

July 27, 1983 - 83/207

Statement by Mr. Salehkhon on Afghanistan
Executive Board Meeting 83/112
July 27, 1983

On behalf of the Afghan authorities, I would like to express their appreciation for the quality of the staff's assessment of Afghanistan's economic developments since the last Article IV consultation in 1978, and for the mission's efforts to analyze the country's present economic difficulties and prospects despite the lack of comprehensive data and information.

Four important interrelated factors have deeply affected economic developments in Afghanistan since the last consultation with the Fund. These factors include (a) a dramatic deterioration in the country's security situation; (b) large population movements within Afghanistan and to neighboring countries; (c) initial difficulties in the implementation of the new Government's fundamental social and economic changes, particularly the land reform program, and (d) a substantial reduction in Western aid and grants which were only partly offset by concessional loans and grants from Council for Mutual Economic Assistance countries. Even loans and grants from the CMEA countries have been declining in the last two years.

These developments resulted in a rapid general deterioration of Afghanistan's economy, particularly with respect to domestic output, which fell sharply in 1979/80 and 1980/81, resulting mainly from the destruction of infrastructural and production facilities, and, on the other hand, from the considerable decline in productive investments induced by the cessation of Western aid. Marked declines affected agricultural, mineral, and industrial production. Table 1 of SM/83/109 indicates that, in the case of cotton, output declines amounted to 20 percent and 38 percent in 1979/80 and 1980/81, respectively; a further 8 percent decline occurred in 1981/82. A noticeable exception to this trend was the substantial increase in natural gas production in 1980/81 with the opening of a new field. As Afghanistan's consumption of natural gas is very small, the latter improvement allowed for an important increase in gas export receipts which greatly attenuated the adverse effects of the above-mentioned factors on the balance of payments and on the public sector finances.

In the face of the continued deterioration in economic activity, the authorities have adopted annual socio-economic development plans aimed at restoring economic growth. Other measures include the gradual implementation of the land reform program, substantial adjustment in industrial crops procurement prices, an improvement in the provision of modern inputs to the agricultural sector, particularly to farmers' cooperatives, and an extension of workers' training programs. However, and due mainly to the continued delicate security situation, considerable shortfalls from plan targets have been registered, and economic activity has remained sluggish.

With regard to domestic financial developments, the public sector's recourse to bank financing rose sharply during the last two fiscal years. This development resulted primarily from a deceleration in the growth of

gas export revenues, large increases in debt service payments and security-related expenditures, a 27 percent adjustment in the salaries of civil servants, and from the adverse effects of output declines and curtailed external aid on the finances of public entities. Although the authorities reacted to the deterioration in public sector finances by substantially scaling down development expenditures, the increased recourse to bank financing may have resulted in high monetary expansion, which contrasted with the downward trend in economic production and contributed to the acceleration in the rate of inflation.

Other factors contributing to consumer price increases included the exchange rate depreciation, particularly in the bazaar free exchange market, and the higher costs of both imported and locally-produced goods.

The Afghan authorities are aware of the unsustainability of public sector finances and of the negative effects of high monetary expansion. In this regard, important measures are envisaged for fiscal year 1983/84 and should result in the containment of public sector expenditures and in an increase in budgetary revenues, possibly through higher tax rates.

With regard to external developments, despite a substantial increase in natural gas export receipts, trade deficit increased further in the last two years, while net capital inflows were substantially lower than in previous years. The deterioration of the trade deficit intensified despite a slowing down of import growth and resulted mainly from output declines in traditional exports and from transportation difficulties. On the other hand, net capital inflows were adversely affected by a considerable decline in external aid and grants, and by rising debt service payments.

Although the overall balance of payments showed relatively large surpluses throughout the 1970s, mainly as a result of high workers' remittances and substantial external assistance, Afghanistan's international reserves can hardly be regarded as comfortable. Indeed, the authorities are concerned with the trend of deterioration in the balance of payments, and particularly with the sharp increase in the country's outstanding external debt and rising debt service payments. While the measures to be implemented under fiscal and monetary policy should reduce the pressure on the balance of payments, the authorities believe that meaningful progress in this area is largely dependent upon the resumption of external assistance and on improvement of the security situation.

Finally, concerning Afghanistan's exchange and trade system, although the measures implemented since the 1979 unification of banks' exchange rates have resulted in the re-emergence of multiple currency practices, they have generally been in line with the authorities' economic policy aimed, in particular, at containing import-induced inflationary pressures. The large differentials between the various exchange rates have not apparently resulted in the development of illegal transactions since foreign trade is mainly the responsibility of the public sector. On the other hand, the authorities have compensated for the disincentive effect of the exchange rate on export production by substantially increasing the procurement prices of industrial crops.