans to banks	7	9
Other loans	9	11
Commercial banks		
Savings deposits	6	8
Loans to customers	10	11
Da Afghanistan Bank and commercial banks		
Time deposits - 3 months	3 2/	4
Time deposits - 6 months	4 2/	6
Time deposits - 12 months	6 2/	7

Source: Da Afghanistan Bank.

1/ Effective June 1975.
2/ Bank Mellie only.

The behavior of the components of the money supply has been typified by the maintenance of a high ratio of currency in circulation to total liquidity of about 65 per cent. In 1973/74, there occurred some temporary substitution of currency for quasi-money resulting from the effects on private sector confidence of the change in government. In 1974/75, however, the various components of the money supply grew at broadly the same rate. The composition of the money supply in 1975/76 does not appear to have been influenced by the interest rate changes introduced in June 1975. During the first 11 months of the year, currency in circulation and demand deposits increased by 17 per cent, while quasi-money grew by only 4 per cent. As a result of these developments the ratio of currency to total liquidity rose by about 1 percentage point to 66 per cent during the first 11 months of 1975/76 (Appendix I, Table 17).

Table 9. Changes in Money and Quasi-Money and Factors Affecting Changes

(In millions of Afghanis)

	Year Ended March 20				First 11 Months	
	1971/72	1972/73	1973/74	1974/75	1974/75	1975/76
Money and quasi-money	712	2,047	1,592	1,294	1,710	2,152
Currency in circulation	272	1,308	1,259	705	756	1,641
Demand deposits	134	50	212	384	284	378
Quasi-money	306	689	121	205	670	133
Foreign assets (net)1/	687	45	432	925	834	2,428
Domestic assets (net)	25	2,002	1,160	369	956	-276
Claims on private sector2/	-100	768	54	994	947	-100
Claims on public sector (net)	95	1,497	1,392	244	-464	-468
National Government3/4/	(1,448)	(39)	(1,046)	(-598)	(-410)	(-960)
Official entities	(-1,353)	(1,458)	(346)	(842)	(-54)	(492)
Other items (net)	30	-263	286	-869	393	292
Import deposits	(-86)	(-22)	(-410)	(-898)	(-31)	(-593)
SDR allocations	(-177)	(--)	(--)	(--)	(--)	(--)
Other (net)5/	(293)	(-241)	(124)	(29)	(424)	(885)
Changes in per cent						
Money and quasi-money	7.5	19.9	12.9	9.3	12.3	14.2
Money	5.2	16.6	15.4	9.9	9.5	16.7
Quasi-money	17.2	33.0	4.3	7.1	23.1	4.3
Claims on private sector	-2.8	22.0	0.1	23.3	22.2	-1.9

Source: Research Department, Da Afghanistan Bank,

1/ Excludes impact of changes in foreign assets arising out of revaluation of: 1) foreign exchange holdings in March 1972 (Af 20 million); 2) gold holdings in April 1972 (Af 147 million); 3) gold holdings in August 1972 (Af 177 million); 4) foreign exchange holdings in March 1973 (Af 36 million); 5) gold holdings in December 1973 (Af 228 million); 6) foreign liabilities on bilateral clearing accounts in April 1973 (Af 55 million).

2/ Excludes impact of transfer of part of gold revaluation profits (Af 48 million) to private sector accounts in September 1973.

3/ Excludes impact on net claims on the Government of transfer to government accounts of: 1) part of first gold revaluation profits in May 1972 (Af 86 million); 2) part of second gold revaluation profits in September 1972 (Af 82 million).

4/ Includes change in "inter-Da Afghanistan Bank" item.

5/ Excludes impact on unclassified items of revaluation of foreign assets and liabilities and subsequent transfer of gold revaluation profits to government and private sector accounts as mentioned in footnotes 1, 2 and 3, above.

During the first 11 months of 1975/76, monetary expansion accelerated to 14 per cent as compared with 12 per cent in the corresponding period of the previous year. This expansion was entirely attributable to the substantial increase in net foreign assets which occurred primarily during the second half of the year. By contrast, the main expansionary factor in the first half of the year had been an increase in net domestic assets, resulting mainly from heavy public sector bank borrowing. This situation was reversed in the second half as the official entities were able to liquidate some of their outstanding credits through the sale of stocks of goods acquired earlier in the year. Moreover, the Central Government's net deposits with the banking system increased due to an improved fiscal performance and the receipt of foreign cash grants.1/ Credit to the private sector, however, declined due to a reduced overall level of business activity and despite expanded cotton financing.

The liquidity position of the commercial banks deteriorated in 1975/76. The ratio of reserves (cash in till and reserves at Da Afghanistan Bank) to private sector deposits fell by three percentage points to 17 per cent during the first three quarters. These liquidity problems tended to be exacerbated in the third quarter by the relatively greater appreciation of the bazaar foreign exchange rates vis-a-vis the free market rates offered by the commercial banks. Over this period the commercial banks were required to purchase foreign exchange at the same rates as Da Afghanistan Bank, and with these depreciated rates, the commercial banks found it difficult to balance purchases and sales of foreign exchange. In order to alleviate this problem, the banks were given permission in January 1976 to set their foreign exchange rates independently of Da Afghanistan Bank: as the banks' free market rates were moved toward the bazaar rate, their purchases and sales of foreign exchange equilibriated, and the tightness in their liquidity positions arising from this factor eased.

It is difficult to identify a close relationship between monetary and price developments in Afghanistan. Short-run changes in the level of nominal aggregate income and prices appear to be determined predominantly by changes in agricultural output as induced by weather conditions, fertilizer usage and the level of external demand. For instance, the substantial price increases in 1970/71 and 1971/72 were accompanied by only moderate rates of monetary expansion of about 7 per cent and reflected essentially drought-induced shortages of basic agricultural commodities rather than increased demand caused by excessively expansionary monetary policies. By contrast in 1972/73 when the rate of monetary expansion increased sharply to 20 per cent, the price level declined absolutely by 14 per cent due to the return of more normal agricultural supply conditions. In turn, the temporary surge in prices in 1974/75 was attributable primarily to speculative hoardings of foodgrains and occurred despite a slowed rate of monetary expansion in both that and the preceding year. The absence of any observable relationship between recorded rates of inflation and monetary expansion appears to lie in part in the deficiencies of available price indices, but also, and more importantly, in the instability of the velocity of circulation of money.

1/ See Chapter III, Section 3.

A number of factors appear to substantiate this proposition. Given the low level of development of Afghanistan's financial system, the accumulation of currency notes is the only widely available means of holding financial assets. A significant proportion of currency in circulation may therefore be presumed to represent savings or precautionary balances rather than balances held to finance current transactions. Moreover, as these currency holdings are large in absolute terms, there exists at any point of time the potential to finance a much higher volume of expenditure than is normally conducted. Since the demand for basic foodstuffs appears to have a very low price elasticity, nominal expenditure on such items may increase considerably in years of agricultural shortage with the added expenditure financed through shifts in holdings of currency stocks yielding a variable velocity of circulation. In the absence of reliable national income estimates it is not possible to test this hypothesis statistically.

c. Specialized banks

Of the three specialized banks in Afghanistan the two largest, the ADBA and the IDBA, were established fairly recently. The ADBA, a fully government-owned bank, was incorporated in 1970 and assumed the functions of the Agriculture and Cottage Industries Bank in addition to being given new responsibilities. The organization and management of the new bank are stronger than its predecessor; since its establishment, the ADBA has been managed by a team of foreign experts operating under the auspices of UNDP and the IBRD. The IDBA was incorporated in 1973 and its equity capital (Af 240 million) is 60 per cent owned by Afghan shareholders with the remaining 40 per cent held by a group of foreign banks. It also has been receiving technical assistance from international organizations and is currently operated by a foreign management team. As both banks operate under their own personnel and salary policies, the quality of their staff is relatively high. The third and smallest specialized bank, MCB, is mainly engaged in making loans to government employees, and its business has not increased substantially in recent years.

The expansion of the specialized banks' lending activities in recent years is mainly attributable to ADBA operations (Table 10, below). The volume of loans extended by this bank has increased steadily from Af 47 million in 1971/72 to about Af 870 million in 1974/75. In 1974/75, loans to finance farmers' fertilizer purchases formed the largest single category of credit extended by ADBA and amounted to 52 per cent of total lending. Another 25 per cent was accounted for by ADBA's participation in cotton financing. The rest of ADBA's lending was directed toward financing purchases of farm equipment and farm improvements. In 1975/76, when ADBA did not participate in cotton financing, total farm credits amounted to more than Af 700 million.

Table 10. Consolidated Statement of the Specialized Banks 1/

(In millions of Afghanis)

	Year Ended March 20				Dec. 20
	1971/72	1972/73	1973/74	1974/75	1976
Liquid assets 2/	141	406	869	853	863
Foreign assets	1	37	102	110	103
Loans to private sector	228	379	688	1,359	1,269
Participations	35	39	39	41	44
Other assets 3/	53	83	104	160	270
Assets = Liabilities	458	944	1,802	2,523	2,549
Private sector deposits	9	10	15	81	59
Government deposits 4/	11	12	120	56	155
Special deposits with ADBA 5/	--	89	438	948	775
Long-term domestic liabilities 6/	6	72	171	290	366
Foreign liabilities	53	37	145	101	23
Capital accounts 7/	333	674	855	958	1,083
Other liabilities	46	49	58	89	88

Source: Research Department, Da Afghanistan Bank.

1/ Consolidated Statement of the Agricultural Development Bank of Afghanistan (ADBA), the Mortgage and Construction Bank, and, from March 1973, the Industrial Development Bank of Afghanistan (IDBA). The statement excludes certain managed funds and long-term domestic loans to Afghan Fertilizer Company (AFC), and long-term liabilities to United States Agency for International Development (USAID).

2/ Cash on hand and bank deposits.

3/ Includes deduction for provisions of the ADBA and the IDBA.

4/ Includes retained proceeds of the ADBA from collection of government fertilizer loans.

5/ Mainly deposits of the AFC with the ADBA.

6/ Includes liabilities to the Afghan Government of the ADBA and to Da Afghanistan Bank of the IDBA.

7/ Includes capitalized counterpart of loans received by the ADBA from IDA and participation of foreign banks in the IDBA.

Despite the great expansion in the volume of ADBA's loan activity, the bank extended credits to only about 50,000 farmers in 1974/75. Shortages of trained manpower and financial resources as well as difficulties in obtaining full loan repayment have been major obstacles to expanded lending: of fertilizer loans extended in 1974/75, only about 60 per cent had been collected as of March 1976. ADBA has been funded mainly by government loans and by two credits from IDA. The first was approved in 1970 for US$5 million, mainly to finance the purchase of agricultural supplies and equipment. In 1975 IDA support was also obtained for a second agricultural credit project of Af 1 billion of which 70 per cent will be met from IDA funds.

The scale of IDBA lending operations has been small. The number of investment loans thus far extended has been limited due to the depressed investment climate in the private sector; however, IDBA has participated in cotton financing along with the other banks and has made loans for industrial working capital. IDBA has accumulated large liquid balances as it has been receiving in annual installments a long-term low-interest loan of Af 560 million from Da Afghanistan Bank and has found few outlets for these funds.

III. The External Sector

1. Overall balance of payments developments

The external payments position of Afghanistan cannot be analyzed adequately as a significant proportion of transactions are unrecorded and the existent data are subject to large margins of error. There are no official balance of payments estimates. Those provided in Table 11 are based on data1/ collected by the staff and can be taken only as indicative of major trends in Afghanistan's balance of payments. The only firm figures in the external accounts are changes in net foreign assets of the banking system. A significant proportion of total foreign trade is unrecorded, and deficiencies exist in the compilation of recorded trade data. No reliable estimates are available of invisible trade and non-monetary capital flows except for approximations for net travel receipts and somewhat more accurate estimates of official foreign aid and debt service. The unrecorded and omitted transactions are partially reflected in net residual transactions. Coverage deficiencies in Afghanistan's balance of payments accounting result in part from the large proportion of external transactions financed through the money bazaar and not recorded by the banking system. Such transactions include not only invisibles, private capital flows, and illicit trade, but also a large part of the trade that is recorded by customs. As the money bazaar dealers are not believed to change their holdings of foreign currency balances by significant amounts from year to year, the bazaar free market exchange rates are determined mainly by the private sector's residual supply and demand for foreign exchange and are one important indicator of the strength of the total balance of payments position.

While Afghanistan has recorded an external surplus in each of the past three years the causal factors have varied from year to year. In 1973/74 the surplus of SDR 12 million was primarily due to a sharply reduced trade deficit: the level of imports remained unchanged owing in part to uncertainties following the change of government in mid-1973, while total export value increased by 20 per cent essentially as a result of higher prices for Afghanistan's major exports. The reduced level of net capital inflows was offset in part by a lower negative entry for net residual transactions. In 1974/75, despite a widening of the recorded trade deficit and a reduced net official capital inflow, a surplus of SDR 10 million emerged, mainly as a result of a sharp turnaround in the net residual entry. The merchandise trade deficit more than doubled despite continued strong export growth as import payments expanded more sharply. The increase in commercial imports of 75 per cent, reflecting primarily higher international prices for sugar, tea, and vegetable oil, was only partly offset by a decline in aid-financed imports owing to the termination of the commodity

1/ The data underlying the balance of payments estimates have been compiled from customs accounting of exports and imports, foreign exchange transactions of Da Afghanistan Bank, separate estimates of net travel receipts and project aid imports, aid receipts and debt service payments as recorded by the Ministry of Finance, and foreign assets and liabilities of the banking system.

aid foodgrain program. The growth of exports by 35 per cent reflected increased international prices for cotton, natural gas and carpets as well as a sharp increase in the volume of cotton and fresh and dried fruit exports and was attributable to favorable agricultural developments and increased external demand. Outside the trade accounts, net official capital receipts declined by SDR 12 million from the previous year as amortization payments on debt owed the U.S.S.R. and the Federal Republic of Germany rose, while commodity aid was substantially reduced. Offsetting the weakening in the trade and nonmonetary capital accounts was a sharp turnaround in the residual item, probably reflecting, apart from deficiencies in the recorded trade data, an increase in unrecorded trade receipts and inward remittances from Afghans working abroad.

Contrary to original expectations, Afghanistan's external payments position showed unexpected strength in 1975/76 and registered a record overall balance of payments surplus of SDR 53 million, a 60 per cent increase over the cumulative net surplus of the previous four years. While the trade deficit remained substantial, a steep increase was recorded in official loans and grants while debt repayments declined substantially due to a debt rescheduling agreement with the U.S.S.R. Moreover, the net residual transactions entry recorded a sizable further increase, mainly as a result of higher unrecorded exports of agricultural products and livestock and inward remittances. On the trade account, the growth rates of both export receipts and import payments declined sharply. The slowed growth of commercial imports reflected stagnant imports of petroleum products and recent declines in international sugar prices. Despite a fall in world prices for some of Afghanistan's traditional exports, notably fruits and nuts, the decline in the value of these exports was more than compensated for by the 50 per cent increase in natural gas receipts.1/

In addition to increases in net foreign assets, the strength of Afghanistan's total balance of payments position has also been reflected in a substantial appreciation of the Afghani over the past four years from Af 84.0 per US$1 in 1971/72 to Af 57.7 per US$1 in 1975/76 on an annual average basis (Appendix I, Table 23). While over the period 1972/73-1974/75, the Afghani appreciated sharply and reserves accumulation was moderate, in 1975/76 government policy was directed at limiting the appreciation of the currency and the rate of reserve accumulation accelerated.

1/ Natural gas receipts are estimated to have reached SDR 40.6 million in 1975/76. This figure differs from that recorded in the budget due to timing differences and a change in October 1975 from the official rate to the Da Afghanistan Bank free market rate for the conversion into Afghanis of the proceeds from natural gas exports.

Table 11. Balance of Payments Estimates

(In millions of SDRs)

Afghan year ended March 20	1971/72	1972/73	1973/74	1974/75 1/	1975/76 1/
A. Merchandise trade	-40.1	-33.2	-10.4	-21.2	-26.9
Exports, f.o.b. 2/	102.1	110.2	132.1	178.8	191.8
Imports, c.i.f.	-142.2	-143.4	-142.5	-200.0	-218.7
Commercial imports	(-84.4)	(-87.3)	(-100.1)	(-175.2)	(-183.9)
Imports financed by loans and grants 3/	(-57.8)	(-56.1)	(-42.4)	(-24.8)	(-34.8)
B. Services, transfers and nonmonetary capital	38.7	41.8	28.6	16.7	54.7
Travel (net)	6.2	6.1	5.6	7.4	7.5
Service component of project aid (net) 4/	-4.0	-3.9	-5.1	-8.7	-10.1
Official loans and grants	63.8	67.7	57.7	50.8	78.6
Project loans and grants	(30.0)	(38.8)	(30.8)	(41.4)	(50.3)
Commodity loans and grants	(33.8)	(28.9)	(26.9)	(9.4)	(14.7)
Cash grants	(--)	(--)	(--)	(--)	(13.6)
External public debt service 5/	-27.3	-28.1	-29.6	-32.8	-21.3
Principal	(-17.9)	(-18.5)	(-19.1)	(-24.0)	(-16.6)
Interest	(-9.4)	(-9.6)	(-10.5)	(-8.8)	(-4.7)
C. Net residual transactions (including errors and omissions	11.9	-11.7	-6.7	14.6	25.1
D. Total (A+B+C)	10.5	-3.1	11.5	10.1	52.9
E. Allocation of SDRs	3.9	--	--	--	--
F. Total (D+E)	14.4	-3.1	11.5	10.1	52.9
G. Monetary movements (increase in assets -)	-14.4	3.1	-11.5	-10.1	-52.9
Da Afghanistan Bank	-15.0	4.7	-8.9	-8.2	-53.6
Other banks	0.6	-1.6	-2.6	-1.9	0.7

Sources: Da Afghanistan Bank, Ministry of Finance and Central Statistical Office.

1/ Preliminary.
2/ Export values of karakul, wool and cotton are based on foreign exchange receipts of Da Afghanistan Bank. Export values of other exports are based on customs data.
3/ Consists of project and commodity aid imports.
4/ One third of the service component of project aid is assumed to be remitted abroad.
5/ Varies in some years from budget estimates due to timing differences and inclusion of servicing of publicly-guaranteed debt.

2. Foreign trade

a. Exports

Natural gas exports to the U.S.S.R. became Afghanistan's leading source of foreign exchange receipts in 1975/76 due to sharp increases in the price of natural gas in October 1974 and January 1975.1/ During the same period prices fell for most of Afghanistan's traditional agricultural and animal product exports, and the proportion of total exports accounted for by natural gas in 1975/76 rose to 21 per cent from an average of about 14 per cent over the four-year period ended 1974/75.

Apart from natural gas and handicrafts, Afghanistan's exports consist almost entirely of a range of unprocessed or semiprocessed agricultural and animal products (Appendix I, Table 18). In 1975/76 the major export items and their share in total exports were: natural gas (21 per cent); dried fruits and nuts (20 per cent);2/ cotton (15 per cent);3/ fresh fruits (9 per cent); carpets (7 per cent); karakul skins (7 per cent); and wool (4 per cent). In recent years as cotton production has risen sharply and cotton export prices have remained strong after doubling in 1974/75, cotton has emerged as a leading export item. Karakul exports, which traditionally have been a major source of Afghanistan's foreign trade receipts, have not increased in recent years and have gradually fallen relative to other exports. While karakul prices were on the average higher in 1975/76, the quantity exported was substantially reduced from the previous year.

In recent years some new items, i.e., cement and various minerals, have been added to Afghanistan's export list but their total value is relatively small. An item of considerable prospective importance is chemical fertilizers (urea), for which export contracts have been recently signed with shipments scheduled for 1976/77.

b. Imports

Afghanistan's import statistics (Appendix I, Table 19) are based on customs data on commercial imports and a separate accounting of aid-financed imports (not all of which have been recorded at the customs houses in the past). The latter consist mainly of food items, petroleum products and fertilizers imported under commodity aid agreements, and imports for

1/ See Chapter I, Section 3.

2/ The export values of dried fruits and nuts and, to a lesser extent, fresh fruits, are believed to be somewhat overstated in customs statistics of the past two years because of problems related to the valuation of exports to India, the major market for these exports.

3/ Cotton exports in any one year are mainly from production in the previous year. Cotton is harvested in October-December, ginned mainly in the following six months and the main export season starts in February/March.

the public sector development program (project aid imports) which consist almost entirely of capital goods. In the balance of payments estimates commodity aid financed imports correspond to the inflow of commodity loans and grants, while project aid imports are less than project loans and grants to the extent that project aid is expended on the services of experts. As an increasing proportion of development expenditure in recent years has been directed toward feasibility studies and technical assistance, the ratio of project aid imports to total project aid has declined.

While data for 1974/75 and 1975/76 have not yet been compiled on a final basis, preliminary statistics indicate that the commodity structure of imports has not changed significantly in recent years: consumer goods, mainly food items and various simple manufactures, have remained predominant. Sugar imports in value terms grew substantially over the three-year period ended 1974/75 and are believed to have doubled in 1975/76 as a result of higher prices. Importation of wheat, which reached record levels during 1971/72 and 1972/73, in response to the severe drought declined sharply in 1973/74; no wheat imports were required in 1974/75 and 1975/76 as a consequence of increased domestic production.

Imports of both intermediate goods and capital goods are small and have not exhibited any strong upward trend with the exception of fertilizers following upon the inception of an expanded government-sponsored fertilizer distribution program. Fertilizer imports have been financed mainly by commodity aid in recent years; as domestic production of urea increased in 1975/76, fertilizer import requirements declined in that year. Imports of petroleum products, mainly gasoline and diesel oil, are estimated to have accounted for only about 5 per cent of total import value in 1974/75 as contracts for these imports were entered into before October 1973; in 1975/76, however, the value of petroleum imports increased sharply.

c. Direction of trade

The U.S.S.R. has traditionally been Afghanistan's major trading partner supplying 20-30 per cent of imports and taking 30-40 per cent of exports in recent years (Appendix I, Table 20). Commercial trade with the U.S.S.R. is carried out under a bilateral trade and payments agreement. Major exports are comprised of natural gas, cotton, wool, dried fruits and nuts; imports from the U.S.S.R. include a large proportion of Afghanistan's petroleum requirements, sugar, and a variety of consumer goods. However, the bulk of imports from the U.S.S.R. has been comprised of capital goods for the public sector development program and financed through aid agreements. Due mainly to rising prices for natural gas, the value of Afghanistan's exports to the U.S.S.R. has increased notably over the past two years, and the growing bilateral trade balance with the U.S.S.R. has been used to finance debt service payments to that country (Appendix I, Table 24).

Afghanistan's other main trading partners include India, with whom a payments agreement is maintained, the Federal Republic of Germany, Japan, and the United Kingdom. The distribution of import sources has remained relatively stable in recent years with the exception of a shift in 1974/75 from the United States to Japan; imports declined sharply from the United States due to the decline in commodity aid, while Japan's share has increased steadily over the past four years. With respect to exports, India's share reflects mainly exports of dried fruits and nuts, while the shares of the leading Western European countries have tended to fall due partly to the decline in the relative importance in exports of karakul. Although Iran is not listed as a major trading partner, it is believed that considerable unrecorded exports are shipped to that country.

3. Foreign aid and external public debt

Afghanistan has depended heavily on external loans and grants to finance its development programs as well as certain nonproject imports. The major source of foreign aid has been the U.S.S.R.; however, substantial assistance has also been received from the United States and the Federal Republic of Germany. The level of foreign aid disbursements declined steadily from a peak of SDR 95 million in the mid-1960s to SDR 41 million in 1970/71 (Table 12, below). The fall in aid disbursements was temporarily interrupted in 1971/72 and 1972/73 due to an increase in aid-financed foodgrain imports but declined in 1974/75 when these imports were terminated. The level rose again in 1975/76 owing mainly to the receipt of cash grants of SDR 12 million from Saudi Arabia, Iraq, and Iran and in addition higher project aid and increased commodity aid for sugar and fertilizer imports.

External public debt service payments showed a continuous upward trend from 1969/70 to 1974/75 although the rate of growth slowed during 1972/73-1973/74 due to rescheduling of about SDR 28 million of debt service payments to the U.S.S.R. A further reduction in debt servicing occurred in 1975/76 as the U.S.S.R. agreed to reschedule external debt payments equivalent to SDR 105 million and falling due during 1975/76-1980/81. The rescheduled debt is equivalent to about 40 per cent of the U.S.S.R. debt service payments due during the six-year period and about 60 per cent of total U.S.S.R. debt servicing. After taking the rescheduling into account, the debt service ratio is estimated to have declined to about 11 per cent in 1975/76.

As of March 1975, the outstanding external public debt amounted to SDR 1,271 million of which SDR 614 million had been disbursed (Appendix I, Tables 21 and 22). The total outstanding debt had on the average an interest rate of 1.6 per cent, a grace period of 12.9 years and a maturity of 34 years; the grant element was 69.1 per cent.

Table 12. Official Aid and Debt Servicing

(In millions of SDRs)

Afghan year ended March 20	Official Aid 1/ (1)	Repayments of Principal (2)	Net Capital Inflow (1 - 2)	Interest Payments on External Loans (4)	Total Debt Service 2/ (2 + 4)	Debt Service Ratio 3/
1969/70	62.4	14.2	48.2	8.6	22.8	28.0
1970/71	41.1	14.9	26.2	8.7	23.6	26.3
1971/72	63.8	17.9	45.9	9.4	27.3	25.2
1972/73	67.7	18.5	49.2	9.6	28.1	24.2
1973/74	57.7	19.1	38.6	10.5	29.6	21.5
1974/75	50.8	24.0	26.8	8.8	32.8	17.6
1975/76	78.6	16.6	62.0	4.7	21.3	10.7

Sources: Table 11; Appendix I, Table 21; and information received from the Afghan authorities.

1/ Receipts of official loans and grants in the form of project and commodity aid and cash grants.
2/ Details are provided in Appendix I, Table 21. The projections take into account the recent rescheduling of debts due to the U.S.S.R.
3/ Ratio of debt service payments to the total of exports and net travel receipts.

4. International reserves and related items

Data on international reserves and related items of Da Afghanistan Bank and the other two commercial banks are shown in Table 13, below. The net balance of payments surplus of SDR 33 million over the four years ended March 1975 was reflected only partially in international reserves of Da Afghanistan Bank as almost two thirds of the surplus was accounted for by an increase in net balances under bilateral payments agreements and in Afghanistan's IMF position. Gold holdings have remained unchanged for several years at about SDR 33 million (valued at SDR 35 per troy ounce).

During 1975/76, while there was a substantial growth in net bilateral balances, the bulk of the balance of payments surplus was reflected in the acquisition of convertible foreign exchange by Da Afghanistan Bank; these reserves increased over the year by SDR 46 million. As of March 20, 1976, net foreign assets of the banking system (SDR 121 million) and international reserves of Da Afghanistan Bank (SDR 99 million) were equivalent to about eight months and six months, respectively, of commercial imports at the 1975/76 level.

5. The exchange rate system

The exchange market in Afghanistan consists of Da Afghanistan Bank, two commercial banks, and the money bazaar. Da Afghanistan Bank accomodates foreign exchange needs of the Central Government and public corporations, settles trade accounts with bilateral payments agreements countries, and, at its option, deals with the private sector. The commercial banks accommodate the foreign exchange requirements of importers, purchase exchange receipts of exporters and meet other exchange needs of the private sector. The money bazaar handles all exchange transactions which are not accommodated by the banking system; exchange transactions through the bazaar remain uncontrolled.1/

1/ For a more complete description of the structure of Afghanistan's exchange system, see SM/75/177.

Table 13. International Reserves and Related Items

(In millions of SDRs)

Afghan year ended March 20	1971	1972	1973	1974	1975				1976[1/]
	March				March	June	Sept.	Dec.	March
I. Da Afghanistan Bank	30.53	45.49	40.83	49.68	57.85	64.99	71.75	105.68	111.49
International reserves	47.01	57.01	48.74	49.25	52.63	56.26	63.26	98.56	99.03
Gold	(32.63)	(32.62)	(32.62)	(32.62)	(32.62)	(32.62)	(32.62)	(32.62)	(32.62)
SDRs	(5.86)	(4.57)	(1.13)	(4.22)	(5.02	(2.63)	(2.57)	(5.32)	(5.49)
Reserve position in the Fund	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)	(--)
Convertible foreign exchange	(8.52)	(19.82)	(15.00)	(12.41)	(14.99)	(21.01)	(28.07)	(60.62)	(60.92)
Inconvertible exchange	0.84	0.91	0.73	1.60	1.89	1.86	2.28	2.56	2.88
Net balances under bilateral payments agreements	-4.79	-4.71	-2.92	5.06	6.05	7.60	15.38	13.80	18.82
Use of fund credit	-12.53	-7.73	-5.73	-6.23	-2.72	-0.73	-9.17	-9.24	-9.24
II. Foreign exchange of other banks	4.35	3.81	5.39	7.99	9.91	9.12	10.00	9.33	9.16
Convertible exchange	3.02	2.81	4.90	7.72	9.23	8.17	8.57	7.93	7.80
Inconvertible exchange	1.33	1.00	0.49	0.27	0.68	0.95	1.43	1.40	1.36
III. Total (I+II)	34.88	49.30	46.21	57.67	67.76	74.11	81.75	115.01	120.65

Source: Da Afghanistan Bank.

1/ Preliminary.

Afghanistan's exchange system includes an official rate for certain government transactions. Da Afghanistan Bank quotes an official selling rate for certain foreign exchange payments by the Central Government (debt service, contributions to international organizations, and foreign exchange requirements of Afghan embassies and missions abroad); the official buying rate applies to 40 per cent of the foreign currency salaries of foreign employees of the Government, government enterprises and domestic companies and to purchases of bilateral payments agreement currencies for maintenance in Afghanistan of bilateral partner countries' embassies and state trading organizations. Most other transactions take place at free market rates which are quoted by Da Afghanistan Bank, the other commercial banks, and in the money bazaar; the exchange rates between the Afghani and the accounting units used for some bilateral payments agreements are established by Da Afghanistan Bank (Table 14, below). Substantial progress was made by Afghanistan during 1975/76 in simplifying the exchange system. The bilateral dollar accounting rates applied to transactions with the U.S.S.R. and Czechoslovakia were unified with Da Afghanistan Bank's multilateral free market rate.1/ The special arrangements which had applied to proceeds from cotton, karakul, wool and walnut exports to multilateral and bilateral markets were substantially modified, and these commodities are now traded at Da Afghanistan Bank's free market rates.2/ Furthermore, export proceeds from natural gas sales to the U.S.S.R. which had previously been converted at the official rate were moved to Da Afghanistan Bank's free market rate in October 1975.

In recent years, during which the Afghani appreciated sharply, all banks quoted identical free market rates for the U.S. dollar, normally within Af 2.0 per US$1 above the daily bazaar free market rate. The money bazaar gives an unrestricted facility for exchange transactions, and its free market rate is a reflection of the private sector's residual supply and demand for foreign exchange. A differential has normally existed between the banks' and the bazaar rates, as there has been only limited arbitrage: different types of customers have preferred to deal with either the banks or the bazaar depending on the size and nature of the transaction, the services rendered, and other factors. Recently, the banks' free market rates have been held at a depreciated level vis-a-vis the bazaar rate, owing to an official policy of limiting the possible adverse effect on exports of the Afghani's appreciation. The differential widened notably in the third quarter of 1975/76, when the bazaar rate appreciated sharply, reflecting a large net inflow of foreign exchange into the economy, while the commercial banks' rates were held at the more depreciated rates offered by Da Afghanistan Bank and required under the stand-by arrangement (Appendix I, Table 23). Consequently, exporters and tourists utilized the banks for sales of foreign exchange while importers purchased their exchange in the bazaar market. The resultant net foreign exchange inflow to the commercial banks made it difficult for the banks to balance foreign exchange sales and purchases; this situation was alleviated on a temporary basis through foreign exchange purchases by Da Afghanistan Bank from the commercial banks. As a longer-term solution, the commercial banks were allowed in January 1976 to set their free market rates independently of Da Afghanistan Bank; as a result the banks' rates were moved closer toward the bazaar rates, and their purchases and sales of foreign exchange equilibrated.

1/ See Section 6, below.
2/ See Appendix III, Section 1.

Table 14. Effective Exchange Rates as of March 17, 1976

Buying		Selling	
		Convertible Currencies (In Afghanis per U.S. dollar)	
Af 44.70 1/	40 per cent of convertible currency salaries of foreign employees of Afghan Government and private sector (official rate)	Af 45.30 1/	Sales of exchange to Central Government to cover debt service payments, contributions to international organizations, salaries of foreign experts, and foreign exchange needs of Afghan embassies and missions abroad (official rate)
Bazaar rate (Af 54.83)	Transactions not subject to other rates	Bazaar rate (Af 55.29)	Transactions not subject to other rates
Commercial bank rate (Af 55.50)	Transactions not subject to other rates	Commercial bank rate (Af 56.25)	Transactions not subject to other rates
Af 57.00	Purchase of export proceeds by Da Afghanistan Bank	Af 58.00	Sales of exchange by Da Afghanistan Bank to Central Government and public sector entities for transactions not eligible for official rate
		Bilateral accounting units 2/ (In Afghanis per accounting dollar)	
Af 44.70 1/	Purchases of exchange for maintenance in Afghanistan of embassies, missions, etc., 40 per cent of bilateral accounting salaries of foreign employees of Afghan Government and private sector (official rate)	Af 45.30 1/	Sales of exchange to Central Government to cover debt service payments, salaries of foreign experts, foreign exchange needs of Afghan embassies and missions abroad and specified government imports (official rate)
Af 57.00	All transactions not subject to other rates (free rate)	Af 58.00	All transactions not subject to official rate (free rate)
		(In Afghanis per accounting sterling)	
Af 145.00	All bilateral accounting transactions with the People's Republic of China	Af 150.00	All bilateral accounting transactions with the People's Republic of China

Source: Da Afghanistan Bank.

1/ Da Afghanistan Bank applies charges of Af 0.30 per U.S. dollar as commission to the official rate of Af 45 per U.S. dollar.

2/ Applicable to bilateral accounting transactions with the U.S.S.R. and Czechoslovakia

6. Bilateral arrangements

Afghanistan maintains bilateral payments agreements with India, the U.S.S.R., Czechoslovakia and the People's Republic of China. Afghanistan has been moving toward freer payments relationships with the state-trading countries. Payments agreements with Bulgaria and Poland were terminated in 1973, and payments with these countries are currently made on a convertible currency basis. In 1974, Afghanistan signed a trade agreement with Romania which provided for payments on a convertible currency basis, and in 1975 the bilateral payments agreement with Yugoslavia which had been inoperative for some time was allowed to expire.

Prices of commodities traded with the U.S.S.R., including natural gas exports and petroleum imports, have been shifted to an international price basis; a similar change has taken place in trade with Czechoslovakia. In view of these changes, the bilateral dollar accounting rates applied to transactions with these trading partners were unified with Da Afghanistan Bank's multilateral free market rates. Moreover, the special exchange rates, which were applicable in the past to proceeds from walnut exports to the U.S.S.R. and Czechoslovakia have now been terminated, and such proceeds are now converted at Da Afghanistan Bank's free market rate for bilateral accounting dollars. The special rate of Af 60 per bilateral accounting dollar which had applied to proceeds from cotton exports to bilateral payments agreements countries has been suspended; these cotton receipts are currently converted at the official rate plus an exchange subsidy equivalent to the difference between the official rate and the Da Afghanistan Bank free market rate. Receipts from wool exports to the bilateral countries, which must be surrendered at the official rate, receive a subsidy of Af 15 per bilateral accounting dollar, implying an effective rate of Af 60 per bilateral accounting dollar; however, until official policy is clarified, any amount over the free market rate for the accounting dollar is being held for exporters of wool in a blocked account in Da Afghanistan Bank. As trade with China continues to be conducted on a negotiated price basis, the bilateral accounting unit used with that country (bilateral accounting sterling) has not been unified with the free market rate; however, with the appreciation of the Afghani, Da Afghanistan Bank has adjusted this accounting rate over the past two years to equate supply and demand and ensure approximate balance in bilateral payments, thus in effect adjusting bilateral prices toward world market prices.

Despite the substantial appreciation in recent years of the Afghani relative to each of the bilateral accounting units, and the move toward bilateral trade at international prices, there has been a build-up of bilateral balances in Afghanistan's favor (Appendix I, Table 24). This build-up was particularly notable during the first three quarters of 1975/76 in Afghanistan's accounts with the U.S.S.R. and reflected the increased price for natural gas exports to that country as well as reduced debt service payments resulting from debt rescheduling. With the exception of the increase in the bilateral balance with the U.S.S.R., Afghanistan's net residual bilateral credit position was reduced during the first nine months of 1975/76.

7. Commercial policy

Afghanistan's trade system is generally liberal and free of restrictions. Imports are not subject to license but all import transactions must be registered with the Ministry of Commerce before orders are placed abroad. In July 1974, Afghanistan adopted a new import tariff schedule replacing the previous schedule instituted 20 years earlier. The commodity classification system was linked with the SITC and BTN systems through cross coding of the tariff numbers. A revised customs tariff structure was introduced at the beginning of 1975/76 with the objectives of classification reform and rationalization for protective and revenue purposes. Although the new tariff schedule expanded dutiable imports from 750 items to more than 3,000 items, there was a reduction in the rates applied to imported raw materials and intermediate goods used as inputs in domestic industries. The list of import prohibitions was expanded during the year for protective purposes by the addition of certain minor consumer goods. In addition to general export taxes imposed on various commodities for revenue purposes, temporary export taxes were levied in March 19[illegible] [illegible] the proceeds from certain exports experiencing particularly strong external demand (cotton, oilseeds, walnuts and raisins); however, in view of changing world prices, the temporary taxes on cotton and raisins were eliminated in late 1975 and those on walnuts and sesame oil and cake were reduced.

Table 15. Afghanistan: National Price Index

(1961/72 = 100)

Year ended March 20		General Index	Percentage change over previous year	Cereal	Meat	Fruit and Nuts	Vege-tables	Other food items	Nonfood items
(Weights)		(100.0)		(58.1)	(10.7)	(10.6)	(5.7)	(5.1)	(9.8)
Annual averages									
1971/72		312.5	(+18.1)	400.7	204.2	227.7	240.7	161.6	119.7
1972/73		267.0	(-14.6)	307.0	244.5	260.7	218.4	202.8	123.2
1973/74		246.1	(-7.8)	232.8	310.9	351.3	293.9	206.3	133.4
1974/75		280.2	(+13.9)	278.2	355.8	371.0	282.2	212.8	143.8
Quarterly averages									
1974/75	I	267.4	(+4.8)	241.5	360.6	412.9	363.7	205.9	138.7
	II	247.2	(+0.6)	252.0	338.0	277.7	190.1	207.4	140.4
	III	280.5	(+20.9)	293.1	344.9	340.0	211.8	214.1	145.6
	IV	325.5	(+19.8)	326.2	379.5	458.0	363.0	223.6	150.4
1975/76	I	313.9	(+17.4)	317.0	385.0	398.7	328.8	251.3	147.3
	II	273.3	(+10.5)	292.0	355.8	239.8	215.8	252.1	146.5
	III	283.0	(+1.0)	305.9	361.3	251.8	215.1	255.4	153.7

Source: Central Statistical Office

Table 16. Afghanistan: Selected Fiscal Indicators

	1971/72	1972/73	1973/74	1974/75	Revised Estimates 1975/76	Approved estimates 1976/77 1/
			(In nominal terms)			
Percentage annual change						
Total revenue	...	5.0	14.8	46.1	18.1	13.1
Tax revenue	...	2.8	24.8	61.5	-0.8	12.7
Total expenditure	...	17.7	-1.4	15.0	28.7	72.7
Ordinary expenditure	...	8.1	9.8	7.7	31.4	24.2
			(In per cent)			
Overall deficit/total expenditure	-28.7	-36.4	-25.9	-5.9	-16.2	-43.5
Change in bank credit to government/change in broad money 2/	203.4	1.9	65.7	-46.2	...	54.5
Change in bank credit to public sector/change in broad money 3/	13.4	73.1	87.4	18.9	...	63.6
Interest payment on government debt/current revenue	9.9	10.9	9.8	7.4	...	...

Sources: Data provided by the Ministry of Finance, Da Afghanistan Bank (Research Department), and the Ministry of Planning.

1/ Estimates based on official projections.

2/ Broad money is defined as the sum of currency in circulation, demand deposits, and quasi-money.

3/ Following the definitions in the monetary accounts, the public sector consists of the National Government and the official entitities. The official entities include the Food Department and the Government Sugar, Petroleum, and Liquidation Monopolies.

Table 17. Afghanistan: Monetary Survey

(In millions of Afghanis)

		Year Ended March 20				Feb. 20
		1971/72	1972/73	1973/74	1974/75	1976
A.	Foreign assets (net)	2,228	2,653	3,258	4,183	6,611
	Foreign assets	2,886	3,081	3,606	4,327	7,113
	Foreign liabilities	-658	-428	-348	-144	-502
B.	Claims on Government (net)	7,490	8,940	10,269	11,118	9,361
	National Government (net)	9,715	9,708	10,691	10,698	8,449
	Claims on Government	(10,671)	(11,106)	(12,057)	(12,568)	(12,613)
	Deposits of Government	(-956)	(-1,398)	(-1,366)	(-1,870)	(-4,164)
	Official entities (net)	-2,225	-768	-422	420	912
	Food Department	(-986)	(-378)	(-222)	(-504)	(-302)
	Sugar Monopoly	(-663)	(-199)	(106)	(1,408)	(622)
	Petroleum Monopoly	(-483)	(-32)	(-147)	(-330)	(718)
	Liquidation Monopoly	(-93)	(-159)	(-159)	(-154)	(-151)
	Stationery Monopoly	(...)	(...)	(...)	(...)	(26)
C.	Claims on private sector, of which:	3,485	4,253	4,259	5,253	5,153
	Government enterprises	(186)	(261)	(332)	(450)	(758)
	Investment banks	(282)	(392)	(513)	(611)	(629)
	(A + B + C = D + E + F + G + H)	13,203	15,846	17,786	20,554	21,125
D.	Money supply	8,173	9,531	11,002	12,091	14,110
	Currency in circulation	6,607	7,915	9,174	9,879	11,520
	Demand deposits	1,566	1,616	1,828	2,212	2,590
E.	Quasi-money	2,089	2,778	2,899	3,104	3,237
	Time and savings deposits	1,939	2,430	2,666	2,863	3,012
	Foreign currency deposits	150	348	233	241	225
	(Domestic Liquidity = D + E)	(10,262)	(12,309)	(13,901)	(15,195)	(17,347)
F.	Import deposits	519	541	951	1,840	2,442
G.	SDR allocations	574	574	574	574	574
H.	Other items (net)	1,848	2,422	2,360	2,936	762
	Inter-Da Afghanistan Bank items 1/	667	788	725	1,330	41
	Other	1,181	1,634	1,635	1,606	721

Source: Research Department, Da Afghanistan Bank.

1/ Reflects mainly government accounts which cannot be identified.

Table 18. Afghanistan: Commodity Composition of Exports

(Value: In millions of SDRs)

Afghan year ended March 20	1971/72	1972/73	1973/74	1974/75	Estimate[1] 1975/76
Raisins[2]					
Value	6.8	14.4	25.2		
Quantity: thousand tons	25.6	34.3	38.6		
Unit price: SDRs per ton	266.0	418.0	652.0		
Other dried fruits and nuts[2] (combined with raisins in 1974/75 and 1975/76)					
Value	10.7	14.1	13.8	46.9	38.3
Quantity: thousand tons	16.6	17.5	14.7	62.1	...
Unit price: SDRs per ton	644.0	804.0	937.0	754.9	...
Fresh fruits					
Value	8.9	9.7	18.2	26.2	18.1
Quantity: thousand tons	82.0	73.8	98.6	157.3	...
Unit price: SDRs per ton	108.5	131.8	184.0	166.7	...
Karakul skins[3]					
Value	17.4	14.3	13.9	14.2	12.6
Quantity: million skins	1.7	1.2	0.9	1.2	...
Unit price: SDRs per skin	10.5	11.9	15.5	11.9	...
Wool[3]					
Value	7.8	5.4	4.8	6.8	7.8
Quantity: thousand tons	6.1	4.4	3.3	5.1	...
Unit price: SDRs per kilo	1.3	1.2	1.5	1.3	...
Cotton[3]					
Value	12.2	10.1	6.0	29.8	29.3
Quantity: thousand tons	20.7	15.6	9.8	23.7	...
Unit price: SDRs per ton		646.0	612.0	1,256.5	...
Carpet and rugs					
Value	7.8	9.8	12.0	17.9	13.6
Quantity: thousand sq. meters	492.0	574.0	512.0	57.2	...
Unit price: SDRs per sq. meter	16.0	17.1	23.4	31.3	...
Natural gas					
Value	14.2	15.5	14.9	26.3	40.6
Quantity: billion cubic meters	2.6	2.8	2.8	2.9	...
Unit price: SDRs per thousand cubic meters	5.5	5.5	5.3	9.1	...
Other					
Value	11.3	19.5	23.1	20.7	31.5
Total exports (customs basis)					
Value	97.1	112.8	131.9	188.8	191.8
Balance of payments adjustment[4]	5.0	-2.6	0.2	-10.0	--
Total exports					
Value (balance of payments basis)	102.1	110.2	132.1	178.8	191.8

Sources: Central Statistical Office and Da Afghanistan Bank.

1/ Unit prices and quantity exported not available for full year.

2/ Export values and unit prices are believed to be overestimated from 1973/74 due to overvaluation of export receipts from India.

3/ Based on the customs data. See footnote 4, below.

4/ The difference between foreign exchange receipts of Da Afghanistan Bank on karakul skins, wool and cotton, and the recorded customs value of these exports. In 1973/74, foreign exchange receipts of Da Afghanistan Bank, for example, amounted to SDR 13.4 million for karakul skins, SDR 4.8 million for wool, SDR 6.7 million for cotton, i.e., a total of SDR 24.9 million; on the other hand the customs value totaled SDR 24.7 million for the three items.

Table 19. Afghanistan: Commodity Composition of Imports[1/]

(In millions of SDRs)

Afghan year ended March 20	1970/71	1971/72	1972/73	1973/74
Food and tobacco products	21.3	38.4	37.5	31.8
Wheat, of which:	5.9	20.3	17.4	8.5
Commodity aid	(5.9)	(20.3)	(17.4)	(8.5)
Sugar, of which:	5.1	3.6	9.0	11.8
Commodity aid	(2.9)	(1.4)	(0.3)	(0.2)
Tea	7.9	9.7	8.7	8.4
Vegetable oil and other food, of which:	1.8	3.9	1.8	2.3
Commodity aid	(--)	(2.0)	(0.1)	(1.0)
Tobacco products	0.6	0.9	0.6	0.8
Chemical and petroleum products	13.7	21.4	21.6	28.5
Petroleum products, of which:	6.8	7.1	6.8	7.2
Commodity aid	(1.9)	(3.1)	(2.6)	(2.8)
Chemical fertilizers, of which:	1.5	6.9	7.0	12.5
Commodity aid	(0.5)	(2.4)	(7.0)	(12.5)
Pharmaceutical and other chemical products	5.4	7.4	7.8	8.8
Other commercial imports	55.3	53.5	55.6	64.9
Clothing fabric and footwear	16.4	11.7	12.8	16.1
Automobile and other transport equipment	10.1	13.6	15.3	17.4
Other manufactures and capital goods	23.2	20.8	18.4	20.4
Other	5.6	7.4	9.2	11.0
Other commodity aid imports	2.2	4.9	1.5	1.8
Project aid imports	22.1	24.0	27.2	15.5
Total imports	114.6	142.2	143.4	142.5
Commercial imports	79.0	84.4	87.3	100.1
Aid-financed imports	35.6	57.8	56.1	42.4
Commodity aid imports	(13.5)	(33.9)	(28.9)	(26.9)
Project aid imports	(22.1)	(24.0)	(27.2)	(15.5)

Sources: Ministry of Commerce, Central Statistical Office, Ministry of Planning, and Da Afghanistan Bank.

1/ Data not available for 1974/75 and 1975/76.

Table 20. Afghanistan: Direction of Trade

(In per cent of total)

Afghan year ended March 20	1971/72	1972/73	1973/74	1974/75
Exports				
U.S.S.R.	39.3	29.0	30.5	42.3
India	4.8	24.4	17.1	15.5
Other bilateral countries	2.5	3.4	3.2	2.7
United States	2.2	2.0	1.3	2.0
United Kingdom	19.9	16.0	14.6	11.2
Germany, Fed. Rep. of	8.7	6.1	4.3	2.5
Pakistan	5.4	4.2	14.4	9.8
Other	17.2	14.9	14.6	14.0
Total	100.0	100.0	100.0	100.0
Imports 1/				
U.S.S.R.	27.3	24.8	21.0	28.7
India	7.9	7.5	10.3	12.1
Other bilateral countries	6.4	3.5	4.1	2.9
United States	14.0	10.5	12.0	2.0
United Kingdom	6.6	3.7	4.2	4.1
Germany, Fed. Rep. of	7.4	9.1	6.1	3.9
Japan	12.8	15.3	17.3	26.1
Pakistan	2.5	3.7	3.5	5.5
Other	15.1	21.9	21.5	14.7
Total	100.0	100.0	100.0	100.0

Sources: Central Statistical Office and Research Department, Da Afghanistan Bank.

1/ Including both commercial and aid-financed imports.

Table 21. Afghanistan: Service Payments on External Public and Publicly-Guaranteed Debts

(In millions of SDRs)

	Debts Outstanding as of March 20, 1975		Servicing of Debts	
	Disbursed	Undisbursed	1974/75	1975/76
U.S.S.R.[1]	452.6	468.9	18.8	6.0
Principal			13.4	4.7
Interest			5.4	1.3
China, P.R. of	14.7	47.9	--	--
United States	76.1	9.7	4.5	4.8
Principal			2.9	3.3
Interest			1.6	1.6
Germany, F.R. of	54.8	15.2	6.4	6.9
Principal			5.0	5.4
Interest			1.4	1.5
United Kingdom	1.4	1.2	1.0	0.3
Principal			0.9	0.4
Interest			0.1	0.1
France	0.9	--	0.6	0.7
Principal			0.5	0.7
Interest			0.1	--
Kuwait	2.0	--	0.8	1.5
Principal			0.8	1.5
Interest			--	--
Others (including IDA and ADB)	11.9	114.1	0.7	0.8
Principal			0.5	0.6
Interest			0.2	0.2
Total debt outstanding	614.4	657.0		
Total servicing on debts outstanding			32.8	21.3
Principal			24.0	16.6
Interest			8.8	4.7

Sources: IBRD, Economic Analysis and Projection Department and data provided by the Ministry of Finance, the Ministry of Planning and Da Afghanistan Bank.

1/ Includes debt rescheduling of 1973, which reduced debt service payments by SDR 5.6 million in 1973/74, 1974/75, and 1975/76; also includes debt rescheduling of 1975 which reduced debt service payments by SDR 15.2 million in 1975/76.

Table 22. Afghanistan: Interest and Maturity Terms of External Public Debt Outstanding as of March 20, 1975

(In millions of SDRs)

Interest Rate (per cent)	Original Maturity (in years) 1-5	5-15	15-25	Over 25	Unknown	Total 1/
0-3	5.71	126.41	53.84	744.66	170.16	1,100.78
3-6	0.28	3.74	3.62	--	--	7.64
Over 6	--	--	--	--	--	--
Unknown	--	--	--	43.82	119.50	163.32
Total 1/	5.99	130.15	57.46	788.48	289.66	1,271.74

Average interest rate : 1.615 per cent

Average grace period : 12.9 years

Average maturity : 34.2 years

Grant element of loans: 69.1 per cent

Sources: Ministry of Finance and IBRD.

1/ Totals do not add due to rounding.

Table 23. Afghanistan: Free Market Exchange Rates

(Monthly average rates in Afghanis per U.S. dollar)

Afghan year ended March 20	Bazaar			Da Afghanistan Bank			Commercial Banks 1/		
	Buying	Middle	Selling	Buying	Middle	Selling	Buying	Middle	Selling
Annual averages									
1971/72		84.83			83.98				
1972/73		79.75			80.60				
1973/74		60.66			61.05				
1974/75		56.86			58.21				
1975/76		55.05			57.66				
1975/76 monthly averages 2/									
March/April	54.69	54.94	55.19	55.62	56.62	57.62			
April/May	55.05	55.30	55.55	56.50	57.50	58.50			
May/June	54.91	55.16	55.41	56.50	57.50	58.50			
June/July	55.12	55.37	55.62	56.50	57.50	58.50			
July/August	55.62	55.87	56.12	56.96	57.96	58.96			
August/September	54.35	54.62	54.88	57.00	58.00	59.00			
September/October	54.34	54.59	54.84	57.00	58.00	59.00			
October/November	54.17	54.42	54.67	57.00	58.00	59.00			
November/December	54.28	54.53	54.78	57.00	58.00	59.00			
December/January	54.69	54.95	55.21	57.00	57.84	58.68	55.25	55.75	56.25
January/February	55.48	55.76	56.05	57.00	57.50	58.00	55.25	55.75	56.25
February/March	54.80	55.09	55.38	57.00	57.50	58.00	55.50	55.87	56.25

Source: Da Afghanistan Bank.

1/ Until January 1976 commercial banks maintained exchange rates identical to L_ Afghanistan Bank.
2/ Months ending on the 20th or 21st day.

Table 24. Afghanistan: Net Balances Under Bilateral Accounts

(In millions of SDRs)

	March 20 1972	March 20 1973	March 20 1974	March 20 1975	Dec. 20 1975
Czechoslovakia	0.69	1.58	1.82	4.49	2.86
People's Republic of China	0.21	0.05	0.11	-0.56	-0.31
U.S.S.R.	-5.28	-4.50	3.13	2.13	11.26
Yugoslavia	-0.01	-0.01	-0.01	-0.01	-0.01
Total	-4.71	-2.92	5.06	6.05	13.80

Source: Da Afghanistan Bank.

Afghanistan: Summary of the Tax System, March 1976

(All amounts in Afghanis)

Tax	Nature of Tax	Exemptions and Deductions	Rates
A. Central Government			
1. Taxes on net income and profits			
1.1 Taxes on companies, corporations, and enterprises			
1.11 Corporate income tax (Income Tax Law enacted June 8, 1943, as amended to March 1976)	Annual tax on net accrued taxable income earned in Afghanistan and abroad by domestic corporations and limited liability companies. Except as otherwise specified, the tax year corresponds to the solar year. Nonresident foreign corporations are subject to tax on (gross) income from all sources within Afghanistan. Resident foreign corporations are taxable on net income earned in Afghanistan. Government-owned enterprises, including state trading entities and Da Afghanistan Bank, are subject to net income taxation. Gains from the sale or exchange of fixed assets and investments are subject to tax. Losses from the sale or exchange of fixed assets, but not losses from the sale or exchange of shares, are deductible from taxable income in the taxable year in which the sale or exchange took place. Tax incentive legislation reduces tax liability for approved corporations. (See the annex on tax incentives.)	Exemptions: Upon approval by the Ministry of Finance, the income of corporations organized for educational, cultural, literary, scientific, or charitable purposes are exempt. Deductions: Ordinary and necessary expenses; interest paid on business debts; depreciation of property except agricultural land; net losses not compensated for; bad debts; gifts and charitable contributions; interest on bonds issued by the State and municipalities; dividends paid in money; taxes on dividends received from other taxable companies and taxes on business transactions. Credits: A tax credit is granted to corporations and limited liability companies engaged in manufacturing or mining for the purchase of new machines, equipment, and apparatus. Foreign income taxes paid by a subsidiary and/or a branch of a resident corporation may be credited against the Afghan income tax.	20 per cent on net taxable income of corporations or limited liability companies. There is also a withholding tax of 20 per cent on all dividends and distributed profits paid in money which is credited against the individual's income tax liability. An additional 10 per cent is levied on dividends and profits paid to anonymous investors. Tax credit: A maximum of 15 per cent of the cost of qualifying purchases for a period of five years, but not exceeding 5 per cent in any taxable year, is applicable against the income tax liability of approved corporations and limited liability companies.

Afghanistan: Summary of the Tax System, March 1976 (continued)

(All amounts in Afghanis)

Tax	Nature of Tax	Exemptions and Deductions	Rates
1.2 Taxes on individuals			
1.21 Individual income tax (Income Tax Law of 1943 as amended to March 1976)	Tax on net taxable income received during the tax year (which corresponds to the solar year) is levied on all Afghan citizens whether residing in Afghanistan or not. Tax on net taxable income from sources within Afghanistan is payable by resident and nonresident aliens. Taxes are collected by withholding from wages and salaries, by withholding at source from dividend payments by corporations, and by withholding from rents paid by the Government. Tax is withheld in accordance to a table provided by the Ministry of Finance. Individuals engaged in certain activities are subject to fixed taxes that are levied in lieu of the income tax but are based on specific activities and/or types of property. These include a tax on contractors based on the contract amount, a tax on persons engaged in transportation based on the number and size of vehicles, a tax on the operators of cinemas and theatres based on gross admissions, a tax on shopkeepers based on net income potential estimated from characteristics such as the type and volume of business, the rental value of shops, and the population of the surrounding village or city. While these taxes are not based on net income, they are applied as part of the income tax law and collections are classified with income tax receipts.	Exemptions: Income-in-kind is exempt from tax. Personal exemptions granted to citizens and resident aliens include: Af 18,000 personal allowance; Af 12,000 for spouse (limited to one spouse); Af 2,000 for each dependent child under 19 years and for each dependent child in full-time education; Af 1,000 for each dependent parent. The maximum personal exemptions for each taxable year is Af 45,000 for each taxpayer. Other exemptions include the proceeds on life insurance policies; health, accident, and unemployment insurance benefits; donations made to the State and to approved nonprofit organizations; interest from internal banks on individual savings and time deposits; interest on bonds issued by the State and by municipalities of Afghanistan. Deductions: Advertising and entertainment expenses evidenced by documents and up to 2 per cent of net income. Damages to property caused by fire, earthquake, and other natural disaster are deductible over a three-year period.	Taxable Income — Rate (Per Cent) Up to 10,000 — 4 10,001 to 20,000 — 5 20,001 to 30,000 — 6 30,001 to 40,000 — 7 40,001 to 50,000 — 8 50,001 to 75,000 — 12 75,001 to 100,000 — 18 100,001 to 125,000 — 21 125,001 to 150,000 — 24 150,001 to 175,000 — 27 175,001 to 200,000 — 30 200.001 to 250,000 — 33 250,001 to 300,000 — 36 300,001 to 400,000 — 39 400,001 to 500,000 — 42 500,001 to 750,000 — 45 750,001 to 1,000,000 — 48 1,000,001 to 1,500,000 — 51 1,500,001 to 2,000,000 — 54 2,000,000 to 2,500,000 — 57 Over 2,500,001 — 60
2. Social Security Contributions None			
3. Payroll Taxes (other than social security contributions			

Afghanistan: Summary of the Tax System, March 1976 (continued)

(All amounts in Afghanis)

Tax	Nature of Tax	Exemptions and Deductions	Rates
4. Taxes on property			
4.1 Real estate taxes			
4.11 Tax on agricultural land (Land Tax Law, effective March 1920)	The tax applies only to agricultural land, and is based on the productivity of land. The tax is levied against a village as a whole and the village chief allocates the tax liability to be paid by each landowner in the village. The tax is payable in two installments. The tax is assessed on the basis of a land register maintained by the land tax officer who reports to the Revenue Department of the Ministry of Finance.	Public lands are not subject to the tax. Tax liability may be reduced to the extent of loss and damage to land and/or its produce caused by natural disaster and certified by the land tax officer.	Taxes were previously levied and collected in kind as part of produce. In-kind payments have been replaced by monetary payments. Tax assessments vary with the size and productivity of land holdings. Information of tax rates is not available.
4.2 Net wealth taxes			
None			
4.4 Death and gift taxes			
None			
4.5 Property transfer tax (Income Tax Law enacted on June 8, 1943 as amended to March 1976)	The tax applies to the sale or transfer of any land owned by an individual, individuals as partners, or by families. Collections from this tax are classified with income tax receipts.	The sale or transfer of land owned by the Government, municipalities, and corporations. Corporations pay income tax on all gains from sales or transfers of assets.	One per cent of the price received, or, if not a sale or inheritance, one per cent of the market value of the property at the time of transfer.
4.7 Other			
4.71 Livestock tax	Specific tax on selected livestock, including sheep, goats, horses, camels, cattle, and mules.		Not available.

Afghanistan: Summary of the Tax System, March 1976 (continued)

(All amounts in Afghanis)

Tax	Nature of Tax	Exemptions and Deductions	Rates
5. Taxes on goods and services			
5.1 General sales taxes (Law for tax on consumer goods produced and sold in Afghanistan, approved in April 1974)	Single stage tax on consumer goods produced and sold domestically. The tax is collected from manufacturers. Except for a few items, such as furniture, chemical and pharmaceutical goods, all goods are taxed at specific rates. Payments are made on a quarterly basis.	Books, newspapers, and other printed items printed in Afghanistan are exempt from the tax.	Various specific rates per unit of product. The number of categories taxable at specific rates exceeds forty. Furniture, chemical, and pharmaceutical products are taxable at a rate of 10 per cent of the finished cost of manufacture.
5.2 Selective excises			
5.21 Tobacco[1/]			Not available
5.22 Liquor[2/]			
5.23 Hydrocarbon oils[1/] (None)			
6. Taxes on international trade and transactions			
6.1 Taxes on imports			
6.11 Customs duties (The current customs tariff was implemented in March 1975)	Import duties are levied on a variety of imports. The Afghanistan custom tariff code is based on the Brussels tariff nomenclature. Duties are levied on a c.i.f. valuation.	Government imports, including project aid imports, are exempt. Also exempt are several goods specified in the custom tariff. Special concessions apply to imports under the Foreign and Domestic Private Investment Law. (See annex on tax incentives.)	A mixture of ad valorem and specific rates is applied. Specific rates generally take the form of percentages of administered unit values. Although rates vary up to 100 per cent, low rates are generally applied on chemical and pharmaceutical products and basic foodstuffs.
6.12 Fixed tax on importers	A fixed tax paid by importers on the price of imports, valued c.i.f. and including customs duties.		6 per cent.

Afghanistan: Summary of the Tax System, March 1976 (continued)

(All amounts in Afghanis)

Tax	Nature of Tax	Exemptions and Deductions	Rates
6.2 Export taxes			
6.21 Export duties	Specific taxes on several exports included in the custom tariff.	Products of approved investments under the Foreign and Domestic Investment Law are exempt. (See the annex on tax incentives.)	Specific rates in the form of percentages of administered unit values. Various rates apply.
6.22 Selective exports tax (effective on March 1, 1974)	Windfall exports profits tax on selected export goods including walnuts, sesame and oil cake.		Not available.
6.3 Exchange taxes			
None			
6.4 Other			
None			
7. Other taxes			
7.1 Poll taxes			
None			
7.2 Stamp taxes	Sale of stamps affixed to contracts and other legal documents.	Approved enterprises under the Foreign and Domestic Private Investment Law (See annex on private incentives.)	Not available.
7.3 Other			
None			

1/ Trading in tobacco and hydrocarbon oils is monopolized by the State; revenue accrues to the Government from monopoly taxes and from the net profits of the trading monopolies.
2/ The import or sale of liquor is prohibited except by Government permission. Licensed merchants pay tax on sales; no information on tax rates is available.

Afghanistan: Summary of the Tax System, March 1976 (concluded)

TAX INCENTIVES		ANNEX
Foreign and Domestic Private Investment Law (Effective 1974)	The benefits provided under this law apply equally to approved investments by foreigners and residents. However, foreign participation in approved projects must not exceed 49 per cent of of total equity capital. The effective period of exemption from corporate income tax and tax on distributed dividends is limited to 4 years for investments within the capital (Kabul) province, and to 6 years for investments outside the capital province. To be approved, investments must satisfy some specified guidelines including the maximum use of Afghan raw materials, the maximum use of Afghan manpower, import substitution and maximum value added. In addition to exemptions from, and reductions in, tax rates, approved investments are granted benefits including: (1) the repatriation of payments for interest, capital and profits of foreign investments at the Da Afghanistan Bank free market exchange rate; (2) the repatriation of up to 60 per cent of the salaries of foreign personnel through the Da Afghanistan Bank at its free market exchange rate; (3) the requirement that Government departments and enterprises must purchase their necessary supplies and services from approved enterprises provided that such supplies and services are produced in Afghanistan and that their prices do not exceed 15 per cent of the prices of similar import goods.	<u>Exemptions and reductions in tax rates</u> A. <u>Income tax</u>: (1) Exemption from taxes on all income of the company for a period of 4 consecutive years beginning with the year in which the first sale of goods and services occurs. (2) Exemption from personal income tax and corporate tax on all dividends for 4 consecutive years beginning with the year in which a dividend is first distributed, provided that the tax exemption shall not extend beyond the seventh year from the date of approval of the investment. (3) Interest on foreign loans that are part of an approved investment is fully exempt from income taxes. B. <u>Import tax</u>: <u>Capital goods</u>: exempt <u>Spare parts</u>: 10 per cent, based on invoice c.i.f. or on an administered unit price. <u>Raw materials and semi-finished goods</u>: 20 per cent maximum, based on invoice c.i.f. or on an administered unit price. C. <u>Other taxes</u> <u>Export tax</u>: exempt. <u>Stamp tax</u>: exempt from stamp taxes, registration fees, and other court-levied fees for the preparation of documents related to bank transactions.

Afghanistan: Exchange and Trade System · Position on April 1, 1976

1. Exchange and rate system

The par value of Afghanistan's currency, the Afghani, is 0.0197482 gram of fine gold, corresponding to Af 45 = SDR 1. No exchange transactions take place at the par value. Da Afghanistan Bank quotes official buying and selling rates for the U.S. dollar of Af 44.70 and Af 45.30, respectively. The official selling rate applies to foreign exchange payments by the Government for debt service, contributions to international organizations, salaries of foreign experts, and the foreign exchange requirements of Afghan embassies. The official buying rate applies to 40 per cent of the foreign currency salaries of foreign employees of the Government, government enterprises, and domestic companies and to purchases of bilateral agreement currencies for maintenance in Afghanistan of embassies and state trading organizations by the bilateral partner countries (except India).

With the exception of transactions at the official rate and with the People's Republic of China, and the special arrangements applicable to wool exports to bilateral markets, all other transactions take place at free market rates. Market imperfections and official policy result in some differences among the free market rates quoted by Da Afghanistan Bank, commercial banks and the money bazaar. On April 1, 1976, the free market rates of Da Afghanistan Bank were Af 56.50 buying and Af 57.50 selling per US$1, and the bazaar rates were Af 54.05 buying and Af 54.63 selling per US$1.

Transactions involving purchases or sales of bilateral agreement clearing units of account, either clearing dollars for the U.S.S.R. and Czechoslovakia or clearing sterling for the People's Republic of China, are made at rates set by Da Afghanistan Bank. The rate for clearing dollars is maintained at par with Da Afghanistan Bank's free market rate for the U.S. dollar, while the rate for clearing sterling reflects supply and demand for that accounting unit. Da Afghanistan Bank buys in the free market bilateral accounting dollars and sterling resulting from exports to the bilateral agreement countries and sells these accounting units mainly to government commercial and industrial enterprises for their imports from the countries concerned.

While formerly special arrangements were applicable to the proceeds of karakul, cotton and wool exports, these arrangements were modified substantially during 1975. Maximum surrender rates previously applicable to exchange receipts from exports of these three commodities to multilateral markets were eliminated, in addition to the special rate previously applicable to cotton export proceeds from bilateral countries; the latter now are exchanged at the official rate plus an exchange subsidy equivalent to the difference between the official rate and Da Afghanistan Bank's free market rate. Proceeds from wool exports to bilateral countries are exchanged at the official rate plus an exchange subsidy of Af 15 per accounting dollar; however, until official policy is clarified, any amount over Da Afghanistan Bank's free market rate for the accounting dollar is being held for wool exporters in blocked accounts. Moreover, the special exchange rates applied to proceeds from walnut exports to the U.S.S.R. and Czechoslovakia were terminated, and such proceeds are now converted at Da Afghanistan Bank's free market rate for bilateral accounting dollars.

2. Administration of control and prescription of currency

Foreign exchange is controlled by the Government through Da Afghanistan Bank. The control is facilitated by the existence of relatively large companies specializing in the export of such commodities as karakul, cotton, wool and carpets. However, these companies do not exercise a monopoly over the export of such commodities, with the exception that the export of cotton to both multilateral and bilateral markets is reserved for seven authorized companies and is now effectively controlled by the Government. Settlements with countries with which Afghanistan has bilateral payments agreements must be made in the foreign currencies specified in the agreements. The proceeds from exports of karakul, wool and cotton to other countries must be obtained in convertible currencies. There is no other prescription of currency.

3. Imports and import payments

Imports are not subject to license, but import transactions must be registered before orders are placed abroad. Imports of a few items (e.g., some drugs, liquor, arms and ammunitions) are prohibited on public policy grounds or for security reasons; in some instances, however, special permission to import these goods may be granted. The importation of certain other goods (e.g., a few textiles and other minor consumer goods) is also prohibited. There are no quantitative restrictions on other imports with the exception of those specified in bilateral agreements. Most bilateral trade now takes place at international prices. On the whole, trade with bilateral agreement countries is carried out on a compensation basis, and usually both imports and exports are arranged by the same trader; imports against exports of cotton and wool to bilateral markets are carried out by the Government or government agencies.

4. Exports and export proceeds

Exports (other than gold) are not subject to license, but export transactions must be registered. Exports of a few commodities (e.g., opium and museum pieces) are prohibited. Otherwise, control is exercised only over exports to bilateral agreement countries. Exchange receipts from exports of karakul, wool, and cotton to multilateral markets must be surrendered at Da Afghanistan Bank's free market rates. The proceeds of all other exports may be sold at free market rates to a domestic bank or may be used by the exporter to pay for imports. Although export taxes are levied on a number of items under the customs tariff, the special taxes relating to cotton, oilseeds, walnuts, and raisins were modified during 1975/76.

5. Invisibles and exchange restrictions on tourist travel

Central government payments for foreign debt service and certain other invisibles are made at the official rate. All other payments are settled at free market rates. In September 1973, certain ceilings were introduced on the amount of foreign exchange a traveler could take out of the country. Previously there had been no such limitations. The ceilings differed according to purposes of travel; Afghan residents going abroad for medical treatment were allowed, after obtaining a certificate from the Ministry of Health, to take out the equivalent of US$20 per day in the case of travel to the United States, Europe and Japan, and US$10 per day in the case of travel to other areas. Merchants were allowed the equivalent of US$20 per day for a maximum period of one month for business purposes; and specific guidelines were imposed on students and government officials. Without specific permission, the maximum amount a traveler could take out of the country was limited to the equivalent of US$50 and this was in effect the allocation for tourist travel. Afghan nationals were instructed to obtain certificates either from Da Afghanistan Bank or from two commercial banks stating the purpose and amount of foreign exchange taken abroad, and show the certificates at the borders. It was understood, however, that the foreign exchange authorities would in some circumstances grant exchange in excess of the specified guidelines in individual cases, but not normally for tourist travel.

On April 27, 1974 the banks were authorized to sell foreign exchange for pleasure trips abroad up to the equivalent of US$400 a person a trip a year or US$20 multiplied by the number of days spent abroad, whichever was less; no additional foreign exchange for tourism is granted by the authorities. In late 1975, the exchange allocation from the banks for tourist travel was doubled to US$800 per person for one trip a year. The other provisions of the September 1973 directive remain unchanged. The banks and customs officials at the borders are instructed to comply strictly with the regulations. It may be noted, however, that no specific directives have been issued to restrict exchange transactions through the money bazaar which, in fact, remains uncontrolled. Travelers are not allowed to bring in or take out more than Af 500 in Afghan banknotes.

Forty per cent of the foreign currency salaries of foreign employees of the Afghan public and private sectors must be converted into Afghanis at the official rate, but the remaining 60 per cent may be remitted abroad or exchanged at the free market rate. Except in the case of India, receipts over bilateral payments agreement accounts from the embassies and state trading organizations of the countries concerned for their local expenses in Afghanistan are converted at the official rate. All other receipts from invisibles are sold at free market rates through either the banks or the bazaar.

6. Capital

Foreign investment in Afghanistan requires prior approval and is administered, as is domestic private investment, by an Investment Committee composed of five cabinet ministers. The Foreign and Domestic Private Investment Law of 1353 (issued on July 4, 1974) provides for a number of benefits, which include (1) income tax exemption for four years, beginning from the date of the first sale of products resulting from the new investment; (2) exemption from import duties on essential imports (mainly of capital goods); (3) exemption from taxes on dividends for four years after the first distribution of dividends, but not more than seven years after the approval of the investment; (4) interest on foreign loans which constitute part of an approved investment are deductible for the purposes of the personal and corporate income taxes; (5) exemption from export duties, provided that the products are permitted to be exported; and (6) mandatory purchases by government agencies and departments from enterprises established under the Law, provided prices of such products are no more than 15 per cent higher than the price of the equivalent import. The Law provides that foreign investment in Afghanistan can only take place through joint ventures, with foreign participation not exceeding 49 per cent. It also establishes that an investment approved by the Investment Committee shall require no further license to operate in Afghanistan.

Principal and interest installments on loans from abroad may be remitted freely to the extent of the legal obligation involved. Profits may be repatriated freely, and capital may be repatriated after five years at an annual rate not exceeding 20 per cent of the total registered capital. All the foregoing transfers are made through the free market.

7. Bilateral payments agreements

Afghanistan maintains bilateral payments agreements with a Fund member (India) and three non-Fund members (Czechoslovakia, the People's Republic of China, and the U.S.S.R.). Under the agreements with Czechoslovakia and the U.S.S.R. trade targets for imports and exports by volume or value are normally established in annual protocols, and trade is carried out at international prices. The annual trade protocol with the U.S.S.R. usually contains provisions concerning debt servicing, commercial loans, and technical assistance. Swing margins are established as follows: for the U.S.S.R., US$2 million, and for Czechoslovakia, US$1 million. In the case of the agreement with the People's Republic of China, indicative targets by weight or value are established for specified exports and all imports are eligible under the agreement; the swing margin is £ 50,000. In the case of the clearing arrangements with the U.S.S.R. and the People's Republic of China, excess balances over the swing margins are subject to an interest rate of 2 per cent per annum; the corresponding rate for the agreement with Czechoslovakia is 3 per cent per annum. Extra-swing overdrafts are not normally settled in convertible exchange.

The agreement with India contains special provisions. Certain portions of trade with India are settled by bilateral accounts and the rest by convertible currencies. Three methods of settlement are established: (1) by payment in inconvertible rupees; this covers about 90 per cent of trade, principally Afghan fruits and nuts, and Indian consumer manufacturers and engineering goods; (2) through a special self-balancing account maintained by Da Afghanistan Bank with the State Bank of India. Rupees generated in this account by Afghan sales of goat and sheep hides (excluding karakul) are used by the Afghan Government in payment for certain goods and services purchased in India; (3) by payments under letters of credit in U.S. dollars or in pounds sterling; this type of trade involves mainly goods that could be sold for convertible currencies elsewhere, such as, Afghan cotton and Indian capital and durable consumer goods.

8. Gold

Residents may freely purchase, hold, and sell domestically gold in any form in Afghanistan. Imports of gold are restricted. Exports of gold and silver in any form other than jewelry require licenses issued by the Council of Ministers; such licenses are not normally granted except for exports by or on behalf of the monetary authorities. Commercial exports of gold and silver jewelry and of other articles containing minor quantities of gold or silver do not require a license and may be made freely. Customs duties are payable on imports and exports of silver in any form unless the import or export is made by or on behalf of the monetary authorities. The import duty on gold is 1 per cent.

9. Changes since the last consultation

1975

February 16. The buying rate for the U.S.S.R. clearing dollar was changed from Af 61 to Af 60 per clearing dollar.

February 26. The buying rate for clearing dollar acquired from Czechoslovakia and Yugoslavia was changed from Af 65 to Af 64 per clearing dollar.

June 30. Maximum surrender rates applicable to proceeds from karakul, cotton, and wool exports to multilateral markets were eliminated. Such proceeds are now to be surrendered at the free market rate.

June 30. The importation of certain goods, mainly consumer products, was prohibited.

July 12. The buying rate for clearing dollars acquired from Czechoslovakia, Yugoslavia, and the U.S.S.R. was changed to Af 58 per clearing dollar and that for Chinese clearing sterling to Af 175 per sterling clearing unit.

October 1. The surrender rate for proceeds of natural gas exports to the U.S.S.R. was changed from the official rate to the Da Afghanistan Bank free market rate for bilateral accounting dollars.

October 28. The two special exchange rates for exports of walnuts to the U.S.S.R. and Czechoslovakia were abolished. All proceeds from walnut exports were to be converted at the Da Afghanistan Bank free market rate for bilateral accounting dollars, and were subject to an export tax of 2.0 per cent on proceeds exceeding parity.

October 29. The special exchange rate of Af 60 per bilateral accounting dollar for cotton exports was suspended; proceeds from cotton exports to bilateral countries were to be settled at the Da Afghanistan Bank free market rate.

October 30. Da Afghanistan Bank's free market buying and selling rates for clearing dollars acquired from Czechoslovakia, Yugoslavia and the U.S.S.R. were changed to Af 57 and Af 59, respectively; this change unified the rates with the multilateral free market rate for the U.S. dollar.

October 30. The buying rate for Chinese clearing sterling was changed to Af 170 per sterling accounting unit; on November 22 it was changed to Af 165.

1976

January 11. Commercial banks were permitted to set their free market exchange rates independently of Da Afghanistan Bank. Da Afghanistan Bank changed its selling rate from Af 59 per US$1 to Af 58 per US$1. The buying and selling rates were further changed to Af 56.5 per US$1 and Af 57.5 per US$1, respectively, on March 27, 1976.

B I B L I O G R A P H Y

Publications

Ministry of Planning, The Third Five-Year Economic and Social Plan of Afghanistan, 1967-71.

Ministry of Planning, Survey of Progress, 1966/67, 1967/68, 1968/69, 1969/70, 1970/71 and 1971/72.

Ministry of Planning, Government Budgets, 1974/75 and 1975/76.

Ministry of Planning, Annual Economic and Social Development Plan, 1974/75 and 1975/76.

Ministry of Finance (General Customs Department), Revised Customs Tariff Schedule (June, 1974).

Ministry of Finance (General Customs Department), General Raw Material Customs Tariff for Afghan Industries (July 1974).

entral Statistical Office, Exports of Merchandise from Afghanistan, 1971/72 and 1972/73.

Central Statistical Office, Imports of Merchandise into Afghanistan, 1971/72 and 1972/73.

Unpublished documents

International Monetary Fund, Afghanistan - 1970 Article XIV Consultation, SM/71/36, and consultation reports for subsequent years.

International Bank for Reconstruction and Development, International Development Association, Current Economic Position and Prospects of Afghanistan, Report No. 684a-AF, July 7, 1975.

International Bank for Reconstruction and Development, International Development Association, Afghanistan, Opportunities for Agricultural and Rural Development Sector Report, Report No. 848a-AF, November 20, 1975.

Ministry of Planning, National Development Plan for Afghanistan (1972/73-1976/77), Draft (July 1973).