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Statement by Mr. Caranicas on Afghanistan
Executive Board Meeting 76/98

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I wish to thank the staff for their papers on Afghanistan especially their report for the 1976 Article XIV Consultation which gives a clear and concise picture of economic developments in 1975-76 and the prospects for 1976-77. In today's fierce struggle of the nations of the Third World to overcome abject poverty and raise their living standards, particularly by the least developed among the developing countries, of which Afghanistan is one, it is gratifying to see that even better than last year the country is performing well. This is more remarkable as Afghanistan is a landlocked nation, possesses few natural resources, and suffers from a harsh climate. Its geopolitical situation and strategic importance is furthermore a constant cause of uncertainties because of the oppressive presence of a superpower on the north while insecurity prevails along its eastern boundaries.

During the past year economic developments continued to be favorable. With agriculture providing jobs for about 75% of the labor force and accounting for approximately half of the gross national product, generally good weather conditions helped the population with another abundant crop. Other factors leading to a better situation were the continued expansion of extension services, better distribution of fertilizers and increased output of cash crops--sugar and cotton--as well as food grains in enough quantities to maintain self-sufficiency.

The availability of domestically produced raw materials helped in turn industrial production; and good foreign demand for a range of products also benefitted the industrial sector, noticeably from the coming into full scale operation of the new fertilizer plant.

All these factors combined led to an estimated growth rate of real gross domestic product of about 3 to 5 per cent, approximately equal to that of 1974-75. This satisfactory output performance has been accompanied by the maintenance of sound domestic finances. A substantial increase in the foreign assets of the banking system and a decline in net domestic assets over the first eleven months of the period 1975-76 had the effect of a slight increase in liquidity--compared to the previous year--that is, of about 14 per cent.

Developments in the Government's financial position were the major cause of a decline in net domestic assets. An estimated increase in total expenditures of about 30 per cent and in total receipts of almost 18 per cent, caused the overall budget deficit to reach 1,919 million Afghanis, as compared to 642 million Afghanis in the previous year.

However, net external financing exceeded the overall deficit with the result that the authorities were able to reduce substantially net borrowing from the banking system for the second consecutive year.

The rate of inflation in Afghanistan has remained substantially below the world average and even fell during the first three quarters of 1975-76 to quite a moderate rate. This could be explained by a good supply situation, and the containment of expansion of domestic liquidity to a level that the economy could absorb without generating excessive pressure on resources. In addition, the Government's policy has been explicitly aimed at limiting the impact of rising tendencies on the cost of living and in the prices of basic commodities. To this end certain custom duties were temporarily reduced, particularly on some essential commodities, while the adverse impact of higher prices of sugar and petroleum was cushioned through subsidies; at the same time retail prices of these imports were raised. Moreover, the appreciation of the national currency also helped in keeping down domestic inflation.

When the Executive Board discussed the 1975 Staff Consultation report on July 16 last year, because of a deteriorating external position, the initial expectation for 1975-76 was for a small deficit. The terms of trade were worsening at that time as lower international prices were prevailing for the country's major export items. But, due to a combination of various factors--lower imports, firming export markets and substantial increase in unrecorded exports--the balance of payments recorded an unprecedented surplus of over 50 million SDR, a result also of a reduced level of external debt servicing coupled with higher foreign aid in both loans and grants.

The Afghani's upward trend--a move reinforced by an accumulation of foreign exchange reserves--continued as a further consequence of the strong external position. This led the Central Bank's authorities to attempt insulating exporters from the adverse effects such an appreciation might have had by standing ready to buy export proceeds at lower rates than those offered in the market.

Prospects for 1976-77 are good. Further growth in real terms can be expected. Although the overall deficit may widen sharply, mainly because of a substantial increase of development expenditures, foreign aid financing on a large scale and domestic bank borrowing--of approximately 1.2 billion Afghanis, a sum not exceeding markedly the budgeted amount for the previous year--will probably reduce the balance of payments surplus.

The combined effect of the likely external and budgetary positions is expected to yield a rate of liquidity expansion within the economy's absorptive capacity. One may therefore be confident of maintaining financial stability in the foreseeable future.

As for the longer-term perspective, because of the availability of substantial aid from abroad--mainly under the foreign aid agreements with the Soviet Union and Iran--increasing attention is paid by the authorities to measures designed to accelerate economic growth. Although all details have not yet been drawn up, a new Seven-Year Plan is coming into being.

Financing and investment allocations of the Plan's program are still under review but the bulk of 170 billion Afghanis devoted for development expenditures is to be financed principally by foreign aid. Project preparation is being improved and efforts are made to avoid the pitfalls of the recent past that led to poor implementation of the development programs, so as to succeed in reaching the targets of the new Plan.

Regarding the exchange system, the Afghani authorities proceeded to a considerable simplification during the past year. All transactions now take place at free market exchange rates, except specified government transactions and those with the People's Republic of China; there remains only one bilateral payments agreement with a Fund member.