

**EXECUTIVE
BOARD
MEETING**

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October 23, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Islamic Republic of Afghanistan—Request for a 42-Month Arrangement Under the Extended Credit Facility**

Board Action:	Executive Directors' consideration (Formal)
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Proposed Decision:	Page 24
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Questions:	Mr. Sadikov, MCD (ext. 37984) Mr. Sumlinski, MCD (ext. 38611) Mr. Nandwa, MCD (ext. 38461)
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*The authorities have indicated that they consent to the Fund's publication of this paper.



ISLAMIC REPUBLIC OF AFGHANISTAN

REQUEST FOR A 42-MONTH ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

October 22, 2020

EXECUTIVE SUMMARY

Context. The COVID-19 pandemic has inflicted a heavy economic and social toll, amplifying the challenges of the armed conflict and fragility. Activity contracted sharply, and new external and fiscal financing needs emerged since the approval of the Rapid Credit Facility disbursement. President Ghani and Mr. Abdullah resolved the contested 2019 presidential election in mid-May, and peace negotiations between the government and Taliban started in September. The authorities are seeking renewed support from the international community for Afghanistan's development and reforms. Donors remain committed but encourage reform implementation and combatting corruption. Aid is likely to decline in the medium term underscoring the need to advance to self-reliance.

Program objectives and modalities. The authorities have requested an Extended Credit Facility (ECF) arrangement to support the recovery from the pandemic, anchor reform implementation, and catalyze aid commitments at the donor conference in late November. Staff proposes an 80 percent of quota (about \$370 million), three and-a-half year ECF arrangement with semi-annual reviews. Financing under the arrangement will help address a protracted balance of payment need, estimated at about \$1.1 billion over 2020–23, and open fiscal space for continued health and social spending to mitigate the pandemic. Capacity to repay is adequate.

Program policies. The program will provide a macroeconomic framework to exit the crisis and create conditions for a recovery, with the focus shifting in the recovery stage to addressing fragilities that hinder sustainable growth and equitable social outcomes. It aims to preserve macro-financial stability, reverse the fiscal deterioration caused by the pandemic, protect development and social spending as aid declines, and maintain price stability with exchange rate flexibility. Complementing reforms supported by development partners, structural reforms under the program aim to improve fiscal governance, bolster the financial sector, and advance anti-corruption efforts.

Staff views. Staff supports the authorities' request for an ECF arrangement. The Letter of Intent and Memorandum of Economic and Financial Policies provide for appropriate policies to pursue program's objectives and the completion of the prior action shows authorities' ownership of the program. The program, however, faces substantial risks given the impact of the pandemic, longstanding fragilities, political uncertainty, and the ongoing conflict. Were these risks to materialize, they could complicate the program's implementation, lower growth, and widen financing gaps. Continued ownership, capacity development, and sustained donor aid will remain key for the program's success.

Approved By
Zeine Zeidane (MCD)
and Gavin Gray (SPR)

Discussions were held remotely from Washington, DC during July 6–August 4, 2020. The staff team comprised Azim Sadikov (head), Mariusz Sumliński, Boaz Nandwa, Tetyana Sydorenko (all MCD), Sandesh Dhungana (SPR), Gayon Hosin (MCM), Daisuke Ishikawa (FAD), and Kathleen Kao (LEG). World Bank staff participated as observers. Messrs. Mojarrad, Sassanpour, and Alavi (all OEDMD) joined opening and concluding meetings. The team met with Finance Minister Arghandiwal, Governor Ahmady, Deputy Finance Minister Zadran, and other officials. Tetyana Sydorenko and Jesus Sanchez (MCD) provided research assistance and Laila Azoor (MCD) managed document production.

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CONTEXT

A. Background

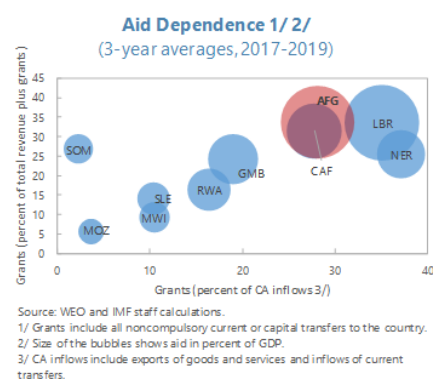
1. The armed conflict and fragility continue to hinder Afghanistan's development. The conflict has taken a heavy toll, causing large casualties, requiring security spending of 30 percent of GDP annually, and stunting economic development. Growth has been weak, unemployment high,¹ and poverty rose to 55 percent in 2017 from 39 percent in 2013. Governance vulnerabilities are high, and corruption remains a concern.

2. Afghanistan depends heavily on aid. Grants of about 40 percent of GDP, about two thirds security-related, finance most of the underlying fiscal and current account deficits. With current aid commitments expiring by the year-end, the authorities and donors will hold a conference on November 23–24, where donors will pledge aid for 2021–24.

3. The political reconciliation reached in May has paved the way for a unified government ready to negotiate peace with the Taliban and step up reform implementation.

The agreement signed by President Ghani and Mr. Abdullah, who is leading the peace talks with the Taliban, has also advanced government formation² and is likely to buoy confidence. The U.S. is withdrawing its forces per the February agreement with the Taliban, in exchange for Taliban's commitment to negotiate a political settlement to the conflict and cut ties to terrorism.

4. The authorities requested a Fund arrangement to support the recovery from the COVID-19 pandemic, catalyze aid, and address a protracted balance of payments need. They and the donors see the new arrangement as a vehicle to support a sound macroeconomic framework and underpin reforms for economic resilience, good governance, and inclusive growth, building on the 2016–19 Fund arrangement.



B. COVID-19

5. The pandemic has inflicted a heavy economic toll (see [Annex I](#)). It hit consumer and investor sentiment, already depressed by the conflict and political uncertainty. The lockdowns, on-off border closures, and social distancing led to aggregate demand shocks across goods, services, and labor. Services and industry appear to have suffered the most, as illustrated by Google's Community Mobility Report indicators, while agriculture appears largely spared.³ Food

¹ About 25 percent according to World Bank estimates.

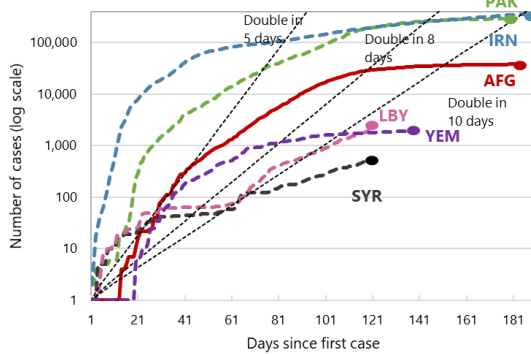
² The cabinet, to be approved by parliament, was named in August.

³ Impacts of COVID-19 on crop and livestock production, FEWSNET.

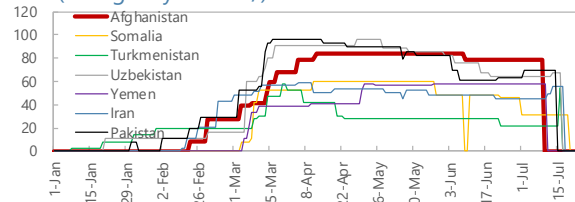
prices jumped due to border closures and panic buying, pushing headline inflation to 8.7 percent in April.

Islamic Republic of Afghanistan: COVID-19 High Frequency Indicators

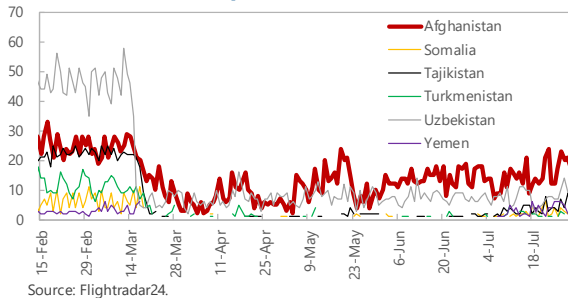
COVID-19 Confirmed Cases



Containment Measures (Stringency Index 1/)

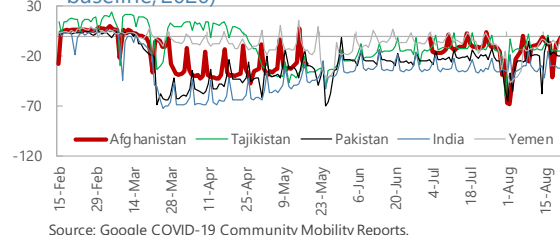


International Departures



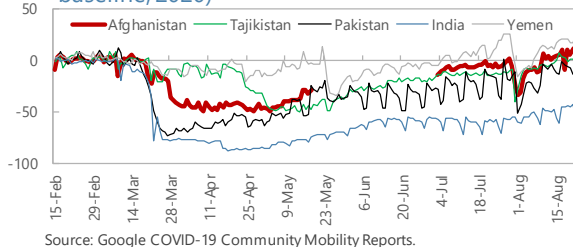
Workplace

(Google Mobility Index, percent change from baseline, 2020)



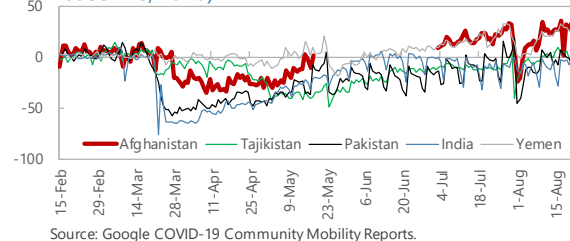
Retail and Recreation

(Google Mobility Index, percent change from baseline, 2020)



Grocery and Pharmacy

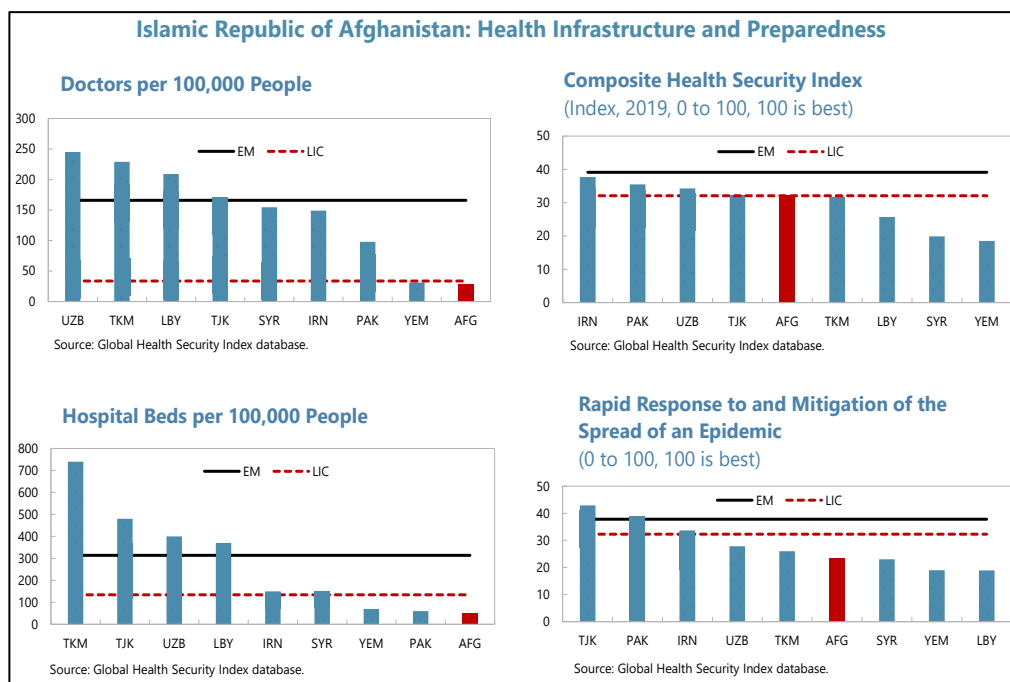
(Google Mobility Index, percent change from baseline, 2020)



6. The crisis has imperiled people's livelihoods and health. With employment concentrated in the informal sector with little job security⁴ and given the lack of an effective social safety net,

⁴ 80 percent of employment was vulnerable in 2019, per ILO.

income losses have been widespread, pushing thousands of families into poverty and possibly hunger. According to the World Bank (WB), the poverty rate has likely increased to 61–72 percent.⁵ The crisis exposed long-standing weaknesses in the health system, largely due to inadequate and ineffective spending and limited capacity.

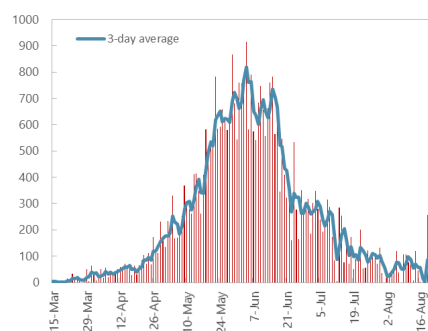


RECENT DEVELOPMENTS, OUTLOOK AND RISKS

A. Recent Developments

7. The economy appears to be recovering from the pandemic-induced slump. As confirmed infections declined, the authorities progressively eased containment restrictions since end-May, with most removed by end-August (see [Annex I](#)); social distancing guidelines remain in place. Border crossings reopened, and trade and some domestic and international flights resumed in May–July. CPI growth moderated to 5.9 percent by end-August as resumed trade and a new harvest boosted foodstuffs supply, but inflation is probably higher given that food's share in the consumption basket has likely risen.

COVID-19 Confirmed Cases

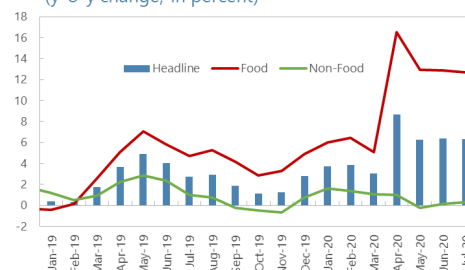


⁵ The World Bank COVID Relief Effort for Afghan Communities and Households (REACH) (P174119), p. 5.

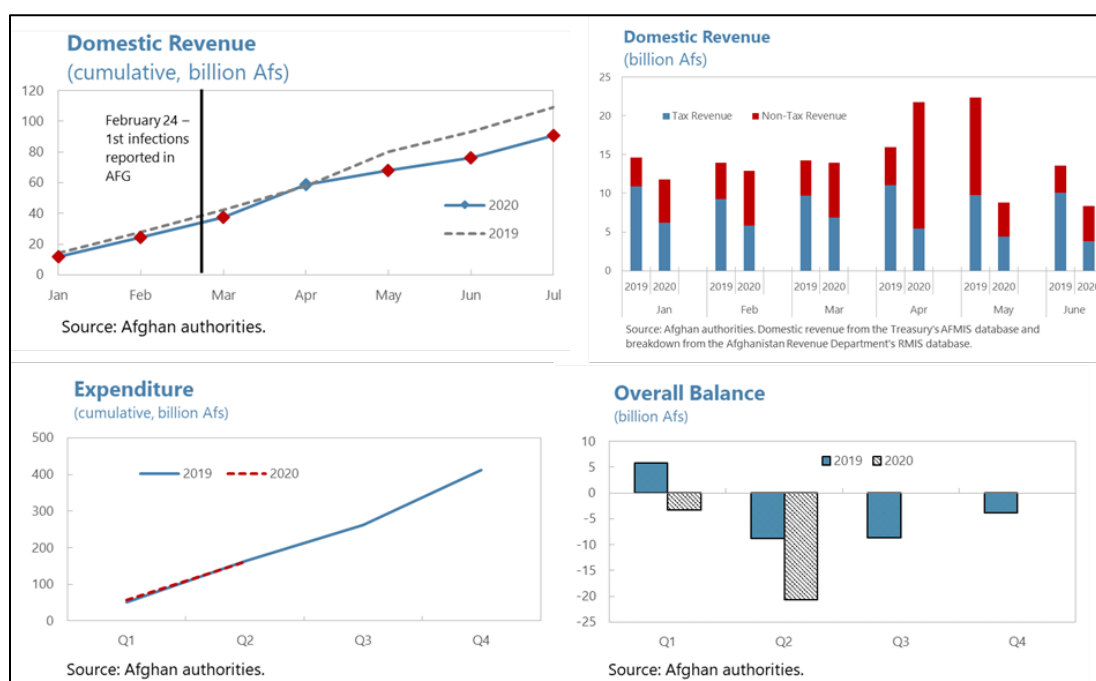
8. The pandemic and the government's response to cushion its impact have worsened fiscal accounts.

Tax revenue dropped by 40 percent in April–May year-on-year, in part due to the 45-day extension of first quarter tax filing, with the shortfall offset by the transfer of Af 12.8 billion of Da Afghanistan Bank (DAB) profits. The government ramped up spending on urgent health and social needs, which amounted to 1.3 percent of GDP through June. As a result, the overall budget deficit in January–June widened to 1.6 percent of 2020 GDP. Revenue started to recover in recent months, and for January–September stood at 83 percent of the last year's level.⁶

CPI Inflation
(y-o-y change, in percent)

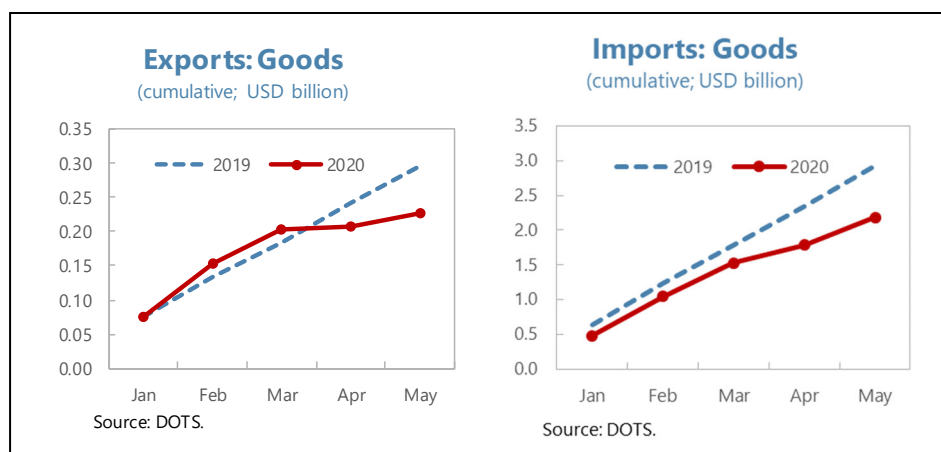


Source: Afghan authorities.

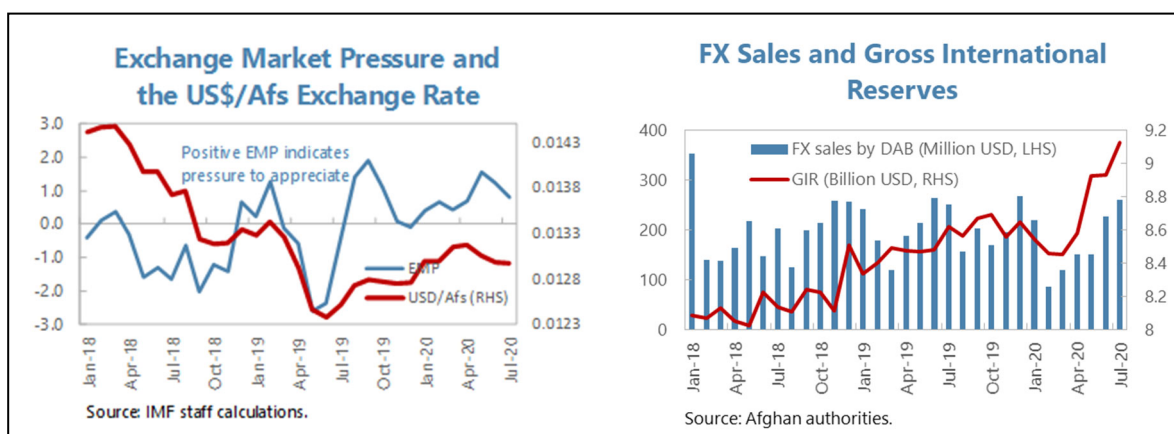


9. The balance of payments has deteriorated. Border closures, including disruption of air corridors, hit exports, and remittances fell as Afghan workers returned from the host countries whose economic prospects soured, especially the oil exporters hit by the pandemic and the drop in oil prices. Imports held up better due to imports of essentials, medical supplies, and aid-financed imports. Hence, the current account deficit before grants is projected to widen to 31 percent of GDP this year. It will be financed by official grants of about 43 percent of GDP, with the increase over 2019 due to COVID-related aid.

⁶ The weekly revenue reports are published on the MoF's Revenue Department [website](#).

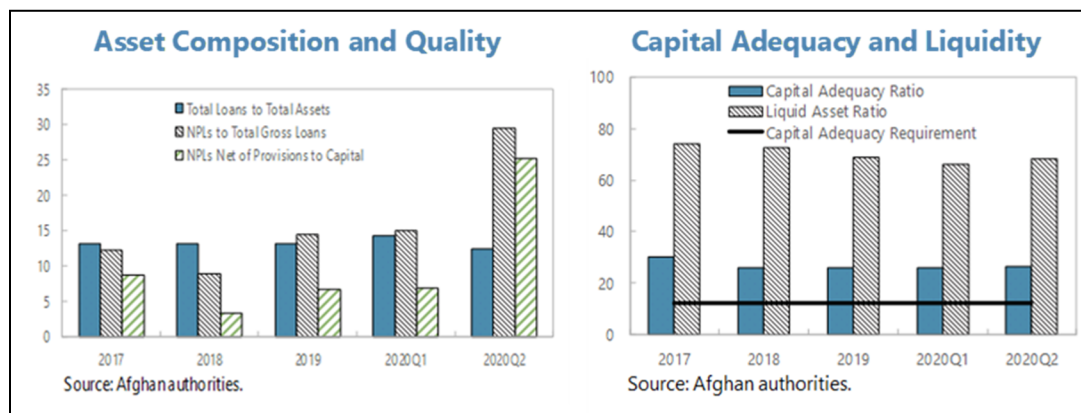


10. The Afghani has been broadly stable against the U.S. dollar, and DAB's international reserves increased. Subdued activity lowered demand for foreign exchange while supply was boosted as households and returning migrants used foreign exchange savings to supplement lost income. With DAB's foreign exchange sales reduced, large official inflows fueled reserve accumulation. Staff considers reserves to be broadly adequate given the Afghanistan's risk profile which the traditional reserve metric does not capture well. An adjusted metric, comprising 100 percent of currency in circulation, all foreign currency deposits, and three months of imports, accounts better for downside risks, including from fragility, insecurity, and faster-than-expected decline in aid. At \$9.3 billion at end-July, gross international reserves are about 122 percent of the adjusted metric.



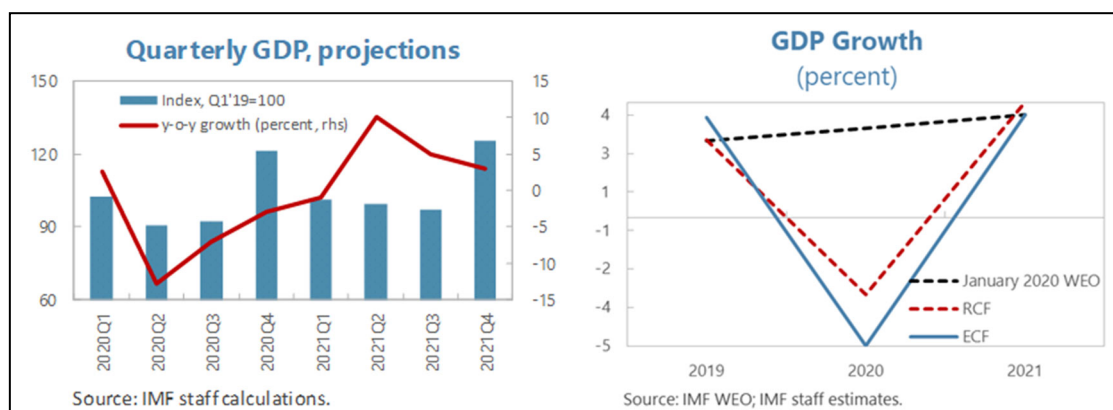
11. The fallout from the pandemic is intensifying strains in weak banks. There have been no liquidity pressures thanks to the sector's high liquidity and DAB's timely actions. However, the banking sector faces the pandemic with weak assets and profitability, the latter in part due to banks' limited financial intermediation. In March, DAB introduced a freeze on loan classification, suspended enforcement of prudential requirements, and delayed the implementation of IFRS 9 to June 2021. Still, nonperforming loans (NPLs) rose since the beginning of the year as a number of banks applied

internal loan classification rules or adopted IFRS 9, which requires recognition of NPLs on a forward-looking basis, ahead of the revised deadline.⁷



B. Outlook and Risks

12. The outlook envisages a gradual recovery. The disruption in supply chains and impairment of household and company balance sheets due to the pandemic will weigh on near-term investment and growth. Assuming the infections continue to subside, the output could return close to the pre-pandemic level in the fourth quarter, implying a 5 percent contraction in 2020. Provided momentum continues, growth could rebound to 4 percent in 2021, and, assuming no significant security deterioration, continued reforms, and sustained aid, could settle at 4.0–4.5 percent over the medium term.



13. The underlying external position is expected to strengthen over the medium term. The current account deficit without grants would improve thanks to sustained exports growth and expansion of domestic production substituting imports, supported by investment in agriculture, better connectivity, and reforms to boost productivity. The current account surplus after grants would shrink however as aid is projected to decline.

⁷ Staff are in contact with DAB while it reviews how banks are applying IFRS 9.

14. The depth and duration of the pandemic are the main risks to the outlook (see [Annex II](#)). Should the pandemic intensify before the end-year, health and social outcomes would deteriorate, the recession in 2020 would be deeper and the projected recovery in 2021 shallower than under the baseline. Revenues would plummet and pandemic spending increase, widening 2020-21 budget deficits and amplifying financing needs. A strong policy response, possibly with emergency revenue measures, and larger donor support would be required to finance government operations, including health and social spending.

15. The outlook is also clouded by risks related to Afghanistan's fragilities. The outcome of peace negotiations is uncertain, and its nature will have a major bearing on security and development of Afghanistan. A sustained peace would boost confidence and lift development prospects. Risks also stem from possible shortfalls in aid, reform fatigue, and adverse regional security developments. Finally, Afghanistan is vulnerable to natural disasters: floods, droughts, and earthquakes.

EXTENDED CREDIT FACILITY

A. Strategic Issues

16. The 2016–19 ECF arrangement contributed to macroeconomic stability and improved economic governance (LoI 14, MEFP 12; [Annex III](#)). The program catalyzed aid while supporting progress towards self-reliance. Nevertheless, growth disappointed due to 2018 drought and as private investment was held back by the armed conflict, political upheaval, weak governance, and constraints to doing business.

17. The authorities are finalizing their 2021–25 development strategy (LoI 13; MEFP 111, 12). It will be presented at the November conference as the second Afghanistan National Peace and Development Framework 2021–25 (ANPDF II).⁸ The ANPDF II has two phases. First, it will guide the transition from pandemic containment to a recovery while mitigating damage to health, livelihoods, and the economy. Next, with the recovery underway, it will support growth that creates jobs, reduces poverty, and facilitates human capital accumulation.

18. Strong private sector-led growth will be needed to absorb nearly 500,000 Afghans entering the labor force yearly. This requires political stability, an exit from fragility (see [Annex III](#)), and an improved investment climate. Ensuring that economic opportunities become accessible to broad segments of the society will be crucial to avoid the exclusion of the poor and disadvantaged and underpin future peace settlement (MEFP 113, 44).

19. The growth potential centers around agriculture, services, and mining (MEFP 112, 32). Agriculture, which accounts for a quarter of GDP and employs 40 percent of the workforce, could lift living standards in the rural areas, while services could fuel urban job growth, including thanks to

⁸ The [first 2017–21 ANPDF](#) framed reforms supported by the 2016 conference in Brussels and the 2016–19 ECF.

regional integration. Once security and robust governance framework are in place, mining can generate large revenue to finance development. Given vulnerabilities to climate change, especially agriculture, the government has designated climate adaptation and mitigation among the selection criteria for public projects.

B. Design of the Program

20. **The program's objectives—restoring and preserving macro-financial stability and supporting sustainable growth and poverty reduction—rest on two pillars (MEFP ¶13, 17).**

Under the first pillar, the ECF arrangement will provide a macroeconomic framework to navigate the crisis and create conditions for a recovery. Under the second pillar, it will focus on addressing structural fragilities that obstruct sustainable and inclusive growth and equitable social outcomes (see [Annex III](#)). The program will aim to mobilize domestic revenue, improve the quality of public spending, bolster the financial sector, and support anti-corruption efforts, cementing gains and continuing reforms initiated under the 2016–19 ECF arrangement. Landmark reforms include VAT implementation, strengthening the anti-corruption regime, and, subject to fiscal space and donor support, building a social safety net over the medium term.

21. Strong ownership, sustained donor aid, and continued prioritization will be critical for the program's success. The authorities established a solid track record under the 2016–19 ECF arrangement. However, their capacity to implement reforms has been strained by the pandemic and can be further challenged if the public grows dissatisfied with the government's response to the pandemic. The program therefore balances ambition with realism through prioritization and close coordination with donors who are taking the lead in many structural areas. In recognition of the capacity limitations, there are only four structural benchmarks (SB) for the first review. Given the elevated uncertainty, the performance criteria feature adjusters and build in buffers (MEFP [Table 1](#), [Table 2](#); TMU ¶22–25).

C. First Pillar: Macro-Financial Stability

22. The program will promote macroeconomic stability and resilience (MEFP ¶17). Fiscal buffers and policy credibility built under the 2016–19 ECF afforded the authorities policy space to swiftly respond to the pandemic. Going forward, prudent fiscal policy, stable inflation with a flexible exchange rate, and financial stability will be critical for sustained growth and development. The program will aim to maintain low debt, a prudent discretionary cash balance, and an adequate level of international reserves.

Fiscal Policy

23. The program accommodates spending to mitigate the pandemic and its socioeconomic impact (MEFP ¶18). The authorities' response to the crisis has been bolstered by substantial new and reallocated grants. The draft mid-year budget submitted to parliament envisages about 3.0 percent of GDP spending on COVID-19 in 2020, with about 60 percent directed

to healthcare and social protection. To support the vulnerable, the authorities are rolling out a 1.5 percent of GDP social relief package financed by the WB, of which two-thirds will be executed this year. Targeting households with incomes of \$2 per day or lower (twice the national poverty line), the package entails a near universal coverage as about 90 percent of households fall under this cut-off. The budget also includes outlays for agriculture to boost domestic food security and compensate for the loss of exports.

Mid-year Budget Amendment: Proposed Measures		
	(In Afs billion)	(In percent of GDP)
Revenue	31.8	2.2
Domestic Revenue	17.3	1.2
DAB profits transfer	12.8	0.9
Fees from Afghan Telecom	2.0	0.1
Fees collected by the Afghan Telecommunication Regulatory Authority	1.0	0.1
Other one-off revenues	1.5	0.1
The World Bank's grants to finance social distribution program (REACH)	14.6	1.0
Expenditure	40.5	2.8
<u>Covid-19-related expenditure</u>	42.6	2.9
<i>Of which for health:</i>	6.6	0.4
Building hospitals and purchasing beds	1.8	0.1
Other health outlays	4.8	0.3
<i>Of which for social:</i>	17.4	1.2
Bread distribution	2.8	0.2
World Bank-supported social distribution program (REACH)	14.6	1.0
<i>Of which for others:</i>	18.7	1.3
Short-term employment program	6.7	0.5
Measures to expedite the supply of agricultural commodities	5.9	0.4
Transfers to provinces to fight COVID-19	2.3	0.2
Wheat purchase program	1.7	0.1
Other outlays	2.1	0.1
<u>Other additional expenditure</u>	13.0	0.9
Operating expenditure	8.3	0.6
Development expenditure	4.7	0.3
<u>Expenditure cuts</u>	-15.1	-1.0
Operating expenditure	-9.6	-0.7
Development expenditure	-5.5	-0.4
Net impact on the budget deficit	8.7	0.6
<i>Memorandum:</i>		
Nominal GDP	1465.9	
Source: Afghan authorities.		

24. The authorities will target a 3.0 percent of GDP fiscal deficit this year (MEFP ¶19).

Revenue should continue to recover through the rest of the year thanks to a gradual pick-up in activity and because no extensions were granted for the second and subsequent quarter tax filings. In addition, the authorities are cutting lower-priority spending (O&M, vehicle purchases, renovations, travel, etc.) and raising fees from the Telecom sector. Should revenues fall short, the authorities have committed to further rationalize expenditures, in addition to mobilizing aid. In 2020–21, ECF disbursements will be directed to the budget to ease the financing constraint to more adequately source health and social sectors and support the economy during the pandemic. Without the ECF disbursements, the government would have to tighten the fiscal stance—ill-advised given critical needs and the state of the economy—or risk exhausting the Treasury cash balances, the only source of domestic financing.

Evolution of the 2020 Budget Outlook			
(In percent of GDP)	Approved Budget	RCF	ECF
Revenues and grants	25.8	25.5	30.3
Domestic revenues	13.0	10.2	12.1
Tax revenues	9.2	5.5	7.1
Nontax revenues	3.8	4.6	5.0
Total Grants	12.8	15.3	18.2
o/w Covid-related grants	0.0	1.6	2.9
Total expenditures	26.6	28.9	33.3
o/w Covid-related expenditures	0.0	3.5	2.9
Operating expenditures 1/	17.9	21.8	21.8
Development expenditures	8.6	7.1	11.6
Overall budget balance excluding Covid-related grants	-0.8	-5.0	-6.0
Overall budget balance including grants	-0.8	-3.5	-3.0
GDP, current prices in billions of Afs	1612	1548	1466
Source: Afghan authorities; IMF staff calculations.			
1/ Includes REACH program.			

25. In line with their intent to reverse the pandemic-induced fiscal loosening, the authorities will cap the FY2021 deficit at 2.2 percent of GDP (MEFP ¶120 and the first review SB). This will be supported by a projected rebound in tax revenue on the back of economic recovery and renewed revenue mobilization efforts (see ¶32-34). While spending is projected to decline, the budget needs to carefully balance preserving resilience and supporting the recovery, while continuing with pandemic spending projected at about 2 percent of GDP, including the WB-financed social support program. Should the risks to the outlook materialize, the authorities would need to adjust their fiscal stance and implement policies broadly outlined in ¶14.

26. Fiscal policy over the medium term is anchored on advancing toward self-reliance. To that end, the authorities aim to improve the operating balance excluding grants and bring the overall deficit to under one percent of GDP over the medium term, which will help keep public debt contained and rebuild government deposits. Protecting development spending within this envelope, in part owing to bringing on budget off-budget projects as the related grants decline, will require mobilizing domestic revenue.

27. The crisis has reinforced the need for stronger social protection (MEFP ¶111, 13). The authorities are increasing pro-poor spending⁹ from 3.7 percent of GDP in 2019 to 5.3 percent of GDP in 2020 and 4.7 percent of GDP in 2021 (indicative targets). To protect the level and improve the efficiency of social spending over the medium term, the authorities plan to build a targeted social safety net for which they intend to seek donor technical and financial assistance. The program will aid these efforts by creating fiscal space.

28. Despite low public debt, Afghanistan's risk of debt distress is "high" (see Debt Sustainability Analysis). Even with the increase due to the pandemic, public debt would remain at about 10 percent of GDP by end-2025. Given small fiscal deficits (under 1 percent of GDP) projected

⁹ Defined in TMU ¶121.

over the medium term and the authorities' commitment to borrow strictly on concessional terms, public debt would remain below 25 percent of GDP in the long term. The high risk of debt distress arises because, as grants are replaced with loans, the debt service to exports indicator breaches its threshold under the baseline in the 2030s. Debt sustainability hinges on sound fiscal policies, reforms, and continued aid. The government is preparing to issue sukuk next year, which would allow tapping domestic savings and catalyze debt market development (MEFP ¶21).

Monetary Policy and Financial Stability

29. **DAB should continue strengthening the effectiveness of monetary policy (MEFP ¶22).**

With monetary transmission constrained, DAB will continue to target reserve money—with capital notes and foreign exchange auctions as the primary policy tools—to achieve its price stability objective. Operating within this broad objective and exercising due prudence on its foreign exchange sales, DAB will let the exchange rate move freely in response to external shocks. Enhancing DAB's monetary policy toolkit and communication will be key to improve monetary transmission and anchor inflation expectations as will DAB's ongoing efforts to increase the use of the Afghani, which will also contribute to financial stability. This would over time allow DAB to rely more on Afghani-denominated instruments for monetary policy operations although, as large official inflows are channeled through the budget, DAB will continue to supply foreign exchange to the market.

30. Banks are under enhanced monitoring, with DAB ready to intervene. With emergency measures largely unwound in July and DAB supporting prudent loan restructuring, banks are starting to report the worsening in asset quality due to the pandemic. While the system appears to have sufficient capital to absorb possible losses from its small loan portfolio, weak banks with impaired loans and low profitability will likely need capital injection. Staff supported DAB's decision to resume the enforcement of all prudential requirements while exercising flexibility in the application of penalties and prudential triggers. DAB is implementing a post-pandemic sector recovery plan, which includes unwinding remaining emergency measures¹⁰ as warranted by developments, suspending dividend payouts by all banks, and encouraging credit access via digital means. The WB-funded capitalization of the Credit Guarantee Fund should boost its capacity to provide partial credit guarantee for SME loans, while the establishment of a dedicated department in DAB will strengthen consumer protection and financial literacy (MEFP ¶42). While nonbanks appear to have weathered the pandemic, the oversight framework is still in its infancy.

31. High-risk banks are under a dedicated post-pandemic plan (MEFP ¶36, 37, 41). It entails recovery, capital augmentation, and strengthening corporate governance and management monitored by DAB. The plan will also be informed by the special review to be undertaken with the WB. DAB is updating its contingency plans and establishing a dedicated unit to oversee the winding down of defunct institutions under its supervision. It has requested IMF TA to upgrade the framework for early intervention, resolution, and crisis management, and is working with the WB to

¹⁰ They include extended deadlines for submission of prudential reports, loan restructurings, three-month extension of annual clearing of overdrafts from July to October, and DAB's liquidity contingency measures.

strengthen the deposit insurance system. DAB's capacity to identify and control sectoral risks will be further enhanced with application of a risk-based supervision framework, implementation of IFRS 9, and automation of off-site supervisory data collection.

D. Second Pillar: Structural Reforms

Fiscal Reforms

32. Raising domestic revenue will be key to reduce aid dependence and meet development needs (MEFP ¶25). Domestic revenue rose by 3 percentage points of GDP in 2016–19, but mostly due to one-offs and collection remains below potential, especially in customs. Revenue mobilization under the program will be underpinned by the post-pandemic recovery in compliance, VAT introduction in 2022, and, starting in 2023, fees from pipeline and power transmission projects. To increase the revenue stream and improve its reliability, the authorities will adopt targeted and graduated collection methodologies aimed at boosting taxpayer compliance (first review SB), create risk profiles for large taxpayers, and automate tax filing and collection.

33. VAT adoption will be a crowning achievement of tax policy reforms (MEFP ¶26). In view of the pandemic and in consultation with the IMF, WB, and EU, the authorities postponed the VAT implementation from 2021 to 2022. The 10 percent VAT, which would replace the cascading business receipt tax (BRT), could yield 1.2 percent of GDP net revenue while eliminating BRT's distortions. The authorities requested the IMF TA to update the VAT's yield estimate and will consider introducing a simple tax scheme for taxpayers below the VAT threshold to maintain them under the tax net when the BRT is abolished. To mitigate the impact on the poor, the authorities have exempted a number of basic goods and will study the need for compensatory spending measures.

34. Significant leakages in customs should be reduced (MEFP ¶27–31). The Customs Department's action plan aims to encourage compliance, facilitate cross-border and transit trade, and modernize customs and its workforce. In 2019, the department developed multi-criteria risk profiles for major crossing points and inland customs offices to detect noncompliance through better targeting. Through June, it recommended the removal of licenses for 123 noncompliant trading companies. To better identify high-risk traders and shipments, the Customs Department will enhance its risk analysis by mid-2021. It will also launch mobile verification teams, transit vehicle tracking, and trader identity verification. These will be supported by further automation of customs processes which should improve information exchange with the customs of trading partners, detection of fraud, and internal risk management. The tax and customs administration systems will be linked with the warehouse inventory records, the appeal process, and—to facilitate e-payment—with the core banking system and DAB. Finally, strengthened internal control and a merit-based recruitment process to be adopted with WB's support aim to improve workforce integrity and reduce corruption.

35. A public expenditure review (PER), a new civil service pay policy, and strengthened Supreme Audit Office (SAO) should improve budget planning, its execution and evaluation

(MEFP ¶33, 34, 35). The PER with a medium-term perspective aiming to establish top-down parameters for savings is scheduled for 2021. It will aid strategic allocation and efficient use of public resources, which motivated a new 2019 civil service pay policy to be implemented in the Ministry of Finance (MoF) first. It links compensation with verified competencies to professionalize civil service and will be supported by an automated payment system for payroll verification. To strengthen control and transparency over the use of contingency reserves, budgeted up to 3 percent of spending, the authorities will define eligible purposes and establish reporting requirements by end-2020. Once implemented, a new SAO law will strengthen SAO's authority and capacity to evaluate public finances.

36. There is a pressing need to advance the functionality of public financial management (PFM) (MEFP ¶35). The PFM system has some strengths, e.g., with budget preparation and reporting scoring better than regional peers.¹¹ Now, PFM reforms need to advance the sectoral and project prioritization to improve alignment between the budget and national priority programs (MEFP [Annex I](#)). This exercise will be supported by the Fiscal Strategy Paper (FSP) that identifies priority sectors and guides budget allocations and medium-term costed development strategies subject to forward estimates issued by the MoF. It will be implemented first by the Ministries of Public Health and Education. New public investment management (PIM) regulations, to be adopted by end-2020, will strengthen the project implementation cycle, institutionalizing the Project Evaluation Committee and mandating rule-based project selection process. This will reduce opportunities for political interference and corruption.

37. The public finance needs to move towards a comprehensive oversight of public entities and risks (MEFP ¶35).

- The budget process and its coverage have so far focused on central government fiscal operations and its direct liabilities. Given the authorities' intent to increase reliance on PPPs, there is a need to strengthen the management of related fiscal risks and contingent liabilities, including their recognition, quantification, and reporting. To that end, the authorities are creating an integrated database of public investments and PPP projects which will include information on their life-cycle service payments and contingent commitments. The institutional arrangement for PPPs should entrust the MoF with strong budget and fiscal risk management authority at every stage of the project cycle.
- Operational and financial oversight of state-owned entities (SOE) needs enhancing. They have been a go-to source for ad-hoc revenues, but little is known about their financials, including income and on- and off-balance sheet liabilities. This will be remedied by building the capacity of the MoF's SOE department and collecting the relevant information. The authorities plan to have the 2020 financial statements of the five largest SOEs audited externally by September 2021 and will prepare a report on the financial performance of SOEs by end-2021. Further, the

¹¹[Open Budget Survey 2019](#).

analysis of fiscal risks stemming from PPPs and SOEs will be included in the FY2022 FSP and budget.

Financial Sector Reforms

38. Forging ahead with the reforms of state-owned commercial banks (SOCBs) is critical for building a healthy and well-managed financial sector (MEFP ¶138, 39). Given SOCBs' systemic importance—they hold over one-quarter of banking system's assets—and quasi-fiscal risks they pose, the authorities plan to step up the implementation of haltingly progressing reforms. In August, the High Economic Council chaired by the President announced a merger of Bank-e-Millie Afghan and New Kabul Bank per the reform strategy under implementation with the WB support. Contracting advisors to support the merger, including in financial and operational due diligence and integration of processes, is the first review SB (MEFP [Table 1](#)).

39. To reduce informality in the financial sector, DAB is advancing the corporatization of unlicensed financial institutions (MEFP ¶140). Per the U.S. Treasury TA, DAB is implementing a phased corporatization of money service providers and foreign exchange dealers over the next three years. DAB has established a department to supervise nonbank financial institutions. As it builds capacity, the department is establishing the regulatory and supervisory frameworks, including AML/CFT, and preventing unlicensed operations.

40. Efforts to reduce the financial sector's exposure to illicit flows should continue, guided by the 2019 AML/CFT National Risk Assessment (NRA) (MEFP ¶143). The NRA will be published by end-2020 and will inform a national action plan through 2023. In addition, by September 2021, DAB will prepare a national AML/CFT strategy that will prioritize risk mitigation measures. DAB has continued to enhance the AML/CFT supervisory framework during the pandemic, including through reviews of internal procedures and regulations in line with the NRA findings. All banks will undergo AML/CFT examinations by year-end, along with nine nonbank institutions examined already.¹² The authorities have recently formed an interagency Oversight Committee to coordinate preparations for the 2022 AML/CFT assessment of Afghanistan by the Asia Pacific Group on Money Laundering.

Governance and Corruption

41. The legal and institutional framework for anti-corruption strengthened in recent years. The authorities developed a national anti-corruption strategy, enacted an anti-corruption law, established relevant institutions, and, under the 2016–19 ECF arrangement, adopted an asset declaration regime. Despite this progress, corruption remains widespread and continues to stifle development. Implementation has been tardy owing to overlapping reform agendas, weak capacity of anti-corruption bodies, and the challenging domestic environment.

42. The reform agenda under the program will focus on operationalizing and building capacity of anti-corruption institutions, boosting the effectiveness of the asset declaration

¹² AML/CFT inspections were completed in 40 MSPs and FXDs last year.

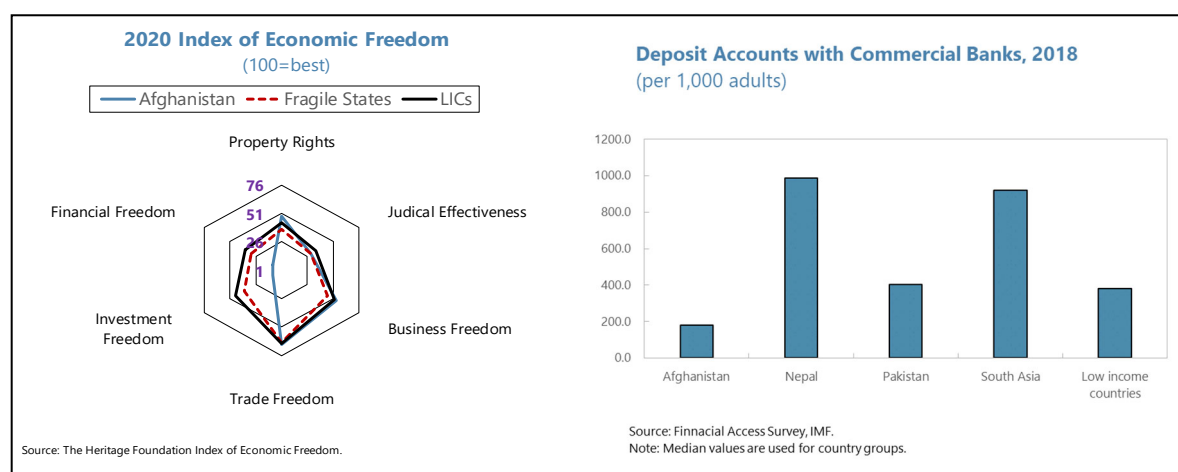
regime, and strengthening accountability of public spending, including in response to the COVID-19 crisis:

- Execution of emergency pandemic spending has raised concerns about its soundness and efficiency. Per its commitment in the context of the RCF, the government intends to publish its first quarterly report on pandemic spending by end-October. The other related RCF commitment—audit of select pandemic spending by the SAO and publication of audit reports—will be completed by June 2021 to allow time to conclude audits after the fiscal year ends in December (MEFP ¶48). The audit will focus on large domestically financed items given that most donors require a third-party audit of their programs.
- As the program’s prior action (PA), on September 30, 2020, the authorities amended public procurement procedures to require that, starting November, all entities bidding for public contracts submit information about their beneficial owners to the National Procurement Agency, which will publish on its website beneficial ownership information of winning bidders within 30 days of contract signing (MEFP ¶48).
- Identification and registration of the beneficial ownership of assets and entities is critical for effective operation of the AML/CFT framework. The government is making the regulatory and institutional changes required by the Financial Action Task Force (FATF) to advance this goal (MEFP ¶47). Relatedly, FATF standards will be used to develop rules applicable to politically exposed persons by June 2021.
- To strengthen the anti-corruption regime, the authorities will operationalize the Anti-Corruption Commission, which will be fully staffed by March 2021 with the civil society’s input and begin its operations in June 2021 (MEFP ¶45). Once operational, the ACC is expected to take over the handling of asset declarations pursuant to the Anti-Corruption Law. The National Strategy for Combating Corruption, dating back to November 2018, will be updated by March 2021.
- The asset declaration regime will be enhanced with digitization and a risk-based verification of declarations (MEFP ¶46). The Administrative Office of the President (AOP) will systematically digitize all current year asset declarations and publish online senior officials’ declarations. Making declarations publicly available in a machine-readable format will facilitate their verification and allow the civil society to play a watchdog role. Further, the work on improving and expanding public registries of land, property, and companies and integrating them with the asset declaration regime will continue as will joint efforts by the AOP, DAB, and donors to develop locally based training capacity on anti-corruption and asset declarations.
- To improve the effectiveness of prosecution of corruption offences, the authorities plan to strengthen the criminal justice system and enhance anti-corruption structures (MEFP ¶47). The government is reviewing the Penal Code to tighten pre-trial custody procedures and improve transparency of court proceedings. Further, in line the Action Plan for Improving Detection and Prosecution of Corruption Cases and to formalize the affiliation of the Major Crimes Task Force (MCTF) with the Anti-Corruption Justice Center (ACJC), the authorities will develop the necessary

regulations and protocols to clarify the coordination between ACJC prosecutors and MCTF inspectors and the MCTF's reporting line to the Minister of Interior.

Business Environment

43. Improved business environment is a key element of the government's reform strategy (MEFP ¶44). Insecurity, weak governance and institutions, and infrastructure gaps prevent Afghanistan from becoming a transit hub and attractive investment destination. Despite progress in recent years, significant challenges remain in areas such as investment freedom, including starting business, enforcing contracts, and quality of judicial proceedings. Further, Afghanistan lags its peers on financial intermediation, quality of education, and gender equality. Fund staff will support donors, particularly the WB, helping the authorities to improve the business climate.



PROGRAM MODALITIES

44. Access, phasing, monitoring, risks and capacity to repay:

- *Access under the arrangement is proposed at 80 percent of quota (SDR 259.04 million, about \$370 million or 1.8 percent of GDP). Phasing will be frontloaded* in line with projected BOP needs (about \$900 million in 2020–21) that emerged due to the acute impact of the pandemic on fiscal and external accounts. 71 percent of access will be available at the approval and first review, with small, even disbursements in 2022–23.
- *Disbursements in 2020–21 will be directed to the budget.* Domestic financing sources are limited to government deposits,¹³ which need to be kept at prudent levels given the high-risk environment of Afghanistan. To that end, the program sets an indicative floor of Af 10 billion on the Treasury's discretionary cash balance. Disbursements in 2022–23 will be directed to DAB.

¹³ There is no recourse to central bank financing, domestic debt market remains undeveloped, and the government has not borrowed domestically for years.

- *Program performance will be monitored by semi-annual reviews* using quantitative performance criteria and indicative targets, and SBs (MEFP [Table 1, Table 2](#)).
- *SBs for the second review.* The mission reached preliminary agreement with the authorities on measures that could be proposed as SBs at the time of the next review (Table 11). These measures will be discussed with stakeholders to ensure consistency with the ANPDF II and donors' initiatives and conditionality. Therefore, they are not proposed for IMF Executive Board approval at this time.
- *Program risks.* The outlook is subject to high uncertainty (¶14), and program implementation faces substantial risks given the impact of the pandemic (¶5-6), longstanding fragilities (¶15), and capacity challenges. Broad contours of the authorities' policy response in case of a more severe crisis are outlined in MEFP ¶24. The IMF TA will be mobilized to support the implementation of structural reforms (Annex III, Table 2).
- *Capacity to repay remains adequate.* The IMF credit outstanding is projected to peak at 7.6 percent of reserves in 2023-24 and repayments at 4.8 percent of exports in 2027, but repayments could reach 17 percent of exports in 2027 under the most extreme downside scenario for exports in the DSA. The authorities' track record of servicing the IMF debt is strong.
- *The authorities are seeking parliament's authorization to request a disbursement.*¹⁴ The RCF disbursement was initially rejected by the Lower House, which sought elaboration of government's spending plans and terms of the loan. It was subsequently approved by the Upper House.
- *Debt Service Suspension Initiative.* The authorities have received debt service suspension from bilateral creditors (0.02 percent of GDP of eligible debt service). Afghanistan has received the first tranche (SDR 2.4 million) of debt service relief from the IMF under the Catastrophe Containment and Relief Trust and will receive the same amount of relief under the second tranche.

45. Financing assurances and donor support. Donors are supportive of Afghanistan's development agenda and reforms, and continued performance under the ECF arrangement would provide policy assurances, thus catalyzing aid. Reflecting donors' intentions, the baseline assumes a gradual decline in grants with an increased share disbursed to the budget. The program is fully financed for the next 12 months, and there are good prospects for the remainder of the program.

46. The 2020 safeguards assessment found continuing capacity constraints and that DAB's autonomy, governance structure, and internal controls need strengthening (MEFP ¶49). The assessment proposed measures to address shortcomings exposed by DAB's recent internal investigations into alleged instances of corruption. The assessment's priority recommendation to enact the amendments to the DAB law, which were submitted to parliament in 2017 and have not

¹⁴ The Constitution mandates that any external government borrowing be approved by parliament. Parliament has used this lever to scrutinize public finances responding to corruption concerns.

been ratified yet, is set as a first review SB. While financial reporting practices and the external audit mechanism are aligned with international standards, the internal audit function should be modernized. DAB and the MoF signed a Memorandum of Understanding clarifying responsibilities for holding and repaying the RCF disbursement and prospective ECF disbursements directed to the budget.

STAFF APPRAISAL

47. Afghanistan continues to be challenged by the armed conflict and fragility. Insecurity, political uncertainty, and a weak institutional setting have combined to hold back economic and social development. Average growth over the past five years has been below population growth, and many social indicators stagnated.

48. The pandemic has amplified these challenges and is testing Afghanistan's resilience. While the authorities' determined response and expedient donor support have prevented a humanitarian crisis, the pandemic has inflicted a heavy damage to the economy and livelihoods and set back progress toward self-reliance.

49. The outlook hinges on the evolution of the pandemic, security situation, and reform progress. Should the pandemic intensify, the incipient recovery would come to a halt and the fiscal and external financing needs increase sharply. With political stability, good policies, and sustained donor support, growth after the pandemic could settle at about 4 percent. While downside risks loom large, a lasting improvement in security conditions with peace agreement would materially lift development prospects.

50. Against this backdrop, the authorities are seeking renewed support from the international community. They look forward to aid commitments at the donor conference in November in support of reforms under their updated national development framework. To support their challenging reform journey ahead, the authorities have also requested a three-and-a-half year ECF arrangement to provide a macroeconomic framework, anchor reform implementation, and catalyze donor financing.

51. The Fund-supported program will support a post-pandemic recovery and a move toward self-reliance. It aims to preserve macro-financial stability, reverse the fiscal deterioration caused by the pandemic, protect development spending, maintain low debt and adequate level of international reserves, and ensure price stability. Structural reforms will aim to improve fiscal governance, bolster financial sector stability, and combat corruption, focusing on areas of the Fund's comparative advantage and complementing reforms supported by development partners. The frontloaded phasing of access is justified given the nature of BOP needs arising due to the pandemic, while conditionality has been streamlined, relative to the 2016–19 ECF, in view of implementation capacity strained by the pandemic. In this regard, continued realism in program design, agility in response to shocks, and capacity development will be essential for ensuring that program continues to meet its objectives.

52. The program allows a temporary fiscal loosening to boost pandemic spending and accommodate revenue shortfalls. The authorities have rightly prioritized mitigating the social and economic impact of the pandemic in their revised 2020 budget targeting a 3.0 percent of GDP deficit. As the recovery gets underway, the program aims to gradually bring the deficit down and rebuild government deposits. With grants projected to decline over the medium term, increasing much needed development and social spending will require mobilizing domestic revenue. These efforts are also essential considering the need to decisively tackle poverty, including by establishing a social safety net in step with gaining ground on self-reliance.

53. Resolute fiscal structural reform effort is essential for self-reliance. Revenue and customs administration reforms should focus on boosting compliance and reducing leakages through better risk targeting, detection of fraud, and stronger internal control. Resuming, as soon as feasible, preparations for the VAT introduction in 2022 will be key to the success of this landmark reform. On the expenditure side, the program will support reforms to more closely align spending with national priorities and improve budget formulation, execution, and evaluation. Enhancing the oversight of public entities and risks stemming from PPPs will be an essential next step in reforming public financial management.

54. Monetary policy should remain focused on price stability with a flexible exchange rate serving as a shock absorber. Enhancing the effectiveness of monetary policy and DAB's communication in the context of macroeconomic stability would help anchor inflation expectations and boost confidence in the Afghani. Enacting the amendments to the DAB law aimed at strengthening its autonomy and governance structure will be essential to ensure that it can effectively pursue its price and financial stability mandates.

55. Rising strains in banks call for intensified oversight and timely intervention by DAB. A healthy banking sector with good governance and risk management practices is critical to support the post-pandemic recovery and the authorities' goal of financial inclusion. The authorities should address weak banks in a timely manner, completing the special review of weak banks with priority given to high-risk banks. The authorities' intent to intensify the implementation of SOCBs reforms, including progressing with the merger of Bank-e-Millie Afghan and New Kabul Bank, is welcome. In addition, there is a need for continued strengthening of oversight, including AML/CFT, of the nonbank sector.

56. Firm progress in anti-corruption reforms is needed to reassure domestic and external stakeholders. The focus should be on operationalizing relevant institutions and strengthening the effectiveness of prosecution of corruption offences and the use of the asset declaration regime and AML/CFT as anti-corruption tools. With the planned digitization of asset declarations, the asset declaration regime should become a critical tool for civil servants' accountability. The completion of the prior action on procurement signals the authorities' commitment to strengthen governance of public spending. In the same spirit, they should ensure full accountability and transparency of pandemic spending, including publishing the first quarterly report on such spending and commissioning its audit by the SAO.

- 57. Improving the business environment is critical for private sector-led growth.** Easing regulations, strengthening property rights, and boosting access to markets and finance, and gender equity will be needed for a vibrant private sector to emerge.
- 58. Staff supports the authorities' request for a three-and-a-half-year arrangement under the ECF, with access of SDR 259.04 million (80 percent of Afghanistan's quota).**

Proposed Decision

The following decision, which may be adopted by a majority of the votes cast, is proposed for adoption by the Executive Board:

1. The Islamic Republic of Afghanistan has requested a 42-month arrangement under the Extended Credit Facility in a total amount equivalent to SDR 259.04 million.
2. The Fund approves the arrangement set forth in EBS/20/160 and decides that the Islamic Republic of Afghanistan may request the first disbursement under the arrangement on the condition that the information provided by the Islamic Republic of Afghanistan on the implementation of the measure specified as a prior action in Table 1 of the Memorandum of Economic and Financial Policies attached to the letter dated October 20, 2020 from the Acting Minister of Finance and the Acting Governor of Da Afghanistan Bank is accurate.

Table 1. Islamic Republic of Afghanistan: Selected Economic Indicators, 2018–21

(Quota: SDR 323.8 million)
 (Population: approx. 32.2 million; 2019)
 (Per capita GDP: approx. US\$586; 2019)
 (Poverty rate: 54.5 percent; 2016–2017)
 (Main exports: dried and fresh fruits and vegetables, medical seeds, 2019)

	2018	2019	2020		2021	
		Est.	RCF	Proj.	RCF	Proj.
Output and prices 1/	(Annual percentage change, unless otherwise indicated)					
Real GDP	1.2	3.9	-3.0	-5.0	4.5	4.0
Nominal GDP (in billions of Afghanis)	1,328	1,470	1,548	1,466	1,690	1,598
Nominal GDP (in billions of U.S. dollars)	18.4	18.9	18.9	19.0	19.9	20.0
Consumer prices (period average)	0.6	2.3	4.7	5.4	4.5	4.8
Food	-1.1	3.8	...	...	...	...
Non-food	2.3	0.9	...	...	...	...
Consumer prices (end of period)	0.8	2.8	4.5	5.0	5.0	4.5
Investment and savings	(In percent of GDP)					
Gross domestic investment	18.0	18.2	16.5	17.9	17.5	18.1
Of which: Private	5.4	6.0	6.0	5.0	7.1	6.0
Gross national savings	30.2	29.9	21.4	27.2	23.3	26.1
Of which: Private	16.0	18.7	14.4	17.4	14.3	16.2
Public finances (central government)						
Domestic revenues and grants	30.6	26.9	25.5	30.3	25.9	26.0
Domestic revenues	14.3	14.1	10.2	12.1	12.6	12.0
On-budget grants (excl. donors' direct spending outside the budget)	16.3	12.9	15.3	18.2	13.3	14.0
Expenditures	28.9	28.0	28.9	33.3	27.3	28.2
Operating 2/	19.4	18.5	21.8	21.8	18.6	19.3
Development	9.5	9.5	7.1	11.6	8.7	8.9
Operating balance (excluding grants) 3/	-5.1	-4.5	-11.7	-9.6	-6.0	-7.3
Overall balance (including grants)	1.6	-1.1	-3.5	-3.0	-1.4	-2.2
Public debt 4/ 5/	7.4	6.1	8.7	7.7	8.9	9.0
Monetary sector	(Annual percentage change, end of period, unless otherwise indicated)					
Reserve money	-2.7	10.6	8.6	12.4	9.2	10.9
Currency in circulation	-0.2	13.6	6.5	14.7	10.0	10.0
Broad money	2.6	5.7	4.1	10.0	5.3	10.8
Interest rate, 28-day capital note (in percent)	3.0	3.0	...	...	...	...
External sector 1/	(In percent of GDP, unless otherwise indicated)					
Exports of goods (in millions of U.S. dollars)	875	864	641	558	831	747
Exports of goods (annual percentage change)	11.6	-1.3	-24.8	-35.4	29.5	33.8
Imports of goods (in millions of U.S. dollars)	6,596	6,158	6,408	6,009	6,507	6,285
Imports of goods (annual percentage change)	-2.1	-6.6	0.4	-2.4	1.5	4.6
Merchandise trade balance	-31.1	-28.0	-30.6	-28.6	-28.6	-27.7
Current account balance 8/						
Excluding official transfers	-31.4	-27.0	-33.4	-30.6	-30.2	-28.5
Including official transfers	12.2	11.7	4.9	9.3	5.8	8.0
Foreign direct investment	0.4	0.0	0.0	0.0	0.5	0.5
Total external debt 4/	6.8	6.1	8.5	7.7	8.6	8.7
Gross international reserves (in millions of U.S. dollars)	8,273	8,573	8,249	8,896	8,149	8,788
Import coverage of reserves 6/	13.5	14.5	12.5	14.3	11.9	13.9
Exchange rate (p.a., Afghanis per U.S. dollar)	72.2	77.9	...	...	...	...
Real exchange rate (average, percentage change) 7/	6.8	6.1	...	...	...	...

Sources: Afghan authorities, United Nations Office on Drugs and Crime, WITS database, and IMF staff estimates and projections.

1/ Excluding the narcotics economy.

2/ Comprising mainly current spending.

3/ Defined as domestic revenues minus operating expenditures.

4/ Public sector only. Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.

5/ Public debt includes promissory note issued by MoF to settle DAB's Kabul Bank exposure.

6/ In months of next year's import of goods and services

7/ CPI-based, vis-a-vis the U.S. dollar. Positive - real appreciation of the Afghani.

8/ Current account does not include COVID emergency financing grants.

Table 2. Islamic Republic of Afghanistan: Medium-Term Macroeconomic Framework, 2018–25

	2018	2019	2020	2021	2022	2023	2024	2025
		Est.			Proj.			
Output and prices 1/	(Annual percentage change, unless otherwise indicated)							
Real GDP	1.2	3.9	-5.0	4.0	4.5	4.5	4.0	4.0
Nominal GDP (in billions of U.S. dollars)	18.4	18.9	19.0	20.0	21.0	22.2	23.3	24.5
Consumer prices (period average)	0.6	2.3	5.4	4.8	4.3	4.0	4.0	4.0
GDP Deflator	2.1	6.5	5.0	4.8	4.3	4.0	4.0	4.0
Investment, savings and consumption	(In percent of GDP, unless otherwise indicated)							
Gross domestic investment	18.0	18.2	17.9	18.1	18.9	19.8	20.6	21.4
<i>Of which: Private</i>	5.4	6.0	5.0	6.0	6.5	7.1	7.4	7.8
Gross national savings	30.2	29.9	27.2	26.1	26.9	27.4	27.9	28.3
<i>Of which: Private</i>	16.0	18.7	17.4	16.2	15.7	15.2	15.5	15.7
	Public finances (central government)							
Domestic revenues and grants	30.6	26.9	30.3	26.0	26.9	28.5	28.1	27.6
Domestic revenues	14.3	14.1	12.1	12.0	14.2	16.3	16.4	16.6
On-budget grants (excl. donors' direct spending outside the budget)	16.3	12.9	18.2	14.0	12.7	12.2	11.7	11.0
Expenditures	28.9	28.0	33.3	28.2	28.2	29.0	28.8	28.5
Operating 2/	19.4	18.5	21.8	19.3	18.8	18.5	18.2	17.8
Development	9.5	9.5	11.6	8.9	9.3	10.5	10.6	10.7
Operating balance (excluding grants) 3/	-5.1	-4.5	-9.6	-7.3	-4.6	-2.2	-1.8	-1.2
Overall budget balance (including grants)	1.6	-1.1	-3.0	-2.2	-1.2	-0.5	-0.7	-0.9
External sector 1/								
Merchandise trade balance	-31.1	-28.0	-28.6	-27.7	-25.6	-24.3	-23.0	-21.9
Current account balance, excluding official grants	-31.4	-27.0	-30.6	-28.5	-25.3	-23.5	-21.9	-20.5
Current account balance, including official grants 7/	12.2	11.7	9.3	8.0	8.0	7.6	7.4	6.9
Gross reserves (in millions of U.S. dollars)	8,273	8,573	8,896	8,788	8,688	8,590	8,495	8,400
Import coverage of reserves 4/	13.5	14.5	14.3	13.9	13.4	13.0	12.5	11.7
Memorandum items:								
Total public debt 5/	7.4	6.1	7.7	9.0	9.6	10.1	10.5	11.0
<i>Of which: External debt</i>	6.8	6.1	7.7	8.7	9.0	9.2	9.4	9.7
Domestic debt	0.5	0.0	0.0	0.3	0.6	0.9	1.1	1.3
Sukuk	0.0	0.0	0.0	0.3	0.6	0.9	1.1	1.3
Promissory note	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GDP per capita (in U.S. dollars) 6/	582	586	578	593	608	628	646	664
Donors' direct spending outside the budget	27.3	25.9	24.7	22.5	20.5	18.9	17.6	16.4

Sources: Afghan authorities and Fund staff estimates and projections.

1/ Excluding the narcotics economy.

2/ Comprising mainly current spending. It is assumed that donors' recurrent expenditure off-budget, mostly in the security sector, is being moved onto the budget by

3/ Defined as domestic revenues minus operating expenditures.

4/ In months of next year's import of goods and services.

5/ Public sector only. Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.

6/ Population figures are from the Afghan authorities.

7/ Current account does not include COVID emergency financing grants.

Table 3a. Islamic Republic of Afghanistan: Central Government Budget, 2018–25
(In billions of Afghanis)

	2018	2019	2020		2021		2022	2023	2024	2025
			RCF	Proj.	RCF	Proj.		Proj.		
Revenues and grants	405.9	395.9	394.5	444.1	438.0	415.5	468.9	540.1	575.2	610.9
Domestic revenues	189.9	207.0	157.2	177.8	212.8	191.8	247.2	308.9	335.3	367.0
Tax revenues	121.8	122.9	85.6	104.6	126.0	127.9	170.6	200.9	221.1	246.1
Income, profits, and capital gains	48.4	46.0	31.8	40.7	43.8	49.0	62.2	70.0	78.0	87.8
International trade and transactions	36.3	37.1	26.7	30.5	35.7	38.4	46.6	50.5	54.5	59.9
Goods and services	34.2	35.7	24.7	30.6	43.5	37.2	57.7	75.8	83.8	93.2
Of which: net increase from VAT introduction	0.0	0.0	0.0	0.0	10.1	0.0	10.5	22.7	24.6	26.6
Other	2.9	4.0	2.3	2.8	3.1	3.4	4.1	4.5	4.9	5.3
Nontax revenues 1/	68.0	84.2	71.6	73.2	86.7	63.9	76.6	108.0	114.2	120.9
Grants to operating budget 2/	84.6	80.0	94.1	104.2	98.3	95.0	92.7	94.8	98.4	97.6
LOTFA	25.0	23.5	28.7	26.4	...	...	...	...	...	...
CSTC-A	59.6	56.6	65.5	77.7	...	...	...	...	...	...
Other grants	0.0	0.0	0.0	0.1	...	...	...	...	...	...
Grants to development budget 3/	131.4	108.8	143.2	162.1	126.9	128.7	129.0	136.4	141.4	146.4
Of which: for Covid-19	0.0	0.0	24.6	42.9	0.0	19.2	0.0	0.0	0.0	0.0
Total expenditures	384.2	411.5	448.0	488.6	461.6	450.7	490.4	549.6	589.4	631.7
Of which: for Covid-19	0.0	0.0	53.9	42.6	23.2	32.3	0.0	0.0	0.0	0.0
Operating expenditures	258.1	272.5	337.8	319.2	314.1	309.0	328.0	350.8	372.3	394.7
Of which: Security	136.5	153.1	...	...	...	...	...	...	...	...
Wages and salaries	183.6	197.5	201.9	204.5	209.4	209.6	224.3	239.7	254.2	269.6
Purchases of goods and services	37.6	40.0	82.1	64.8	71.0	56.7	57.5	56.8	55.3	53.2
Transfers, subsidies, and other	2.6	2.2	23.1	17.4	0.0	12.2	12.5	17.1	22.0	27.1
Pensions	27.4	26.4	19.9	20.5	21.7	23.6	25.7	28.0	30.2	32.7
Capital expenditures	6.2	5.8	10.1	11.6	10.9	6.3	6.9	7.5	8.1	8.7
Interest	0.8	0.6	0.6	0.6	1.0	0.6	1.2	1.8	2.5	3.4
Development expenditures:	126.1	139.0	110.2	169.4	147.5	141.7	162.4	198.8	217.1	237.0
Of which: Discretionary	52.9	60.9	...	...	...	...	...	...	...	...
Infrastructure and natural resources	54.6	65.3	...	...	...	...	...	...	...	...
Education	6.0	4.8	...	...	...	...	...	...	...	...
Health	17.1	15.8	...	...	...	...	...	...	...	...
Agriculture and rural development	27.9	28.1	...	...	...	...	...	...	...	...
Other	20.4	25.0	...	...	...	...	...	...	...	...
Operating balance excluding grants	-68.2	-65.4	-180.6	-141.4	-101.3	-117.2	-80.8	-41.9	-37.0	-27.7
Overall budget balance excluding grants	-194.3	-204.4	-290.8	-310.8	-248.9	-258.9	-243.2	-240.7	-254.0	-264.7
Overall budget balance excluding Covid-19 grants	21.7	-15.5	-78.1	-87.5	-23.6	-54.4	-21.5	-9.5	-14.2	-20.8
Overall budget balance including grants	21.7	-15.5	-53.5	-44.6	-23.6	-35.2	-21.5	-9.5	-14.2	-20.8
Float and discrepancy 4/	17.4	16.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	-39.1	-0.7	53.5	44.6	23.6	35.2	21.5	9.5	14.2	20.8
Sale of nonfinancial assets	0.0	0.2	0.0	0.0	0.0	4.8	4.8	0.0	0.0	0.0
External loans (net)	-1.6	0.2	25.6	23.6	12.1	20.7	11.2	12.0	14.2	18.1
o/w IMF's Rapid Credit Facility	0.0	0.0	18.1	17.0	0.0	0.0	0.0	0.0	0.0	0.0
o/w IMF's Extended Credit Facility	0.0	0.0	0.0	9.0	0.0	17.4	0.0	0.0	0.0	0.0
Domestic (net)	-37.5	-1.1	19.5	21.0	3.6	9.7	5.5	-2.5	0.0	2.7
Central bank, change in	-37.5	-1.1	17.6	21.0	1.4	4.4	0.3	-8.2	-6.0	-4.6
Government deposits	-29.3	5.9	18.4	21.2	2.0	4.4	0.3	-8.2	-6.0	-4.6
Claims on government	-8.2	-7.0	-0.8	-0.2	-0.6	0.0	0.0	0.0	0.0	0.0
o/w Promissory note (- = repayment)	-8.2	-7.0	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Domestic debt (sukuk)	0.0	0.0	1.9	0.0	2.1	5.3	5.2	5.7	6.0	7.3
Promissory note (end-of-period stock)	7.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pro-poor spending 5/	41.8	54.2	...	78.2	...	75.1	...	...	...	...

Source: Afghan authorities and Fund staff estimates and projections

1/ Profits transfer from DAB of Afs12.8 billion is included in 2020.

2/ LOTFA: Law and Order Trust Fund for Afghanistan;

CSTC-A: Combined Security Transition Command - Afghanistan (now NTM-A: NATO Training Mission - Afghanistan)

3/ Some of the grants to development budget can finance operating expenditures.

4/ Positive number indicates that expenditures have been recorded, but not yet executed.

5/ Pro-poor spending covers ministries of education, labor and social affairs, martyrs and disabled, public health.

Table 3b. Islamic Republic of Afghanistan: Central Government Budget, 2018–25
(In percent of GDP)

	2018	2019	2020		2021		2022	2023	2024	2025
			RCF	Proj.	RCF	Proj.		Proj.		
Revenues and grants	30.6	26.9	25.5	30.3	25.9	26.0	26.9	28.5	28.1	27.6
Domestic revenues	14.3	14.1	10.2	12.1	12.6	12.0	14.2	16.3	16.4	16.6
Tax revenues	9.2	8.4	5.5	7.1	7.5	8.0	9.8	10.6	10.8	11.1
Income, profits, and capital gains	3.6	3.1	2.1	2.8	2.6	3.1	3.6	3.7	3.8	4.0
International trade and transactions	2.7	2.5	1.7	2.1	2.1	2.4	2.7	2.7	2.7	2.7
Goods and services	2.6	2.4	1.6	2.1	2.6	2.3	3.3	4.0	4.1	4.2
Of which: net increase from VAT introduction	0.0	0.0	0.0	0.0	0.6	0.0	0.6	1.2	1.2	1.2
Other	0.2	0.3	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Nontax revenues 1/	5.1	5.7	4.6	5.0	5.1	4.0	4.4	5.7	5.6	5.5
Grants to operating budget 2/	6.4	5.4	6.1	7.1	5.8	5.9	5.3	5.0	4.8	4.4
LOTFA	1.9	1.6	1.9	1.8	...	...	...	...	...	...
CSTC-A	4.5	3.8	4.2	5.3	...	...	...	...	...	...
Other grants	0.0	0.0	0.0	0.0	...	...	...	...	...	...
Grants to development budget 3/	9.9	7.4	9.2	11.1	7.5	8.1	7.4	7.2	6.9	6.6
Of which: for Covid-19	0.0	0.0	1.6	2.9	0.0	1.2	0.0	0.0	0.0	0.0
Total expenditures	28.9	28.0	28.9	33.3	27.3	28.2	28.2	29.0	28.8	28.5
Of which: for Covid-19	0.0	0.0	3.5	2.9	1.5	2.0	0.0	0.0	0.0	0.0
Operating expenditures	19.4	18.5	21.8	21.8	18.6	19.3	18.8	18.5	18.2	17.8
Of which: Security	10.3	10.4	...	...	...	...	...	...	...	...
Wages and salaries	13.8	13.4	13.0	13.9	12.4	13.1	12.9	12.7	12.4	12.2
Purchases of goods and services	2.8	2.7	5.3	4.4	4.2	3.6	3.3	3.0	2.7	2.4
Transfers, subsidies, and other	0.2	0.1	1.5	1.2	0.0	0.8	0.7	0.9	1.1	1.2
Pensions	2.1	1.8	1.3	1.4	1.3	1.5	1.5	1.5	1.5	1.5
Capital expenditures	0.5	0.4	0.7	0.8	0.6	0.4	0.4	0.4	0.4	0.4
Interest	0.1	0.0	0.0	0.0	0.1	0.0	0.1	0.1	0.1	0.2
Development expenditures:	9.5	9.5	7.1	11.6	8.7	8.9	9.3	10.5	10.6	10.7
Of which: Discretionary	4.0	4.1	...	...	...	...	...	...	...	...
Infrastructure and natural resources	4.1	4.4	...	...	...	...	...	...	...	...
Education	0.4	0.3	...	...	...	...	...	...	...	...
Health	1.3	1.1	...	...	...	...	...	...	...	...
Agriculture and rural development	2.1	1.9	...	...	...	...	...	...	...	...
Other	1.5	1.7	...	...	...	...	...	...	...	...
Operating balance excluding grants	-5.1	-4.5	-11.7	-9.6	-6.0	-7.3	-4.6	-2.2	-1.8	-1.2
Overall budget balance excluding grants	-14.6	-13.9	-18.8	-21.2	-14.7	-16.2	-14.0	-12.7	-12.4	-11.9
Overall budget balance excluding Covid-19 grants	1.6	-1.1	-5.0	-6.0	-1.4	-3.4	-1.2	-0.5	-0.7	-0.9
Overall budget balance including grants	1.6	-1.1	-3.5	-3.0	-1.4	-2.2	-1.2	-0.5	-0.7	-0.9
Float and discrepancy 4/	1.3	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing	-2.9	0.0	3.5	3.0	1.4	2.2	1.2	0.5	0.7	0.9
Sale of nonfinancial assets	0.0	0.0	0.0	0.0	0.0	0.3	0.3	0.0	0.0	0.0
External loans (net)	-0.1	0.0	1.7	1.6	0.7	1.3	0.6	0.6	0.7	0.8
o/w IMF's Rapid Credit Facility	0.0	0.0	1.2	1.2	0.0	0.0	0.0	0.0	0.0	0.0
o/w IMF's Extended Credit Facility	0.0	0.0	0.0	0.6	0.0	1.1	0.0	0.0	0.0	0.0
Domestic (net)	-2.8	-0.1	1.3	1.4	0.2	0.6	0.3	-0.1	0.0	0.1
Central bank, change in	-2.8	-0.1	1.1	1.4	0.1	0.3	0.0	-0.4	-0.3	-0.2
Government deposits	-2.2	0.4	1.2	1.4	0.1	0.3	0.0	-0.4	-0.3	-0.2
Claims on government	-0.6	-0.5	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
o/w Promissory note (- = repayment)	-0.6	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic debt (sukuk)	0.0	0.0	0.1	0.0	0.1	0.3	0.3	0.3	0.3	0.3
Promissory note (end-of-period stock)	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pro-poor spending 5/	3.1	3.7	...	5.3	...	4.7	...	...	...	...

Source: Afghan authorities and Fund staff estimates and projections.

1/ Profits transfer from DAB of Af\$12.8 billion is included in 2020.

2/ LOTFA: Law and Order Trust Fund for Afghanistan;

CSTC-A: Combined Security Transition Command - Afghanistan (now NTM-A: NATO Training Mission - Afghanistan)

3/ Some of the grants to development budget can finance operating expenditures.

4/ Positive number indicates that expenditures have been recorded, but not yet executed.

5/ Pro-poor spending covers ministries of education, labor and social affairs, martyrs and disabled, public health.

Table 4a. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2018–22
(In billions of Afghanis, at current exchange rates, unless otherwise indicated)

	2018	2019	2020		2021		2022
			RCF	Proj.	RCF	Proj.	Proj.
Net foreign assets	608.2	659.8	699.2	654.3	701.2	661.7	670.6
Net international reserves	570.7	621.0	642.0	609.9	640.8	615.0	622.6
Foreign assets	628.8	680.9	719.6	701.4	721.6	728.5	740.4
Gross international reserves	620.1	672.2	711.9	693.9	713.9	720.6	732.3
Assets in nonconvertible currencies	8.7	8.8	7.7	7.6	7.7	7.9	8.2
Foreign liabilities	20.6	21.1	20.4	47.1	20.4	66.8	69.8
IMF accounts (loans)	4.4	4.3	4.4	30.5	4.4	49.3	51.8
IMF SDR allocation	16.2	16.8	16.0	16.6	16.0	17.5	18.0
Foreign currency reserves of commercial banks	45.0	46.9	65.5	53.5	68.6	56.2	57.8
Net domestic assets	-275.0	-291.3	-291.5	-239.9	-256.2	-202.0	-162.6
Domestic assets	-130.6	-121.5	-108.3	-88.5	-106.3	-69.2	-53.3
Net claims on government	-98.2	-98.1	-80.2	-51.9	-78.2	-32.4	-31.5
Gross claims on government	22.7	16.9	16.5	43.0	16.5	62.5	65.5
MOF promissory note 1/	7.2	0.2	0.0	0.0	0.0	0.0	0.0
IMF accounts 2/	15.6	16.8	16.5	43.0	16.5	62.5	65.5
Liabilities to government	121.0	115.1	96.7	94.9	94.7	94.9	97.0
Domestic currency deposits	24.3	29.6	13.8	12.9	11.8	9.6	9.4
Foreign currency deposits	96.7	85.4	82.9	82.0	82.9	85.3	87.6
Net credit to state and local government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net credit on financial corporations	-33.3	-24.3	-29.7	-38.4	-29.7	-38.4	-23.4
Net credit to public nonfinancial corporations	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Credit to private sector	0.9	0.8	1.4	1.7	1.4	1.4	1.4
Other items net	-144.4	-169.8	-183.2	-151.4	-149.8	-132.8	-109.2
DAB's capital	155.5	177.8	159.6	204.6	159.6	225.0	247.5
Reserve money	333.2	368.6	407.6	414.4	445.0	459.7	508.1
Reserve money in domestic currency	288.2	321.6	342.2	360.9	376.4	403.5	450.3
Currency in circulation	228.2	259.3	276.2	297.5	303.8	327.2	358.3
Bank deposits in domestic currency	44.8	49.9	54.9	51.3	61.5	64.1	79.9
Bank deposits in domestic currency	39.1	44.2	50.0	41.7	56.6	52.1	64.9
Reserve requirements in domestic currency	5.7	5.7	4.9	9.6	4.9	12.0	15.0
Bank deposits in foreign currency	45.0	46.9	65.5	53.5	68.6	56.2	57.8
Bank deposits in foreign currency	26.7	29.7	48.6	35.0	51.7	36.8	37.8
Reserve requirements in foreign currency	18.3	17.2	16.9	18.5	16.9	19.5	20.0
Other deposits	15.2	12.4	11.1	12.1	11.1	12.1	12.1
Other deposits in domestic currency	15.2	12.4	11.1	12.1	11.1	12.1	12.1
Other deposits in foreign currency	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:							
International reserves, in millions of U.S. dollars							
Net	7,614	7,920	7,439	7,819	7,315	7,501	7,387
Gross	8,273	8,573	8,249	8,896	8,149	8,788	8,688
Interest rate, 28-day capital notes (percent)	3.0	3.0	...	...	...	...	...
Exchange rate (eop, Afghanis per U.S. dollar)	75.0	78.4	...	...	...	...	...

Sources: Afghan authorities and Fund staff estimates and projections.

1/ A nonmarketable security issued to DAB by the Ministry of Finance for the cost of a lender of last resort assistance to Kabul Bank.

2/ Includes Afghanistan's SDR holdings (MoF is the fiscal agent for the IMF).

Table 4b. Islamic Republic of Afghanistan: Central Bank Balance Sheet, 2019–21
(At program exchange rates) 1/

	2019	2020	2021			
	Dec. 21	Dec. 21	Mar. 20	June 20	Sep. 20	Dec. 21
		Proj.		Proj.		
Net foreign assets	649.3	643.4	647.2	639.7	632.4	619.0
Net international reserves	613.2	599.7	603.5	596.0	588.7	575.3
Foreign assets	669.8	689.8	693.4	697.1	695.0	681.5
Gross international reserves	663.3	682.3	686.0	689.7	687.6	674.0
Assets in nonconvertible currencies	6.5	7.4	7.4	7.4	7.4	7.4
Foreign liabilities	20.6	46.4	46.2	57.4	62.6	62.5
IMF accounts (loans)	4.2	30.0	29.9	41.1	46.3	46.1
IMF SDR allocation	16.4	16.4	16.4	16.4	16.4	16.4
Foreign currency reserves of commercial banks	45.9	52.6	52.6	52.6	52.6	52.6
Net domestic assets	-281.3	-229.9	-223.5	-205.5	-187.5	-162.9
Domestic assets	-120.1	-87.8	-97.5	-83.3	-76.9	-67.8
Net claims on government	-96.7	-51.3	-60.6	-46.5	-40.1	-30.9
Gross claims on government	16.5	42.3	42.2	53.4	58.6	58.5
MOF promissory note 1/	0.2	0.0	0.0	0.0	0.0	0.0
IMF accounts 2/	16.3	42.3	42.2	53.4	58.6	58.5
Liabilities to government	113.2	93.6	102.8	99.8	98.7	89.4
Domestic currency deposits	29.6	12.9	19.8	17.6	16.7	9.6
Foreign currency deposits	83.6	80.7	83.0	82.3	82.0	79.8
Net credit to state and local government	0.0	0.0	0.0	0.0	0.0	0.0
Net credit on financial corporations	-24.3	-38.4	-38.4	-38.4	-38.4	-38.4
Net credit to public nonfinancial corporations	0.1	0.1	0.1	0.1	0.1	0.1
Credit to private sector	0.8	1.7	1.4	1.4	1.4	1.4
Other items net	-161.2	-142.1	-126.0	-122.2	-110.5	-95.1
DAB's capital	177.8	204.6	225.0	225.0	225.0	225.0
Reserve money	367.9	413.5	423.7	434.2	445.0	456.1
Reserve money in domestic currency	321.6	360.9	371.1	381.6	392.4	403.5
Currency in circulation	259.3	297.5	304.6	312.0	319.5	327.2
Bank deposits in domestic currency	49.9	51.3	54.3	57.5	60.8	64.1
Bank deposits in domestic currency	44.2	41.7	44.2	46.7	49.4	52.1
Reserve requirements in domestic currency	5.7	9.6	10.2	10.8	11.4	12.0
Bank deposits in foreign currency	46.3	52.6	52.6	52.6	52.6	52.6
Bank deposits in foreign currency	29.1	34.4	34.4	34.4	34.4	34.4
Reserve requirements in foreign currency	17.2	18.2	18.2	18.2	18.2	18.2
Other deposits	12.4	12.1	12.1	12.1	12.1	12.1
Other deposits in domestic currency	12.4	12.1	12.1	12.1	12.1	12.1
Other deposits in foreign currency	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:						
International reserves, in millions of U.S. dollars						
Net	7,994	7,819	7,869	7,771	7,676	7,501
Gross	8,648	8,896	8,944	8,992	8,965	8,788
Interest rate, 28-day capital notes (percent)	3.0	...	...	...	...	...
Exchange rate (eop, Afghanis per U.S. dollar)	78.4	...	...	...	...	...

Sources: Afghan authorities and Fund staff estimates and projections.

1/ A nonmarketable security issued to DAB by the Ministry of Finance for the cost of a lender of last resort assistance to Kabul

2/ Includes Afghanistan's SDR holdings (MoF is the fiscal agent for the IMF).

Table 5. Islamic Republic of Afghanistan: Monetary Survey, 2018–22 1/
(At current exchange rates)

	2018	2019	2020		2021		2022
			RCF	Proj.	RCF	Proj.	Proj.
Net foreign assets	722.3	773.8	831.2	765.2	835.2	778.3	790.5
Foreign assets	756.1	805.2	862.6	821.9	866.8	855.1	870.6
Central bank	628.8	680.9	719.6	701.4	721.6	728.5	740.4
Commercial banks	127.3	124.3	143.1	120.5	145.2	126.6	130.2
Foreign liabilities	-33.8	-31.4	-31.4	-56.7	-31.6	-76.8	-80.1
Central bank	-20.6	-21.1	-20.4	-47.1	-20.4	-66.8	-69.8
Commercial banks	-13.2	-10.3	-11.0	-9.5	-11.2	-10.0	-10.3
Net domestic assets	-236.3	-260.1	-296.2	-200.1	-272.1	-152.2	-94.2
Net domestic credit	-60.7	-57.9	-32.0	-7.5	-27.6	-61.2	-48.7
Nonfinancial public sector	-106.3	-104.9	-79.5	-55.1	-77.5	-113.6	-107.4
Net credit to central government	-106.4	-105.5	-80.2	-55.3	-78.2	-113.8	-107.7
Central bank	-98.2	-98.1	-80.2	-49.7	-78.2	-110.9	-110.0
Commercial banks	-8.2	-7.4	0.0	-5.6	0.0	-3.0	2.3
Net credit to public nonfinancial corporations	0.1	0.6	0.7	0.3	0.7	0.3	0.3
Net credit to private sector	46.6	47.5	48.0	47.9	50.4	52.7	59.1
in national currency	21.4	26.1	24.0	24.9	22.7	28.5	33.7
in foreign currency	25.2	21.3	24.0	23.0	27.7	24.3	25.4
Net credit to other financial corporations	-1.0	-0.5	-0.5	-0.4	-0.5	-0.4	-0.4
Other items net	-175.5	-202.2	-264.2	-192.6	-244.5	-90.9	-45.5
Broad money M2	486.0	513.7	535.0	565.1	563.1	626.1	696.3
Broad money M2 in domestic currency	315.5	344.4	347.6	396.9	418.0	439.6	491.9
Narrow money M1	453.5	479.9	497.8	532.1	520.0	580.0	634.3
Narrow money M1 in domestic currency	305.7	337.1	340.1	387.6	409.9	428.2	478.2
Currency outside banks	219.9	249.9	268.9	288.2	294.5	317.2	346.3
Currency in circulation	228.2	259.3	276.2	297.5	303.8	327.2	358.3
Currency held by banks	8.3	9.4	7.3	9.3	9.3	10.0	12.0
Demand deposits	233.6	229.9	228.9	243.9	225.5	262.8	288.0
in national currency	85.8	87.1	71.2	99.5	115.4	110.9	131.9
in foreign currency	147.8	142.8	157.7	144.4	160.1	151.8	156.1
Other deposits	32.6	33.9	37.2	33.0	43.1	46.1	62.0
in national currency	9.8	7.3	7.6	9.2	8.0	11.4	13.7
in foreign currency	22.8	26.6	29.6	23.8	35.1	34.7	48.3
(12-month percentage change)							
M2	2.6	5.7	4.1	10.0	5.3	10.8	11.2
M1	3.8	5.8	3.7	10.9	4.5	9.0	9.4
Currency outside banks	-0.3	13.7	7.6	15.3	9.5	10.1	9.2
Net credit to private sector	-5.6	1.8	1.2	1.0	5.0	10.0	12.0
(In percent of GDP)							
M2	36.6	35.0	34.6	38.5	37.0	39.2	40.0
M1	34.2	32.7	32.7	36.3	34.1	36.3	36.4
Net credit to the private sector	3.5	3.2	3.0	3.3	3.2	3.3	3.4
Memorandum items:							
M2 velocity	2.7	2.9	2.9	2.6	3.0	2.6	2.5
Reserve money multiplier	1.5	1.4	1.5	1.5	1.5	1.5	1.5
Banking sector							
Loan dollarization (percent)	54.1	45.0	50.0	48.0	55.0	46.0	43.0
Deposit dollarization (percent)	64.1	64.2	65.4	60.7	72.7	60.4	58.4
Currency-to-deposit ratio (percent)	85.8	98.3	103.8	107.4	113.1	105.9	102.4
Loans-to-deposit ratio (percent)	17.5	18.0	18.1	17.3	17.5	17.1	16.9
Ratio of banks FX deposits at DAB to banks' FX deposits (percent)	26.4	27.7	34.9	31.8	35.2	30.1	28.3

Sources: Afghan authorities and Fund staff estimates and projections.

1/ End of period (Dec.21). Data underlying the survey are not fully consistent because DAB and the public banks use the solar calendar, while commercial banks use the Gregorian calendar.

Table 6. Islamic Republic of Afghanistan: Balance of Payments, 2018–25 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2018	2019	2020		2021		2022	2023	2024	2025
		Est.	RCF	Proj.	RCF	Proj.		Proj.		
Current account	2,237	2,209	932	1,773	1,153	1,607	1,667	1,694	1,713	1,702
Excluding official grants	-5,776	-5,102	-6,290	-5,817	-5,993	-5,688	-5,296	-5,208	-5,112	-5,023
Trade balance of goods	-5,721	-5,294	-5,767	-5,451	-5,676	-5,538	-5,374	-5,372	-5,354	-5,376
Exports of goods and services	1,609	1,509	1,039	890	1,353	1,231	1,672	1,879	2,087	2,332
Goods	875	864	641	558	831	747	973	1,085	1,209	1,360
Services	734	645	398	332	523	484	699	794	877	972
Imports of goods and services	7,984	7,371	7,785	7,107	7,934	7,478	7,589	7,753	7,907	8,128
Goods	6,596	6,158	6,408	6,009	6,507	6,285	6,347	6,457	6,563	6,736
Services	1,388	1,213	1,377	1,098	1,428	1,193	1,243	1,297	1,344	1,393
Income, net	212	307	250	201	255	232	235	237	239	252
Of which: Interest on official loans	5	7	8	8	10	9	11	14	18	22
Current transfers, net	8,399	7,764	7,428	7,789	7,479	7,622	7,349	7,331	7,294	7,247
Of which: Official 2/	8,013	7,311	7,222	7,590	7,146	7,295	6,962	6,901	6,826	6,726
Capital account	0	0	0	0	0	0	0	0	0	0
Financial account, net	-393	139	-1,789	-2,346	-1,264	-1,932	-1,782	-1,806	-1,801	-1,764
Foreign direct investment	79	-3	3	3	98	98	113	130	148	170
Portfolio investment	-141	15	-201	-40	-124	37	47	57	67	77
Official loans 3/	-20	10	92	-29	143	42	137	141	162	202
Disbursement	2	30	120	0	171	71	166	177	203	246
Amortization	22	21	28	29	28	29	29	36	42	44
Other investment	-311	118	-1,683	-2,279	-1,381	-2,108	-2,079	-2,133	-2,177	-2,212
Errors and omissions	-1,706	-2,052	0	0	0	0	0	0	0	0
Overall balance	138	296	-857	-573	-111	-325	-116	-112	-88	-62
Financing	-138	-296	857	573	111	325	116	112	88	62
Central bank's gross reserves ("-" = accumulation)	-134	-300	324	-323	111	108	100	98	95	95
Use of Fund resources, net	-4	4	213	330	-7	210	13	14	-7	-33
Disbursements	13	14	220	338	0	217	19	19	0	0
RCF Disbursement	0	0	220	223	0	0	0	0	0	0
ECF Disbursement	13	14	0	115	0	217	19	19	0	0
Repayments	16	10	8	7	7	7	5	5	7	33
Exceptional Financing (grants)	0	0	315	557	0	0	0	0	0	0
World Bank	0	0	200	380	0	0	0	0	0	0
ADB and other IFIs	0	0	45	118	0	0	0	0	0	0
Bilateral Support	0	0	70	59	0	0	0	0	0	0
Grant for debt relief under CCRT 4/	0	0	5	5	7	7	2	0	0	0
Debt Service Suspension Initiative (DSSI)	0	0	0	4	0	0	0	0	0	0
Memorandum items:										
Gross international reserves, central bank	8,273	8,573	8,249	8,896	8,149	8,788	8,688	8,590	8,495	8,400
Import coverage of reserves 5/	13.5	14.5	12.5	14.3	11.9	13.9	13.4	13.0	12.5	11.7
External debt stock, official 6/	1,212	1,147	1,530	1,457	1,666	1,714	1,868	2,026	2,182	2,352
in percent of GDP	6.8	6.1	8.5	7.7	8.6	8.7	9.0	9.2	9.4	9.7
Current account, in percent of GDP 7/	12.2	11.7	4.9	9.3	5.8	8.0	8.0	7.6	7.4	6.9
Trade balance, in percent of GDP	-31.1	-28.0	-30.6	-28.6	-28.6	-27.7	-25.6	-24.3	-23.0	-21.9
Export of goods and services, in percent of GDP	8.7	8.0	5.5	4.7	6.8	6.2	8.0	8.5	9.0	9.5
Import of goods and services, in percent of GDP	43.4	39.0	41.3	37.4	40.0	37.4	36.2	35.0	33.9	33.2
Official grants, in percent of GDP	43.5	38.7	40.0	42.8	36.0	36.5	33.2	31.2	29.3	27.4

Sources: Afghan authorities and Fund staff estimates and projections.

1/ BoP data exclude the narcotics economy.

2/ As the breakdown between capital grants and current grants is difficult to identify, all grants are included in current transfers.

3/ Excluding IMF.

4/ The grant for the debt service falling due in the 18 months from October 14, 2020 is subject to the availability of resources under the CCRT.

5/ In months of next year's import of goods and services.

6/ Incorporates committed but not yet delivered debt relief. Debt relief recorded fully at time of commitment.

7/ Current account does not include COVID emergency financing grants.

Table 7. Islamic Republic of Afghanistan: Financial Soundness Indicators, 2018–20 1/
(In percent)

	2018	2019				2020			
		Q1	Q2	Q3	Q4	Q1	April	May	June
Capital adequacy									
Regulatory Capital to Risk-weighted Assets (capital adequacy ratio – “CAR”)	25.8	27.0	27.0	25.8	26.1	26.0	25.6	26.0	26.7
Total Capital to Total Assets	10.9	11.5	11.0	11.6	11.6	11.9	11.6	11.5	11.6
Asset composition and quality									
Total Loans to Total Assets	13.1	14.0	14.2	14.2	13.2	14.3	13.4	12.8	12.5
Non-performing Loans to Total Gross Loans	8.9	10.9	12.8	13.2	14.5	15.0	15.5	15.7	29.4
Non-performing Loans Net of Provisions to Capital	3.4	4.5	6.3	5.9	6.7	6.9	7.0	7.1	25.2
Earnings and profitability									
Return on Assets	0.3	0.1	0.7	0.6	0.9	-0.1	0.01	0.15	0.40
Return on Equity	3.0	1.2	6.5	5.0	7.4	-1.1	0.1	1.1	3.3
Liquidity									
Liquid Assets to Total Assets (Liquid Asset Ratio)	72.7	70.9	69.7	67.7	68.7	66.0	67.3	68.6	68.1
Liquid Assets to Short-term Liabilities	90.6	89.9	89.1	86.6	87.3	86.0	86.8	87.5	86.6
Sensitivity to Market Risk									
Net open position in foreign exchange to capital 2/	30.8	27.6	37.6	37.4	30.3	40.5	45.6	45.7	43.3
Foreign currency denominated liabilities to total liabilities	68.6	69.3	70.8	68.0	66.5	66.9	68.5	64.7	64.1
Foreign currency denominated loans to total loans	58.1	54.5	54.0	51.8	49.2	48.4	54.5	48.2	48.9

Source: Afghan authorities.

1/ NPLs include loans 121 to 481 days or more past due for payment of principal and/or interest. This differs from the IMF's FSI Compilation Guide which advises recognition of loans 90 days or more past due payment of interest or principal as NPLs.

2/ Net open positions are due to high and persistent dollarization.

Table 8. Islamic Republic of Afghanistan: Proposed Schedule of Reviews and Disbursements Under the ECF Arrangement

Availability date	Amount of Disbursements		Conditions
	Millions of SDRs	Percent of Quota	
November 6, 2020	80.9500	25.0	Approval of arrangement
April 21, 2021	103.6160	32.0	First review and continuous and December 21, 2020 performance criteria
October 20, 2021	48.5700	15.0	Second review and continuous and June 21, 2021 performance criteria
April 20, 2022	6.4760	2.0	Third review and continuous and December 21, 2021 performance criteria
October 19, 2022	6.4760	2.0	Fourth review and continuous and June 21, 2022 performance criteria
April 21, 2023	6.4760	2.0	Fifth review and continuous and December 21, 2022 performance criteria
October 21, 2023	6.4760	2.0	Sixth review and continuous and June 21, 2023 performance criteria
Total	259.0400	80.00	

Source: International Monetary Fund.

Table 9. Islamic Republic of Afghanistan: External Financing Requirement and Sources, 2020–24

(In millions of U.S. dollars)

	2020	2021	2022	2023	2024
	Proj.	Proj.		Proj.	
Gross financing requirement	5,853	5,724	5,330	5,248	5,161
Current account Deficit (excluding grants)	5,817	5,688	5,296	5,208	5,112
Amortization	37	36	34	41	49
Of which: IMF	7	7	5	5	7
Available financing	4,950	5,500	5,311	5,230	5,161
Drawdown in Reserves	-323	108	100	98	95
Official transfers (grants)	7,590	7,295	6,962	6,901	6,826
Foreign direct investment	3	98	113	130	148
Official medium- and long-term loans	0	71	124	126	169
Other flows	-2,320	-2,072	-1,988	-2,026	-2,077
Financing gap	903	224	19	19	0
Identified financing (provisional)	903	224	19	19	0
Of which: IMF RCF and ECF	338	217	19	19	0
Other IFIs and bilateral donors	557	0	0	0	0
Grant for debt relief under CCRT	5	7	0	0	0
Debt Service Suspension Initiative (DSSI)	4	0	0	0	0
Remaining gap	0	0	0	0	0

Sources: Afghan authorities; and Fund staff estimates and projections.

Table 10. Islamic Republic of Afghanistan: Projected Payments and Indicators of Capacity to Repay the Fund
(In SDR million)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Obligations from existing drawings															
1. Principal															
PRGT repayments	1.2	4.8	3.8	3.2	5.0	22.7	38.9	37.5	35.7	33.9	16.2	0.0	0.0	0.0	0.0
2. Charges and interest 1/															
PRGT interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDR assessments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDR net charges	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total obligations	1.2	4.9	3.8	3.2	5.0	22.8	39.0	37.6	35.8	34.0	16.3	0.1	0.1	0.1	0.1
(percent of quota)	0.4	1.5	1.2	1.0	1.6	7.0	12.0	11.6	11.1	10.5	5.0	0.0	0.0	0.0	0.0
Obligations from prospective drawings 2/															
1. Principal															
PRGT repayments	0.0	0.0	0.0	0.0	0.0	0.0	26.6	47.3	49.9	51.8	51.8	25.3	4.5	1.9	0.0
2. Charges and interest 1/															
PRGT interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations	0.0	0.0	0.0	0.0	0.0	0.0	26.6	47.3	49.9	51.8	51.8	25.3	4.5	1.9	0.0
(percent of quota)	0.0	0.0	0.0	0.0	0.0	0.0	8.2	14.6	15.4	16.0	16.0	7.8	1.4	0.6	0.0
Cumulative obligations (existing and prospective) 2/															
1. Principal															
PRGT repayments	1.2	4.8	3.8	3.2	5.0	22.7	65.4	84.8	85.6	85.7	68.0	25.3	4.5	1.9	0.0
2. Charges and interest 1/															
PRGT interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDR assessment and net charges	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total obligations	1.2	4.9	3.8	3.2	5.0	22.8	65.5	84.9	85.7	85.8	68.1	25.4	4.6	2.0	0.1
Outstanding Fund credit, end of period	282.4	429.8	439.0	448.8	443.9	421.2	355.8	271.0	185.4	99.7	31.7	6.5	1.9	0.0	0.0
Memorandum items:															
Outstanding Fund credit, in percent of															
Exports of goods and services 3/	44.2	49.9	37.8	34.5	30.8	26.3	21.2	15.4	10.0	5.1	1.5	0.3	0.1	0.0	...
External public debt	27.0	35.8	33.8	32.0	29.5	26.0	16.6	10.1	5.7	2.6	0.7	0.1	0.0	0.0	...
Gross official reserves	4.4	7.0	7.3	7.6	7.6	7.3	7.3	5.5	3.8	2.0	0.6	0.1	0.0	0.0	...
GDP	2.1	3.1	3.0	2.9	2.8	2.5	2.0	1.5	0.9	0.5	0.1	0.0	0.0	0.0	...
Quota	87.2	132.7	135.6	138.6	137.1	130.1	109.9	83.7	57.3	30.8	9.8	2.0	0.6	0.0	...
Total Obligations, in percent of															
Exports of goods and services 3/	0.2	0.6	0.3	0.2	0.4	1.4	3.9	4.8	4.6	4.4	3.3	1.1	0.2	0.1	...
External public debt	0.1	0.4	0.3	0.2	0.3	1.4	3.1	3.2	2.7	2.3	1.5	0.5	0.1	0.0	...
Gross official reserves	0.0	0.1	0.1	0.1	0.1	0.4	1.3	1.7	1.8	1.8	1.4	0.5	0.1	0.0	...
GDP	0.0	0.0	0.0	0.0	0.0	0.1	0.4	0.5	0.4	0.4	0.3	0.1	0.0	0.0	...
Quota	0.4	1.5	1.2	1.0	1.6	7.0	20.2	26.2	26.5	26.5	21.0	7.8	1.4	0.6	...
Quota	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8	323.8

Source: Fund staff estimates and projections.

1/ Projections are based on current interest rates for PRGT loans.

2/ Based on the proposed level and phasing of access, and subject to the approval of the IMF's Executive Board.

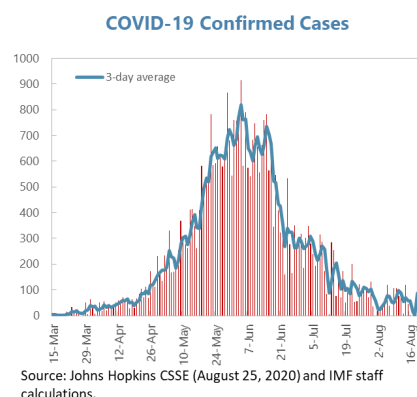
3/ Excluding reexports.

Table 11. Islamic Republic of Afghanistan: Policy Measures Discussed with the Authorities that Could be Proposed as Structural Benchmarks at the Time of the Next Review

Measure	Area	Date	Rationale
The Supreme Audit Office to undertake audits of select COVID-19 emergency spending in FY2020 (as outlined in ¶48 of the MEFP) and publish its audit reports.	Governance, anti-corruption	End-June 2021	Strengthen accountability and governance.
The government to submit to parliament amendments to the VAT Law to eliminate the Business Receipt Tax (BRT), including under the VAT threshold, in consultation with the IMF staff.	Fiscal	End-June 2021	Simplify tax regulation and allow tax administration to focus on the VAT.
Afghanistan Customs Department to enhance multi-criteria risk profiles, including by expanding the number of risk criteria for goods and authorized operators, and implement them across all customs offices to increase detection of non-compliance through better selectivity criteria setting and targeting.	Fiscal	End-June 2021	Improve compliance and reduce leakages and corruption.
Afghanistan Revenue Department to introduce the risk differentiation framework and create risk profiles for all large taxpayers to better detect non-compliance.	Fiscal	End-September 2021	Improve revenue collection efficiency and reduce leakages.
The AOP to complete systematic digitalization of all current year asset declarations in machine-readable format and publish the declarations of government officials (as specified in ¶46 of the MEFP) on its website.	Governance, anti-corruption	End-September 2021	Strengthen accountability and governance and reduce corruption.

Annex I. COVID-19 and the Government's Response

1. The number of daily new COVID-19 recorded cases has averaged about 130 in recent weeks. There were 38,815 COVID-19 cases with 1,426 deaths and 32,098 recoveries as of September 15, although the actual number of infections has been likely higher given the low testing capacity. As the infection spread from late February, when the first case was recorded, the government progressively tightened containment measures, from screening at ports of entry, quarantine for infected people, and closure of public places to imposing countrywide lockdown on March 28. The lockdown was lifted after the Eid holidays in May, in part because of poor compliance, and containment measures were gradually removed over the summer.



2. Afghanistan's fragilities made it highly vulnerable to the pandemic (see [Annex III](#)). This reflects a weak health system, widespread poverty, constrained access to water and sanitation, high-density settlements, and low levels of education. The government's administrative capacity remains weak, while the armed conflict constrains its ability to access and provide basic public services to territories controlled by insurgents. The large influx of returning Afghan migrants from neighboring Iran and Pakistan triggered by the pandemic—about 313,000 since the beginning of 2020 until the pandemic's peak in early June (and nearly 0.5 million as of mid-September)—has further strained Afghanistan's ability to control the pandemic. Women and girls, who have more limited access to healthcare services and information about COVID-19, suffered disproportionately. There are reports that women experienced more job losses and higher levels of violence, while incidents of child marriage increased due to the pandemic.¹

3. The government ramped up spending to mitigate the pandemic, focused on health and social sectors. At the start of the pandemic, the government directed its contingency funds to cover urgent health needs, including establishing testing labs, setting up dedicated wards in hospitals, and procuring critical medical supplies. To prevent hunger as daily laborers lost their income due to the lockdown and food prices spiked due to border closures and panic buying, the government launched a bread provision program in April. The program ended in June after the lockdown was lifted and in part owing to allegations of mismanagement. In May, the government waived electricity bills of less than Af 1,000 (\$13) for a family residence in Kabul for two months and paid utility bills of the previous two months for half of city's households. More recently, the authorities unveiled a 1.5 percent of GDP social distribution program, funded by the World Bank, targeting households with incomes of \$2 per day or less (twice the national poverty line). The government has also allocated \$160 million for short-term employment programs and agriculture to

¹ See United Nations, "The Situation in Afghanistan and its Implications for International Peace and Security." Report of the Secretary-General, August 2020; paragraph 52 and OCHA "Strategic Situation Report: COVID-19", No. 71, August 27, 2020.

finance investment in irrigation, storage facilities, and agroprocessing. This will boost domestic food security and help the sector overcome the temporary loss of access to export markets.

4. Financial buffers and policy credibility built thanks to prudent macroeconomic management provided policy space to respond to the shock. Government's ample discretionary cash balances covered emergency financing to meet immediate relief needs before international assistance could be mobilized, while international reserves helped maintain confidence in the Afghani. Low debt meant that much-needed resources would not be diverted for debt service and that Afghanistan had space to tap the emergency RCF loan. Going forward, ensuring the effectiveness of pandemic spending by enhancing budget execution controls and transparency to avoid misuse and mitigate corruption vulnerabilities will be critical to shore up public trust in government's anti-crisis actions and provide assurances to development partners.

Annex II. Risk Assessment Matrix

Global Risk Assessment Matrix (July 24, 2020)¹

Risks	Likelihood	Expected Economic Impact if Realized	Possible Mitigating Measures
Conjunctural Shocks and Scenario			
<p>Unexpected shift in the COVID-19 pandemic.</p> <ul style="list-style-type: none"> Downside. The disease proves harder to eradicate (e.g., due to difficulties in finding/distributing a vaccine), requiring more containment efforts and impacting economic activity directly and through persistent behavioral changes (prompting costly reallocations of resources). Monetary and fiscal policy response is insufficient amid dwindling policy space and concerns about debt sustainability. Financial markets reassess real economy risks leading to a repricing of risk assets, unmasking of debt-related vulnerabilities, and weakening banks and nonbank financial intermediaries—forcing them to reduce credit (further weighing on growth). Financing difficulties extend to vulnerable sovereigns, leading to cascading debt defaults, capital outflows, depreciation pressures, and in some cases inflation. Pandemic-prompted protectionist actions (e.g., export controls) reemerge, disrupting trade and global value chains. Upside. Alternatively, recovery from the pandemic is faster than expected due to the discovery of an effective and widely available vaccine and/or a faster-than- 	High/ Low	<p>High</p> <p>Downside. Larger than currently expected economic contraction in 2020 (and a shallower recovery in 2021) resulting in additional job losses and higher poverty. Higher pandemic spending and revenue losses with the attendant worsening of the fiscal position translating into larger fiscal and external financing gaps. The return of refugees and migrant workers putting pressure on the labor market and social services. Escalating social pressures undermining support for reforms and prudent macroeconomic policies.</p> <p>Upside. Stronger than projected economic recovery in 2021 boosting employment and income, supporting higher revenue and an improvement in fiscal accounts. Medium-term growth outlook is likely to remain similar to the one under the baseline.</p>	<p>Downside. Ensure that the health sector remains adequately resourced and prioritize policies to minimize long-term scarring. Maintain macroeconomic stability; mobilize external financing, focusing on grants, to maintain critical health and social spending until the pandemic abates; and allow the fiscal position to loosen, financing permitting. Limit the fiscal deterioration by curtailing nonessential spending.</p> <p>Upside. Support the recovery, including by accelerating structural reforms. As the recovery gets underway, reverse the fiscal loosening due to the pandemic and strengthen social protection.</p>

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon. Please consult the G-RAM operational guidance on the SPR Risk Unit website.

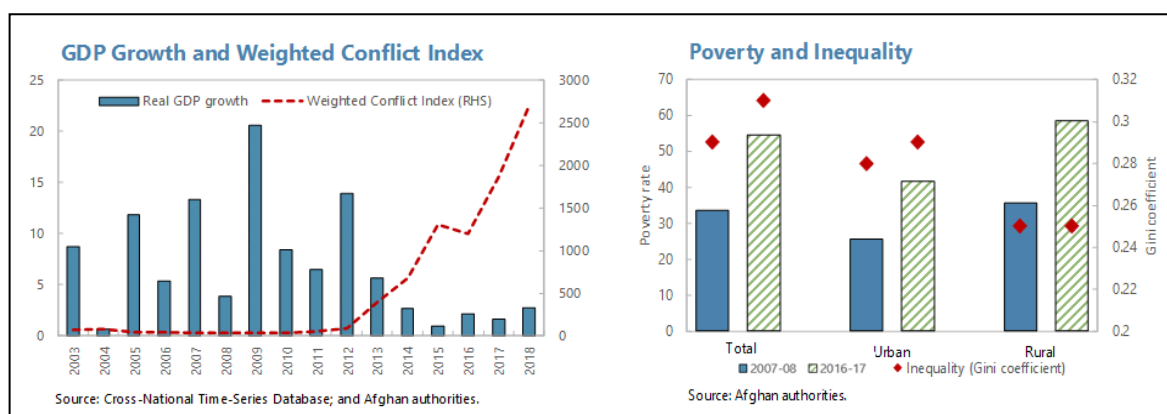
Risks	Likelihood	Expected Economic Impact if Realized	Possible Mitigating Measures
expected behavioral adjustment to the virus that boosts confidence and economic activity.			
Widespread social discontent and political instability. Social tensions erupt as the pandemic and inadequate policy response cause economic hardship (including unemployment, higher incidence of poverty, and shortages and higher prices of essentials) and exacerbate preexisting socioeconomic inequities. Economic activity is disrupted. Growing political polarization and instability (e.g., contested elections) weaken policy-making and confidence.	High	High Larger than currently expected economic contraction leading to higher unemployment, poverty, and revenue losses. Lower investor and consumer confidence and exports impacting foreign reserves and the exchange rate. Weakened support for economic reforms and adjustment to the expected decline in grants.	Safeguard macroeconomic stability. Curtail nonessential spending to create room for a targeted delivery of relief to the neediest. Strengthen communication, accelerate governance and anti-corruption reforms to build public trust.
Oversupply and volatility in the oil market. Supply increases following OPEC+ disagreements and lower demand keep energy prices close to historical lows, but uncertainty about possible production cuts and the pace of demand recovery lead to bouts of volatility.	Medium	Low Lower fuel prices benefitting the economy once the recovery from the pandemic gets underway. Improved trade balance and lower inflation.	Maintain macroeconomic stability and allow the exchange rate to adjust to the external shock.
Intensified geopolitical tensions and security risks (e.g. in response to pandemic) cause socio-economic and political disruption, disorderly migration, higher commodity prices (if supply is disrupted), and lower confidence.	High	Medium Intensified warfare, refugee flows, depressed market sentiment, capital flight and downward pressure on the exchange rate, weaker growth, heightened exposure of the financial sector to illicit flows.	Maintain macroeconomic stability; allow the exchange rate to depreciate while intervening to prevent disorderly market conditions; support well-balanced expenditure allowing to finance security and well-targeted relief to the neediest; foster resilience of domestic institutions; strengthen the AML/CFT regime.
Structural Risks			
Accelerating de-globalization. Geopolitical competition and fraying consensus about the benefits of globalization lead to further fragmentation. Reshoring and less trade reduce potential growth.	High	Low The overall impact is low due to the lack of Afghanistan's integration with global value chains. Transmission through trade, lower investment and remittances, with an impact on fiscal revenues, reserves, and exchange rate.	Improve business climate, foster competitiveness, and domestic financial intermediation. Strengthen monetary and fiscal policies. Promote regional economic integration.

Risks	Likelihood	Expected Economic Impact if Realized	Possible Mitigating Measures
Cyber-attacks on critical global infrastructure, institutions, and financial systems trigger systemic financial instability or widespread disruptions in socio-economic activities and remote work arrangements.	Medium	Low Low financial intermediation contains impact.	Educate financial community and the public about the risk. Develop the relevant supervisory capacity and cyber resilience.
Higher frequency and severity of natural disasters related to climate change cause severe economic damage to smaller economies susceptible to disruptions (medium probability). A sequence of severe events in large economies reduces global GDP and prompts a recalculation of risk and growth prospects. Disasters hitting key infrastructure or disrupting trade raise commodity price levels and volatility (low probability).	Medium/ Low	Medium Weaker and more volatile growth, challenging the environment for macroeconomic policy making, pressure on fiscal resources, ambiguous inflation impact, possibly higher poverty, internal displacements.	Safeguard macroeconomic stability; create fiscal space for climate change mitigation policies (e.g. investment in drought-resistant crops, irrigation, storage); screen investment projects for climate adaptation.
Country-Specific Risks			
Nature/Source of Risk	Likelihood ¹	Expected Economic Impact if Realized	Possible Mitigating Measures
Retreat from sustainable macroeconomic policies weakening domestic revenue mobilization, reserve buffers, and central bank independence.	Medium	High Sustained drawdown of government deposits leading to their depletion and pressure to allow central bank financing of the deficit; loss of reserves and confidence in the Afghani; rising inflation and risks to growth.	Solidify commitment to prudent policies; entrench macroeconomic stability, including through prudent budgeting, and the institutional setup to underpin it.
Deeper-than-expected decline in aid inflows.	Medium	High Lower public spending, weaker growth, increased unemployment and possibly poverty, and depreciation pressures.	Accelerate growth-enhancing reforms, mobilize domestic revenue and improve spending effectiveness, strengthen governance, institutional and regulatory frameworks, and anti-corruption enforcement.
Peace process fails after withdrawal of foreign troops.	Medium	High Intensified warfare, large refugee flows, pressure on currency and capital flight, considerably weaker growth with higher poverty.	Maintain macro-stability; support well-balanced expenditures allowing to finance security, foster resilience of domestic institutions.

Annex III. Country Engagement Strategy

A. Sources and Consequences of Fragility

1. Afghanistan achieved impressive social gains since 2001, but significant challenges remain, and progress slowed in recent years. GDP per capita has quadrupled, life expectancy increased to 64 years from 56 years, and maternal mortality declined to 396/100,000 births from 1,600 since 2001. Despite this progress, GDP per capita remains the lowest in the immediate region, and Afghanistan trails other low-income countries in most social indicators. Growth weakened and GDP per capita stagnated since the reduction of international troops in 2011–14 coupled with a spike in violence and reduction in aid. The poverty rate increased to 54.5 percent in 2016/17 from 33.7 percent in 2007/08, while inequality—measured by the Gini coefficient—rose to 0.33 from 0.28 during the same period.



2. Widespread fragility continues to hamper Afghanistan's development. It hinders growth and job creation and holds back social progress, including fair outcomes and human development, undermining the already delicate social fabric. Afghanistan continues to heavily rely on foreign aid, which—including for security expenses—amounts to 40 percent of GDP. Despite improvement in recent years, the business environment remains challenging with particular weaknesses in the rule of law and regulatory quality. Infrastructure and delivery of public services are poor, especially in rural areas. The COVID-19 pandemic has laid bare the frailty of healthcare and social protection systems and strained the administrative capacity.

3. Afghanistan's multi-dimensional fragilities stem from various deficiencies. Corruption and weak governance undermine the rule of law and hinder the emergence of strong public institutions. With limited capacity and operating in a difficult environment, weak institutions are at risk of being captured by powerful vested interests and are challenged to design and implement consistent policies and reforms and ensure adequate and effective provision of public goods, including security, infrastructure, social protection, enabling business environment, etc. This worsens economic, political, and social outcomes and further erodes trust in the state, reinforcing drivers of fragility.

4. The armed conflict and instability are the root cause of fragility in Afghanistan. Decades-old conflict coupled with recurrent political crises has created a challenging security and

political environment. The government controls about half of the country's territory (where two-thirds of population reside) with the Taliban operating in the rest. The conflict has resulted in the loss of life, damage to the infrastructure, and more than 2.6 million registered refugees from Afghanistan—the second highest in the world. It forces the state with limited means to divert substantial resources to security. Both the 2014 and 2019 presidential elections ended in dispute, resolving which required drawn-out negotiations with the engagement of the international community and significantly delayed government formation.

B. Fund Engagement and Priorities

5. Despite its fragility, Afghanistan has established a strong track record implementing Fund-supported programs. The authorities have progressed with reforms laid out in the Afghanistan National Peace and Development Framework (ANPDF) II aimed at boosting growth, creating jobs for the growing labor force, and reducing poverty. These reforms were supported by the successfully completed 2016–19 Extended Credit Facility (ECF) arrangement, which contributed to macroeconomic stability and improved economic governance. Four out of five success indicators have been met (see table). The program supported progress towards self-reliance and catalyzed aid. Nevertheless, growth disappointed as private sector investment was held back by risks and costs stemming from the armed conflict, political upheaval, weak infrastructure, and other constraints to doing business.

Indicators of Program Success 1/ (In percent of GDP; unless otherwise indicated)					
	2016	2017	2018	Average	Met
2016 program request projections					
Anti-poverty spending	IT	IT	IT	...	...
Capital expenditure	7.5	7.7	8.0	...	...
Domestic fiscal revenue	10.3	10.7	11.0	...	...
Inflation (average; in percent)	4.5	6.0	7.0	...	...
GDP growth (in percent)	2.0	3.4	4.3	...	...
Outcome					
Anti-poverty spending	IT met	IT not met	IT met	...	...
Capital expenditure	7.1	7.6	8.8	...	...
Domestic fiscal revenue	10.7	12.4	13.3	...	...
Inflation (average; in percent)	4.4	5.0	0.6	...	...
GDP growth (in percent)	2.2	2.9	2.7	...	...
Outcome less 2016 program request projection					
Anti-poverty spending	1.0	-1.0	1.0	0.3	yes
Capital expenditure	-0.4	-0.1	0.8	0.1	yes
Domestic fiscal revenue	0.4	1.7	2.3	1.5	yes
Inflation (average; in percent)	-0.1	-1.0	-6.4	-2.5	yes
GDP growth (in percent)	0.2	-0.5	-1.6	-0.6	no
<small>Note: IT=indicative target. Indicators are considered met when the average projection error (actual minus projected) for 2016–18 has a favorable sign. ECF approved mid-2016. 1st program review considered end-2016 outcomes.</small>					
<small>1/ See "2018 Review of Program Design Conditionality" for PRGT programs methodology.</small>					

6. The Fund remains committed to helping Afghanistan to tackle fragilities that impede inclusive growth and better social outcomes. Prior to the pandemic, Afghanistan could be viewed as a country in a stable, if low-growth, macroeconomic equilibrium with protracted balance of payment needs. The political reconciliation in May and improved prospects for stepped-up implementation of reforms, once the pandemic abates, provide an opportunity to further deepen the Fund's engagement, including through the proposed Fund arrangement. Afghanistan could transition to a *pivotal moment*, with attendant intensification of the Fund's engagement, if the peace talks between the government and the Taliban produce a credible path toward durable political settlement.

7. The authorities have requested a successor ECF arrangement to support their economic reform program outlined in the ANPDF II for 2021–25 and address a protracted balance of payments need. They view the Fund-supported program as providing a macroeconomic framework to navigate the pandemic crisis and address its legacies and as a critical driver of reforms through capacity development and mobilization of domestic support (see table). The proposed program also aims to catalyze financing from donors who seek assurances that prudent macroeconomic policies are in place and economic reforms are being implemented.

Table 1. 2016–19 ECF: Selected Structural Reforms

Fiscal Policy	Governance	Financial Sector	Monetary Policy
Improve budget transparency by tracking contractual commitments through the Afghanistan Financial Management Information System.	Bolster the legal framework for combatting corruption by enacting the Anti-Corruption Law in line with the UN Convention on Anti-Corruption.	Strengthen risk and crisis management capacity by establishing Financial Stability Committee comprising MoF and DAB.	Foster confidence in the Afghani, while allowing exchange rate flexibility. Maintain inflation in single digits.
Adopt risk-based customs clearance procedures to improve the detection of fraud. In addition, report customs revenue online in near-real time.	Strengthen corruption prevention efforts by establishing the High Council for Anti-Corruption, chaired by the President, and the Anti-Corruption Judicial Center.	Strengthen the financial sector by recapitalizing New Kabul Bank, including providing an appropriate capital cushion and core banking systems.	Restore DAB's Lender of Last Resort capacity by extinguishing its Af 29.3 billion exposure from the Kabul Bank crisis.
Establish a Single Large Taxpayer Office to raise tax revenue yield and improve its predictability.	Establish a legal framework for asset declaration regime by select public officials by enacting the relevant legislation.	Launch a long-term strategy to reform state-owned commercial banks including addressing their business model and governance deficiencies and minimizing operational risk.	Advance debt management framework by developing technical capacity for debt recoding, monitoring assessing its sustainability, and reporting.
Adopt State-Owned Corporation Law to strengthen the governance of public corporations and improve management of fiscal risks.	Operationalize the asset declaration regime, by requiring under the penalty of law submission of declarations. Publicize declarations on the official website in a local language and English.	Bolster DAB's regulatory and supervisory capacity, developing risk management plans for weak banks, and strengthening capacities to resolve defunct banks.	
Adopt Public Private Partnerships (PPP) Law to improve the identification and management of fiscal and contingent risks stemming from PPP activities.	Strengthen anti-money laundering and combating the financing of terrorism (AML/CFT) framework as agreed with FATF, resulting in the removal of Afghanistan from FATF monitoring in 2017.	Launch National Financial Inclusion Strategy aimed at improving access to financial services, including sharia-complaint banking, including for the disadvantaged groups.	
Strengthen public investment management, thereby improving the management of resources and boosting the government's ability to fill infrastructure gaps.	Advance adoption of standards under the EITI. Implement recommendations of the EITI Board following the evaluations by the EITI.	Conduct a forensic audit of the Kabul Bank's assets recovery process, identify impediments, and propose practical ways to improve recoveries of the remaining assets.	

8. The proposed ECF arrangement aims to aid authorities' response to the pandemic and post-pandemic recovery. In the initial stage, it would aim to safeguard macroeconomic stabilization, entrench financial sector resilience, and allow for a temporary fiscal loosening to help mitigate the immediate human and social impact of COVID-19. As the economy moves to a recovery

stage, the focus would shift to reversing the fiscal deterioration, while boosting social spending, and addressing structural fragilities that hamper sustained growth, strong job creation, and poverty reduction. In particular:

- *Fiscal policy* would aim to preserve sustainability and protect development spending amid declining aid. This requires revenue mobilization, strengthening fiscal governance, and boosting the level and effectiveness of pro-growth and pro-poor spending, including to finance infrastructure that could facilitate regional integration. Strengthening social protection, by creating fiscal space for a new targeted social safety net, would help ensure a more equitable sharing of growth dividends, contribute to an improved social cohesion, and better prepare Afghanistan for future shocks like the COVID-19 pandemic.
- *Financial sector reforms* would strengthen the resilience and facilitate the development of the financial sector that can support inclusive growth. This requires addressing weak banks, completing the reforms of state-owned banks, and promoting financial inclusion.
- *Monetary policy* would continue to aim for price stability with an exchange rate flexibility while strengthening monetary policy transmission and reducing dollarization.
- *Governance reforms* would improve transparency and the effectiveness of key state functions. In addition to governance reforms in fiscal and financial sectors, including strengthening transparency and accountability in public spending, this requires operationalizing the anti-corruption regime, boosting the utility of the asset declaration system, and improving the business environment and institutions (e.g. rule of law, contract enforcement).

9. Past experience offers some lessons for ongoing and future engagement:

- *Close engagement* with the authorities remains imperative to ensure policy continuity and program implementation and would also contribute to inter-agency coordination. The Fund has not had a Resident Representative since 2014, and missions do not travel to Afghanistan for security reasons. Nevertheless, staff has maintained close engagement with key counterparts through missions outside Afghanistan and frequent exchanges, including teleconferencing. This experience helped staff and the authorities adjust to the suspension of mission travel due to COVID-19, although the 8.5-hour time difference remains a constraint. Since the onset of COVID-19, staff completed two remote missions—to discuss a disbursement under the Rapid Credit Facility in April and, in July-August, an economic reform program negotiation to be supported by the new three-and-a-half year ECF.
- *Realism* in program design is important for reform implementation and traction. Timetables should account for capacity constraints, further tightened by the pandemic, to avoid overburdening weak institutions and incomplete implementation. A series of individual, if small-scale, measures could help maintain reform momentum toward the overall objectives of the program.
- *Agility* is essential, especially in the post-COVID environment, as the authorities' policy priorities must adapt to the changing domestic, regional, and external environment and to the shocks that frequently hit Afghanistan. As conditions evolve, the arrangement may need adjusting so that it

continues to meet its overall objectives. In this regard, structural benchmarks and performance criteria will be determined on a rolling basis as the ECF arrangement progresses.

- *Capacity development (CD) integrated with ECF arrangement (see below).*
- *Donor coordination.*¹ The Fund staff maintains close coordination with the World Bank, which provides substantial financial and policy support to Afghanistan, maintains in-country presence, and serves as the secretariat of the Afghanistan Reconstruction Trust Fund, a pool of resources from several donors. Staff has strengthened engagement with other multilateral institutions (e.g., ADB, and EU) and bilateral donors, including in the context of forums of development partners in preparation for the November donor conference.
- *Outreach.* Given the challenging operating environment, the Fund staff will look for opportunities to engage other stakeholders (e.g. civil society, non-governmental organizations, and the business community) and inform them about the Fund's support to Afghanistan and reforms under the program. In addition, regular press releases after Board consideration of program reviews, mission conclusion statements, and press interviews are avenues to reach wider audience, including the public, on the Fund's support to Afghanistan.

10. Afghanistan's TA and training needs remain significant (see table). TA in fiscal policy will help the authorities mobilize revenue, by supporting reforms in customs and tax administration and the implementation of VAT; strengthen the management of fiscal risks stemming from government guarantees, PPPs, and SOCs; and enhance public investment management. TA in the monetary and financial sectors could support reforms to strengthen the monetary policy framework, including broadening Da Afghanistan Bank's monetary policy instruments and enhancing its forecasting; develop the domestic debt market; and strengthen crisis preparedness and the bank resolution framework (also supported by the World Bank). Legal TA will aim to address weaknesses in the anti-corruption and AML/CFT regimes and could also support reforms to establish or upgrade legal frameworks in fiscal, financial, and monetary areas. Statistics TA could help the authorities address shortcomings in macroeconomic statistics. Staff turnover in government agencies will sustain the need for training, including through peer-to-peer workshops.

11. Customizing CD to the authorities' needs and ensuring dedicated follow-through would further improve its effectiveness. Given the authorities' weak capacity, there will be a strong need for extensive hands-on follow-through to support the implementation of individual reforms laid out in TA reports. The Fund should continue to coordinate its TA with development partners (especially the World Bank, ADB, EU, and DFID) who also provide substantial TA. Prior to the pandemic, Fund TA and training were delivered outside of Afghanistan given security-related risks. Travel costs and visa complications meant that the authorities were selective in their requests and possibly sent fewer staff than could have benefitted from TA and training. Until pandemic-related travel restrictions are lifted, TA will be delivered remotely, which may be challenging logistically (e.g. time difference) but could yield some benefits, including a higher number of participants from the authorities.

¹ This note benefitted from comments from the World Bank.

Table 2. IMF Technical Assistance: Delivered and Tentative Plans, 2019–21

Policy Area	Lead Provider	Timeline
Tax Policy and Revenue Administration		
Preparation for the value-added tax (VAT) implementation, follow-up on the establishment of a refund system and VAT audit	METAC	2020, 2021
Development of compliance improvement plan in the Single Large Taxpayer Office	METAC	July 2019
Revenue impact of replacing the Business Receipt Tax with the VAT	FAD	March 2019
Strengthening customs administrations, including compliance risk management	METAC	2019, August 2020
Public Financial Management		
Strengthening oversight over State-Owned Corporations, Public-Private Partnerships (PPPs), and fiscal risks	LEG; FAD	July 2020
Assessing contingent liabilities from PPPs	FAD	2020–21
Public investment cycle: planning	FAD	2021
Cash planning and forecasting	METAC	September 2019
Financial Sector Stability		
Strengthening banking resolution framework	LEG; MCM	2020–21
Corporate governance as part of bank supervision and regulation	MCM	2020–21
Monetary Policy and Central Bank Governance		
Monetary policy framework diagnostic	MCM	2020
Debt management framework	MCM	2021
DAB procurement framework	FIN	2021
Governance		
Legal framework on beneficial ownership and its implementation by public agencies and private sector	LEG	2021
Strengthening the asset declaration regime, its effectiveness and use	IMF (LEG)	2021
Review of the AML/CFT legal framework and capacity of relevant agencies in advance of the Asia Pacific Group assessment	LEG	2021
Economic Statistics		
External statistics: unrecorded exports, imports, and remittances	STA	2020
Back-casting the national accounts	METAC	2021
Developing quarterly national accounts	METAC	October 2020
Price Statistics	STA, METAC	April 2019
Balance of payments	METAC	April 2019, 2020

C. Authorities' Views

12. The authorities underscored the need for continued Fund support for Afghanistan's reform efforts. They believe that the Fund's financial and technical assistance has helped Afghanistan implement sound macroeconomic policies and structural reforms in support of their inclusive growth agenda. They broadly agreed with the staff's assessment of the sources and consequences of fragility in Afghanistan and policy priorities in key macro policy areas. They believe that realism and agility in the program design and close donor coordination will remain critical for the successful implementation of the proposed ECF arrangement. They emphasized the invaluable role of CD and training in building institutions and capacity to design and implement reforms.

Three-and-a-Half Year Arrangement Under the Extended Credit Facility

Attached hereto is a letter dated October 20, 2020 (the "Letter"), with its attached Memorandum of Economic and Financial Policies (the "MEFP") and Technical Memorandum of Understanding (the "TMU"), from the Acting Minister of Finance and the Acting Governor of Da Afghanistan Bank (DAB) requesting from the International Monetary Fund, as Trustee of the Poverty Reduction and Growth Trust (the "Trustee"), a 42-month arrangement under the Extended Credit Facility ("ECF"), and setting forth:

- (a) The objectives and policies of the program that the authorities of the Islamic Republic of Afghanistan intend to pursue during the 42-month period of the arrangement;
- (b) The objectives, policies and measures that the authorities of the Islamic Republic of Afghanistan intend to pursue during the first year of the arrangement; and
- (c) Understandings of the Islamic Republic of Afghanistan with the Trustee regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of the Islamic Republic of Afghanistan will pursue during the second year and the remaining period of the arrangement.

To support these objectives and policies, the Trustee grants the requested arrangement in accordance with the following provisions, and subject to the provisions applying to assistance under the Poverty Reduction and Growth Trust (the "PRG Trust") including in particular Section II, paragraph 1(b)(4) of the PRG Trust instrument annexed to Decision No. 8759-(87/176) ESAF, as amended.

1. (a) For a period of 42 months from the date of approval of this arrangement, the Islamic Republic of Afghanistan will have the right to obtain disbursements from the Trustee in a total amount equivalent to SDR 259.04 million, subject to the availability of resources in the PRG Trust.
- (b) Disbursements under this arrangement shall not exceed the equivalent of SDR 233.136 million during the first 12 months of the arrangement, and the equivalent of SDR 246.088 million during the first 24 months of the arrangement.
2. During the period of the arrangement:
 - (a) The first disbursement, in an amount equivalent to SDR 80.95 million, will be available upon approval of the arrangement, at the request of the Islamic Republic of Afghanistan;
 - (b) The second disbursement, in an amount equivalent to SDR 103.616 million, will be available on or after April 21, 2021 at the request of the Islamic Republic of Afghanistan and subject to paragraphs 4 and 5 below; and

- (c) The third disbursement, in an amount equivalent to SDR 48.57 million, will be available on or after October 20, 2021, at the request of the Islamic Republic of Afghanistan and subject to paragraphs 4 and 5 below; and
 - (d) The fourth disbursement, in an amount equivalent to SDR 6.476 million, will be available on or after April 20, 2022, at the request of the Islamic Republic of Afghanistan and subject to paragraphs 4 and 5 below.
3. The right of the Islamic Republic of Afghanistan to request further disbursements during the second year and remaining period of this arrangement shall be subject to such phasing and conditions as shall be determined in the context of reviews under the ECF arrangement for the Islamic Republic of Afghanistan.
4. The Islamic Republic of Afghanistan will not request:

The second, third, and fourth disbursements under this arrangement specified in paragraphs 2(b), (c), and (d) above, respectively:

- (a) If the Managing Director of the Trustee finds that with respect to the second disbursement the data as of December 21, 2020, with respect to the third disbursement the data as of June 21, 2021, and with respect to the fourth disbursement the data as of December 21, 2021, indicate that:
 - (i) The ceiling on net credit to the central government from DAB; or
 - (ii) The ceiling on reserve money in domestic currency; or
 - (iii) The floor on net international reserves of DAB

as set out in Table 2 of the MEFP and further specified in the TMU was not observed; or

- (b) Until the Trustee has determined that, with respect to the second disbursement the first program review, with respect to the third disbursement the second program review, and with respect to the fourth disbursement the third program review referred to in paragraph 51 of the MEFP, has been completed.
5. The Islamic Republic of Afghanistan will not request a disbursement under this arrangement if at any time during the period of this arrangement:
- (a) The ceiling on new non-concessional external debt contracted or guaranteed by the public sector as set out in Table 2 of the MEFP and further specified in the TMU, is not observed; or
 - (b) The ceiling on new short-term external debt contracted or guaranteed by the public sector as set out in Table 2 of the MEFP and further specified in the TMU, is not observed; or

- (c) The ceiling on new external payments arrears as set out in Table 2 of the MEFP and further specified in the TMU, is not observed; or
 - (d) The ceiling on new borrowing by public enterprises in need of restructuring—from DAB or state-owned banks or government-guaranteed as set out in Table 2 of the MEFP and further specified in the TMU, is not observed; or
 - (e) The Islamic Republic of Afghanistan:
 - (iv) Imposes or intensifies restrictions on the making of payments and transfers for current international transactions, or
 - (v) Introduces or modifies multiple currency practices, or
 - (vi) Concludes bilateral payments agreements that are inconsistent with Article VIII, or
 - (vii) Imposes or intensifies import restrictions for balance of payments reasons.
6. When the Islamic Republic of Afghanistan is prevented from requesting disbursements under this arrangement because of paragraphs 4 and 5 above, such disbursements may be made available only after consultation has taken place between the Trustee and the Islamic Republic of Afghanistan and understandings have been reached regarding the circumstances in which the Islamic Republic of Afghanistan may request the disbursements.
 7. In accordance with Paragraph 6 of the Letter, the Islamic Republic of Afghanistan will provide the Trustee with such information as the Trustee requests in connection with the progress of the Islamic Republic of Afghanistan in implementing the policies and reaching the objectives of the program supported by this arrangement.
 8. During the period of this arrangement, the Islamic Republic of Afghanistan shall remain in close consultation with the Trustee. In accordance with Paragraph 6 of the Letter, the Islamic Republic of Afghanistan shall consult with the Trustee on the adoption of any measures that may be appropriate at the initiative of the government or whenever the Managing Director of the Trustee requests such a consultation. Moreover, after the period of this arrangement and while the Islamic Republic of Afghanistan has outstanding financial obligations to the Trustee arising from loan disbursements under this arrangement, the Islamic Republic of Afghanistan will consult with the Trustee from time to time, at the initiative of the government or whenever the Managing Director of the Trustee requests consultation on the Islamic Republic of Afghanistan's economic and financial policies. These consultations may include correspondence and visits of officials of the Trustee to the Islamic Republic of Afghanistan or of representatives of the Islamic Republic of Afghanistan to the Trustee.

Appendix I. Letter of Intent



Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, DC 20431

Kabul, October 20, 2020

Dear Ms. Georgieva:

1. Afghanistan has made significant gains over the past decade despite continued security, economic, and political challenges. We are determined to tackle these challenges head-on and realize the decades-long hopes of all Afghans for a peaceful and prosperous Afghanistan. To that end, we are committed to pursue a lasting peace for the benefit of our people and the regional and global stability and are pressing ahead with reforms to develop a self-reliant, productive, and inclusive economy.

2. We continue to spare no effort to protect lives and livelihoods from the COVID-19 pandemic which has inflicted heavy damage to the health of our people and to our economy. We took swift and resolute measures to slow the epidemic and, with help of our development partners, allocated financial and administrative resources to boost our health system and emergency response preparedness. We have rolled out programs to provide urgently needed relief to affected households and meet immediate needs of our economy.

3. We are finalizing the Afghanistan National Peace and Development Framework (ANPDF II) for 2021–25 which we will officially present to development partners ahead of the donor pledging conference in November. The ANPDF II is grounded in our vision to improve welfare of all Afghans and reduce our dependence on aid and has two principal objectives: (i) mitigating the immediate human and social impact of COVID-19 while stabilizing our economy in 2020–21; and (ii) generating sustained growth with strong job creation and poverty reduction.

4. We would like to thank the IMF for its continued support over the years. With the successful completion of the 2016–19 Extended Credit Facility (ECF) arrangement, we demonstrated our strong commitment to sound policies and reform. We would also like to express our gratitude for an expeditious approval of the \$223 million emergency disbursement under the Rapid Credit Facility in April, which helped us meet our pressing financing needs.

5. We request a three-and-half-year ECF arrangement to help us fight COVID-19, support our challenging reform agenda, and address a protracted balance of payments need. We request financing in the amount of SDR 259.04 million (80 percent of Afghanistan's quota) during the

arrangement from November 6, 2020 to May 5, 2024. The arrangement will help catalyze development assistance, support a sound macroeconomic framework, and underpin our reforms for economic resilience, good governance, and inclusive growth.

6. We believe that the economic and financial policies set forth in the attached Memorandum of Economic and Financial Policies (MEFP) are adequate to achieve the objectives of our economic program and commit to take any additional measures that may become appropriate for this purpose. We will consult with the IMF on the adoption of such measures and in advance of any revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We intend to remain in close consultation with Fund staff and provide timely information necessary for monitoring economic developments and implementation of policies under the ECF-supported program.

7. We have engaged our parliament and hope to secure soon its authorization to receive disbursements under the ECF in line with the Afghan Constitution that requires such approval for any government borrowing from external sources. We consider the parliament's approval a signal of joint ownership, by the government and parliament, of reforms supported by the ECF.

8. In line with our commitment to transparency, we hereby request that the staff report, this letter of intent, the attached MEFP and TMU, including all annexes, attachments, and other ECF-related documents, be published on the IMF website.

Sincerely yours,

/s/

Abdul Hadi Arghandiwal
Minister of Finance (Acting)
Government of Afghanistan

/s/

Ajmal Ahmady
Governor (Acting)
Da Afghanistan Bank

Attachments (2)

Attachment I. Memorandum of Economic and Financial Policies

INTRODUCTION

1. **This memorandum reviews recent economic developments and lays out our economic objectives and policy framework for the period through May 5, 2024, for which we are seeking support under a three-and-half-year Extended Credit Facility (ECF) arrangement with the IMF.**
2. **Afghanistan successfully completed a three-and-half year program supported by the ECF arrangement in December 2019.** The program contributed to macroeconomic stability, helped improve economic governance, and catalyzed aid flows and donor engagement, while supporting progress towards self-reliance. It also helped improve policymaking, including by strengthening fiscal institutions, extinguishing Da Afghanistan Bank's (DAB) lender-of-last resort exposure stemming from the 2011 liquidation of Kabul Bank, and, through the establishment of the Financial Stability Committee, helped to enhance coordination between the Ministry of Finance (MoF) and DAB. On the governance front, it underpinned our anti-corruption reforms, including the adoption of an asset declaration regime and a strengthening of the legal framework.
3. **Our government will work tirelessly for peace which remains a foremost demand of all Afghans.** Negotiations between the government and the Taliban that commenced on September 12 provide an opportunity to pursue comprehensive peace and stability, which would free up resources previously dedicated to security for development, allow for the restoration of public services throughout the country, and ultimately lift Afghanistan's growth and development trajectory.
4. **COVID-19 has interrupted our progress with development and reforms.** The pandemic has inflicted severe economic and social damage. So far, we have identified about 40,000 infections, with 33,000 recoveries and 1,500 deaths, but, given the limited testing capacity of our health system, the number of infections is likely higher. The epidemic and containment measures, including on-off border closures and the lockdown of major cities, led to a collapse in economic activity and temporary shortages of necessities. The resulting losses of jobs and income, in the formal and informal sectors, and higher prices have pushed thousands of Afghan families into poverty and threaten to reverse our social development gains of the past decade.
5. **The ECF arrangement will support our efforts to respond to COVID-19 and reforms to address structural weaknesses in the economy.** It will provide a macroeconomic framework to help navigate the crisis, lay the foundation for a sustained recovery, address social and economic legacies of COVID-19, and help finance our balance-of-payments needs. Building on the progress made under the 2016-19 ECF arrangement, the program will aim to address structural fragilities that continue to hamper sustainable and inclusive growth and equitable social outcomes by improving fiscal governance, bolstering the financial sector, and supporting efforts to combat corruption and strengthen social protection.

RECENT ECONOMIC DEVELOPMENTS

6. The pandemic led to a sharp drop of economic activity, and we expect the output to contract by 5 percent this year. Our services and industry have suffered the most from lockdowns and supply disruptions, but we are relieved that agriculture appears to have been spared thanks to the favorable weather. With the gradual easing of containment measures since late May, economic activity is regaining its footing, and, assuming that the resurgence of infections is avoided, we expect it to return close to the pre-pandemic level in the fourth quarter.

7. Inflation spiked in the first half of 2020 due to border closures and panic buying. It jumped to 8.7 percent y/y in April, driven by higher food prices, which disproportionately hurt lower-income households. As borders reopened and supply constraints eased, inflation subsided to 5.9 percent in August and is expected to continue the downward trend in the rest of the year, including thanks to a good harvest. We therefore project headline inflation to moderate to 5 percent by year-end.

8. The balance-of-payments position has deteriorated. Border closures have disrupted our exports and imports, and inflows of remittances have fallen as thousands of Afghan migrants returned from neighboring countries. Subdued activity and imports have curbed demand for foreign exchange, resulting in the broadly stable exchange rate versus the U.S. dollar. At about \$9.3 billion, our international reserves remain broadly adequate given the high-risk environment facing Afghanistan.

9. Our fiscal accounts sharply worsened in the first nine months of 2020. Through end-September, our tax revenue fell by 15 percent compared to the same period of the last year due to the economic downturn, the extension of the first quarter tax filing and payment deadlines, and a weakening of taxpayer's discipline. The tax shortfall was only partially offset by Af 12.8 billion transfer of DAB profits based on its 2019 audited financial report. On the expenditure side, we accommodated urgent COVID-related health and social spending needs amounting to 1.3 percent of GDP through June. As a result, the overall budget deficit widened to Af 24 billion in January–June. It was financed mainly by the drawdown of the treasury's discretionary cash balance which fell to Af 21 billion by end-June from Af 36 billion at end-2019.¹

10. While the pandemic has largely spared our financial sector so far, risks to stability have risen. There have been no liquidity pressures in part thanks to DAB's actions to maintain confidence in the Afghani and among depositors. Nonperforming loans (NPLs) have increased since the beginning of the year as a number of banks continued to apply internal loan classification policies despite the DAB's temporary loan classification freeze and some banks proceeded with the implementation of IFRS 9 ahead of the revised June 2021 deadline. DAB is scrutinizing these closely. Additionally, gross loans declined, mainly due to charge-offs. Activities of money service providers (MSPs) and foreign exchange dealers (FXDs) slowed during the pandemic, but the utilization of mobile banking services and digital payments through electronic money institutions (EMIs) increased.

¹ See TMU paragraph 15 for a definition of cash balance for program purposes.

ECONOMIC AND DEVELOPMENT PROGRAM FOR 2020–24

Our economic program articulates an immediate response to COVID-19, policies to protect livelihoods and lay the foundation for a sustained post-pandemic recovery, and the reform priorities to progress toward self-reliance and promote job-rich growth and poverty reduction.

11. COVID-19 relief and recovery are our most urgent priorities. None of our other objectives can be achieved without first addressing the threat to lives and livelihoods posed by COVID-19. We have cancelled some lower-performing projects, including those financed by donors, to create fiscal space for urgent spending to mitigate the health and social impact of COVID-19 and limit economic scarring. With the support of the World Bank, we will roll out a social relief package, amounting to 1.5 percent of GDP, to Afghan households with incomes of \$2 per day or lower (twice the national poverty line). With its broad coverage, about 90 percent of all households, the program will be near universal in scope and delivered in 2020-21. Households in rural areas will receive an equivalent of \$50 in essential food staples and hygiene products, while those in urban areas a combination of cash and in-kind equivalent to \$100, in two tranches. We are also investing in digital infrastructure to expand access to remote work and learning technology.

12. We will strive to develop a self-reliant, well-governed, and inclusive economy. Afghanistan needs strong private sector-led growth that can absorb nearly 500,000 Afghan youth entering the labor market annually. To create conditions for such growth, we must strengthen the rule of law, eliminate corruption, invest in health and education, and address the infrastructure deficit in transit, energy, and digital connectivity. Our medium-term growth priorities center around agriculture, extractive industries, and services. We are accelerating the modernization of agriculture and agribusiness, which employ the bulk of our population, by increasing investment in the sector (e.g., irrigation, land management) to boost productivity, processing, and storage capacity. This will increase domestic food production, strengthen food security, reduce rural poverty, and help the sector overcome the temporary loss of access to export markets due to the pandemic. Recognizing the sector's vulnerability to climate change, our investment plans prioritize climate adaptation measures.

13. Poverty reduction and social inclusion are at the top of our agenda. The harmful social impact of COVID-19—according to World Bank estimates, poverty could rise to 61–72 percent from 55 percent in 2016-17—has reinforced the need to implement economic policies that are equitable and inclusive. Going forward, we will take a holistic approach to poverty reduction, strengthen protection of the most vulnerable, and enhance resilience of the population by expanding access to basic services, especially for the poor, women, youth, disadvantaged, and displaced people. We are boosting pro-poor spending (indicative target) to 5.3 percent of GDP this year and 4.7 percent of GDP in 2021 and intend to put in place a targeted social safety net program over the medium term. To that end, we will create fiscal space under the ECF arrangement and engage our development partners to provide co-financing and help us design the program. We will continue to invest in education to advance gender equity and access for all disadvantaged groups, and encourage more women to work in the education, health care, and other sectors where they are underrepresented.

14. We will redouble our efforts to root out corruption which continues to plague our country. We have made significant strides in recent years, including strengthening the

anti-corruption laws in line with good international practice, developing and implementing an anti-corruption strategy, and establishing an asset declaration regime. Moving forward, our focus will be on the effective implementation of the anti-corruption regime, targeting high-level corruption, stamping out impunity, and strengthening institutions.

15. Support from our international partners remains vital. Aid finances Afghanistan's development, covers underlying fiscal and external deficits, and, together with technical assistance, buttresses our reforms. We are grateful to our partners for their generous support during the pandemic and look forward to a renewal of mutual commitments at the November 23–24 pledging conference. Realizing Afghanistan's vision for self-reliance remains our long-term goal despite new challenges brought by the pandemic and the ongoing uncertainty around security. While the policy framework outlined in this MEFP will help us advance toward self-reliance, its success will continue to hinge on sustained donor support.

16. The ECF-supported program will aid an inclusive economic recovery from the pandemic leading to sustained growth in the medium term. Our fiscal strategy will aim to preserve fiscal sustainability and finance higher development and social spending by raising domestic resources to offset the expected decline in grants. To that end, we will continue our reforms to boost domestic revenue and the quality and effectiveness of spending. Our monetary policy will aim to maintain low and stable inflation in the context of the flexible exchange rate regime aimed at protecting international reserves and competitiveness. Structural reforms will focus on: (i) improving fiscal governance, including the management of public investment and fiscal risks; (ii) bolstering the financial sector and its capacity to contribute to growth; and (iii) strengthening the anti-corruption regime and transparency.

MACROECONOMIC POLICIES

17. We see a stable macroeconomic environment as a foundation for sustained growth and development. Financial buffers and policy credibility built thanks to our prudent macroeconomic management before the pandemic bolstered the resilience of our economy and provided policy space to respond to the shock. Going forward, we will continue to maintain low debt, a prudent discretionary cash balance, and a level of international reserves adequate to risks that we are facing. We expect growth to resume in 2021, with the economy expanding by up to 4 percent. Growth should accelerate in 2022–23 as the economy continues to recover from COVID-19 before stabilizing at 4 percent over the long term.

18. We will allow the fiscal deficit to widen this year to accommodate pandemic-related spending and revenue shortfalls. In October, we submitted to parliament a mid-year budget revision, which fully accounts for the expected shortfall in tax revenue through year-end. The revision accommodates almost 3 percent of GDP spending for COVID-19 related programs, including:

- Health package amounting to Af 6.6 billion, including for building hospitals;
- Social package, including the now concluded bread distribution program of Af 2.8 billion and Af 14.6 billion spending under the World Bank-supported social distribution program (the remainder will be executed next year);

- Wheat purchase program (Af 1.7 billion);
- Transfers to provinces to finance COVID-19 response (Af 2.3 billion); and
- Packages to support agriculture (Af 5.9 billion) and short-term jobs (Af 6.7 billion).

Our response to the pandemic has been boosted by substantial support from donors who are providing new and reallocating existing grants expected to amount in total to 2.9 percent of GDP.

19. We will contain the overall deficit to 3.0 percent of GDP this year. To that end, we discontinued all pandemic-related tax relief measures in July and are cutting lower priority spending, such as nonperforming projects, operation and maintenance, vehicle purchases, renovations, and travel. In addition, we will collect nontax revenue from the following sources:

- Fees from Afghan Telecom (Af 2.0 billion);
- Fees collected by the Afghan Telecommunication Regulatory Authority (Af 1.0 billion);
- Dividends from state-owned North Coal Enterprise (Af 1.5 billion).

We are financing the 2020 deficit by drawing on the treasury's discretionary cash balances, the \$223 million RCF disbursement, and \$115 million prospective ECF disbursement.

20. We will reverse this year's fiscal loosening and move toward self-reliance over the medium term. We plan to gradually phase-out pandemic-related spending and expect tax revenue to recover in 2021. By mid-November, we will submit to parliament the draft FY2021 budget that contains the deficit to 2.2 percent of GDP and is broadly in line with the macroeconomic framework agreed with the IMF staff (first review structural benchmark). Over the medium term, we intend to bring the overall budget deficit below 1 percent of GDP. This will allow us to keep our public debt contained while rebuilding government deposits and preparing for potential realization of contingent liabilities. Preserving and increasing development spending within this fiscal target—in part to bring off-budget programs on budget as grants decline—will require higher domestic revenue. Our revenue mobilization will be supported by the post-pandemic recovery in collection, in line with the rebounding economy, VAT introduction in 2022, and fees from pipeline and power transmission projects expected in 2023 and beyond.

21. We will continue to pursue a prudent debt policy that has served Afghanistan well. While Afghanistan's public debt is low, our debt sustainability is at high risk of debt distress given the expected gradual shift in the financing mix from grants to borrowing. The government will therefore continue to rely on grants and concessional debt financing with minimum 35 percent grant element. We will not contract any non-concessional external loans and consult with the IMF staff on the terms of any new external debt in advance of contracting it. Building on the ongoing technical assistance from the World Bank, we will continue strengthening our debt recording, monitoring, and managing capacity. With support from the IsDB and other partners, we are setting up a legislative, institutional, and regulatory framework for government sukuk and preparing the ground for an inaugural issue in 2021. The sukuk will allow the government to tap domestic savings, thus expanding the financing options beyond the treasury's cash balances and external loans.

22. Monetary policy will continue to target low and stable inflation with reserve money as operational target. We remain committed to an independent central bank. In line with its primary objective to foster price stability, DAB will aim to keep headline inflation in the range of 2–8 percent and target reserve money growth of 12.4 percent in 2020 and 10.9 percent in 2021. DAB and the MoF will continue to regularly exchange information on cash flow projections to enhance the conduct of monetary policy and liquidity management. We are committed to an exchange rate flexibility—within DAB’s broad objective of price stability, DAB will let the Afghani move with market trends, intervening only to avoid disorderly market conditions. DAB intends to study the impact of the government sukuk on money markets, including market liquidity, with a view of adding the sukuk to its monetary policy toolkit, currently limited to foreign exchange auctions and capital notes. To further strengthen the effectiveness of our monetary policy, we are promoting the greater use of Afghani by raising public awareness, especially in border areas, and accelerating the implementation of the National Financial Inclusion Strategy (NFIS).

23. DAB has largely phased out emergency pandemic measures. With DAB ending the freeze on loan classifications on July 1, we expect further asset quality deterioration and an uptake in loan restructurings. While capital, in excess of the regulatory ratio, and provisioning buffers remain sufficient to absorb expected losses in most banks, some weaker banks will likely need capital injection to meet the regulatory requirement. DAB has also recommenced the enforcement of all prudential requirements from July to support transparency and supervisory effectiveness but, mindful of the pandemic context, will exercise flexibility in the application of related penalties and prudential triggers pursuant to banks’ corrective action plans. DAB has developed a post COVID-19 improvement plan for the banking sector to apply from July 2020 to December 2021. The plan envisages unwinding remaining emergency measures contingent on further normalization; expanding electronic, mobile, and branchless banking; supporting credit recovery, focusing on SMEs, including through partial credit guarantees from the Afghanistan Credit Guarantee Fund; and reducing banks’ operating costs and suspending dividend payments for all banks for the rest of 2020. The emergency measures for the nonbank sector expired in July.

24. Given the elevated uncertainty, we need to be prepared for a possibility that the crisis becomes more severe and protracted than currently envisaged. The depth and duration of the pandemic remain subject to great uncertainty. Were the pandemic to persist through early 2021, it would further weigh on the economy, severely strain our health system and social services, and fuel political and social instability. We would face a deeper contraction in 2020 and a more sluggish recovery in 2021, with a significantly worse fiscal position as revenues slip and health and social spending soars. In such a situation, to provide for health and social sectors, maintain basic government function, and close the fiscal and external financing gaps, we would use the November pledging conference to request increased grants or their frontloading, redouble efforts to shift expenditure, including donor-financed projects, to where it would be most needed, and introduce one-off revenue measures.

STRUCTURAL REFORMS

A. Fiscal Reforms

25. We are targeting a recovery of revenue collection and its continued improvement. As the recovery gets underway, our immediate priority is to restore compliance and the tax revenue intake to its pre-pandemic levels. To improve the reliability of large taxpayers' revenue stream which accounts for the majority of tax revenue, we will adopt by end-December 2020 targeted and graduated methodologies aimed at increasing filing and payment compliance rates (first review structural benchmark). We will also introduce the risk differentiation framework and create risk profiles for all large taxpayers to better detect non-compliance by September 2021. We will continue our efforts to embed and strengthen the tax compliance culture among the taxpayers by lowering the cost of compliance with the implementation of electronic filing, conducting public awareness campaigns, and engaging directly with businesses and their professional organizations. To automate the sharing of information on taxpayers and their tax transactions, we have initiated the integration of the Afghanistan Payments System (APS) with SIGTAS, the Afghanistan Revenue Department's IT system, and will link SIGTAS with the Afghanistan Central Business Registry (ACBR).

26. The medium-term focus of our revenue mobilization agenda is VAT adoption by 2022. Regretfully, the pandemic stretched our capacity and resources and, after consultations with the World Bank, EU, and IMF, we decided to postpone a VAT adoption by one year to January 2022. So far this year, we established a VAT adoption steering committee and progressed with the appointment of a VAT implementation team. To simplify administration, the large taxpayer office has the same threshold as the VAT. To reduce administrative cost and opportunities for arbitrage, by end-June 2021, the government will submit to parliament amendments to the VAT Law to eliminate the Business Receipt Tax (BRT) under the VAT threshold and to introduce a tax scheme for taxpayers below the VAT threshold following a thorough analysis and in consultation with the IMF staff.

27. We will take all necessary measures to reduce revenue leakages in our customs. To improve collection, the Afghanistan Customs Department risk management unit has developed 91 multi-criteria risk profiles (MCRPs) in ASYCUDA for customs offices at the Kabul airport and provinces of Nangarhar, Herat, Kandahar, Balkh, Nimroz, and Farah. In 2020, informed by the risk analysis, we recommended that 123 non-compliant companies have their licenses suspended and be removed from ASYCUDA. To further increase detection of non-compliance through better selectivity criteria setting and targeting, we will enhance MCRPs, including by expanding the number of risk criteria, and implement them across all customs offices by June 2021. By mid-2021, we will also launch mobile verification teams which are authorized to examine compliance after imports are released from the customs. Relatedly, we intend to require installation of a transit vehicle tracking system to prevent transit system abuse. In addition, we will introduce an identity verification to combat fraud and misreporting on customs declarations.

28. We look forward to assistance and cooperation from our partners in the customs area. To combat misdeclaration of imports, we plan to introduce an automatic vehicle registration at the border (and its automatic renewal) and registration of smartphones when their shipments cross the border. We look forward to assistance from the World Bank and UNCTAD (ASYCUDA) to help us integrate these measures into ASYCUDA. We are also exploring connecting digital weight scales

used at eight border crossings to ASYCUDA to verify declared volumes of cargo and discharge international transit only upon confirmation of reception by neighboring customs through ASYCUDA. We are counting on enhanced customs data and information exchange with our trading partners. We have signed the mutual assistance agreements with China, Iran, Turkmenistan, Tajikistan, and Uzbekistan and plan to enter into similar arrangements with India, Pakistan, Russia, UAE, and other partners over time.

29. We continue to invest in automation and digitalization in customs processing. The automation of payment processing of import taxes and duties is an integral part of these efforts. It will begin with adopting electronic declarations required of traders and brokers. Next, we will automate warehouse inventory records and link them to ASYCUDA to improve cargo control. Finally, the automation of the appeal process and linking it with ASYCUDA will enhance transparency and internal risk management. By end-2020, we expect to introduce e-payment by linking ASYCUDA and SIGTAS to the core banking system and DAB under the World Bank's Incentive Program Development Policy Grant (IP DPG).

30. We will reduce the cost of trading across our borders to facilitate trade and boost our transit potential. Most notably, we will finalize procedures for duty-free shops, import guarantees, treatment of perishable goods, and implement a tariff specification code procedure allowing improved classification for tax purposes. In 2021, we will introduce new procedures for payments of customs debt, treatment of intellectual property rights, disposal and destruction of hazardous goods, and application of preferential tariffs. We will also develop and implement the guidelines for the determination of the origin of property and will accede to the Revised Kyoto Convention of the World Customs Organization.

31. We are working to improve integrity and combat corruption among the customs employees. As of mid-2020, we referred to the Attorney General cases against nearly 600 customs officers where our internal audit detected suspicion of corrupt activities. Going forward, we are preparing to introduce a merit-based recruitment process, including higher pay, to discourage petty corruption. The candidates will have to pass exams to confirm that they possess the required ethical and professional qualifications. These reforms are supported by the World Bank's IP DPG.

32. The reform of the fiscal regime for extractive industries remains essential for domestic revenue mobilization. While development of extractive industries has been hampered by ongoing security problems, inadequate infrastructure, and depressed commodity prices, we are striving to become a conforming member of the Extractive Industries Transparency Initiative (EITI) by advancing towards compliant, effective, and transparent fiscal regime for natural resources. To this end, following Afghanistan's suspension from the EITI in January 2019, we have taken the remedial steps towards compliance with EITI standards set out in the January 2019 EITI Board decision on Afghanistan's first validation. The Ministry of Mines and Petroleum is leading our efforts in this area. Most notably, we have established a [transparency portal](#) which contains data on all issued mineral rights, exploration, mining, dealers and exporters licenses, as well as the related payments. Other advancements towards lifting of our suspension are documented in the "AEITI Quarter 1 Activity Report 2020" available [online](#). The second validation by the EITI took place in July and August. A preliminary assessment is that Afghanistan has fully addressed 13 of the 19 corrective actions and has made "meaningful progress" with considerable improvements in addressing the remaining six

corrective actions. We look forward to the assessment's consideration by the EITI Board in October and a final decision by November.

33. We are planning to launch a public expenditure review in 2021 to evaluate the effectiveness of our spending. The constrained fiscal environment—given the expected decline in grants and large spending needs—requires the best possible use of public funds. The review will help us understand current trends and cost drivers, identify scope for efficiency improvements and savings, and ensure alignment between expenditure allocations and policy priorities.

34. We will fully implement the new civil service pay policy. Adopted last year, this policy aims to link increased compensation and verified competencies, thereby incentivizing professionalization of civil service cadres. Qualified technical personnel will have opportunities to advance to the professional positions thus benefiting from a corresponding rise in compensation. Non-technical professionals will be compensated in line with tested competencies, and support staff will be protected through a pre-set pay supplement. The policy will be first implemented in the MoF, before being adopted by the rest of the government. In addition, we will set up an automated payroll system—linked with Afghanistan Financial Management Information System (AFMIS)—to generate payroll based on the data from the national civil servant system (HRMIS). Since the HRMIS has full records of civil servants, the AFMIS-HRMIS link will allow to verify the payroll rank and eliminate any discrepancies. This project is supported by the World Bank TAGHIR project.

35. We continue to build a better functioning and more credible public financial management system. The ultimate objective is to ensure efficient and effective use of taxpayer money by reducing opportunities for corruption and improving the quality of spending. Our reforms will focus on strengthening the budget process, better managing public investments, enhancing the management of fiscal risks emanating from PPPs, SOCs, and guarantees, and improving fiscal reporting and transparency.

- We will strengthen the national budget formulation as a primary tool for planning and implementing our expenditures. At the start of each budget cycle, we will identify key priority sectors and related projects and submit for cabinet's consideration the draft Fiscal Strategy Paper (FSP) which will subsequently guide our budget allocations. This will help ensure a closer strategic alignment between development priorities, as reflected in our National Priority Programs (NPPs, see Annex I), and the budget and promote a long-term orientation of our fiscal policy. Further, at each mid-year budget review, we will reallocate resources from poorly performing to performing projects based on implementation progress, time/cost overrun, and forward spending needs.
- To strengthen budget preparation, we implemented a forward baseline estimation (FBE) methodology in 2018–19 which enables tracking multi-year spending commitments to estimate space available for new programs. Ministries/agencies are now initiating plans to establish systems for preparing medium-term costed development strategies with an output orientation and forward estimates. These will be linked to the forward estimates issued by the MoF which will be first prepared for priority sectors such as infrastructure, energy, and agriculture. We plan to pilot the methodology with two ministries producing a Portfolio Budget Statement and preparing an annual report with financial statements by mid-2021.

- We continue to improve the efficiency of our public investment management (PIM). With help from the World Bank, we will adopt by end-December 2020 new PIM regulations that will formalize the formulation, selection, appraisal, and approval of public investment projects as defined there. In this context, we will institutionalize the Project Evaluation Committee responsible for systematically reviewing all project proposals, including Public Private Partnership projects, in the pre-investment phase (i.e., preparation and appraisal). Only projects meeting the established feasibility criteria and aligned with development priorities will be approved. Requiring all projects to undergo defined project selection processes will significantly reduce the risks of interference and political bargaining. Regulations will also clarify institutional responsibilities throughout the project cycle, assigning the MoF the central role in managing the process and decision-making, and establish consistent criteria for project assessment, including climate change impact.
- Before entering into any PPP contract (and on an ongoing basis throughout its life), we will ensure that associated fiscal risks are assessed by the MoF, which will continue to play a critical gatekeeper role in managing fiscal risks. This is consistent with the 2018 PPP Law which indicates that public entities shall not enter into contracts with private parties until the financial analysis of related risks and contingent and non-contingent liabilities has been conducted, approved, and recorded by the MoF. We are working on an integrated database of public projects, which, for PPP projects, will include information on service payments over the life of the project as well as all guarantees or contingent commitments attached to it. Starting in 2021, we will expand the information about PPPs that we disclose in the FSP and budget document in line with recommendations of the recent IMF technical assistance mission.
- We will build the capacity of the department of state-owned enterprise/corporations (SOE/SOCs) to conduct operational and financial oversight of SOE/SOCs by hiring staff with requisite skills and seeking technical assistance. Consistent with a risk-based approach, the department will start collecting full financial information for the ten largest SOE/SOCs—income statement, balance sheet, and financial flows between the government and the SOE/SOCs—including indirect financial support received by the SOC from non-operational income earned from leasing the land or office space. Based on this information, the department will submit by end-2021 a comprehensive report on SOE/SOCs' financial performance to the Oversight Board whose functions will be further differentiated from those of the MoF, particularly with regards to approval of any type of financial support and budgeting functions. We intend to have the 2020 financial statements of the five largest SOE/SOCs externally audited by end-September 2021. We look forward to the IMF's support, including training, to develop capacity to properly quantify fiscal risks stemming from SOE/SOCs and PPPs with a view to producing initial analysis to be included in the FY2022 FSP and budget document.
- The Public Finance and Expenditure Management (PFEM) Law allows up to three percent of the total budgeted expenditures to be allocated to a contingency reserve. We see the need to strengthen how we allocate funds to contingent spending and how we execute the related spending to address the concerns about public expenditure control and transparency. To that end, by end-December 2020, the government will adopt and publish regulation on the use of contingency budget management to: (i) define eligible purposes for the use of contingency reserves; (ii) include provisions allowing for early or pre-emptive responses to disasters; and

(iii) establish full reporting requirements, including publication of utilization of all contingency reserves by expenditure category.

- The Supreme Audit Office (SAO) is an important institution that can help us verify that the resources are spent in line with our plans and for the benefit of the nation. With the support of the World Bank, we have submitted to parliament a revised SAO law to strengthen its operational independence and capacity in line with international good practice and consistent with relevant provisions of the Constitution and the PFEM Law.

B. Financial Sector Policies

36. DAB continues to build its financial sector supervision framework and capacity. In addition to pandemic-related financial sector stabilization priorities, key reforms going forward include developing and implementing a risk-based supervision framework, enhancing internal capacity to supervise banks' implementation of IFRS 9, and automating off-site supervisory data collection and analyses.

37. DAB is implementing a specific post-pandemic plan for high-risk banks. DAB is closely monitoring their performance through off-site assessments and on-site examinations which resumed in July. It has developed a one-year plan for high-risk banks, which includes recovery, capital augmentation, reforms to strengthen their corporate governance and risk management practices, as well as supervision and enforcement actions. Bank-specific plans will be informed by the findings of the special review of high-risk banks to be undertaken with the support of the World Bank. DAB will also update its contingency plans for an adverse event in any individual bank and establish a dedicated unit to oversee the winding down of defunct banks and other financial institutions under its supervision.

38. We will accelerate the reforms of state-owned commercial banks (SOCBs). Earlier this year, the President signed a decree to authorize the merger of Bank-e-Millie Afghan and New Kabul Bank in accordance with the reform strategy under implementation with the World Bank support. The merger will create the second largest bank with about 21 percent of system assets. By mid-April 2021, the MoF will sign a contract with advisors to support the merger (first review structural benchmark), which is also being aided by the related World Bank project. The scope of advisory support will cover financial and operational due diligence, integration of technology and business processes, and other issues as relevant. We will continue to ensure close coordination between the MoF team leading the project and DAB supervisors in charge of the prudential monitoring of SOCBs.

39. We will redouble efforts to improve recovery of Kabul Bank Receivership (KBR) assets. This is one of the top priorities of the commission established under Presidential decree to assist recovery of NPLs. The commission, of which DAB is a member, has restarted meetings and will ensure timely and effective implementation of recommendations of the KBR asset recovery diagnostic completed last year. In particular, by end-2020, we plan to (a) implement recommendations of the diagnostic for recovery of assets outside Afghanistan, acquisition and implementation of accounting software, and completion of compilation and audit of receivership financial statements; and (b) provide the first progress report on the recovery of assets and other objectives pursuant to the new and the continuing measures.

40. DAB has embarked on reforms to formalize unregulated financial services and implement an oversight framework for nonbank financial institutions. Phased corporatization of MSPs and FXDs over the next three years has commenced, consistent with U.S. Treasury TA. The branchless banking regulation issued in late 2019 includes a framework for the authorization of qualifying agents of banks, including MSPs and FXDs. However, no application has been submitted so far. DAB has recently established a new nonbank financial supervision department (NBFSD) for the oversight of over 3,300 MSPs and FXDs, nine corporate money services businesses, and four EMLs. The department is currently focusing on implementing the supervisory and AML/CFT oversight frameworks, enforcing against unlicensed financial operations, building capacity, and developing the regulatory framework for other nonbank financial operations.

41. We will upgrade the legal and regulatory framework for early intervention, resolution, and crisis management. With the technical assistance of the IMF, we plan to amend our banking law to introduce a more robust resolution framework in line with international practices. Amendments will aim to (i) establish clear objectives and scope of the resolution regime, distinction between early intervention and resolution, revision of grounds for appointing a conservator and petitioning for receivership; (ii) strengthen DAB's and conservator's powers; (iii) introduce recovery and resolution planning; and (iv) specify the mandate of the new resolution unit. As part of this effort, we are strengthening the deposit insurance system with the technical and funding support of the World Bank and are reviewing the current framework for emergency liquidity assistance.

42. We will support financial intermediation deepening and financial inclusion. We will promote broader use of credit and collateral registries by banks, risk-sharing, and partial credit guarantee schemes and build on these measures to encourage term lending instead of bank overdrafts. We expect sukuk issuance to give an impulse to domestic debt market development, which over time will help to channel domestic savings to investment and, thereby, finance development. In line with our NFIS, DAB has established a new department for consumer protection and financial literacy. Our vision is to leverage the high penetration of mobile devices and make available to the public a wide range of core financial services, thereby gradually moving towards an economy less dependent on cash. DAB will continue to upgrade the retail payment infrastructure and support development of digital finance. To support SME access to credit, we are strengthening the capacity of the Afghanistan Credit Guarantee Fund with the World Bank funding.

43. We will continue to strengthen the AML/CFT regime to promote the integrity of our financial system in line with findings of the 2019 National Risk Assessment (NRA). We recognize the importance of shielding our financial sector and broader economy from illicit financial flows, including those associated with the drug economy, corruption, smuggling, and terrorist activities. Last year, we completed Afghanistan's first AML/CFT NRA, which we plan to publish by December 2020 and which provides the basis for our national action plan through 2023. Despite challenges posed by the pandemic, DAB has continued to enhance its AML/CFT supervisory capacity, including through reviews of relevant regulations and internal procedures (e.g., the AML/CFT responsibilities and preventative measures) in line with findings of the NRA. The banking supervision department plans to conduct AML/CFT examinations of all 12 banks by year-end, and the NBFSD completed AML/CFT inspections of 40 MSPs and FXDs in 2019 and nine so far in 2020 and imposed sanctions for noncompliance, including suspension and revocation of licenses. We have recently formed an interagency Oversight Committee to coordinate our preparations for the

AML/CFT assessment by the Asia Pacific Group on Money Laundering (APG) in 2022. As a first step, we will review the AML/CFT legal and regulatory framework to identify shortcomings and critical reforms needed in the criminal justice system to enhance money laundering enforcement efforts. Further, by September 2021, we plan to develop a national AML/CFT strategy which will outline policy priorities and guide risk mitigation measures.

C. Business Environment and Corruption

44. We are committed to improving our business environment to promote private sector-led growth. In recent years, we have reduced the cost of obtaining a business license, introduced electronic tax filing, and approved new limited liability company and insolvency laws. The planned linking of SIGTAS with the ACBR will ease the issuance of digital Tax Clearance Certificates and thereby facilitate business license renewals. Going forward, we will focus on reforms to improve the timeliness and quality of judicial proceedings in commercial cases (e.g., case management) and further strengthen contract enforcement and property protection. Further, we will strive to improve the quality of education and training programs to nurture entrepreneurship and equip our people with marketable skills.

45. We have an ambitious anti-corruption reform agenda. It is captured in the National Strategy for Combating Corruption (NSCC), last updated in November 2018 to add a pillar on strengthening economic institutions. We have made strides to meet the established benchmarks: 79 percent of benchmarks for 2019 and 90 percent for 2018 have been completed, and we continue to work on remaining ones. We are currently updating the NCSS, which we aim to complete by March 2021. With the passage of the Anti-Corruption Law in 2018, the legal framework for critical anti-corruption institutions has been solidified. Our efforts are now focused on operationalizing the anti-corruption regime, including the Anti-Corruption Commission (ACC), which will be fully staffed by March 2021, pursuant to the selection process agreed with civil society, and begin carrying out its statutory functions by June 2021. The ACC is expected to take over the handling of asset declarations after operations start in June 2021.

46. Important progress has been made to modernize the asset declaration system, including steps towards digitalization and a risk-based system of verification. The Administrative Office of the President (AOP) continues to build its capacity and strengthen coordination with relevant agencies to improve the utility of the asset declaration regime, in particular, to advance cases of illicit enrichment. It is working with DAB and international partners to develop a training curriculum on anti-corruption and asset declarations at the Afghanistan Institute of Banking and Finance. Updates to the regulation on asset declarations and the AOP's internal rules and procedures to facilitate digitalization were finalized in September 2020. Making asset declarations available in machine-readable format will enhance transparency of the asset declaration regime and facilitate the verification and scrutiny of declarations by allowing the civil society at large to play a watchdog role. To this end, the AOP will complete systematic digitalization of all current year asset declarations in machine-readable format and publish the declarations of government officials, as defined in the Law on Declaration and Registration of Assets of Officials and Government Employees, on its website <https://www.aop.gov.af/dr/index> by end-September 2021. We will continue enhancing our public registries of land, property, and companies to support verification of asset declarations and improve transparency and accessibility to information more generally.

47. We remain committed to fighting impunity, eradicating vested interests, and pursuing high-level corruption cases. We intend to prioritize and focus criminal enforcement efforts on the most egregious instances of corruption and those that are most detrimental to Afghanistan's development. Efforts to strengthen our criminal justice system are continuing. We have undertaken a review of the Penal Code, including to clarify bail procedures and those relating to the publication of reasoned court decisions (*faisala*), and will continue to assess our legal framework to identify gaps and shortcomings. We will also ensure that the existing anti-corruption structures are coherent and effective, including by implementing reforms to the prosecution service detailed in the Action Plan for Improving Detection and Prosecution of Corruption Cases and formalizing the affiliation of the Major Crimes Task Force (MCTF) with the Anti-Corruption Justice Center (ACJC) pursuant to the Anti-Corruption Law. With respect to the latter, we will develop the necessary regulations and protocols to clarify the relationship between ACJC prosecutors and MCTF inspectors as well as the reporting line of the MCTF directly to the Minister of Interior. Finally, to better leverage the AML/CFT framework in anti-corruption efforts, we will make the necessary legal, regulatory, and institutional changes to ensure the identification, documentation, and registration of beneficial owners of entities and accounts in line with the requirements of the Financial Action Task Force (FATF). Similarly, we will review our legislative and regulatory framework with an eye to developing a uniform set of rules applicable to politically exposed persons by June 2021 pursuant to the FATF standard.

48. We are fully committed to transparency and accountability in public spending. In line with broader efforts to improve the management of public finances, we are transitioning to e-procurement, including the development of an online procurement portal on the National Procurement Agency's website <https://ageops.net/en/procurement-procedure/announcement/award-decision>, which regularly publishes procurement contracts. In furtherance of this initiative and as a **prior action for the ECF arrangement**, on September 30, 2020, the National Procurement Agency (NPA) revised the procurement regulations to require in all public procurements, starting November 1, 2020, collection of beneficial ownership information in bidding documents and online publication of beneficial ownership information of all entities contracting with the government within 30 days of contract signing. We commenced in September the preparation of the first quarterly report on pandemic-related spending, which we aim to publish by end-October. Further, as directed by the President and in line with our commitments at the time of the RCF disbursement, the SAO will undertake audits of the following COVID-19 spending items in FY2020: health spending, including for building hospitals; the bread distribution and wheat purchase programs; package to support agriculture; transfers to provinces for COVID-19 response; and will publish its reports by end-June 2021.

D. Safeguards Assessment

49. We are committed to meeting the Fund's safeguards policy requirements. We intend to implement recommendations of the recent safeguards assessment by the IMF's Finance Department. In particular, to strengthen the autonomy and governance structure of DAB, we will work with parliament to secure enactment of amendments to the DAB law, submitted to parliament in 2017, by end-March 2021 (first review structural benchmark). By June 2021, DAB will adopt a procurement policy that establishes adequate controls and oversight and engage a reputable audit firm to review its internal control systems.

E. Data

50. We continue to improve the timeliness and quality of our statistics. We recognize the importance of reliable data for sound policy making. There are several deficiencies we plan to correct, particularly in the area of national accounts and balance of payments. To help us with this effort, we are requesting continued technical assistance and training from our international partners, including the IMF.

PROGRAM MODALITIES

51. We will closely monitor the implementation of the ECF arrangement through quantitative targets and structural benchmarks. The proposed performance criteria and indicative targets and structural benchmarks are listed in Tables 1 and 2, in the MEFP. The ECF arrangement will be monitored based on performance through the following test dates: December 21, 2020; June 21, 2021; December 21, 2021; June 21, 2022; December 21, 2022; and June 21, 2023. The first, second, and third reviews of the program are scheduled to be completed on or after April 21, 2021; October 20, 2021; and April 20, 2022. The performance criteria, indicative targets, and the benchmarks are defined in the Technical Memorandum of Understanding.

52. Further commitments under the arrangement. During the program period, we will not impose or intensify restrictions on the making of payments and transfers for current international transactions, or introduce or modify multiple currency practices, or conclude bilateral payments agreements inconsistent with Article VIII, or impose or intensify import restrictions for balance of payments purposes.

53. Engagement with the Fund. We will work with our international partners, especially the IMF and the World Bank, to successfully implement the reforms outlined above.

Table 1. Islamic Republic of Afghanistan: Prior Action and Structural Conditionality under the Extended Credit Facility

Prior action: The National Procurement Agency (NPA) will revise the procurement regulations to require in all public procurements, starting November 1, 2020, collection of beneficial ownership information in bidding documents and online publication of beneficial ownership information of all entities contracting with the government within 30 days of contract signing	Met on September 30, 2020.		
First Review Structural Benchmarks			
Measure	Area	Date	Rationale
The Ministry of Finance to sign a contract with advisors to support the merger of Bank-e-Millie Afghan and New Kabul Bank. The scope of advisory support will cover financial and operational due diligence, integration of technology and business processes, and other issues as relevant.	Financial	April 15, 2021	Strengthen financial stability and management of state assets.
The government to submit to parliament the draft 2021 budget that contains the deficit to 2.2 percent of GDP and is broadly in line with the macroeconomic framework agreed under the ECF.	Fiscal	November 15, 2020	Preserve macroeconomic stability.
Afghanistan Revenue Department to adopt targeted and graduated methodologies to increase timely filing and payment compliance rates for the large taxpayers, with a view to increasing the reliability of the large taxpayer revenue stream.	Fiscal	End-December 2020	Improve revenue collection efficiency and reduce leakages.
Enact amendments to the Da Afghanistan Bank law submitted to parliament in 2017 (and drafted in consultation with the IMF staff).	Monetary, financial	End-March 2021	Strengthen DAB autonomy and governance structure.

Table 2. Islamic Republic of Afghanistan: Quantitative Performance Criteria and Indicative Targets Under the Extended Credit Facility, December 2020–December 2021 1/
(Cumulative in Af billion unless otherwise indicated)

	2019	2020		2021		2021		
	Dec.21	Dec.21		Mar.21	June.21	Sep.21	Dec.21	
	Beginning stocks	Performance criteria	Year-end stocks	Indicative target date	Performance criteria	Indicative target date	Performance criteria	Year-end stocks
Performance criteria:								
Net credit to the central government from DAB (ceiling) 2/	-97	45	-51	-9	5	11	20	-31
Reserve money in domestic currency (ceiling) 2/	322	39	361	10	21	31	43	403
Net international reserves of DAB (floor; in U.S. dollars million) 2/	7994	-175	7819	50	-48	-143	-318	7501
Non-concessional external debt, new (ceiling) 3/	0	0	0	0	0	0	0	0
Short-term external debt, new (ceiling) 3/	0	0	0	0	0	0	0	0
External payments arrears, new (ceiling) 3, 4/	...	0	...	0	0	0	0	...
Borrowing by public enterprises in need of restructuring—from DAB or state-owned banks, or government-guaranteed, new (ceiling) 3/	0	0	0	0	0	0	0	0
Indicative targets:								
Revenues of the central government (floor) 5/	...	165	...	41	85	131	192	...
Operating budget deficit, excluding grants (ceiling) 5/	...	154	...	9	48	81	117	...
Treasury cash balance, discretionary (floor)	...	10	...	10	10	10	10	...
Social and other priority spending (floor)	...	78	...	23	45	60	75	...
Memorandum items:								
Nominal external concessional borrowing (in U.S. dollars million) 2, 6/	...	0	...	46	46	46	46	...
Reference values for the adjusters:								
Core budget development spending	...	169	...	6	43	75	142	...
External financing of the core budget and sale of non-financial assets 7/	...	290	...	23	95	157	249	...

Source: Afghan authorities and IMF staff estimates/projections.

1/ The quantitative targets, indicative targets, their adjusters, and program exchange rates are defined in the Technical Memorandum of Understanding (TMU).

2/ Cumulative from the beginning of the year.

3/ These quantitative targets are applied on a continuous basis.

4/ Afghanistan owes a small amount (US\$10 million) of pre-HIPC Initiative arrears to a non-Paris Club creditor, which continue to be deemed away under the revised arrears policy for official creditors.

5/ In line with the TMU, profits transfer from DAB of Af\$12.8 billion in 2020 is excluded.

6/ Prospective concessional borrowing.

7/ Includes operating and development donor assistance, net external loans, and sale of non-financial assets.

Annex I. National Priority Programs

	Priority Program	Time Frame	Lead Council	Status/Actions Required in 2020
1	Peace Program	2021–25	Peace Council	New. Preparation for Peace
2	Security Sector	2014–24	National Security Council	Active implementation. Continue reforms.
3	Justice for All	2017–21	High Council for Justice	Costed implementation plans. Last year of current strategy. Refresh and re-enforce implementation
4	Reintegration	2020–22	Human Capital Council	New COVID-19 and long-term Response. Design and implement program
1	Effective Governance	2019–23	Leadership Council	Programs being implemented. Reinforce implementation
2	Human Capital Development (Service Delivery)	2019–23	Human Capital Council	Reprioritize. Combine education and health delivery programs
3	Citizens' Charter (Social Protection)	2017–27	Human Capital Council	Phase one closing. Phase two expansion. Expand to coverage
4	Implementation Support	2020–24	Leadership Council	Design and implement program Reprioritize with cluster development
5	Infrastructure	2020–24	Economic Council	Review implementation as part of construction development
6	National Healthcare	2020–24	Human Capital Council	Reprogramming of Sehatmandi and other public health projects to deal with healthcare issues during and after COVID-19
1	Trade and Transit	2020–24	High Economic Council	New. Support for trade and transit initiatives. Design and implement.
2	Primary Sector Development	2016–21	High Economic Council	Refresh overall strategy and continue to develop program. Includes both agriculture and mineral sector reforms
3	Industrial Development	2020–24	High Economic Council	New. Support for industrial reforms. Design and implement program
4	Urban Development	2016–25	High Urban Council	Costed investment pipeline. Reprioritize.
5	Women's Economic Empowerment	2017–27	High Economic Council	Costed implementation plan being developed. Refocus implementation.

Attachment II. Technical Memorandum of Understanding

This memorandum reflects understandings between the Afghan authorities and the IMF staff in relation to the Extended Credit Facility (ECF) during November 6, 2020–May 5, 2024. It specifies valuation for monitoring quantitative targets under the program (Section A), quantitative targets and indicative targets (Section B), adjustors (Section C), and data reporting (Section D).

A. PROGRAM EXCHANGE RATES AND GOLD VALUATION

1. Program exchange rates are used for formulating and monitoring quantitative targets. All assets and liabilities denominated in U.S. dollars will be converted into Afghanis at a program exchange rate of 76.7 Afghanis per one U.S. dollar, which corresponds to the cash rate as of June 1, 2020. Gold holdings will be valued at \$1,629.80 per troy ounce, the average price during January–May, 2020 sourced from [the IMF website on primary commodity prices](#). Assets and liabilities denominated in SDRs and in foreign currencies other than the U.S. dollar will be converted into U.S. dollars at the exchange rates as of June 1, 2020, reported in the below table:

Exchange Rate	Program Rate
U.S. dollars / Euro	1.1116
U.S. dollars / Swiss Franc	1.0397
U.S. dollars / Pounds Sterling	1.2381
U.S. dollars / SDR	1.3713
U.S. dollars / Canadian Dollar	0.7337
U.S. dollars / U.A.E. Dirham	0.2723
U.S. dollars / Indian Rupee	0.0132
U.S. dollars / Pakistani Rupee	0.0061
U.S. dollars / Egyptian Pound	0.063
U.S. dollars / Hong Kong Dollar	0.129
U.S. dollars / Russian Ruble	0.0143
U.S. dollars / Iranian Rial	0.00002
U.S. dollars / Saudi Arabian Riyal	0.2667
U.S. dollars / China Yuan Renminbi	0.1405

B. QUANTITATIVE PERFORMANCE AND INDICATIVE TARGETS

2. The quantitative performance criteria for December 2020, June 2021, and December 2021, specified in Table 2 of the Memorandum of Economic and Financial Policies, are:¹

- Floor on net international reserves (NIR) of Da Afghanistan Bank (DAB); and
- Ceilings on reserve money in domestic currency; DAB's net credit to the central government (NCG); contracting and/or guaranteeing new medium- and long-term nonconcessional external

¹ Definitions of indicators mentioned in paragraphs 2 and 3 are provided in paragraphs 8–21.

debt by the public sector (continuous); contracting and/or guaranteeing new short-term external debt by the public sector (continuous); accumulation of external payment arrears, excluding interest on preexisting arrears (continuous); lending from state-owned banks or DAB to, or government guaranteed borrowing by, public enterprises in need of restructuring (continuous).

3. The above performance criteria also constitute indicative targets for March 2021 and September 2021. In addition, the program includes the following indicative targets for December 2020, March 2021, June 2021, September 2021, and December 2021:

- Ceiling on the operating budget deficit of the central government excluding grants; and
- Floors on revenue of the central government; Treasury discretionary cash balance, and social and other priority spending.

4. The central government consists of the Office of the President, the ministries, and other state administrations and governmental agencies, including the attorney general's office; the National Assembly; and the judiciary, including the Supreme Court.

5. The definition of "government" includes the budgetary central government, extra-budgetary central government, local government (including government departments), as well as official agencies that do not seek profit and whose budgets are issued independent of the annual operational or development budgets.

6. The public sector comprises the government as defined above, pension administration, DAB, and nonfinancial public enterprises.

7. Public enterprises or corporations refer to enterprises wholly or majority owned by the government, including state-owned enterprises covered by the State-Owned Enterprise (Tassady) Law, state-owned corporations covered by the Corporations and Limited Liability Companies Law, and other government entities (e.g., Microfinance Investment Support Facility for Afghanistan) and government agencies (e.g., Afghanistan Investment Support Agency) engaged in commercial activities but not covered by the Tassady Law.²

8. For program purposes, the definition of **debt** is set out in the "Guidelines on Public Debt Conditionality in Fund Arrangements" as set forth in the Attachment to the IMF Executive Board Decision No. 15688–(14/107), adopted December 5, 2014.

- a. The term "debt" will be understood to mean a current (i.e., not contingent) liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take

² Government control of an entity can be established based on the following criteria: (i) ownership of the majority of the voting interest; (ii) control of the board or other governing body; (iii) control of the appointment and removal of key personnel; (iv) control of key committees of the entity; (v) golden shares and options; (vi) regulation and control; (vii) control by a dominant public sector customer or group of public sector customers; and (viii) control attached to borrowing from the government.

several forms, the primary ones being as follows:

- (i) loans (i.e., advances of money) to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans buyers' credits, and credits extended by the IMF) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);
 - (ii) suppliers' credits (i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided); and
 - (iii) leases (i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property), while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.
- b. Under the definition of debt set out in paragraph 8 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

9. External debt is defined as debt owed to a non-resident.

10. Revenues of the central government are defined in line with the Government Finance Statistics Manual (*GFSM 2001*) but on a cash accounting basis, excluding grants. Revenue is an increase in net worth of the central government (including its units in the provinces and agencies) resulting from a transaction.

- Revenues of the central government include taxes and other compulsory transfers imposed by central government units, property income derived from the ownership of assets, sales of goods and services, social contributions (excluding pensions contributions received by the central government), interest, fines, penalties and forfeits and voluntary transfers received from nongovernment other than grants. The definition, for program monitoring, excludes grants and other noncompulsory contributions received from foreign governments and international organizations; such transfers between central government units would be eliminated in the consolidation of the fiscal reports and not recorded as revenue. Receipts collected by central government on behalf of non-central government units should not be counted as revenue (e.g., Red Crescent fees). Receipts from the sale of nonfinancial assets (e.g., privatization and signature bonuses from natural resource contracts), and transactions in financial assets and liabilities, such as borrowing but excepting interest payments, are also excluded from the definition of revenue. Transfer of profits from DAB to the Treasury is also excluded from the definition of revenue.

- Revenues should be recognized on a cash basis and flows should be recorded when cash is received. The official Afghanistan Government Financial Management Information System (AFMIS) reports will be used as the basis for program monitoring; in particular, the monthly financial statements prepared by the Treasury department based on AFMIS data. Exceptional advanced payments will be treated as if received on the normal due date.

11. Net international reserves are defined as reserve assets minus reserve related liabilities of DAB expressed in U.S. dollars.

- Reserve assets of DAB, as defined in the sixth edition of the Balance of Payments Manual (BPM6), are claims on nonresidents denominated in foreign convertible currencies controlled by DAB, and are readily and unconditionally available to DAB for meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include DAB holdings of monetary gold, SDRs, Afghanistan's reserve position in the IMF, foreign currency cash (including foreign exchange banknotes in the vaults of DAB), and readily available deposits abroad (including balances on accounts maintained with overseas correspondent banks). Reserve assets must be readily available in the most unconditional form. A reserve asset is liquid in that the asset can be bought, sold, and liquidated for foreign currency (cash) with minimum cost and time, and without unduly affecting the value of the asset. No time limit is provided, but to qualify as reserves, an asset should be available in a very short period of time.³ Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; assets in nonconvertible currencies; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).
- Reserve related liabilities are defined as foreign exchange liabilities of DAB to nonresidents; Afghanistan's outstanding credit to the IMF; foreign currency reserves of commercial banks held at DAB; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies.

12. Reserve money in domestic currency is defined as currency in circulation plus Afghani-denominated commercial bank deposits at the central bank, including balances maintained by the commercial banks in the DAB's overnight facility. Reserve money also includes Afghani-denominated deposits of other institutional units at the central bank in line with recommendations of *Monetary and Financial Statistics Manual and Compilation Guide*.

13. DAB's net credit to the central government is defined as the difference between DAB's claims on the central government and the central government deposits at DAB. Claims include the so-called "promissory note," in the amount outstanding (at face value) of DAB's claim on a bank in liquidation that has been guaranteed by the Ministry of Finance (MoF) through issuance of a promissory note, and up to the amount specified therein. In line with the DAB law, DAB will not extend credit to the government or purchase government securities in the secondary market other than for the purpose of conducting monetary operations.

³ Balance of Payments and International Investment Position Manual, Sixth Edition, International Monetary Fund, 2009, page 112.

14. New non-concessional external debt (ceiling). A zero ceiling applies, on a continuous basis, to the nominal value of new nonconcessional borrowing from nonresidents contracted or guaranteed by the public sector with original maturities of one year or more. The ceiling applies to debt and commitments contracted or guaranteed for which value has not yet been received. Excluded from the limits are refinancing credits, rescheduling operations, credits extended by the IMF, and credits on concessional terms as defined below. Consistent with the PFM law, the MoF should have sole responsibility for the contracting and guaranteeing of external debt on behalf of the government.

- For program purposes, the guarantee of a debt arises from any explicit legal obligation of the public sector to service a debt in the event of nonpayment by the debtor (involving payments in cash or in kind), or from any implicit legal or contractual obligation of the public sector to finance partially or in full any a shortfall incurred by the debtor.
- For program purposes, a debt is concessional if it includes a grant element of at least 35 percent, calculated as follows: the grant element of a debt is the difference between the present value (PV) of debt and its nominal value, expressed as a percentage of the nominal value of the debt. The PV of debt at the time of its contracting is calculated by discounting the future stream of payments of debt service due on this debt.⁴ The discount rate used is 5.0 percent.
- For debts carrying a variable interest rate in the form of a benchmark interest rate plus a fixed spread, the PV of the debt would be calculated using a program reference rate plus the fixed spread (in basis points) specified in the debt contract. The program reference rate for the six-month USD LIBOR is 2.42 percent and will remain fixed for the duration of the program. The spread of six-month Euro LIBOR over six-month USD LIBOR is -250 basis points. The spread of six-month JPY LIBOR over six-month USD LIBOR is -250 basis points. The spread of six-month GBP LIBOR over six-month USD LIBOR is -150 basis points. For interest rates on currencies other than Euro, JPY, and GBP, the spread over six-month USD LIBOR is 150 basis points.⁵ Where the variable rate is linked to a benchmark interest rate other than the six-month USD LIBOR, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added.

15. The zero ceiling on **short-term external debt** applies on a continuous basis to the contracting or guaranteeing of new external debt by the public sector (as defined in paragraph 6 of this memorandum) with nonresidents, with an original maturity of up to and including one year.

- It applies to debt as defined in paragraph 8 of this memorandum.
- Excluded from the limit are rescheduling operations (including the deferral of interest on commercial debt) and normal import-related credits.
- Debt to which this ceiling is applicable shall be valued in U.S. dollars at the exchange rate

⁴ The calculation of concessionality will consider all aspects of the loan agreement, including maturity, grace period, payment schedule, upfront commissions, and management fees.

⁵ The program reference rate and spreads are based on the "average projected rate" for the six-month USD LIBOR over the following ten years from the October 2019 World Economic Outlook (WEO).

prevailing at the time the contract or guarantee becomes effective.

16. A continuous performance criterion applies to the **non-accumulation of new external payments arrears** on external debt contracted or guaranteed by the central government or DAB. External payment arrears consist of external debt service obligations (principal and interest) falling due after approval of this arrangement and that have not been paid at the time they are due, as specified in the contractual agreements (including any contractual grace period). Excluded from the prohibition on the accumulation of new arrears are: (i) arrears arising from interest on the stock of arrears outstanding as of the approval of this arrangement; and (ii) external arrears that are subject to debt rescheduling agreements or negotiations.

17. Borrowing by public enterprises in need of restructuring. The zero ceiling on new lending from state-owned banks or DAB to, or government-guaranteed domestic and external borrowing by, public enterprises in need of restructuring applies on a continuous basis.

- For the purposes of this performance criterion: (i) “state-owned banks” refers to those banks that are wholly or majority owned by the government (as defined in paragraph 5 of this memorandum);⁶ and (ii) “public enterprises in need of restructuring” refers to enterprises that meet either of the following: (a) public enterprises that have not had an audited balance sheet in the past two fiscal years; (b) public enterprises that have been identified by the MoF for liquidation; or (c) public enterprises subject to restructuring plans that do not have cabinet-approved restructuring plans.
- It applies to any new loans (or financial contributions) extended directly from DAB or state-owned banks to public enterprises in need of restructuring, and to any explicit government guarantees for borrowing undertaken by these public enterprises (including loan agreements and guarantees for which value has not been received).

18. Operating budget deficit of the central government excluding grants is defined as revenues of the central government minus operating budget expenditure recorded in AFMIS and reported in monthly financial statements.

19. Treasury’s discretionary cash balance is defined as the total discretionary cash balance at the Treasury single account in DAB, including unrestricted funds in TSA, discretionary development fund (code 20,000), balance in provinces (unspent funds), cash reserve/realized exchange gain account, and floor limit (minimum threshold of Treasury funds).

20. Rerouting of Treasury’s IMF accounts to DAB’s balance sheet. The Afghan authorities have designated MoF as the fiscal agent and DAB as the depository. For program purposes, the government’s financial positions arising from dealing with the IMF are treated as if these functions were performed by DAB on behalf of the Treasury that is as if DAB has assumed these positions and established corresponding counter position vis-à-vis the Treasury calculated as the sum of Afghanistan’s outstanding credit to the IMF and SDR allocation minus the sum of SDR holdings, reserve tranche position, and the outstanding credit under the 2016–19 Extended Credit Facility arrangement.

⁶ As of July 31, 2020, state-owned banks comprise of Bank-e-Millie Afghan, Pashtany Bank, and New Kabul Bank.

21. Social and other priority spending is defined as the sum of pro-poor spending identified in accordance with the Afghanistan National Development Strategy poverty profile by the Ministry of Education, Ministry of Public Health, and Ministry of Labor, Social Affairs, Martyrs, and Disabled within the central government's operating budget for a particular fiscal year.

C. ADJUSTORS

22. The floor on NIR and the ceiling on the NCG are consistent with the assumption **that core budget development spending**, defined as on-budget development expenditure, will amount, on a cumulative basis from the beginning of the respective fiscal year, to:

Date	Accumulative Over the Respective Year (Billion Afghani)
December 21, 2020	169
June 21, 2021	43
December 21, 2021	142

Should core budget development spending exceed these projections, the NIR floor will be adjusted downward and the NCG ceiling will be adjusted upward by the difference between the actual level (up to the appropriated amount) and the projected level of development spending.

23. The NIR floor and NCG ceiling are defined consistent with the assumption that the **external financing of the core budget and receipts from the sale of nonfinancial assets** will amount, on a cumulative basis from the beginning of the respective fiscal year, to:

Date	Accumulative over the Respective Year (Billion Afghani)
December 21, 2020	290
June 21, 2021	95
December 21, 2021	249

External financing of the core budget is defined as a sum of on-budget operating and development grants and net external loans (disbursement of external loans to the MoF minus repayments of external loans by the MoF).

Should external financing of the core budget and the receipts from the sale of nonfinancial assets collectively exceed (fall short of) these projections, the NIR floor will be adjusted upward (downward) and the NCG ceiling will be adjusted downward (upward) by the difference between their actual level and the projected level. The downward adjustment to the NIR floor for these projections will be capped at \$400 million and the upward adjustment to the NCG ceiling for these projections will be capped at Af 30.7 billion.

24. **Should some expenditure currently financed directly by donors outside the budget** be moved on to the operating budget, the NIR floor will be adjusted downward, and the NCG ceiling and the indicative targets (ceilings) for the operating budget deficits of the central government, excluding grants, will be adjusted upward, by the actual amount of these expenditures on the condition that (i) the moving on budget of these expenditures is justified by a statement

from donors indicating their decision to stop financing them; and (ii) they are subject to a supplementary appropriation approved by parliament. The downward adjustment to the NIR floors for these conditions will be capped at \$300 million.

25. Should **the MoF recapitalize (receive dividend from) DAB**, the NCG ceiling will be adjusted upward (downward) by the amount of this recapitalization (dividend).

D. PROVISION OF INFORMATION TO THE IMF

26. **To facilitate monitoring of program implementation**, the MoF and DAB will provide the IMF with the information specified below.

27. **Actual outcomes will be provided with the frequencies and lags indicated below**, provided that any data and information indicating the non-observance of the continuous performance criteria will be provided immediately.

- DAB net international reserves: weekly, no later than one week after the end of each week. Net international reserves will be provided at actual and program exchange rates and gold price.
- Monetary statistics, including exchange rates, government accounts with DAB, currency in circulation, reserve money, and a monetary survey: biweekly and no later than ten days after the end of the two-week period (four weeks in the case of the monetary survey). The monetary survey will include the balance sheet of DAB and a consolidated balance sheet of the commercial banking sector. The balance sheet of DAB will be provided at actual and program exchange rates and gold price.
- Detailed cash flow on gross and net international reserves biweekly and no later than ten days after the end of the two-week period.
- Core budget operations and their financing: monthly and no later than four weeks after the end of the month. The official reports for program monitoring will be the monthly financial statements from the AFMIS. The structure of financing (grants and loans should be separately identified) and expenditure data should be on a consistent cash basis, with separate identification of direct payments by donors that are included in budget development spending, with a counterpart grant figure. Core operating expenditures should be reported monthly using the budget appropriation economic and administrative classification in addition to the program and functional classification as reported in the budget documents. Core development expenditures should also be reported separately monthly using the budget program classification in addition to the economic, administrative, and functional classification consistent with the operating budget. All the data should also compare outturns against the approved budget. Core operating and development revenues and expenditures should also be reported by province, separately on the same monthly basis.
- External debt data: quarterly and no later than six weeks after the end of the quarter. These will include, with respect to bilateral and multilateral creditors: (i) details of new loans contracted or guaranteed during the quarter, including the terms of each new loan; (ii) the stock of debt at the end the quarter, including short-term debt, and medium- and long-term debt; (iii) loan

disbursements and debt service payments (interest and amortization) during the quarter; (iv) the stock of committed but undelivered debt relief at the end of the quarter and debt relief received during the quarter; (v) information on all overdue payments on short-term debt, and on medium- and long-term debt, including new external arrears (if any); and (vi) total outstanding amount of arrears.

- National accounts data: annually and no later than three months after the end of the year. Merchandise trade data should be reported quarterly and no later than eight weeks after the end of the quarter.
- Monthly consumer price indexes (CPIs) for Kabul and other major cities ("national" CPI) with a lag of four weeks after the end of each month.
- Four-monthly and with a three-month lag, financial flows and other key variables of the state electricity company (DABS), aggregated as well as disaggregated by regional hubs, for the preceding 12 months and (in the last four-monthly period of the year) a forecast for the following fiscal year. The report will use the template agreed with the IMF staff, with all lines filled in, but excluding the disaggregation of losses into technical and nontechnical for regions outside Kabul.
- Financial Stability Indicators for each commercial bank: monthly and with a one-month lag after the end of each month. These indicators will include banks' prudential ratios, capital adequacy ratio, liquidity ratio, portfolio quality indicators (e.g., nonperforming loans, provisions as percentage of classified loans), concentration ratio, related loan ratio, information on open foreign exchange positions, large loan and deposits statistics, income and expense information such as net income to total assets ratio (ROA), rate of return on capital, and net interest margin, and other relevant information. Monthly, balance sheet and income statement for each bank compiled from supervisory submissions, as well as the Summary Analysis of Condition and Performance of the Banking System.
- Lending to public enterprises from each commercial bank: monthly with a one-month lag after the end of each quarter share a report on the following balance sheet items and operations for each bank: (i) aggregate value of outstanding loans to all public enterprises; (ii) disaggregated value of outstanding loans by public enterprise for each bank's top 10 borrowers; and (iii) indicators of the quality of these loans. For this reporting requirement, public enterprises refer to those defined in paragraph 7.
- Quarterly activity and cost reports from the Kabul Bank receiver, including the status and financial details of asset recovery, progress updates pursuant to implementation of recommendations of the Kabul Bank asset recovery diagnostic, and disbursements of net proceeds.
- Copies of documents related to asset recovery, such as mutual legal assistance requests (evidence and banking and property information redacted) to foreign jurisdictions, copies of MOUs which cover international cooperation with said jurisdictions.
- Monthly details of the discretionary cash balances held in the MoF's Afghani- and U.S. dollar-denominated TSA accounts, and the discretionary development account. In addition, an

update of the monthly summary report of financial flows under operating budget and development budget (discretionary and nondiscretionary), and the updated monthly cash projections for the next 12 months, annual cash projections for the current and following fiscal year.

- Treasury cash balance: weekly report on the Treasury (discretionary and nondiscretionary) cash balance.
- Banking sector: Monthly CAMEL rating for all the banks, monthly income statements and balance sheets for all the banks, consolidated income statement and balance sheet for all banks.
- Copies of documents related to the progress on structural benchmarks under the program, such as draft legislation, memoranda of understanding, strategies, implementation plans, transmittal letters, etc.

28. The MoF and DAB will send to the IMF reports by the end of each quarter documenting progress with implementing structural benchmarks under the program. These reports will include the relevant documentation and explain any deviations from the initial reform timetable, specifying expected revised completion date and will include other details on major economic and social measures taken by the government that are expected to have an impact on program sequencing (such as changes in legislation, regulations, or any other pertinent).