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Islamic Republic of Afghanistan: Selected Issues and Statistical Appendix

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ISLAMIC REPUBLIC OF AFGHANISTAN

Selected Issues and Statistical Appendix

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Approved by the Middle East and Central Asia Department

February 17, 2006

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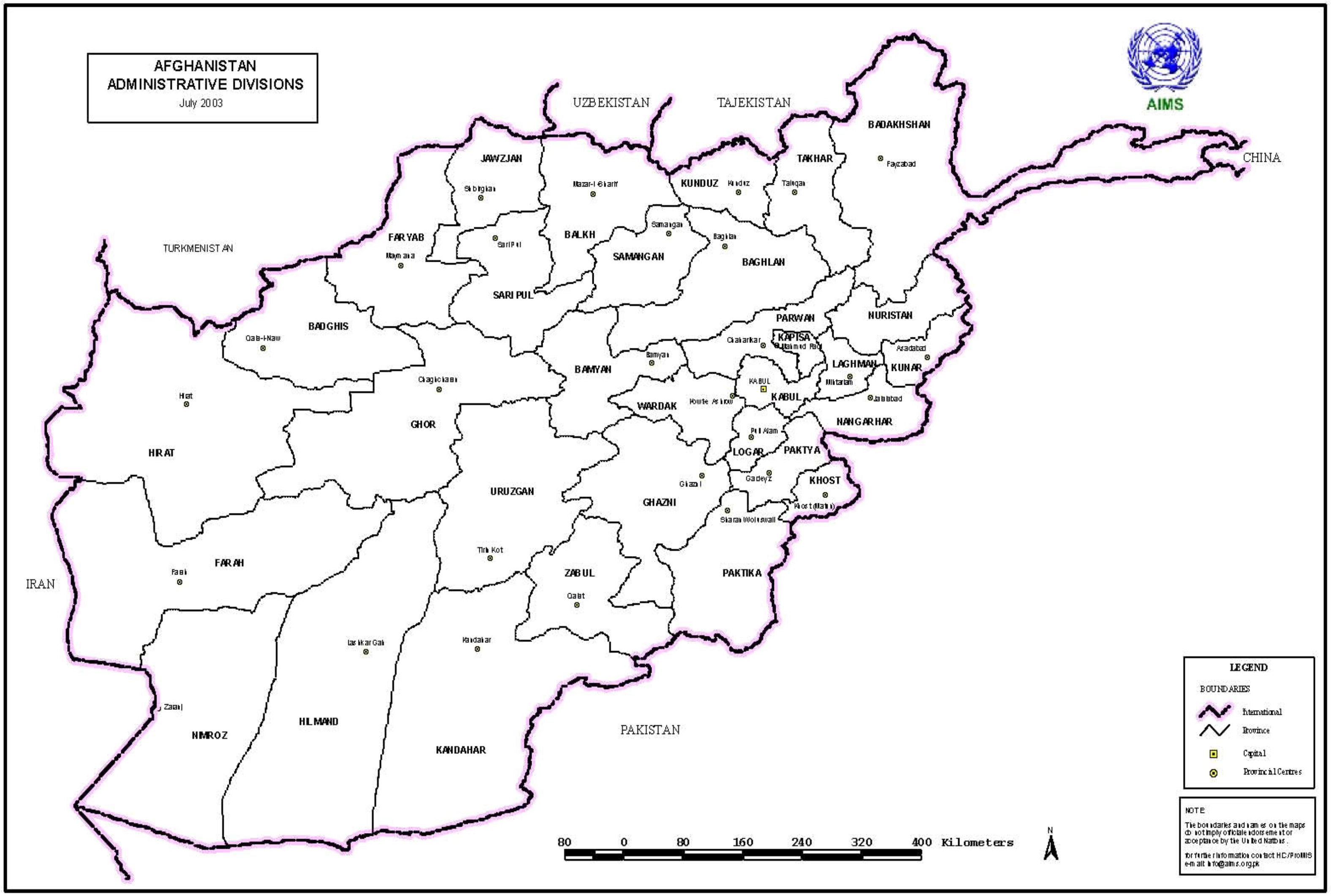

Source: United Nations: Afghanistan Information Management Service

OVERVIEW

This document consists of two parts:

- The first part includes three issues papers. The first one reviews some indicators of Afghanistan's external competitiveness. The second paper discusses the rebuilding of domestic revenue. The third one analyzes the macroeconomic impact of the drug economy and the counternarcotics efforts.

- The second part of this document provides, whenever available, statistical information on the real, fiscal, monetary, and external sectors. It also contains a list of state-owned enterprises and an updated summary of the tax system as of end-December 2005. This information supplements the data contained in the staff report for the 2005 Article IV Consultation.

I. INDICATORS OF AFGHANISTAN'S EXTERNAL COMPETITIVENESS [1]

A. Introduction

1. **This paper attempts to provide a preliminary view on Afghanistan's external competitiveness through a review of some macroeconomic, microeconomic, and institutional indicators.** Data limitations make it difficult to conduct a thorough study of competitiveness. There is a lack of historical information on key macroeconomic variables; and recent data on domestic costs, national accounts, consumer and producer prices, terms of trade, foreign investment, and labor market developments are either unavailable or weak at best. Also, information on the business environment was, until recently, unavailable or incomplete.[2]

2. **Notwithstanding data limitations, reviewing competitiveness issues is important in light of recent developments in the exchange market**. The Afghani appreciated by about 20 percent in real effective terms over the 30 months to September 2005. This appreciation appears to be the result of "Dutch disease" stemming from drug- and aid-related inflows. Other factors affecting external competitiveness include structural rigidities, severe energy shortages, and a weak business and banking regulatory environment.

3. **In the near term, external competitiveness might not be a pressing issue, as aid, in particular, has supported the economy since the fall of the Taliban.** Nonetheless, it needs to be addressed over the medium and long term, particularly in light of the eventual dwindling of donor support and the need to diversify the export base and the sources of growth to place the economy on a sustainable growth path and find alternatives to opium-related activities. The government's new interim national development strategy recognizes the importance of enhancing external competitiveness (Box I.1).[3]

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[1]This paper was prepared by Messrs. Bessaha and Banerjee (MCD).

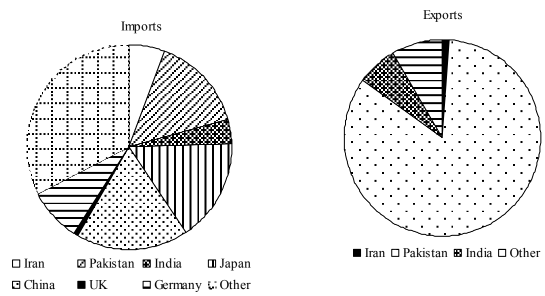
[2]A recent assessment of the investment climate in Afghanistan is provided in "The Investment Climate in Afghanistan: Exploiting Opportunities in an Uncertain Environment", Finance and Private Sector Development Unit, South Asia Region, World Bank. December 2005.

[3]The Interim Afghanistan National Development Strategy (I-ANDS) was submitted to the donor community at the London International Donors' Conference on January 31.

Box I.1. Trade Structure

The low degree of diversification of the economy and its heavy reliance on agriculture makes Afghanistan highly vulnerable to external and exogenous shocks. Afghanistan's total trade in 2005 was estimated by the Central Statistics Office (CSO) at $5.4 billion, comprising about $3.9 billion in imports and $1.7 billion in exports (of which around $1.2 billion represent reexports). [1/] Exports comprise mainly carpets, dried fruits, nuts, sheepskins, and precious stones. Pakistan is the major destination of Afghanistan's exports and reexports (electronics, cosmetics, toiletries, crockery, and auto parts). Recorded imports represent 50 percent of total imports. [2/] Imports come mainly from Japan, India, and Pakistan. While Pakistan was a major source of imports in the past, China and Japan are now Afghanistan's main import partners, followed by India.

Afghanistan: Share of Trade with Partners, 2005



Sources: Afghan authorities; and Fund staff estimates.

1/ The Afghan authorities resumed publication of trade statistics in 2002–03 after a long interruption that dates back to the early years of the return to power of the Mujahidins in 1992–93. The CSO has gradually emerged as the key source of external trade data. Official trade statistics do not capture cross-border trade with the Islamic Republic of Iran, which is believed to be significant.

2/ Unrecorded imports include duty free imports by diplomatic missions, firms holding public contracts, international organizations, nongovermental organizations, and Ariana (the national airline company).

4. **In the present context, from a policy standpoint, there is little that financial policies can do to offset the significant real appreciation of the Afghani that has taken place in recent years.** In particular, a more accommodative monetary policy aimed at avoiding a nominal appreciation of the currency is likely to lead to rising inflation, which is still estimated to be in double digits in 2005/06, and, ultimately, would not prevent a real appreciation. Rather, strengthening competitiveness will require strong efforts to increase efficiency in utilizing external aid as well as decisive implementation of structural reforms to improve productivity, including by lowering the cost of doing business. Removing the structural rigidities that affect Afghanistan's external competitiveness will require major efforts and coordination between the government, donors, and the business community.

5. **The structure of the paper is as follows.** Section B reviews some economic indicators of Afghanistan's competitiveness, including the (Consumer Price Index) CPI- and wage-based real exchange rates. Section C completes the analysis by discussing institutional factors that influence external competitiveness. Section D discusses some competitiveness-enhancing reforms.

B. Economic Indicators of External Competitiveness in Afghanistan

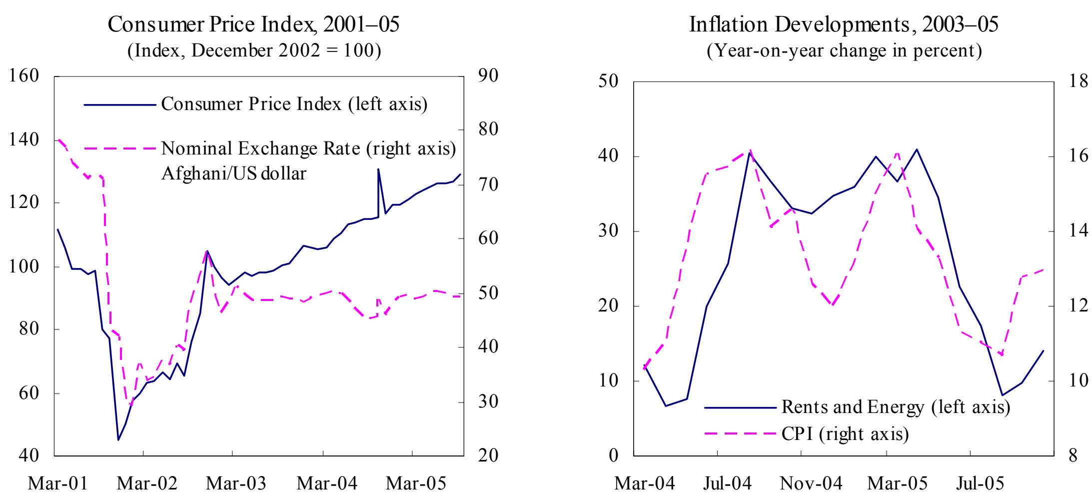
6. This section discusses Afghanistan's international cost position through various economic and quantitative indicators.

Consumer Prices

7. **While CPIs are imperfect tools for the analysis of competitiveness, they are, nonetheless, one of the few sources of information readily available on a regular basis.**[4] Consumer prices fluctuated widely in 2001/02, owing to the change in political regime and the introduction of a new currency. Between March 2003 and October 2005, prices rose steadily by 36 percent. This was mostly attributable to a significant increase in rents and energy prices (Figure I.1). Even, excluding these items, the CPI increased by 24 percent over the same period, which was mostly fueled by strong aggregate demand stemming from the return of refugees, as well as rising wages associated with donor and drug-related flows.

Figure I.1. Islamic Republic of Afghanistan: Price and Exchange Rate Developments, 2001–05

(In units as stated)



Sources: Afghan authorities; and Fund staff estimates.

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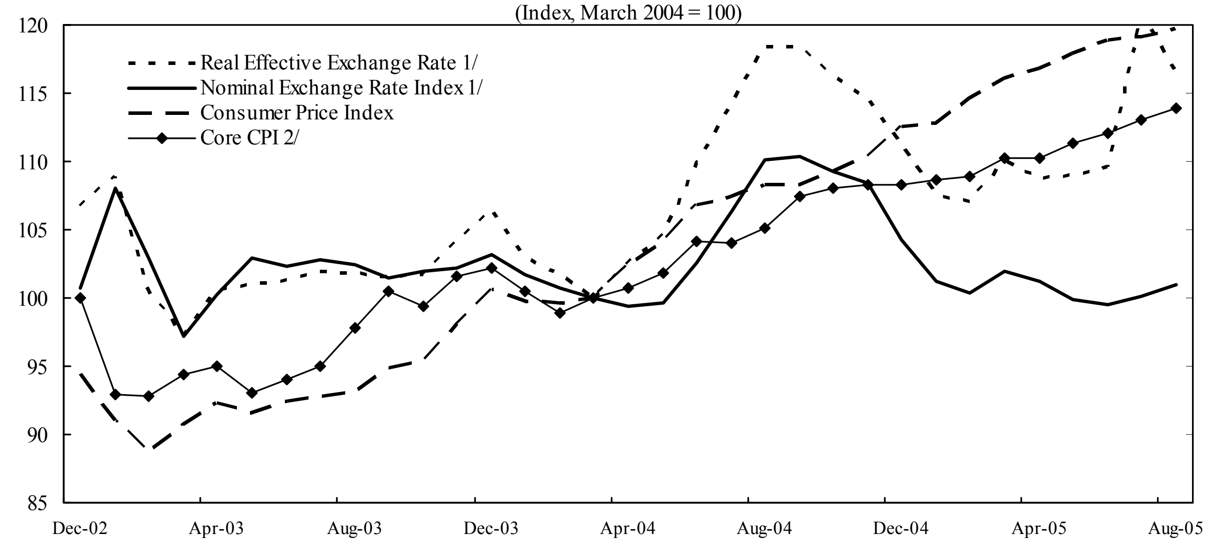
[4]The CSO compiles and publishes CPI for the capital city, Kabul, and a national CPI covering five cities namely: Herat, Kandahar, Jalalabad, Mazar-e-Sharif, and Khost. The CPI is calculated on the basis of a weighted average of the prices of a basket of goods and services established by a household budget survey conducted by CSO and the United Nations in 1979, with some modifications. The Kabul consumer basket includes 202 goods and services typically consumed by urban middle- and low-income households. The Laspeyres formula is used to calculate the CPIs.

The CPI-Based Real Effective Exchange Rate

8. **In light of the relative stability of the nominal exchange rate and modest inflation experienced by Afghanistan's major trading partners, Afghanistan's real effective exchange rate (REER), in terms of the CPI, has appreciated by about 15.7 percent since early 2003 (Figure I.2).**[5] There was a period of relative stability between April 2003 and March 2004, followed by a large real appreciation between April and September 2004, and a subsequent real depreciation through the end of 2004 (Box I.2). Overall, the net real appreciation was driven primarily by a large increase in consumer prices. There was another real appreciation of about 8.6 percent in 2005, driven again by domestic inflation.

Figure I.2. Islamic Republic of Afghanistan: Consumer Prices and Effective Exchange Rates, 2003–05

(Index, March 2004 = 100)



Sources: Afghan authorities; and Fund staff estimates.

1/ Increase implies appreciation.

2/ Excludes rents, energy and education.

9. **The REER provides only partial information about changes in external competitiveness**. On one hand, a trend appreciation of the REER is considered unfavorable for export growth if there are signs of "Dutch disease." On the other hand, a real appreciation can reflect an increase in competitiveness if there have been substantial relative productivity gains in the tradable sector. We will review these issues below.

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[5]The REER appreciated by about 20 percent over the 30 months ended in September 2005.

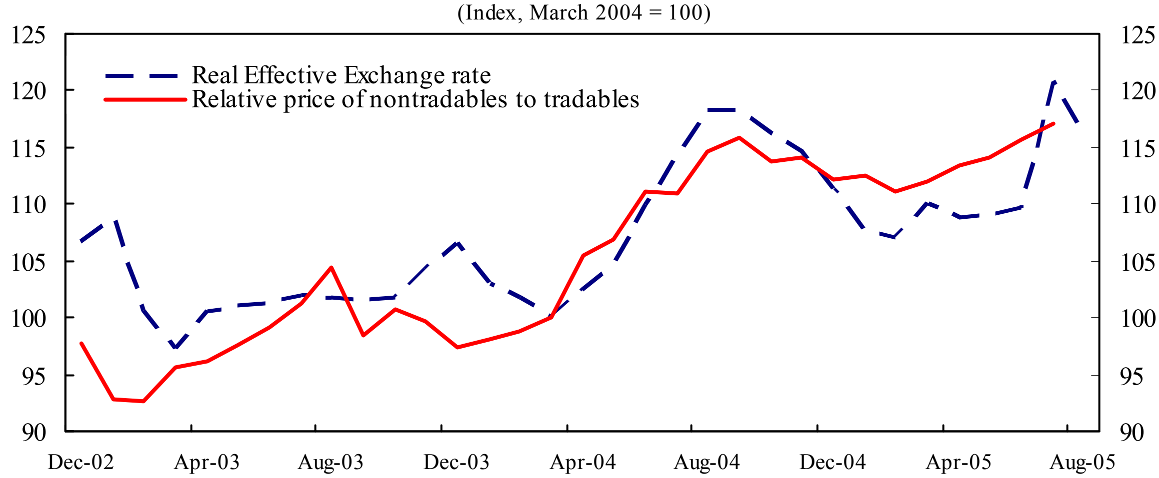
Box I.2. The Exchange System

Currently, Afghanistan has a de facto unified exchange rate. The central bank, Da Afghanistan Bank (DAB), provides daily quotes for the official Afghani-U.S. dollar rate based on early morning quotations in the free market of money changers. The rate is used for all transactions, including those with the government. DAB exchange rates for other currencies are based on cross rates with the U.S. dollar. DAB uses the buying and selling rates from the free market rather than a fixed spread around a central rate. The spread between the two rates (for cash transactions) fluctuates within a range not exceeding 1 percent. DAB collects a small commission on travelers' checks and international transfers. The current system is appropriate in view of the structural changes taking place in the economy.

The Relative Price of Nontradable to Tradable Goods

10. **Movements in the REER mirror closely those in the relative price of nontradables to tradables (Figure I.3).** In this regard, and to some extent, the recent real appreciation may reflect positive productivity gains in the tradable sector. While no data are available to corroborate this argument, there is ample anecdotal evidence that significant foreign technical assistance and sustained imports of sophisticated equipment may have facilitated a transfer of technology and contributed to improving productivity. However, it could also be the case that wages and the prices of nontradables have risen as a result of strong domestic demand stemming from large exports of opium and foreign aid or that the productivity gains have mostly affected the nontraded service sector. These pressures are likely to have affected adversely the competitiveness of the tradable sector.

Figure I.3. Islamic Republic of Afghanistan: Relative Price of Nontradable to Tradable Goods, 2002–05 1/
(Index, March 2004 = 100)

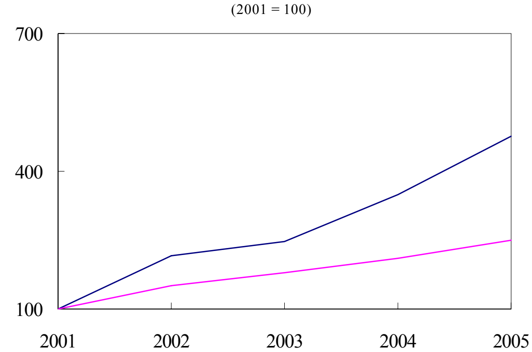


Sources: Afghan authorities, IMF Direction of Trade Statistics; and Fund staff estimates.
1/ Increase implies appreciation.

The Wage-Based Real Exchange Rate

11. **The lack of reliable information makes it difficult to construct an index of unit labor costs in Afghanistan to capture the impact of productivity gains in recent years relative to the gains experienced by trading partners.** Thus, we will seek to reach some preliminary conclusions based on simple calculations of Afghanistan's wage-based real exchange rate vis-à-vis its main trading partners (Pakistan and Iran) using data on average manufacturing costs in both countries. Figure I.4 indicates that the wage-based real exchange rates of the Afghani vis-à-vis the Pakistani rupee and the Iranian rial experienced a significant appreciation during the postwar period. As productivity in Afghanistan is unlikely to have increased much faster than in Pakistan and Iran, this appears to reflect primarily upward pressure on wages stemming from aid and drug-related activities (a form of "Dutch disease" similar to that experienced by oil-producing countries).

Figure I.4. Islamic Republic of Afghanistan: Wage-based Real Exchange Rates vis-à-vis Pakistani rupee, Iranian rial 2001–05
(2001 = 100)



Sources: National authorities; and Fund staff estimates.

Labor Costs[6]

12. **A static analysis based on the limited available information suggests that wages (unadjusted by productivity differences) are significantly higher in Afghanistan than in neighboring countries (Table I.1).** In the manufacturing sector, average hourly wages exceed those paid in Pakistan and Iran by a factor of 2.3 and 1.2, respectively. The wage gap is wider regarding compensation of managers and highly trained professionals. While annual salaries for this category of staff are within the $3600 to $8000 range in neighboring countries, they amount to about $12,000 in Afghanistan. This higher compensation reflects acute shortages of skilled labor in Afghanistan, fueled by strong competition from the donor community. In the agricultural sector, hourly wages in Afghanistan are about $1.90, compared with $1.70 in Pakistan, $1.10 in India, and $1.25 in Iran. The higher level of wages in the licit rural economy reflects strong competition for labor from the drug sector, especially during the poppy harvest (April–June).[7] It has been reported that higher wages in drug-related activities lead to

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[6]Labor cost indicators in Afghanistan are subject to severe limitations, including: (a) the lack of a stable labor market—on account of decades of war and other disruptions; and (b) distortions caused by topography, ethnic divisions, movements of refugees and internally displaced persons, and poppy cultivation. Labor costs analysis is further hampered by the seasonal nature of unemployment and underemployment, especially during the winter months; and the degree of informality. Thus, the information in this paper should be regarded as highly tentative.

[7]See WFP/FAO (2003, 2004, and 2005).

chronic shortages in regional markets and encourages labor migration, particularly of teachers and other civil servants, who leave their posts to get employment in the poppy fields.[8]

Table I.1. Relative Wage Levels, 2005 1/
(Hourly wages in U.S. dollars; unless otherwise indicated)

	Afghanistan	Pakistan	India	Iran
Manufacturing	1.87	0.80	0.50	1.50
Highly Trained Professionals (annual salary in U.S. dollars)	12,000	3,600-6,000	5,000-8,000	5,000-8,000
Agriculture	2.00	1.70	1.00	1.25

Source: Fund staff estimates.

1/ These data are partial and not extracted from consistent long-term series. Accordingly, they should be regarded as purely indicative.

C. Other Factors Influencing External Competitiveness

13. **Other institutional and structural factors also play an important role in influencing Afghanistan's external competitiveness.** These include land tenure, business regulations, transparency, the political and security climate, infrastructure, the trade framework, and human resources. In all these areas, there are significant weaknesses which add to the cost of doing business.

Access to Land

14. **Access to land is a major constraint faced by the business community.** Uncertainty surrounding land tenure discourages investment, particularly by foreign companies. On average, it takes a new investor 252 days and expenses equivalent to 9.5 percent of the value of sales to complete the registration of a property, compared with 124 days in neighboring countries. Furthermore, property rights are difficult to enforce in

[8]Most of the active population (90 percent) is employed in the informal sector and family-owned businesses (subsistence agriculture, trading, and cottage industries). The rest is employed in the public sector (about 5 percent of the labor force, including government employees and staff on the payrolls of public enterprises); NGOs and international agencies (both multilateral and bilateral); and the nascent formal private sector.

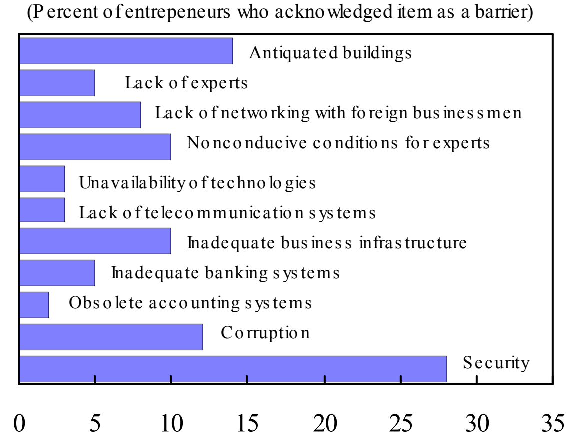
light of the lack of a clear land tenure system and an efficient and transparent judicial system. This uncertainty in land tenure acts as a powerful deterrent to access commercial credit as land cannot be used as collateral.

Business Environment

15. **In recent years, the Afghan authorities have taken a number of steps to improve the business environment, as evidenced by the simplification of procedures to open a business, and the adoption of a liberal legal framework for the labor market.** However, these advances are overshadowed by continued rigidities in other key areas for business activity. A recent World Bank report ranks Afghanistan below regional averages in most measures of business friendliness. For example, the cost of starting a business in Afghanistan is estimated at 53 percent of gross national income per capita, compared with 40 percent on average, for the region (Table I.2). Similarly, 11 steps are required to register property, compared to 7 in neighboring countries. Access to credit is a major constraint due to uncertainties in land tenure, as indicated above. More importantly, the judicial system is inefficient and corrupt, and the time needed to enforce contracts is high by regional and international standards.

16. **In addition to security, there are other noneconomic barriers that hinder private sector activity.** A survey by the Afghan-American Chamber of Commerce (2003) indicated that corruption is regarded as the second most important barrier to business growth in Afghanistan (Figure I.5). Other significant constraints include lack of skilled labor, inadequate infrastructure, and weak banking practices.[9]

Figure I.5. Islamic Republic of Afghanistan: Survey of Barriers to Business Development, 2004 1/
(Percent of entrepeneurs who acknowledged item as a barrier)



Source: Business Climate in Afghanistan, Afghan-American Chamber of Commerce; based on interviews of 1000 entrepreneurs.

[9]It is worth noting that the level of taxation was not mentioned as a barrier to private sector activity.

Table I.2. Islamic Republic of Afghanistan: Doing Business Survey, 2005

Indicator	Afghanistan	Region	OECD
A. Starting a Business 1/			
Procedures (number)	1.0	7.9	6.5
Time (days)	7.0	35.3	19.5
Cost (percentage of income per capita)	52.8	39.7	6.8
Min. capital (percentage of income per capita)	0.0	0.8	28.9
B. Hiring & Firing Workers 2/			
Difficulty of Hiring Index	67.0	37.6	30.1
Rigidity of Hours Index	20.0	35.0	50.4
Difficulty of Firing Index	30.0	42.5	27.4
Rigidity of Employment Index	39.0	38.5	36.1
Hiring cost (percentage of salary)	0.0	5.1	20.7
Firing costs (weeks of wages)	4.0	75.0	35.1
C. Registering Property			
Procedures (number)	11.0	6.9	4.7
Time (days)	252.0	124.0	32.2
Cost (percentage of property value)	9.5	6.3	4.8
D. Getting Credit 3/			
Legal Rights Index	0.0	3.8	6.3
Credit Information Index	0.0	1.8	5.0
Public registry coverage (percentage adults)	0.0	0.1	7.5
Private bureau coverage (percentage adults)	0.0	0.6	59.0
E. Protecting Investors 4/			
Disclosure Index	0.0	4.1	6.1
Director Liability Index	0.0	4.6	5.1
Shareholder Suits Index	2.0	6.4	6.6
Investor Protection Index	0.7	5.0	5.9
F. Paying Taxes 5/			
Payments (number)	2.0	25.0	16.0
Time (hours)	80.0	331.0	192.0
Total tax payable (percentage of gross profit)	21.4	35.3	46.1
G. Trading Across Borders			
Documents for export (number)	...	8.1	5.3
Signatures for export (number)	...	12.1	3.2
Time for export (days)	...	33.7	12.6
Documents for import (number)	10.0	12.8	6.9
Signatures for import (number)	57.0	24.0	3.3
Time for import (days)	97.0	46.5	14.0
H. Enforcing Contracts			
Procedures (number)	...	29.7	19.5
Time (days)	400.0	385.5	225.7
Cost (percentage of debt)	24.0	36.7	10.6
I. Closing a Business 6/			
Time (years)	No practice	4.2	1.5
Cost (percentage of estate)	No practice	7.3	7.4
Recovery rate (cents on the dollar)	0.0	19.7	73.8

Source: The Investment Climate in Afghanistan. Exploiting Opportunities in an Uncertain Environment. The World Bank, 2005 (Annex C)

1/ Entrepreneurs can expect to go through one step to launch a business over seven days on average, at a cost equal to 52.8 percent of gross national income (GNI) per capita. No minimum deposit is required to obtain a business registration number.

2/ Each index assigns values between 0 and 100, with higher values representing more rigid regulations. The Rigidity of Employment Index is an average of the three indices. For Afghanistan, the overall index is 39.

3/ The Legal Rights Index ranges from 0 to 10, with higher scores indicating that those laws are better designed to expand access to credit. The Credit Information Index measures the scope, access, and quality of credit information available through public registries or private bureaus. It ranges from zero to six, with higher values indicating that more credit information is available from a public registry or private bureau.

4/ The index vary between 0 and 10, with higher values indicating greater disclosure, greater liability of directors, greater powers of shareholders to challenge the transaction, and better investor protection.

5/ Entrepreneurs must make 2 payments, spend 80 hours, and pay 21.4 percent of gross profit in taxes.

6/ The recovery rate, expressed in terms of how many cents on the dollar claimants recover from the insolvent firm, is zero.

Institutions and Transparency

17. **Weak institutions and lack of transparency inject uncertainty in the investment climate and raise the cost of doing business (Table I.3).** The 2005 Transparency International Corruption Index ranks Afghanistan 117th out of 158 countries.[10] Corruption is especially discouraging to foreign investors. The 2005 World Bank Survey on the Investment Climate indicates that firms pay bribes equivalent to 8 percent of sales, compared with 2 percent in neighboring Pakistan. The business environment is also clouded by government inefficiency in providing basic services, and a weak financial system. This leads businesses to rely on the informal hawala network, which is inadequate to meet the needs for long-term private sector development.

Table I.3. Islamic Republic of Afghanistan: Governance Indicators, 2000–04 1/

Governance Indicator	Year	Percentile Rank (0-100)	Estimate (-2.5 to +2.5)	Standard Deviation	Number of Surveys/Polls
Voice and Accountability	2004	11.2	-1.4	0.1	9
	2002	11.1	-1.3	0.2	5
	2000	2.1	-1.8	0.3	2
Political Stability	2004	3.4	-2.0	0.2	7
	2002	1.1	-2.3	0.3	4
	2000	0.6	-2.5	0.4	2
Government Effectiveness	2004	9.1	-1.2	0.2	6
	2002	5.0	-1.4	0.3	4
	2000	8.1	-1.3	0.4	1
Regulatory Quality	2004	2.5	-2.1	0.3	4
	2002	3.1	-1.8	0.3	2
	2000	0.0	-3.6	0.5	1
Rule of Law	2004	1.0	-1.8	0.2	7
	2002	2.0	-1.6	0.2	4
	2000	0.0	-2.3	0.4	2
Control of Corruption	2004	3.9	-1.3	0.2	6
	2002	3.1	-1.3	0.3	3
	2000	1.1	-1.6	0.4	1

Source: World Bank (2004).

1/ Higher percentile rank indicates a higher confidence in the people polled with respect to each indicator.

[10] Notwithstanding the poor performance of Afghanistan in the area of corruption, the country still ranks higher than some neighboring countries, including Pakistan and Tajikistan.

Political and Security Environment

18. **Political risks and security concerns are serious in Afghanistan.** This makes it difficult to attract new investors. Over the past few months, there have been improvements in security, and the central government is gradually extending its control over the provinces. At the same time, the implementation of the Bonn Agreement has contributed to greater political stability, and the successful organization of presidential and legislative elections strengthened the institutional framework. Nonetheless, while security concerns do not fully prevent the entry of new businesses, they lead to more business spending. It is estimated that firms allocate 15 percent of their revenues to security infrastructure, compared with 2.2 percent in Pakistan and 1.9 percent in Uzbekistan (World Bank, 2005).

Infrastructure

19. **The poor state of infrastructure also contributes to high production costs, reduces the attractiveness of Afghanistan as an investment alternative, and generates uncertainty about merchandise delivery.** Years of conflict and war and a lack of maintenance have severely damaged the road infrastructure. While the road network is being rehabilitated and thousands of kilometers have been built since the fall of the Taliban regime, there are still many areas that have little access to roads. Also, air transport infrastructure is weak, which makes it difficult to carry freight to and from Afghanistan; the postal system is in disrepair and does not provide adequate services outside Kabul; and UPS services have a high cost and are geographically limited owing to security concerns. Telecommunications infrastructure has significantly improved over the last four years as cellular and internet services have become more widely available in all of the major cities. However, the number of lines continues to be limited, and the cost of telephone calls abroad remains high (Table I.4).

Table I.4. Islamic Republic of Afghanistan: Communications Infrastructure 2001/02–2004/05
(In units as stated)

	2001/02	2002/03	2003/04	2004/05
Number of post offices	321.0	396.0	396.0	424.0
Number of fixed lines and mobile telephones (per 1000 people)	1.3	1.9	11.8	24.0
Price at internet cafes (U.S. dollars per hour)	...	1.8	1.0	1.0
Telephone (Afghanis per minute)				
From Afghanistan to:				
Pakistan, India and Iran	...	...	...	22.5
Saudi Arabia	...	...	...	22.5
United Arab Emirates	...	...	...	22.5
United States	...	...	...	25.0
Western Europe	...	...	...	25.0

Sources: Data provided by the Afghan authorities; and Fund staff estimates.

20. **Electricity costs constitute another constraint on competitiveness (Table I.5).** Industries in Afghanistan are charged about Af 6.0 per kilowatt-hour (kwh), compared with Af 2–4 per kwh in Pakistan, Iran, and Tajikistan. The cost of utilities is high because Afghanistan's power grid is obsolete and inefficient as a result of severe damages caused by years of war. Currently, actual supply amounts to about 300 megawatts, out of an installed power generation capacity of about 420 megawatts while demand is estimated at 2000 megawatts and covered partly by imports from neighboring countries.[11] Consequently, there are acute shortages all over the country, with only 10 percent of the population having access to electricity and for short periods of time each day (Table I.6). Furthermore, power supply is of poor quality and incompatible with the needs of the business community, as it is delivered in low voltage. The lack of reliable supply leads businesses to rely on generators, which raises production costs and severely hinders private sector development.

Table I.5. Islamic Republic of Afghanistan: Electricity Prices for Industrial Users, 2005
(In Afghanis)

Electricity 1/	(Afghanis per Kwh)
Industries	
Afghanistan	6.0
Iran	2.3
Pakistan	4.1
Tajikistan	2.0
Outside Kabul city	5.1

Source: Afghan authorities, Pakistan Economic Survey 2004/05; and Fund staff estimates.

1/ Prices per kilowatt-hour.

Table I.6. Islamic Republic of Afghanistan: Production and Demand for Electricity, 2001/02–2004/05
(In millions of kilowatt-hour)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06 1/
Production of electricity	503	490	557	827	783	366
Hydro	501	488	556	632	564	341
Diesel	2	2	1	1	3	25
Demand for electricity	...	...	...	...	1,987	1,987

Sources: Data provided by the Afghan authorities; and Fund staff estimates.

1/ For the first 9 months of the year.

[11] Kabul suffers severe electricity shortages as only one power plant (the 100 megawatts Naghlu Dam), which has a sizable reservoir capacity, is operational year round. In addition, maintenance and renovation of power plants is very difficult because of the mines in the areas around the plants and numerous technical problems.

Human Resources

21. **Skilled labor is in shortage in Afghanistan.** This is attributable to the protracted conflict, emigration of the country's best trained people, and historical barriers to training women. This severely constrains firms from investing or expanding.

The Trade System

22. **Although Afghanistan has made significant headway in facilitating trade, there are still a number of rigidities.**[12] Administrative barriers, ad hoc fees levied by local governments, cumbersome import and customs clearance procedures, weak standards and regulations, the absence of transparent competition policies, and limited progress on computerization continue to affect adversely the expansion of private sector activity. In addition, traders are faced with a lack of trade finance, cold storage facilities, and insurance.

D. External Competitiveness-Enhancing Measures

23. While the appreciation of the real exchange rate resulting from "Dutch disease" stemming from drug- and aid-related inflows is a significant factor, the relatively high production costs arising from rigid business practices, poor infrastructure, insufficient availability of power, and lack of transparency also weigh heavily on competitiveness.

24. **The policy response to these issues does not lie in a change of the current stance of macroeconomic policy, which remains broadly appropriate.** Fiscal policy should continue focusing on consolidation to reduce internal demand pressures and contain wage and price inflation. Foreign exchange intervention or a relaxation of monetary policy for the sole purpose of depreciating the exchange rate would likely prove counterproductive as it would lead to an increase in inflation and, ultimately, would not prevent a real appreciation.

25. **Rather, productivity gains are central to improving Afghanistan's competitiveness and will require comprehensive structural reforms and efficiency in utilizing external aid**. In a context of close cooperation between policymakers and the business community, these reforms should seek to establish an enabling environment for private sector-led growth by further liberalizing the economy, promoting sound competition, and improving infrastructure. At the same time, better security conditions outside Kabul would help lower the cost of doing business and unlock investment opportunities.

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[12]Beginning in 2004, the government introduced sweeping reforms to the tariff regime and customs administration. As a result, Afghanistan is one of the most open economies in the region. The IMF trade restrictiveness index ranks Afghanistan four on a scale of ten, significantly better than India (six), Pakistan (six), Iran (seven), and Uzbekistan (nine).

26. **Some measures have already been put in place to enhance competitiveness, including a more simplified tax system, favorable labor practices, improved telecommunications, and an appropriate legal framework for corporatization.** Nonetheless, as indicated in the I-ANDS, there is still significant scope for improvement, notably in the following areas:

- **Further liberalizing the economy.** This entails, in particular, a significant reduction of the government's role in productive activities. In this regard, the authorities should accelerate the implementation of their plans for divesting the state-owned enterprises slated for privatization and liquidation. It will also be important to complete an inventory of the various public entities and government agencies engaged in commercial activities. The establishment of a sound underlying regulatory framework would be crucial for reaping the full efficiency and competitive gains from privatization.

- **Creating adequate conditions for private sector activity.** The cost of doing business can be brought down significantly through bold actions aimed at streamlining procedures for entry, further simplifying the tax system, improving contract enforcement, and enhancing transparency of government operations.

- **Building a modern and resilient banking system.** This requires the elimination of the current administrative and legal hurdles impeding the development of the banking sector. In this connection, the authorities should work closely with the donor, business, and banking communities to prioritize the enactment of a core group of laws, including legislation on secure transactions, business organizations and negotiable instruments, and they should also seek to improve tenure laws and regulations.

- **Strengthening labor and factor market flexibility.** The authorities should explore options to further strengthen labor market flexibility, including by harmonizing the current legislation. Opportunities to improve productivity through education, on-the-job training, skill upgrading, and dissemination of new knowledge and techniques should also be explored, as the lack of skilled staff significantly hinders investors in moving into activities with higher value added. At the same time, the authorities should put together a labor market information system to facilitate labor mobility.

- **Strengthening the agricultural sector and building infrastructure networks.** There is potential for expanding exports of agricultural goods and developing a new rural industry, one of the sectors identified by the authorities as having potential for diversification. However, this requires improved access to roads, availability of energy at a lower cost, and the development of transportation networks, and warehousing facilities. The authorities should continue to work closely with the donor community to address these issues.

- **Strengthening the institutional framework and administrative processes underlying the trade regime.** The authorities must work diligently to accelerate the computerization of customs, the establishment of a legal framework for sound competition, and the introduction of standards and regulations consistent with international codes and agreements to facilitate an expansion of trade. At the same time, preparatory work should be stepped up to start discussions for World Trade Organization (WTO) membership. The latter would provide more predictability in trade relations with other countries, as well as access to the WTO dispute settlement apparatus and technical assistance.

- **Improving the organization and management of export firms.** Most of these firms are family-owned and managed by family members and associates. The lack of professionalism hinders expansion and results in poor organization and low productivity. Addressing this issue requires hiring professional managers and skilled labor, and putting in place modern organization methods.

- **Enhancing regional cooperation.** Afghanistan is a hub between Central and South Asia and the Middle and Far East. The reconstruction effort under way has been instrumental in expanding trade at the regional level. The authorities should continue to take advantage of the country's location to boost trade and transit activities with neighboring countries. Membership in regional organizations would allow Afghanistan to benefit from economies of scale and lower costs of production.

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II. Rebuilding Domestic Revenue in Afghanistan [1]

A. Introduction and Overview of the Current Revenue System

1. **Sustaining the rapid growth of revenue is critical to achieving fiscal sustainability.** With revenue excluding grants expected to reach 5.3 percent of non-opium GDP in 2005/06, including 3.6 percent of GDP in tax and customs revenue, Afghanistan has one of the lowest rates of collection in the world. Nonetheless, this rate represents a significant improvement (a 185 percent increase in U.S. dollar terms) from 2002/03, when domestic revenue totaled 3.2 percent of GDP. The task of rebuilding revenue is complicated by the collapse in formal economic activity and administrative capacity in the aftermath of Afghanistan's prolonged conflict.

2. **The government's objective is to mobilize sufficient revenue to cover a large share of public expenditures.** In 2004/05, domestic revenues amounted to less than half of core budget operating expenditures (predominantly employee compensation) and an estimated 28 percent of total recurrent expenditures, including items currently in the external budget (essentially off-budget), such as the Afghan National Army. The benchmark in the Interim Afghanistan National Development Strategy (I-ANDS) discussed with donors in January 2006, is to raise domestic revenue to at least 8 percent of GDP by 2010/11. This would cover the whole of the operating budget (as currently defined) and an estimated 58 percent of total recurrent expenditures. Box I.1 of the staff report provides a fuller discussion of this benchmark.

3. **Afghanistan's long-term revenue potential may be toward the lower end of the 11 percent to 15 percent of GDP range.** A recent study suggests that "for low-income countries, raising the tax share to at least 15 percent of GDP should be seen as a minimum objective."[2] However, Afghanistan shares many of the structural features associated with a low tax base, including: (a) low GDP per capita and a large informal sector; (b) the dominance of the agriculture sector, which is hard to tax; (c)and capacity constraints that hinder the ability of the government to collect taxes.[3] Comparing the tax levels of countries with a similar level of development may provide a guide to a realistic medium-term revenue target (Table II.1).[4] However, the persistent nature of Afghanistan's structural constraints, combined with its large illicit opium economy, which tends to undermine governance, and its

[1]This paper was prepared by Theo Thomas and draws extensively on a paper written for the World Bank sponsored study, *Afghanistan, Managing Public Finances for Development* (December 2005).

[2]See Heller, (2005).

[3]See Keen (2004).

[4]Although this statistically based method has no basis in theory, and choosing the relevant countries is necessarily subjective, it is a commonly used approach in countries where the statistical base is limited.

Table II.1. Central Government Revenues by Group
(in percent of GDP)

Country/region	GDP Per Capita (US$) 1/	Total Revenue	Total tax Revenue	Taxes on Income Profits and Capital Gains			Domestic Taxes on Goods and Services			Trade	Other
				Total	Corporate	Personal	Total	General Sales, Turnover or VAT	Excises		
Afghanistan (2004/05 est.)	**233**	**4.5**	**3.4**	**0.3**	**0.2**	**0.1**	**0.4**	**0.2**	**na**	**2.5**	**0.1**
Sub-Saharan Africa	765	19.7	15.9	3.9	1.9	1.3	7.9	5.5	2.2	1.9	2.2
Asia and Pacific	1,447	16.6	13.2	4.6	2.9	2.0	5.3	2.7	1.9	2.1	1.2
Low-income countries	...	18.0	14.9	3.9	2	1.9	5.9	3.5	2.0	3.7	1.4
Low- middle income countries	...	21.8	15.8	3.8	1.8	2.1	6.3	4.8	2.1	3.6	2.1
Non-OECD average	...	...	15.2	4.5	2.1	2.2	10.1	4.9	2	3.1	...
Selected countries average		**17.4**	**14.3**	**4.7**	**3.0**	**1.4**	**6.3**	**3.2**	**2.0**	**1.9**	**1.6**
Pakistan	420	16.4	12.4	3.0	2.7	0.5	4.7	2.3	2.4	3.6	1.2
Iran	1,700	20.5	8.6	3.3	2.2	1.1	1.8	0.1	1.4	3.2	0.3
India	470	18.5	14.3	2.8	1.5	1.2	8.1	0.0	3.2	2.6	0.8
Kazakhstan	1,520	22.3	18.4	5.4	1.7	2.0	6.2	4.0	0.5	0.6	6.2
Kyrgyz Republic	290	19.1	15.0	3.2	1.1	1.5	11.1	5.4	2.1	0.7	0.0
Azerbaijan	710	20.5	19.4	5.0	1.9	1.5	8.2	3.4	1.5	1.5	4.7
Uganda	240	11.5	10.7	1.8	...	...	4.8	1.2	3.7	1.8	2.3
Rwanda	...	10.4	9.3	2.7	...	...	5.0	...	...	1.6	...

Source: Government Finance Statistics (IMF)

Figures refer to country averages for 1997-2001, where data are available.
1/ Country data refer to GNI per capita (World Bank)

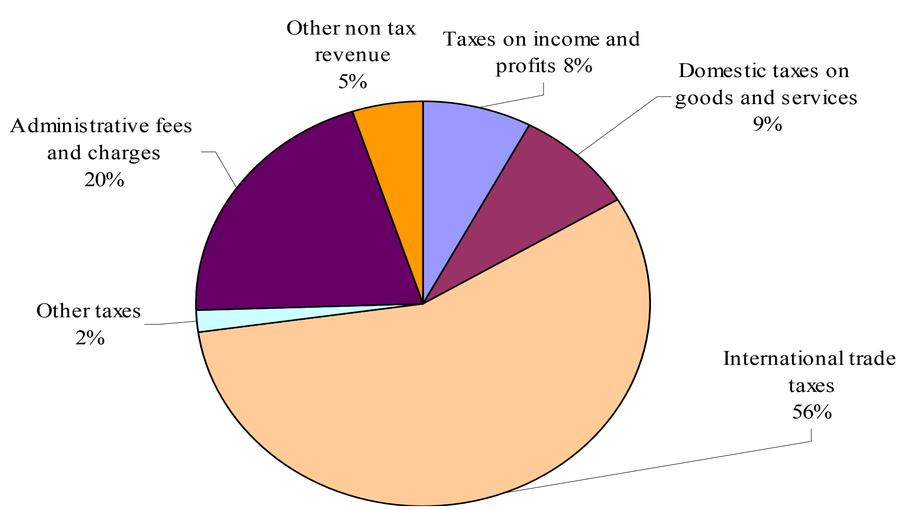
historical record of low tax collection—in the 1970s revenue was around 7 percent of GDP—reinforce the view that the country's tax potential is likely to be toward the lower end of the revenue-to-GDP ratio in other developing countries.[5]

4. **The current revenue policy broadly reflects Fund recommendations, but a large gap between actual revenue and estimated tax potential suggests that Afghanistan needs to drastically improve its tax administration.** In Afghanistan, enforcement mechanisms are weak and compliance rates extremely low. International experience suggests that the larger the tax gap, the more radical the required administration reforms.[6] With a tax gap of more than 40 percent, Afghanistan should adopt a comprehensive reform strategy involving a complete revamping of tax administration to obtain significant improvements in compliance.

5. **Revenue is concentrated in a small number of taxes.** As in many less developed and particularly post-conflict economies, import duties constitute the main source of revenue, comprising over 50 percent of total receipts (Figure II.1), because they are relatively easy to monitor and collect. This pattern is not significantly different from that of the mid-1970s, when around 78 percent of tax revenue was derived from trade taxes.[7] Box II.1 summarizes the major sources of revenue in Afghanistan.

Figure II.1. Structure of Revenue, 2004/05

(In percent of total revenue excluding grants)



[5]See World Bank report, "Afghanistan: The Journey to Economic Development", March 17, 1978.

[6]See Baer and Silvani's (1997) *review of tax administration reforms*.

[7]See World Bank report, "Afghanistan: The Journey to Economic Development," March 17, 1978.

Box II.1. Summary of Major Sources of Revenue in Afghanistan

Appendix I details the current structure of taxation, which can be summarized as follows:

Customs duties constitute the largest source of revenue in Afghanistan, as in many developing countries, largely because they are relatively simple to administer. While domestic taxes tend to grow in importance as countries develop, with consumption-based taxes eventually taking on the primary revenue raising role, they are more difficult to administer and their development constitutes a long-term objective for Afghanistan. In the interim, the average import tariff rates should be kept relatively low, in line with the main trading partners, and with a limited dispersion to reduce arbitrary and excessive effective rates of protection, as well as to minimize incentives for corruption. Recent reforms to Afghanistan's tariff schedule, in 2004, are in line with these principles.

Export taxes should generally be avoided, since they tend to cause a shift in resources away from the export sector toward less efficient uses, thus compromising growth objectives. Recent tax reforms in Afghanistan have significantly lowered the tax rates for exporters. Following the introduction of the new tariff regime, the Business Receipts Tax (BRT) rate for importers and exporters was set at 0 percent. In addition, the fixed tax on importers and exporters was lowered to 0.5 percent for 2004/05.

Income Taxes should ideally be levied on a global basis and on all forms of income. The corporate and top personal tax rates have been aligned at 20 percent, which is relatively low by international standards. To improve compliance, new collection enforcement powers and penalty provisions were approved in 2005 along with the restoration of the wage withholding tax. The level of personal income tax exemption has been set to effectively remove most civil servants from taxation (which should ensure a progressive system). However, tax brackets need to be regularly reviewed, particularly when inflation is high, in order to maintain the desired link to relative incomes.

Sales taxes should be simple to administer and broad-based on final domestic consumption. Afghanistan currently has a complex and cascading system based on turnover (BRT) and numerous presumptive (fixed) taxes for smaller traders, which is far from ideal. While a single rate value-added-tax (VAT), with crediting provisions and zero-rating of exports, is one of the most efficient taxes, it is administratively too complex to implement at this time. Over the medium-term, Afghanistan should expand the current system toward a more broad-based consumption tax that avoids cascading.

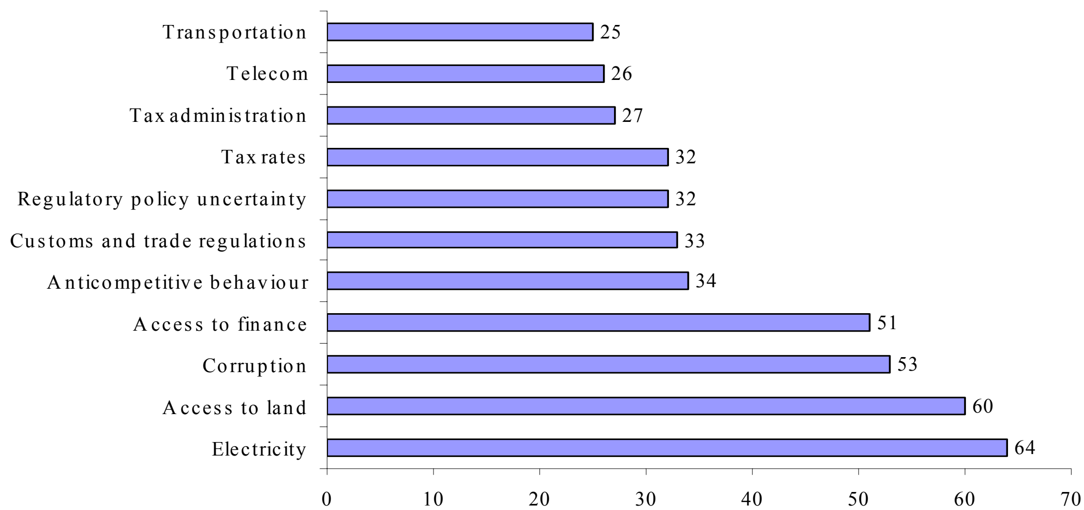
Excise taxes. There are currently no excise taxes in Afghanistan, but they are being considered in the 2006/07 budget for items such as tobacco, fuel and vehicles.

6. **There are a large number of small "nuisance" taxes.** With around 90 different active taxes—half of which generated less than $21,000 in 2004/05—it is highly likely that the administrative costs of some of them outweigh their revenue gains. The income tax law, which has been in force since 1964, provides for a variety of taxes, usually referred to as fixed taxes, including presumptive taxes on small businesses as well as the cascading turnover tax known as the BRT. The law also identifies 170 tax categories of business establishments. Although some of these taxes serve a useful purpose of broadening the tax base to small businesses and the BRT may form the basis of a future consumption tax, removing many of the smaller nuisance taxes and simplifying the tax collection system is

likely to be cost-effective and should help promote the private sector activities. The revised income tax law approved in 2005, changed the income component of the law, but did not address the smaller nuisance taxes.

7. **Illicit revenue collection, double taxation, corruption and ambiguities in the tax laws also add to the costs of doing business in Afghanistan.** The recent business survey conducted by the World Bank noted the positive nature of recent tax reforms in improving the business environment, but also highlighted the need for further improvements (Figure II.2 for the major constraints).[8] Businesses have noted that illicit charges and corruption are widespread and the tax authority of the municipalities (the only separate, albeit relatively small, tier of government) is unclear, leading to instances of double taxation—for example the central government introduced a rent withholding tax in 2004, but some municipalities also collect property taxes.[9] Business organizations have also complained that the legal code is often unclear. This lack of transparency and accountability can lead to disputes and is a potential source of administrative corruption.

Figure II.2. Percentage of Firms Citing Constraints as Major or Severe



Source: "The Investment Climate in Afghanistan, Exploiting Opportunities in an Uncertain Environment," World Bank, December 2005.

[8]World Bank, "The Investment Climate in Afghanistan: Exploiting Opportunities in an Uncertain Environment," December 2005.

[9]Afghan International Chamber of Commerce (AICC) reports have documented instances of illicit taxes, double taxation, and ambiguities in the law. See http://www.en.aicc-online.org/.

B. Revenue Policy and Administration

8. **The ideal tax system is designed to raise revenue required to achieve a sustainable fiscal position while being fair, transparent, and minimizing distortions.**[10] In order to help promote a vibrant private sector, the tax system should; (a) minimize interference with individual consumption, saving and investment decisions; (b) be relatively simple, transparent, and rules-based to encourage compliance with the limited available capacity and discourage corruption; and (c) be stable and predictable to reduce the economic costs of uncertainty.

9. **There is often a trade-off between short-term revenue mobilization needs and economic efficiency.** Given the limited options and administrative capacity available for generating revenues, post-conflict countries often have to implement taxes that are less desirable from an efficiency standpoint, or move only gradually in restructuring the distortionary taxes already in place. For example, in most post-conflict countries, revenue mobilization relies heavily on import duties and on collecting sales and excise taxes only at the border, especially when there are relatively few major border control points. There are even cases where export taxes have been implemented because of the inability to collect at the production stage or implement an income tax, and when the product is largely exported.[11] While taxing imported goods may not be ideal from an efficiency point of view, it can be argued that, with limited domestic production, imports account for a very high proportion of consumption and that the system can form the basis of an eventual move towards a more standard and efficient consumption tax.

10. **Afghanistan has adopted some of the lowest trade and corporate tax rates in the region.** Reforms introduced in 2004 rationalized the former 25 tariff bands, ranging from 7 percent to 150 percent, to 6 bands with a top rate of 16 percent and an average tariff of around 4 percent (see staff report for the 2004 Article IV consultation, IMF Country Report No. 05/33). The corporate income tax rate was also reduced from 25 percent to 20 percent of net taxable income, and in 2004 generous depreciation and loss carry forward provisions replaced an inefficient system of tax holidays and exemptions (see below). Cross-country comparisons are difficult, but corporate tax rates in Pakistan range from 35 percent to 50 percent, the Islamic Republic of Iran charges a flat rate of 25 percent, the rate in China is 30 percent and the rate in India is 36.8 percent for domestic companies, with a more complex schedule for foreign companies.

11. **Future reforms of the tax system need to take into account the country's limited administrative and technical capacity.** Any proposal needs to balance the need for additional revenue against the objective of developing a vibrant private sector. Consequently,

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[10] See Tanzi and Zee, 2001.

[11] Export taxes were introduced in Liberia, Tajikistan, and Timor-Leste after their conflicts. They were viewed as temporary, to be phased out as other sources of income became available. See Gupta, (2005).

the authorities are considering proposals for a more uniform tariff structure, removing taxes on exports, introducing a set of selected excises, and moving towards a broad-based tax on final consumption. In the interim, the cascading Business Receipt Tax (BRT) will have to be maintained, as it constitutes around 70 percent of sales tax receipts, but ideally it should be at relatively low rates to minimize distortions (although with little domestic production and few large firms, the degree of cascading is relatively limited). These proposals are broadly in line with those of private sector groups, who also emphasize the need for further simplification of the tax system and a reduction in the number of nuisance taxes and cumbersome procedures.

12. **Revenue administration reform is crucial for effective tax policy implementation.** In designing Afghanistan's strategy for revenue mobilization, consideration should be given to the very weak state of institutions and the extremely limited capacity of the administration to implement policies after the end of the conflict—as reflected in the large tax gap. Tax policy needs to provide a suitably modern framework within which tax administration can be built. Experience suggests the following guiding principles for administrative reform: [12]

- reduce the complexity of the tax system by reducing the number of taxes, harmonizing rates, removing exemptions, and eliminating elicit charges and double taxation;
- encourage taxpayers' voluntary compliance with new, simplified self-assessment procedures, and improve taxpayer education;
- differentiate taxpayers by their revenue potential, including through the creation of a Large Taxpayer Office (LTO) and risk management strategies; and
- ensure effective management of the reform.

13. **The customs and tax authorities have adopted five-year reform plans through 2007 and 2008, respectively**. The revenue-raising function is located within the Ministry of Finance (MoF). Responsibilities are divided between the Afghanistan Customs Department (ACD) and the General Presidency of Revenue (GPR), both of which report to a Deputy Minister. The ACD is historically a more distinct administrative entity, with functions that include collection and the management of a customs service. The GPR has traditionally been in charge of domestic taxation policy, with the provincial Treasury offices (*Mustofiats*) collecting the taxes. The ACD and GPR reform plans have been designed and are being implemented with the support of considerable external technical assistance.

14. **Efforts to include the private sector and donors in the revenue modernization program should contribute to enhancing implementation.** Many of the policy and administrative reforms adopted in 2004 and early 2005 were implemented with limited

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[12] From Baer and Silvani (1997) and Gupta, (2005).

consultation with the private sector. This occasionally resulted in confusion and uncertainty over specific policies and taxes—for example, the revised tariff schedule introduced in January 2004 had to be temporarily suspended and revised owing to the opposition from the business community. The dialogue has since improved, and in November 2005 the MoF and the Afghanistan Investment Support Agency (AISA) jointly hosted a conference to discuss tax policy and administrative reforms with the business community and donors. Joint government-business working groups were formed to prepare proposals for priority reforms, such as the simplification of the tax structure and the introduction of a consumption tax to replace the BRT. The MoF is also producing taxpayer education guides and public rulings to enhance transparency.

15. **Customs administration reform will continue to dominate the revenue mobilization effort over the medium term.** During 2004, the ACD implemented measures to: (a)simplify the tariff system, including the use of market exchange rates for import valuation and the transfer of responsibility for customs valuations from the Ministry of Commerce (MoC) to the MoF; (b)introduce simplified customs clearance documentation and procedures, including a monitoring system for duty exempt imports, notably aid-related; and (c)establish an effective system of customs brokers to facilitate a speedier and more robust transit process (the brokerage system is designed to expedite the clearance process but needs to be carefully supervised to ensure that it does not create additional administrative barriers). A modern customs code was promulgated, after some delay, in March 2005.

16. **Ongoing reforms in the customs area include:** (a) new regulations and procedures to implement the new customs code should be completed in 2006 produced; (b) customs infrastructure will continue to be upgraded throughout the country, supported by USAID, the World Bank and the European Commission (new facilities have already been completed at the major customs posts near the Pakistan and Iran borders); (c) a computerized recording and management system (Automated System for Customs Data, [ASYCUDA]) will be gradually introduced over the next few years (starting with key border posts in 2006/07); (d) human capacity in the central and regional customs offices will be reorganized and rebuilt, which should reduce corruption; and (e) mobile customs teams and customs police were introduced in 2005 to ensure effective enforcement, combined with an effort to reduce a plethora of reported illegal charges.

17. **Implementation of these measures will be gradual because of the severe physical and human capacity constraints.** The World Bank's Doing Business 2005 survey noted a number of impediments to trade, including the use by customs officials of wide discretion in implementing valuation and inspection procedures, which leads to delays and corruption. Despite a welcome reduction in illicit charges and road blocks, the survey reported that it takes 11 days for imported goods to clear customs (without a bribe), a period slightly longer than in Pakistan, and considerably longer than in other neighboring countries. Nonetheless, substantial progress is being made to simplify customs administration and make the process more transparent. This complements the efforts being made to create a well equipped and professional customs service, which are being supported by a number of donors.

18. **Developing a broader tax base will take time; in the short term the focus will be on the larger taxpayers.** Tax reforms have had to be selective as the administrative apparatus in the provincial Mustofiats was even weaker than that of customs. The decision was taken to create a central LTO to focus scarce resources on the most effective revenue sources and overcome the lack of capacity (see below). A tax reform package was approved by the President in June 2004, which included the reintroduction of a wage withholding tax; the introduction of a BRT tax on selected 'high-value' services, such as restaurants and hotels; a reduction in the corporate tax rate from 25 percent to 20 percent; and a new rent withholding tax.[13] In 2004, a Taxpayer Identification Number (TIN) was introduced which has been progressively rolled out to the major provincial centers.

19. **The implementation of the tax reform package and the consolidation of tax legislation was severely delayed.** The amendments to the income tax law, which included the tax package and addressed the excessive use of tax holidays, exemptions and special agreements, were eventually promulgated in June 2005, having been delayed by the backlog of new laws. A new income tax law, which includes provisions to strengthen administration under the GPR, introduces enforcement powers and includes provisions for the taxation of minerals, was eventually approved in November 2005. While a new comprehensive income tax code is being developed, delays in promulgating the previous reforms created considerable uncertainty amongst both taxpayers and the administration, reportedly hindering collections over the past 18 months. To enhance transparency, the government has established a program to improve the guidance provided to the private sector (including some discussion forums) and to tax administrators. A tax manual should be published in 2006/07.

20. **The focus on large taxpayers is likely to significantly enhance revenues**. Many countries have found that a small number of taxpayers (perhaps 5 percent) may account for 75 percent or more of the total tax collection (Table II.2). This approach has been adopted in many post-conflict countries (e.g. Albania, Kosovo, Liberia, Serbia and Montenegro, Timor-Leste, and West Bank and Gaza). In Afghanistan, the case for establishing a dedicated LTO to monitor, audit, and enforce collection for large taxpayers is heightened by the low level of compliance and extremely weak administrative capacity.

21. **LTOs can help to pioneer administration reforms by piloting new systems and procedures**. Afghanistan established a LTO in 2004 using transparent criteria to select the largest taxpayers (see Box II.2). However, a fully functional LTO requires a high degree of preparation and training to build capacity and establish more efficient procedures. The LTO needs to develop specialist capacity in tax auditing and to reorient its own business practices to facilitate voluntary compliance with new procedures like self-assessment, using enforcement mechanisms only when necessary. To take advantage of the latest reforms and the enhanced professionalism of the LTO staff, many large businesses are expected to deal increasingly with the LTO and to move away from the Mustofiats, where knowledge and capacity to apply the new laws is limited and corruption is reportedly endemic.

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[13] See Appendix I for details of the specific taxes.

Table II.2. Concentration of Domestic tax Collections in Selected Countries

Country	Number of Large Taxpayers Nationally	As a Percent of Total Taxpayers	Share of Total Collection (In percent)
Australia	50,000	0.5	40
Argentina	2,450	0.25	51
Azerbaijan	1,040	1.0	64
Bulgaria	1,350	0.21	68
Brazil	30,000	0.33	92
Côte d'Ivoire	550	6.25	70
Kenya	600	0.4	61
Mongolia	46	0.2	54
Nicaragua	400	0.67	75
Peru	1,600	0.14	58
Sri Lanka	2,024	2.02	92
Tajikistan	185	0.3	43
Togo	581	2.4	81
Uganda	317	2.1	36

Sources: Dos Santos (1994), IMF (2002); and Fund staff estimates. (Iran established a LTO in 2001).

Box II.2. Selecting the Largest Taxpayers

It is important to carefully determine the LTO's clients to ensure that scarce resources are effectively targeted towards those taxpayers that will yield the highest revenue. In Afghanistan, criteria have been developed and approved to select the largest taxpayers, estimated at around 100 (in order):

- Foreign-owned entities with capital investments in Afghanistan exceeding $10 million;
- Foreign-owned entities not included above operating in oil and gas, banking and finance, and international air transport;
- State-owned enterprises operating in oil and gas, banking, and air transport; and
- Other entities ranked by annual sales/turnover (over Af 50 million or $1 million).

Around 170 firms were identified using the above criteria. The LTO is aiming to narrow the list further so that it can prepare proper tax profiles of a more manageable set of companies.

22. **The LTO can be expected to collect at least 60 percent of domestic tax revenue, but implementation has lagged expectations.** It was initially envisaged that by 2004 the LTO would become fully functional and operated by officials with a good knowledge of all the large taxpayers and their activities. Collection enforcement procedures would be working effectively, and audit operations based on risk-management principles should have commenced. However, implementation has been much slower than envisaged, mainly due to delays over the recruitment of new managers and advisory support. The head of the LTO was

eventually appointed in 2005, but taxpayer profiles are still being compiled for some important clients, such as the airlines. It is important that the LTO now focuses on introducing the more significant reforms, such as self-assessment and tax audit, which will facilitate better compliance from its core clients.

23. **Moving to a broad-based consumption tax would remove some of the more serious deficiencies of the current indirect tax system.** The current weaknesses of the BRT include: (a) a narrow tax base leading to low revenue yield; (b) serious potential cascading (albeit at generally low rates with few steps)[14] and (c) disincentives to export. The authorities are considering proposals to address these problems over the medium term by moving toward a broad-based sales tax at the manufacturing level, perhaps within 3–5 years, as an intermediate step before adopting something like a value-added tax (VAT). A working group with private sector representatives has been formed by the MoF to develop proposals for the introduction of a consumption based tax.

24. **A broad-based consumption tax is hampered by capacity constraints.** The VAT, which is imposed by governments in more than 100 countries around the world, is the most common form of consumption tax. The basic characteristics of a VAT are that all persons or businesses that are engaged in the supply of taxable goods and services throughout the production and marketing chain are required to register for the VAT and charge VAT on all taxable sales. However, introduction of a VAT represents a radical reform of the tax system and is constrained by the non-existence or low level of record keeping and accounting, in addition to severe administrative capacity constraints. Thus a retail level VAT will need to part of a longer-term strategy.

25. **A single-stage sales tax at the manufacturing level may be a simpler option and could be operated in conjunction with taxes on selected services and excises.** The phased extension of the recently introduced taxes on selected services could pave the way for the development of a broader-based consumption tax, as administrative capacity permits. A manufacturing sales tax is applied at the point where goods are first sold in the case of domestically produced goods, and at the point of customs clearance, in the case of imported goods. A single tax rate applicable to all goods would be simpler to administer and would not distort relative prices. A single-stage manufacturers sales tax has been employed in many countries, particularly in the earlier stages of their tax development, and can be expanded to further trade levels with a minimum of disruption.

Taxation and Investment Incentives

26. **In 2002, the government introduced a new investment incentive law containing a number of generous tax provisions.** The law allowed for tax holidays (both for income and business receipts taxes) for qualified investments by both domestic and foreign investors, for periods ranging from four to eight years from the date of licensing, or three to seven years

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[14] Tax cascading occurs when the tax at one stage of production or distribution is included, at a later stage, in the price on which further tax is imposed.

from the start of production, whichever came first. Almost 6,000 licenses were granted by the MoC, without much scrutiny, before approvals were centralized in Kabul under a new organization, the AISA, a corporation under the control of the MoC. The main concerns raised by these tax incentives included:

- By exempting profits irrespective of their amount, tax holidays tend to benefit investors expecting a high rate of return, who probably would have invested even if the absence of incentives;

- Tax holidays provide strong incentives for tax avoidance, as taxed enterprises could enter into economic relationships with exempt ones to shift their profits to the latter through transfer pricing. The duration of tax holidays is also prone to abuse;

- Time-bound tax holidays tend to attract, if they have any impact at all, short-run projects, which are typically less beneficial to the economy and could even be a disincentive to long-term investment in the absence of loss-carry forward provisions. In the case of Afghanistan, over 40 percent of tax holidays granted before mid-2004 were reportedly awarded to construction companies, which should not benefit from such incentives.

- The revenue cost to the budget is seldom transparent, unless enterprises are required to file proper tax returns and the aggregate fiscal "loss" is calculated. Conservative estimates published by the MoF put the revenue loss resulting from the exemptions and concessions granted prior to July 2004 at $14.6 million in 2003/04, equivalent to 6 percent of revenue, and at $30.2 million from 2002–04.

27. **The system of tax holidays and exemptions was replaced in 2005 with less distortionary investment incentives.** In addition to the aforementioned concerns, it was acknowledged that revenue measures are best consolidated within the appropriate tax laws. The Income Tax Law was amended in 2005 to provide two types of tax incentives: accelerated depreciation; and unlimited loss carry-forward. Since merely accelerating the depreciation of an asset does not increase the total allowable nominal depreciation beyond its original cost, little distortion in favor of short-lived assets is generated. Neither is there much incentive for an enterprise to engage in profit shifting noted above. Companies were allowed to retain the tax holidays granted before June 2004 under the previous law if they could prove that they had fully complied with all the related regulatory requirements. However, few, if any, companies had filed their annual accounts, as required by the corporate law, which nullified their right to retain such privileges.

Tax Treatment of the Petroleum and Mining Sectors

28. **Mineral exploitation is a potentially significant source of revenue.** A World Bank study suggests that the gross annual market value of extracted solid minerals could increase from an estimated current level of $60 million to $253 million per annum within a 4–5 year time horizon. At that point the sector could generate value added of $108 million and annual

royalties and other taxes of around $18 million.[15] For this to occur, significant reform measures are required, such as the establishment of a legal and regulatory environment, in addition to significant public and private sector investment. Modern minerals and hydrocarbon laws are being prepared with international assistance. However, in both mining and oil and gas, the government will not receive income tax revenue for a significant period of time after the initial investment is made, as it will take firms time to accumulate taxable income. Royalties will be the first revenue stream, although these could also be reduced if the government retains ownership of the enterprises, as some officials have recently indicated.

29. **A pipeline through Afghanistan, carrying natural gas from Eastern Turkmenistan to Pakistan and beyond, could generate significant revenue and employment.** International oil and gas companies explored the feasibility of the Turkmenistan-Pakistan route in the 1990s, but interest waned subsequently with the discovery of new gas reserves in Pakistan and security concerns. However, as conditions in Afghanistan stabilize, interest in constructing the pipeline has reappeared. As a transit country, the fiscal side of a pipeline agreement might include: (a) payment of a transit fee (estimated anywhere between $100–$300 million annually), (b) taxation of profits from the pipeline, and (c) possible benefits in kind. However, completion of this project is highly uncertain, and even in the best circumstances, is likely to be several years away.

Land Taxes

30. **Agricultural taxes were traditionally collected at the district and local levels, and were reportedly a major source of revenue.** However, they have been suspended in most provinces for several years, initially due to the drought. Any attempt to reinstate them is likely to be severely hampered by the security situation, the large opium trade, and widespread poverty. Nonetheless, given the importance of agriculture to the economy, the authorities are reviewing the feasibility and desirability of reintroducing land taxes as part of the 2006/07 budget, although the revenue to be generated initially is likely to be small.

C. Setting Medium-Term Revenue Targets

31. **The priority for the government is to fund its growing operating budget.** In order to maintain aggregate fiscal discipline, the government has committed not to use central bank financing for the budget, that is, to follow a no-overdraft rule, nor to fund recurrent costs with external borrowing, even at highly concessional terms.[16] Operating expenditures are therefore constrained by the availability of revenue, including grants. Given the large weight

[15]For a detailed review of the mining sector see "Transitional Islamic State of Afghanistan: Mining as a Source of Growth," World Bank Report No. 28231-AF, March 2004.

[16]There is currently no government domestic debt market, which adds another limitation to fiscal financing.

of salaries and wages in total operating budget expenditures (around 67 percent), the medium-term funding requirements are likely to be largely driven by public administration reform.

32. **The I-ANDS targets a revenue ratio of at least 8 percent of GDP by 2010/11.** The revenue targets set out in the Medium-term Fiscal Framework (MTFF) presented to Cabinet in November 2005 together with the midyear budget review, are consistent with covering a growing proportion of total recurrent expenditures, up from 28 percent in 2004/05 to 53 percent by 2010/11 (See Box 1 in the Staff Report for the 2005 Article IV Consultation and Sixth Review Under the Staff-Monitored Program). The civil service wage bill, which excludes items such as the Afghan National Army, should be fully covered by domestic revenue from 2006/07. For the foreseeable future, capital spending and significant recurrent costs would be entirely funded by external assistance.

33. **In the context of a rapidly changing environment, domestic revenue projections are subject to a high degree of uncertainty, even under unchanged policy assumptions.** The weak statistical base, in particular for economic variables critical to revenue projections (e.g., national accounts and the structure of dutiable imports or domestic taxpayers), is problematic. Moreover, additional uncertainty is created by the large structural shifts associated with macroeconomic stabilization and restructuring—such as security, control over provincial transfers, the impact of the counter-narcotics strategies and significant tax policy reforms.

34. **Achieving the government's ambitious revenue targets requires robust economic growth and strong implementation of revenue policy and administrative reforms.** If GDP falls below projections, but recurrent costs grow in real terms as envisaged in the I-ANDS, the proportion of recurrent expenditures covered by domestic revenues will be lower than targeted, prolonging the time to achieve some measure of sustainability. The projections presented below follow broadly the same methodology used by the MoF, and are driven by four elements:

- **Economic growth and inflation:** The tax base is expected to grow in line with nominal GDP growth, or for import duties, in line with the growth in dutiable imports. These variables are sensitive to exogenous factors, such as prolonged drought, and could also be negatively affected in the short term by an opium eradication campaign. Nontax revenues are assumed to grow with nominal GDP, with the potential exception of over-flight fees.[17] Hence little growth, relative to GDP, is expected in administrative fees.
- **Customs and tax policy reforms:** The government enacted a sweeping reform of trade taxes in 2004 and has partially implemented a wide range of tax reforms, such as the rental tax, wage withholding, and the airport departure fee, and so forth, aimed

[17]Afghanistan currently receives around $16 million per year as overflight fees. With some additional investment in the sector and more air traffic these fees, could increase.

at mobilizing revenue (see above). Even though these reforms are already applicable, the complete implementation of these measures takes time as procedures and administrative capacity need to be developed.

- **Customs administration reforms:** Measures to improve customs administration have been set out above. They focus on improving enforcement and compliance, including rebuilding of physical and human capacity, general computerization (ASYCUDA), the progressive recovery of customs functions from other agencies (e.g., valuation of goods), and the introduction of a simplified customs declaration form.

- **Tax administration reforms:** Measures to improve tax administration (also discussed above) focus on enforcement and compliance. Important developments include the establishment of a LTO and the restructuring of the headquarters and provincial tax organizations.

35. **Alternative scenarios are used to illustrate the implications of different reform paths.** The underlying macroeconomic assumptions are similar for each scenario, with real GDP growing at around 10 percent a year over the first four years, before declining to around 7.5 percent a year thereafter. Inflation is assumed to fall from 10 percent per annum to 5 percent, with the nominal exchange rate remaining stable. The alternative scenarios include the following changes to key assumptions:

- **Scenario 1 (low-case) assumes no further tax policy reforms.** This scenario is based on the current reforms—there is a gradual implementation of the wage withholding tax, selected services taxes (including a roll-out outside Kabul), and the airport departure fee. Compliance rates improve by around 10 percent per annum over the first five years and by 5 percent per annum during the remainder of the projection period. The improvement in compliance rates may seem high, but the starting point is extremely low (compliance is largely voluntary) and this improvement appears modest relative to changes over the last few years and for other post-conflict countries. No additional major policy reforms are assumed to be implemented.

- **Scenario 2 (baseline) assumes the implementation of the five-year customs and tax administration reforms.** Under this scenario, the government introduces the additional reform measures outlined in the MTFF, including: a tariff rationalization that increases the average tariff, an excise tax that could eventually realize around 1 percent of GDP, road tolls and land taxes.[18] The improvements in compliance rates are slightly higher than in scenario 1, assuming that the performance of the customs

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[18]The MoF assumes that the average tariff would double in 2006/07, with the full impact passed on to revenues. However, given the disruption the last tariff reform caused, in 2004, and the scope for avoidance, full pass through is unlikely. The baseline assumes that only 50 percent of the tariff is realized.

administration and the LTO is better. Specifically, the scenario assumes improvements of 10–15 percent per annum over the first six years and 5 percent per annum for the remainder of the projection period.

- **Scenario 3 (high-case) assumes slightly accelerated implementation of the five-year customs and tax administration reforms, together with some additional revenue measures.** Under this scenario, the improvements in compliance rates are slightly higher than in scenario 2, owing to a stronger performance by the Customs administration and the LTO (improvements of 20 percent per annum over the first four years and 5 percent per annum during the remainder of the projection period). Further to the policy reforms discussed in scenario 2, there is a gradual move toward a consumption tax, and toward the end of the projection period, royalties from the mineral sector and the gas pipeline gradually come on stream.

- **The government's MTFF scenario.** This scenario was presented in the midyear budget review and includes several policy measures to be proposed for 2006/07, including a rationalization of customs tariffs that increases the average tariff (while maintaining the current bands) and almost doubles customs revenues. The tax policy measures introduced in 2005/06, and mentioned in scenario 1, are assumed to increase revenues by at least 5 percent per annum. Compliance rates increase by 5 percent in the first year and 10 percent a year thereafter.

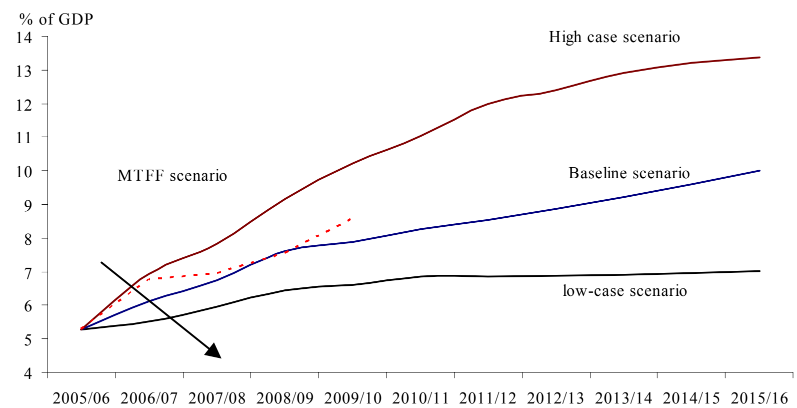
36. **The revenue ratios for each scenario are shown as a percentage of GDP in Figure II.3 and Table II.3.** These ratios provide useful benchmarks for assessing Afghanistan's possible revenue performance, depending on the progress made with the customs and tax reforms.

Table II.3. Revenue Scenarios

	2003/04 Est	2004/05 Est	2005/06 Proj	2006/07 Proj	2007/08 Proj	2008/09 Proj	2009/10 Proj	2010/11 Proj	2011/12 Proj	2012/13 Proj	2013/14 Proj	2014/15 Proj	2015/16 Proj
MTFF operating budget assumptions													
Compensation to employees	6.5	6.6	5.9	5.6	5.7	5.8	5.5						
Total	9.8	9.4	10.0	8.9	8.9	8.9	8.7						
Revenues	4.5	4.5	5.3	6.8	7.0	7.6	8.6						
Staff revenue projections													
Scenario 1 - low-case			5.3	5.5	6.0	6.4	6.6	6.8	6.9	6.9	6.9	7.0	7.0
Scenario 2 - baseline			5.3	6.1	6.8	7.6	7.9	8.3	8.5	8.9	9.2	9.6	10.0
Scenario 3 - high-case			5.3	6.9	7.8	9.2	10.2	11.0	12.0	12.4	12.9	13.2	13.4

Sources: Afghan authorities (MTFF); and Fund staff estimates.

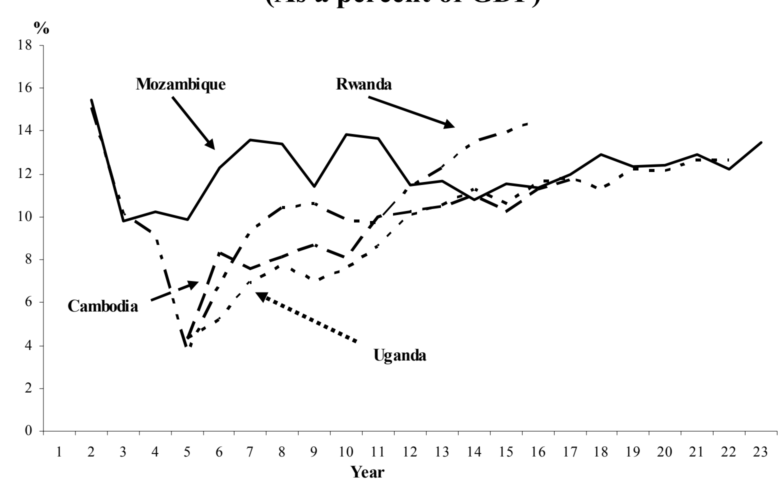
Figure II.3. Medium-Term Revenue Forecast
(In percent of GDP)



Sources: Securing Afghanistan's Future (SAF); and Fund staff estimates.

37. **The MTFF projections appear achievable, assuming the implementation of significant reforms.** Although the revenue increases targeted under the MTFF could be considered ambitious, with the revenue-to-GDP ratio rising by 4 percentage points per year over the first five years, they appear achievable when compared to the experience of other post-conflict countries that also did not have significant natural resources as a source of revenue. For example, the creation of the revenue authority in Uganda helped to double the tax revenue-to-GDP ratio from around 6 percent at the start of the 1990s to around 12 percent in the late 1990s, before a period of more gradual growth (FigureII.4). Similarly, rapid recoveries in revenue performance have been achieved in Rwanda and Cambodia.

Figure II.4. Revenue of Selected Post-Conflict Countries
(As a percent of GDP)



Sources: IMF, Government Financial Statistics and Staff reports.

38. **With institutional capacity still very weak, the achievement of the proposed revenue improvements requires a sustained reform effort and external support.** Administrative capacity is likely to remain weak over the medium term, infrastructure is poor, and compliance rates are extremely low. Consequently revenue administration will remain heavily reliant on external technical assistance for policy development and operational support. Donors are currently providing considerable technical assistance for the implementation of the revenue administration reform plans, particularly in customs.

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III. MACROECONOMIC IMPACT OF THE DRUG ECONOMY AND COUNTERNARCOTICS EFFORTS[1]

We must destroy poppy before it destroys us.
President Hamid Karzai

A. Introduction and Summary

1. The authorities and the donor community's counternarcotics efforts have had a limited impact so far on Afghanistan's opium production, which has remained at historically high levels over the last few years. However, owing to the sustained growth of the licit sector, the size of the opium sector relative to the rest of the economy has declined significantly. Nevertheless, the opium sector remains Afghanistan's largest source of export earnings (although unrecorded) and a major source of revenue in the rural areas. The scheduled intensification of the counternarcotics efforts will therefore have a substantial economic and social impact. To explore this impact, a simple macroeconomic model was developed. While, given the uncertainty surrounding the economic behavior as well as the value of a number of economic variables, the results have essentially an illustrative value, this model seeks to capture, in an integrated way, the key economic transmission channels. The model suggests that even through interdiction and eradication have very different economic effects, the impact of counternarcotics efforts on the real sector will be less pronounced to the extent that a large part of the decline in income could fall on traffickers, who have a lower propensity to consume. Similarly, both the high level of drug-related capital outflows and the large import content associated with drug-related spending could moderate the effect on the balance of payments. The fiscal impact would also be somewhat limited. Nevertheless, in view of the potential social impact of both eradication and interdiction, a gradual approach to the elimination of opium production, allowing the authorities to put in place the necessary sustainable income generation programs in support of the eradication and interdiction campaigns, appears warranted.

B. The Macroeconomic Impact of Drug-Related Activities

The drug sector in Afghanistan

2. **Afghanistan remains, by far, the world's largest opium producer.** Over the last 15 years, Afghanistan's opium production has increased steadily, from 1,570 tons in 1990 to 4,100 tons in 2004 (Table III.1). The main disruption to this increase corresponded to the production ban enacted by the Taliban in 2001, which was successful, at least temporarily, in reducing production (but less so in reducing exports due to the existence of large inventories). As the increase in production in Afghanistan coincided with a drop in

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[1]Prepared by Edouard Martin and Steven Symansky.

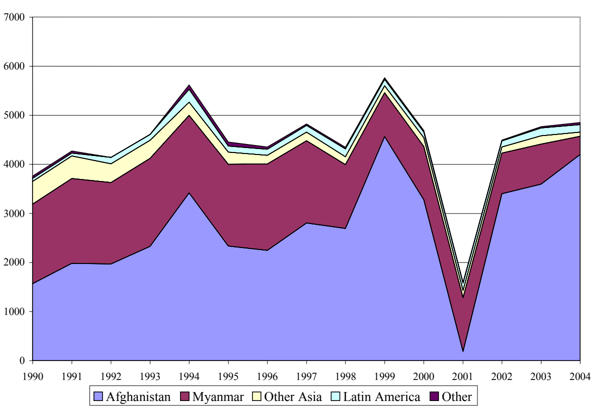
production in the rest of the world triggered by strict bans and intensified counternarcotics efforts, Afghanistan has become by far the world's main opium producer, with a share of world supplies that increased from 42 percent in 1990 to 87 percent in 2005 (Figure III.1).

Table III.1. Islamic Republic of Afghanistan: Opium Production: Basic Indicators, 1986–2005

	1986	1990	1995	1999	2000	2001	2002	2003	2004	2005
Prouction (in metric tons)	350	1,570	2,335	4,565	3,276	185	3,400	3,600	4,200	4,100
Cultivated area (in hectares)	29,000	41,300	53,759	90,583	82,171	7,606	74,100	80,000	131,000	104,000
Yield (in kilogram per hectare)	12.1	38.0	43.4	50.4	39.9	24.3	45.9	45.0	32.1	39.4
Average farmgate price (in U.S. dollars per kilogram)	...	...	23	40	28	303	353	283	143	137
Gross income per ha (in U.S. dollars)	...	...	1,004	2,020	1,107	7,363	16,194	12,750	4,580	5,385

Sources: United Nations Office on Drugs and Crime (UNODC); and Fund staff estimates.

Figure III.1 . Islamic Republic of Afghanistan: World's Opium Production
(In metric tons)



Source: UNODC.(2005b)

3. **Several factors have contributed to the emergence of Afghanistan's prominence in opium production, including:**

- **Favorable cultivation conditions:** Owing to favorable conditions, yields in Afghanistan have been consistently higher than in other opium-producing countries. Over the 2000–04 period, and despite adverse weather, yields in Afghanistan were more than twice than those in Latin America, more than three times those in Myanmar, and more than four times those in other Asian countries.

- **A high morphine content:** In many opium producing countries, notably in South-East Asia, about 10 kilograms of opium are necessary to produce one kilogram of heroin.

However, the transformation yields are much higher in Afghanistan, where on average only 6 to 7 kilograms of opium are needed to produce 1 kilogram of heroin.[2]

- **Insecurity and institutional weaknesses:** The almost complete collapse of any form of central government after the Soviet withdrawal, the warring parties' needs for alternative sources of financing, and the fact that opium was a crop well adapted to the prevailing circumstances, greatly contributed to the development of opium cultivation. Following the fall of the Taliban, lingering insecurity and weak central government control over the provinces contributed, along with widespread corruption, to further development of illicit activities.

- **Poor infrastructure:** Opium is relatively drought resistant, making its cultivation easier than wheat in areas where irrigation is limited. Moreover, dry opium is easy to store and transport, which, given the poor state of roads and stocking facilities in Afghanistan, gives its production an advantage over other crops.

- **Rural poverty:** The decision by many farmers to cultivate opium is primarily dictated by the lack of alternative sustainable livelihoods. In particular, following the sharp increase of opium farm gate prices in 2001–02, the gross income farmers may expect from opium production far exceeds what they would get from cereal production (Table III.2). Moreover, traders/traffickers often provide farmers with the necessary inputs (seeds, fertilizers) and financing, and take delivery of opium at the farm gate, relieving farmers from transportation or storage. While some other cultivations (nuts, orchards) may generate higher revenues, they imply substantial multi-year investments and infrastructure that many farmers cannot afford.

Table III.2. Islamic Republic of Afghanistan: Yields and Income per Hectare for Various Crops, 2005

	Opium	Irrigated wheat	Rainfed wheat	Rice
Yield (in kilogram per hectare)	39	2,510	1,230	2,030
Average price (in U.S. dollars per kilogram)	136.59	0.23	0.23	0.47
Gross revenue (in U.S. dollars per hectare)	**5,385**	**575**	**282**	**947**

Source: UNODC(2005a), FAO(2005a) and FAO (2005b); and Fund staff estimates.

[2]UNODC (2004). The morphine content of opium ranges from 8–24 percent. The highest opium content was observed in the province of Badakshan (slightly more than 16 percent on average). It is worth noting that this high morphine content may be partly canceled out by inefficiencies in processing opium.

4. **The potential export value of the 2005 opium production is estimated by the United Nations Office on Drugs and Crime (UNODC) at $2.7 billion (Table III.3).**[3] This value was estimated on the basis of: (a) the physical transformation ratio of opium to heroin (6–7 to 1); (b) the share of the opium production converted into heroin in Afghanistan (this share has increased steadily over the last ten years, from 41 percent in 1995 to an average of 72 percent in 2002–04 reflecting primarily counternarcotics efforts in neighboring countries and lingering insecurity in Afghanistan); (c) the estimated distribution of opium and heroin exports by neighboring countries (based on seizures in these countries); and (d) the opium and heroin prices observed in the main markets in the neighboring countries' border regions with Afghanistan. The UNODC estimate for 2005/06 corresponds to a potential export value of 420 tons of heroin ($1.6 billion) and 1,169 tons of non-processed opium ($1.0 billion).

Table III.3. Islamic Republic of Afghanistan: Opium Production's Potential Export Value, 2004–05

	2004	2005
Opium production (in tons)	4,200	4,100
Transformation rate	64%	71%
Heroin production (in tons)	414	420
Average export price (in U.S. dollars per kilogram)	4,171	3,856
Export value of heroin (in millions of U.S. dollars)	**1,725**	**1,620**
Opium available for export (in tons)	1,512	1,169
Average export price (in U.S. dollars per kilogram)	725	893
Export value of opium (in millions of U.S. dollars)	**1,096**	**1,044**
Total export value (in millions of U.S. dollars)	**2,821**	**2,663**

Sources: UNODC (2005a); and Fund staff estimates.

5. **The share of the opium sector in the overall Afghan economy has declined steadily over the last few years. This largely reflects sustained growth in the licit economy rather than a decline in exports of illegal drugs, as these exports have remained largely unchanged (Table III.4).** Between 2002/03 and 2005/06, the size of the drug sector relative to licit GDP has declined from 62 percent to 38 percent, and its contribution to overall activity (including opium) from 38 percent to 27 percent. This compares with a contribution of the drug sector to overall activity of less than 1 percent in Colombia, the world's main producer of cocaine, with 57 percent of world supplies (the contribution of the drug sector remained below 2 percent during 1999–2001, when Colombia

[3]UNODC (2005a).

coca production reached its highest levels).[4] The decline of the share of opium-related value added in Afghanistan's agricultural output has been even more pronounced, as the ratio of the opium farm gate value to total agricultural output fell from 37 percent in 2002/03 to 18 percent in 2005/06. At the same time, in 2005/06, the potential export value of opium production was still equivalent to 4.8 times the value of locally-produced exports (compared with 9.2 times in 2002/03).

Table III.4. Islamic Republic of Afghanistan: Relative Size of Opium Production, 2002/03–2005/06

	2002/03	2003/04	2004/05	2005/06	2005/06		
					Licit economy	Drug economy	
	Est.	Est.	Est.	Proj.		Farming	Trading and processing
Licit GDP	4,084	4,585	5,971	7,139	7,139	0	0
Opium GDP	2,518	2,279	2,732	2,594	0	555	2,039
Opium production	2,540	2,300	2,800	2,700	0	560	2,140
Less intermediate consumption 1/	11	12	14	14	0	5	8
Less seizures	10	9	53	92	0	0	92
Total GDP	**6,602**	**6,864**	**8,703**	**9,734**	**7,139**	**555**	**2,039**
Income (net)	1	4	16	20	20	0	0
Gross national income	6,601	6,860	8,719	9,765	7,171	555	2,039
Current transfers (net)	1,222	2,476	2,787	3,149	3,149	0	0
Gross disposable income	**7,823**	**9,336**	**11,506**	**12,914**	**10,320**	**555**	**2,039**
Memorandum items:							
Drug income as as percentage of:							
Licit GDP	61.7	49.7	45.8	36.3			
Total GDP (licit and illicit)	38.1	33.2	31.4	26.7			
Gross disposable income	32.2	24.4	23.7	20.1			
Poppy farmer revenue as a percentage of:							
Licit agricultural revenue	59.6	46.7	27.3	22.1			
Total Agricultural revenue	37.4	31.8	21.4	18.1			

Sources: Afghan authroities and UNODC data; and Fund staff estimates.

1/ Estimated on the basis of UNDCP data (1994), using current seed, fertilizer, and chemical prices.

[4]These estimates are based on UNODC (2004). Steiner (1998) estimates that Colombia's net income from illicit drugs could have been 7 percent of GDP and 70 percent of exports during the first half of the 1980s.

Gross income distribution

Value added

6. **Intermediate consumption is quite limited at the farm level**. [5] While production factor costs (family labor, hiring of daily workers, rental of tractors and/or of land) may be substantial, intermediate consumption, which comprise expenditure on seeds, fertilizers and pesticides is generally considered marginal. A microeconomic study of Pakistan's opiate industry in the early 1990s concluded that these costs amounted to about 4 percent of the opium farm gate value.[6] The intermediate consumption in Afghanistan is currently likely to be substantially lower, at about 1–2 percent of farm gate value, owing to the sharp increase in opium prices, which was only marginally offset by rising seed and fertilizer prices.[7]

7. **In addition to these costs, however, many farmers have to service opium-related debts**. In the absence of savings and other sources of financing, many farmers resort to borrowing, primarily from shopkeepers, traders, and relatives, to finance their intermediate consumption (seeds and fertilizers) and the hiring of production factors (such as day workers and tractors). Typically, the most common form of credit is the *salaam*, an advance on a fixed amount of expected future agricultural production, which is typically contracted at the beginning of the cultivation season and paid back, through the delivery of opium, after the harvest.[8] Even if these advances are usually reimbursed within a few months, shortly after the harvest, their costs can be substantial: the amount of the advance is typically equivalent to half of the current market value. The fact that *salaam* credits are reimbursed through the delivery of opium protects farmers against the risks related to a possible decline in farm gate prices during the duration of the credit (while limiting potential upside gains). The latest UNODC survey (UNODC, 2005a) indicates that, due likely to the high farm gate prices observed since 2001, the average amount of outstanding loans for opium-cultivating farmers has stabilized over the last two years at around $700 per farmer. High farm gate prices, along with increased caution by lenders in the face of intensified counternarcotics efforts, also contributed to a significant decline in the number of farmers contracting new loans, from 47 percent in 2003 to 33 percent in 2005.

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[5]Intermediate consumption corresponds to the value of the goods and services consumed or used up as inputs in the production process, including raw materials and various other operating expenses.

[6]United Nations Drug Control Program (UNDCP, 1994).

[7]Mansfield (2006) estimates these costs at $120 per hectare, equivalent to 2 percent of farm gate prices. It is likely that, in terms of farmer's income, the intermediate consumption was largely offset by the revenue stemming from the sale of by-products.

[8]Cash loans appear to have taken over in many areas due to fear over eradication and crop failure.

8. **Intermediate consumption also appears quite limited at the trafficker level**. As mentioned above, in 2002–04, about 72 percent of Afghanistan's opium production is estimated to have been transformed into heroin in Afghanistan before being exported. The transformation process requires the use of substantial amounts of chemicals (such as acetic anhydride, ammonium chloride, acetone, sodium carbonate, and hydrochloric acid). While in Pakistan in the early 1990s, these chemicals could amount to about 7–8 percent of the heroin price,[9] the sharp increase of heroin export prices over the last ten years has resulted in a sharp drop in the costs of these chemicals relative to heroin export receipts. In the case of Afghanistan, which produces primarily the brown, low quality, type of heroin, these costs are estimated to be equivalent to only 1–2 percent of the export price of heroin.

Actual income

9. **The income generated by drug-related activities is likely to be significantly lower than the potential export value reported by UNODC**. This potential value corresponds to the potential value of opium production (partly transformed in heroin), assuming it is fully sold in the markets neighboring Afghanistan. It is considered to be a good proxy for the potential revenue accruing to Afghans, as individual Afghan groups appear to be involved in opium production, conversion, and trade within Afghanistan and the immediate neighboring countries, but do not appear to participate in international drug trafficking operations.[10] However, the actual income accrued by Afghan farmers and traffickers differ from this potential value due to seizures by counternarcotics enforcement agencies and the change in inventories.

10. **Inventories are considered to be substantial, as illustrated by the fact that the sharp fall in production in 2001, at a time when Afghanistan was already contributing 37 percent of the world opium production, did not translate into major market disruptions.[11]** While farm gate prices increased more than tenfold between 2000 and 2002, border prices increased by a bit less than three times. Following their depletion in 2001, these stocks are assumed to have increased sharply over the last few years. This has contributed, along with the decline in production in the rest of the world, to the stabilization of export prices at high levels despite bumper crops. Under the gross assumption that Afghanistan's opium exports have increased regularly over the last ten years, the build-up in stocks could amount to 400 tons this year ($260 million at export prices), bringing stocks to a level equivalent to more than 6 months of actual exports.[12]

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[9]UNDCP (1994).

[10]UNODC (2005), p. 120a.

[11]Raw opium is a durable good, which is more durable than processed opiates and does not lose value, as its loss of weight in the drying process is compensated by its higher price compared with "wet" opium.

[12]These estimates are based on the assumption that opium exports have increased regularly over the last ten years and that inventories amounted to 15 months of exports prior to the ban enacted by the Taliban in 2001.

(continued)

11. **After increasing sharply, following the ban enacted by the Taliban, the share of revenue accruing to farmers has declined substantially.** Reflecting a substantial drop in farm gate prices, this revenue, which had increased sharply in 2001–02, declined from $1,020 million (44 percent of the potential export value) in 2003, to $560 million (21 percent of the potential export value) in 2005. As the number of farmers involved in opium production increased from 264,000 to 309,000 over the same period, the decline in the gross revenue per farmer was even sharper, from $3,864 in 2003 to $1,812 in 2005. It is worth noting that a significant share of the revenue accrued by the farmers must be used to cover factor costs and pay security. While intermediate consumption is very limited, labor costs are substantial as opium is a highly labor intensive crop, with cultivation and harvesting labor needs for an hectare estimated at about 350 and 200 person days, respectively (two to three times greater than those for wheat). Hence, in 2003, UNODC estimated that on average, the farmers retained slightly more than half of the gross revenue they accrued from opium production, with the rest spent on production factor costs (15 to 20 percent of gross revenue) and on taxes and other levies, including bribes and payments to local commanders (25 to 30 percent of gross revenue). Overall, farmers' net income derived from opium production represented about two thirds of their total income, as it was supplemented by additional income generated through cereal and livestock production and off-farm labor.

12. **The remaining income is divided between the different actors involved in the trading of opium from the farm gate to Afghanistan's borders**.[13] While the farm gate buyers are the most numerous among these actors, they are believed to receive a relatively small part of domestic trade revenue (i.e. drug export value minus farm gate value), owing to intense competition that limits the profit margin linked to these activities. Likewise, the share of domestic trade revenue accruing to shop owners in the regional opium bazaars and to clandestine laboratories appears relatively small. The main part of domestic trade revenue is believed to accrue to a limited number of bulk buyers and large-scale specialist traders who buy opium throughout the year and organize shipping to border areas or directly abroad, and incur large risks. To reduce these risks, a significant part of their revenue is spent on "security providers", including warlords' militias. Contrary to the Colombian drug traffickers, these bulk buyers and specialist traders do not appear to be organized in cartels.

Macroeconomic impact

13. While the potential export value of opium attracts most attention, it is only one among many factors defining the macroeconomic impact of the opium economy on the Afghan economy as a whole. The impact on the real sector will in particular depend on which share of this export value actually enters the economy, how this share is divided between the different actors, and how these different actors allocate their income between consumption, investment, and savings. The drug economy, which is excluded from reported

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These estimates may be conservative as some experts consider that after four years of high production the stocks have likely returned to their pre-2001 level and amount to at least one year of exports.

[13] See IMF (2003) and Byrd et al. (2004).

GDP, adds to the demand for domestic products through the demand it generates. Although not recorded in official balance of payments data, it also has a net positive impact on the balance of payments.

Consumption/savings

14. **Farmers consume a large part of their earnings, largely on domestic goods**. For many farmers, opium is the main cash crop, in contrast with other crops which are cultivated primarily to meet subsistence requirements. Given the limited financial investment opportunities for savings, it is generally assumed that farmers spend almost all of their income. Therefore, opium-related income contributes primarily to increasing consumption, in particular of non-subsistence goods, including imported goods. This assumption appears validated by field studies, such as Mansfield (2004), who estimated that in Nangarhar and Langhman expenditures of the households involved in opium-related activities were, on average, equivalent to their net income. According to this study, most of the farmers' consumption consisted of essential items, such as food, fuel, and health costs, while a small portion, which increased markedly with the farmer's income, consisted of "non-essential" items, such as cars, televisions, motorbikes, and generators. There were some disparities among farmers, with those cultivating more than 75 percent of their land saving up to one third of their income, while the others were dissaving. A small part of spending corresponds to investment, either in productive assets (e.g., tractors) or housing, that is generally included in the official national accounts data.

15. **In the absence of reliable data, it is generally assumed that processors and traffickers save a large part of their income.**[14] Benefiting from substantially higher revenue than the opium farmers, the actors involved in opium trade are likely to have a lower propensity to consume.[15] While secure processing and transport of opium and heroin require investments in arms, laboratories, and vehicles, these capital expenditures are likely to be small relative to the trading revenue of opium trade, leaving processors and traffickers with substantial resources to invest in other productive or financial assets, either domestic or foreign. Domestically, opium-financed investment may have contributed to the boom in construction observed in Kabul and other major cities, including those, such as Kandahar, located in the main opium-producing areas, although this claim is disputed by some experts. Some of the traffickers' income is also believed to be recycled in formal and informal activities, such as trade/smuggling. Investments abroad are facilitated by the informal financial sector in Afghanistan: the money-changers (*hawaladars*) provide low-cost, largely unregulated, and efficient transfer services to other countries. It is also likely that some, if not a large percentage, of the opium export receipts never enter Afghanistan, as the foreign buyers directly transfer the money to the traffickers' offshore accounts. This, along with the

[14]This is consistent with the findings of UNDCP (1994) in the case of Pakistan.

[15]Some of the opium receipts accrued to traders/traffickers are redistributed to security and transport providers, who are likely to have a higher propensity to consume. Even if this contributes to increasing the share of traffickers/traders' opium receipts which are consumed, this share remains lower for the farmers.

illicit nature of the opium trade, the absence of any reliable data on money changer transactions, and the uncertainty about the various actors' propensities to consume, invest and import, make an accurate estimation of the shares of opium trade allocated to consumption, and productive and financial investments extremely difficult and speculative.[16] Table III.5, which breaks down Afghanistan's gross disposable income (including opium) into these different uses, aims to illustrate, through broad estimates based on staff assumptions, the macroeconomic impact of the drug economy.

Dutch disease

16. **Opium-related demand causes, along with aid-related inflows, Dutch disease.** There are two channels. First, by increasing the demand for domestic goods and services, the drug economy contributes to an increase in consumer and asset prices. This spending effect is particularly marked for nontradable goods and services, such as rents, as their supply, contrary to that of tradable goods, cannot adjust directly through an increase in imports. As noted above, it also explains in part, along with aid-related inflows, the increase in real estate prices observed in Afghanistan's major cities. Secondly, by increasing the demand for production factors, the drug economy also contributes to an increase in their rates of remuneration, thereby raising the production costs of other sectors. Given the labor-intensive nature of opium production, this effect translates primarily into an increase in wages. Overall, these factors explain in part the significant appreciation of the real exchange rate over the last few years and contribute, along with other factors such as poor infrastructure and limited human capital, to the limited competitiveness of Afghanistan's tradable sector.[17] It is worth noting that while donor aid inflows, through the demand for goods and labor they induce, also contribute to Dutch disease; their impact on the competitiveness of the licit economy is partly offset by the associated increase in productivity.

17. **Drug-related activities also hinder investment.** Owing to its labor-intensive nature, the drug economy does not crowd out investment in other sectors. On the contrary, it may contribute marginally to the financing of these activities, such as trade and construction. However, the drug economy affects investment primarily through is negative impact on Afghanistan's investment climate. This negative impact manifests itself mainly through lingering insecurity; the sustained growth of informal activities; very high levels of corruption, particularly at the provincial and district levels (either directly through participation, or indirectly through "taxation"); and weaker provincial governments.

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[16]Fund staff had some contacts with donors' agencies specialized in fighting money laundering and the financing of illicit activities, and with some money changers based in Kabul. While instructive in terms of the financial processes involved, these contacts confirmed the impractibility of gathering reliable data on opium-related financial flows.

[17]See accompanying selected issues paper "Indicators of Afghanistan's External Competitiveness."

Table III.5. Islamic Republic of Afghanistan: Use of the Gross Disposable Income, 2002/03–2005/06

	2002/03 Est.	2003/04 Est.	2004/05 Est.	2005/06 Proj.	2005/06 Licit economy	2005/06 Opium economy: Production	2005/06 Opium economy: Trading and processing
	(In millions of US dollars)						
Gross disposable income	**7,823**	**9,336**	**11,506**	**12,914**	**10,320**	**555**	**2,039**
Consumption 1/	4,038	4,992	5,951	7,087	5,934	444	709
Net factor income	-1	-3	16	32	32	0	0
Savings (incl. grants)	**3,786**	**4,347**	**5,539**	**5,795**	**4,354**	**111**	**1,331**
Gross fixed capital formation 1/	1,409	1,928	2,696	3,078	2,757	55	266
Change in opium inventories	84	114	428	267	0	0	267
Current account (incl. grants) 2/	**2,293**	**2,306**	**2,415**	**2,450**	**1,597**	**55**	**798**
Capital account	**-533**	**-471**	**-352**	**-518**	**335**	**-55**	**-798**
Foreign Direct Investment	50	58	187	253	253	0	0
Public loans (net disbursements)	94	90	290	82	82	0	0
Drug-related capital outflows 1/	-677	-619	-829	-853	0	-55	-798
Net errors and omissions	-1,605	-1,456	-1,574	-1,474	...	...	...
Overall balance	**155**	**379**	**489**	**458**	...	...	...
Impact on the balance of payments	1,025	867	855	852	0	347	505
Drug income	2,446	2,178	2,319	2,341	0	560	1,781
Drug-related imports	-744	-692	-634	-635	0	-157	-478
Drug-related capital outflows	-677	-619	-829	-853	0	-55	-798

Sources: Afghan authorities and UNODC data; and Fund staff estimates.

1/ Assuming that 80 percent of the farmer's gross income is consumed, 10 percent invested in productive assets and housing, and 10 percent invested in foreign currency; and that 40 percent of the traffickers/traders' income is consumed, 15 percent invested in productive assets and housing and 45 percent invested in foreign assets.

2/ The drug sector's current account corresponds to the balance of its current transactions both with foreign countries (export of drugs minus consumption of imported goods) and with the Afghan licit sector (consumption of licit domestic goods).

Impact on the balance of payments

18. **The impact of drug exports on the balance of payments is partly offset by drug-related outflows (Table III.5).** As noted above, a significant part of opium-related consumption and investment is on imported goods and services. Moreover, a large part of opium export receipts, primarily at the processor/trafficker level, is believed to be invested abroad. It is also likely that a large part of the savings retained in Afghanistan are held in the

form of foreign-denominated assets, as evidenced by the high degree of financial dollarization (in U.S. dollars, but also in Pakistani rupees and Iranian rials) of the Afghan economy. This limits even further the impact of the drug economy on the balance of payments and the central bank's international reserves. Taken together, these factors could be equivalent to about two thirds of opium export receipts.

19. **Drug-related flows affecting the change in Da Afghanistan Bank's international reserves are not explicitly reported in the balance of payments.** As currently constructed, the balance of payments does not report the main flows directly related to drug activities, such as opium and opiate exports, or the capital outflows corresponding to the investment of the corresponding revenue in foreign assets (including the export receipts that do not enter the country). Other activities, however, such as imports of vehicles by traffickers or food by opium farmers, which are currently statistically indistinguishable from equivalent nondrug-related flows, tend to be captured by the officially recorded trade data or, possibly, as "unrecorded imports" which are estimated and included in the official trade data. While the drug revenue financing these imports is not recorded, the imported goods purchased through illicit income are mostly captured in balance of payments data. Thus, an implicit discrepancy stems from the fact that while substantial drug-related net inflows (i.e. opium exports minus drug-related capital outflows) are not recorded in the current presentation of the balance of payments, this does not translate into substantial positive errors and omissions.

20. **The fact that as currently constructed the official balance of payment does not have a large statistical discrepancy is potentially worrisome and points to an underestimation of the net outflows.** This apparent absence of a discrepancy is not surprising given that the evaluation of some components of Afghanistan's balance of payments rests critically on informed guesses rather than on reliable statistical estimates. This is particularly the case for: inward and outward smuggling (excluding the drug trade); aid-related outflows (e.g., the share of aid-financed wages invested abroad); and drug-related outflows. The non-reporting of the drug-related outflows may therefore be largely offset in the current presentation of the balance of payments by an underestimation of the licit trade deficit and/or an underestimation of capital outflows. From a national accounts point of view, the former would likely be largely counterbalanced by an underestimation of private consumption, which, in the absence of any reliable household expenditure data, is estimated as a residual. Table III. 5 attempts at integrating the drug-related flows in the official balance of payments. By doing so, it makes explicit the aforementioned discrepancy.

Fiscal impact

21. **The positive impact the opium economy may have on fiscal revenue is marginal compared to its cost in terms of government spending**. Owing to their illicit nature, most of the drug-related activities (such as production, processing, trade, and security) are not directly taxed. The primary impact of the drug economy on fiscal revenue results, therefore, from the indirect taxation of consumption and imports financed by drug-related inflows. Given the current structure of government revenue, this impact is likely to stem essentially from the duties levied on imports. Even under the assumption that the effective taxation of

drug-related imports is similar to that of imports related to licit activities, duties collected on drug-related imports would amount to no more than $25 million. This amount represents only a small fraction of government spending aimed at improving security and eliminating the drug economy.

C. The Government Counternarcotics Strategy

A Multi-pronged approach

22. **Counternarcotics efforts have relied on a multi-pronged approach, aimed in particular at combating cultivation and trafficking through eradication and interdiction, while providing farmers with alternative livelihoods.** Eradication consists of the destruction of opium growing fields and may be associated with sanctions against opium farmers. Interdiction consists in the arrest of drug traffickers and processors, seizures of opium and heroin, the destruction of processing laboratories, and the closing of opium markets. In its narrow definition, the concept of alternative livelihoods encompasses a number of programs aimed at providing farmers leaving the opium economy with short- and/or long-term alternative livelihoods. However, the concept of alternative livelihoods has been widened to cover all components of rural development, including farm and off-farm income.

23. **In early 2003, the authorities adopted a multiyear counternarcotics strategy, which aimed at reducing opium production by 75 percent in five years and completely eliminating it within ten years, while emphasizing the importance of alternative livelihood programs.**[18] This strategy has since been updated, and now centers on four key priorities identified for their potential to make the greatest and most sustainable impact on the opium trade in the near term, namely: targeting the trafficker and the top end of the trade; strengthening and diversifying licit rural livelihoods; reducing the demand for opium; and developing state institutions at the central and provincial levels.

24. **In the recently drafted Interim Afghan National Development Strategy (I-ANDS), the authorities redefined their counternarcotics objectives and strategy**. The authorities identified counternarcotics as one of the fundamental cross cutting issues for the success of all investment programs in the area of governance, security and development. Accordingly, they intend to mainstream counternarcotics efforts in the government's overall development and reconstruction program, with the goal of securing a sustained decline in poppy cultivation, drug production, consumption of illicit drugs and trafficking, in order to pave the way for private sector-led economic growth. More specifically, the authorities intend to intensify and better coordinate their efforts with a view to: building strong institutions; enhancing law enforcement and interdiction; continuing eradication efforts;

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[18] Transitional Islamic State of Afghanistan (2003).

reducing the demand for narcotics and increasing treatment of drug addicts; strengthening criminal justice; increasing public awareness; promoting international and regional cooperation; and developing sustainable alternative livelihoods.

Implementation and Results

Establishment of the institutional and regulatory framework

25. **Key institutions have been established.** The minister of interior, with the help of the international community, has established the Counternarcotics Police of Afghanistan (CNPA), which comprises three sections: investigation, intelligence, and interdiction. The Afghan Central Poppy Eradication Force (CPEF) was established in May 2004 to carry out eradication. In addition, in November 2004 the position of Deputy Minister for Counternarcotics was created in the ministry of interior to oversee and coordinate counternarcotics enforcement activities. Lastly, a Criminal Justice Task Force was established and has convicted over 90 traffickers since May 2005.

26. **In December 2004, the government established the Ministry of Counter Narcotics (MCN) to coordinate and oversee its counternarcotics policies.**[19] Moreover, a Counter Narcotics Trust Fund was recently created to coordinate government and donor activities and improve resource allocation at the central, provincial, and district levels. There is also a continued effort to develop government capacity and coordination.

27. **The counternarcotics regulatory framework has been strengthened**. The government recently approved a new counternarcotics law, which lays out significant penalties for corruption and bribery associated with drug trafficking; establishes the procedures for investigating and prosecuting major drug-trafficking offences; establishes the MCN as the leading body to monitor, evaluate, and coordinate all counternarcotics activities in the country; and provides for the creation of new tribunals for drug traffickers and drug regulation commissions. The enforcement of the Anti Money Laundering/Combating the Financing of Terrorism legislation and regulations should make more difficult the use of the formal and informal financial systems for opium-related transfers.

Field implementation

28. **The results of the government counternarcotics efforts have so far fallen short of the counternarcotics strategy objectives**. Estimates by UNODC indicate that opium production declined by 2 percent in 2005, to 4,100 tons, as a 21-percent drop in cultivation was largely offset by a rebound in yields due to more favorable weather conditions. The decline in opium cultivation in 2005 was largely due to the decision by many farmers not to plant in anticipation of intensified government-led counternarcotics efforts, including in implementing alternative livelihood programs. The decline in cultivation was particularly

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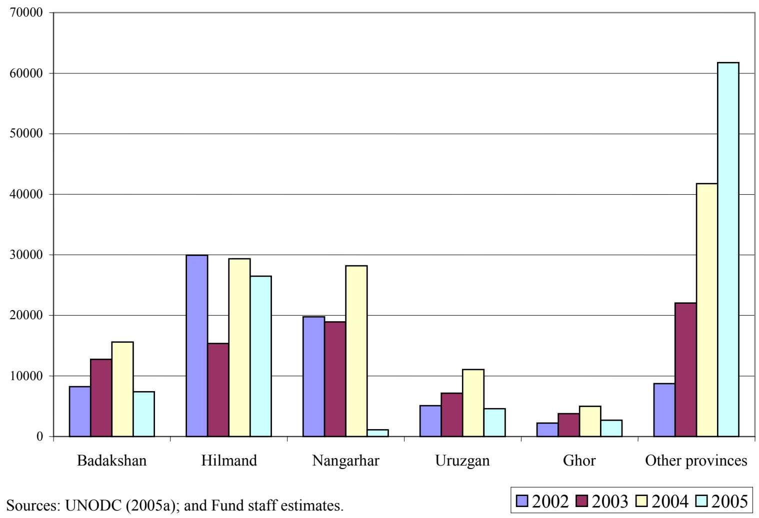
[19]Few of the MCN staff in Kabul are civil servants. Most of the costs of the ministry, including a large part of its wage bill, are directly paid for by donors.

marked in the five highest producing provinces, which accounted for 68 percent of production in 2004, and where production declined by 53 percent. Cultivation in the other provinces increased by 48 percent, reflecting in part the ability of the drug economy to relocate in response to the counternarcotics efforts (Figure III.2). Reflecting a slight decline in prices, export and farm gate values declined by 4 percent and 7 percent, respectively, to $2.7 billion and $560 million. Although efforts so far have not had the desired degree of success, it is likely the expansion of the drug economy over the last few years would have been more vigorous without them.

Figure III.2. Islamic Republic of Afghanistan: Opium Cultivation by Province, 2002–2005
(In hectares)



Sources: UNODC (2005a); and Fund staff estimates.

29. **Interdiction increased sharply in 2004–05, albeit from a low base**. In 2005, 86.6 tons of opium and 7.7 tons of heroin were seized, corresponding overall to about 3.4 percent of opium production. This compares with seizures equivalent to 0.4 percent of production in 2002 and 2003.[20] The sharp increase in 2005 reflected a strengthening of the Afghan Special Narcotics Force (ASNF) assigned to interdiction, as well as greater activity and effectiveness by the counternarcotics police. Law enforcement organizations, including the ASNF under the office of the president, the CNPA, and customs have been authorized to carry out operations to counter the physical trafficking of drugs.

30. **Eradication amounted to 5,100 hectares in 2005, equivalent to about 5 percent of cultivated areas.** Some 4,000 hectares were eradicated by the provincial authorities, the majority of which were in Nangarhar (46 percent) and Hilmand (26 percent). In addition, 1,100 hectares were eradicated by the central government agencies (CPEF and Afghan National Police). This latter figure was lower than targeted, owing in part to an exceptionally

[20] UNODC (2005b).

harsh winter, which delayed CPEF's operations; strong opposition from local farmers; and limited cooperation from local authorities. Eradication worked more efficiently as a deterrent to planting, as it contributed significantly to "voluntary eradication" (the decision by many farmers not to plant because their production could be eradicated) (Table III.6). A new system (including a central Eradication Planning and Monitoring Cell within the MCN) has been established to help governors and the Afghan Eradication Force to plan, execute, and monitor eradication efforts.

Table III.6. Islamic Republic of Afghanistan: Main Factors Influencing Farmers' Decisions to Cultivate Opium, 2005

Main reasons for reducing opium cultivation or not cultivating opium		**Main reasons for increasing opium cultivation**	
Fear of eradication	34.8%	Higher sale price	25.8%
Fear of imprisonment	19.7%	Personal consumption	20.6%
Forbidden by Islam	15.7%	High cost of wedding	15.7%
Poppy ban	15.3%	Higher demand	14.5%
Lower opium prices	4.9%	Expected compensation for eradication	7.3%
Less demand	4.7%	"Salaam"	5.6%
Higher input costs	2.8%	Low cost of inputs	5.6%
No more "salaam"	1.6%	Sufficient water	2.8%

Source: UNODC (2005a).

31. **Further progress in the implementation of alternative livelihood programs is needed**. Owing to capacity and security constraints, the implementation of alternative livelihoods programs, as with most other development expenditures, has been lagging behind projected plans and budget estimates. Moreover, so far, a large number of interventions labeled as alternative livelihood interventions have been of a short-term nature, focused on a single sector (such as micro-finance and infrastructure), and insufficiently coordinated geographically and between donors.

D. Macroeconomic Impact of a Counternarcotics Campaign

32. **The macroeconomic effects of a counternarcotics campaign will depend on the campaign's policies, as different policies create different incentives/disincentives for farmers and traffickers.** For instance, eradication tends to raise farm gate prices due to lower production, while interdiction tends to lower farm gate prices by reducing the demand of traffickers. Moreover, the development of sustainable alternative livelihoods is key to convincing farmers to quit, or not to return to opium production. In addition to the distributional differences between traffickers and farmers, the impact of counternarcotics efforts will vary substantially among provinces.

33. **To simulate the possible macroeconomic impact of the opium economy and counternarcotics efforts, a simple macroeconomic model was developed.** This model,

which is based in part on the Corden and Neary model of Dutch disease, seeks to capture the key transmissions channels described above (see Annex I). Given the uncertainty surrounding various economic relationships and the value of a number of economic variables, the model aims primarily at illustrating, through normative simulations, the potential economic impact of different counternarcotics strategies. The simulations are discussed in this section.

34. **A successful counternarcotics campaign could adversely affect licit GDP growth, the balance of payments, and government revenue.** Based on the transmission channels described earlier, a decline in drug income would, at least temporarily, lead to a slowdown in real growth in the non-drug economy and a deterioration of the balance of payments, putting downward pressure on the real exchange rate.[21] The relative magnitude of the shock to GDP would be less pronounced to the extent that the burden falls on traffickers, owing to their lower propensity to consume. On the external side, the large capital outflows and large import content associated with drug revenue suggest that the impact on the balance of payments would be substantially less than the total decline in drug revenue. The slowdown in growth and the decline in imports will in turn have an adverse effect on government revenue. However, it is likely that this loss of revenue would be more than offset by savings on security and enforcement spending.

Long-term impact: reducing Dutch disease

35. **In the long run, the reallocation of resources to the non-drug sector will allow higher growth in the licit economy.** In macroeconomic terms, the elimination of the drug economy has some similarities with a drop in oil revenue in an oil-producing country, with the decline in the risk-adjusted profitability of opium production leading to a shift of capital and labor toward the non-drug economy. At the same time, the loss of income resulting from the elimination of the opium economy will contribute to a reduction in aggregate demand.

36. **Over time, the increase in opium production costs will affect the relative comparative advantage of Afghanistan in opium**. Thus, in view of its relatively high rate of return, opium production is likely to move, at least partly, to other countries. The drop in Afghan opium production will then translate directly into a decline in opium export receipts. Moreover, the reallocation of labor to the licit economy, combined with a decline in aggregate demand, will contribute to a depreciation of the real exchange rate and an improvement of the non-drug trade balance, stemming from lower domestic demand and a higher supply of tradable items. The elimination of opium-related activities should also contribute to improving the business environment, and thereby to increasing domestic and foreign investment.

[21] However, the more inelastic the world demand for opium, the greater the possibility that the short-term impact on drug-related income might actually be positive.

Short-term and medium-term impact

37. **The short- and medium-term effects of the government's counternarcotics efforts will differ substantially according to the strategy implemented.** The effects of eradication and interdiction are discussed below.

Eradication

38. **In the short term, eradication will lead to a reallocation of opium-related income from traffickers to farmers (Table III.7).** The primary impact of eradication is a decline in opium supply at the farm gate stemming from the decision by farmers not to plant due to a higher risk premium and direct impact of eradication. This decline may be partly offset by the drawdown of inventories, which, together with the increase in border prices, would limit somewhat, the decline in overall export revenue.[22] Given the observed low elasticity of the traffickers' demand for opium to farm gate prices, the allocation of revenue among the different actors would change markedly, as the higher farm gate prices resulting from lower supply would increase the share of revenue accruing to non-eradicated farmers, to the detriment of traders/traffickers. The potential social impact of a successful eradication campaign would, however, be substantial for the farmers that ceased to produce opium, either involuntarily (direct eradication) or by choice (voluntary eradication), as they would experience a sharp drop in income. The loss of income would be particularly acute for the farmers whose production has been directly eradicated, as most of them have to reimburse debts contracted to finance their new production of opium. The reallocation of opium revenue in favor of non-eradicated farmers, who have a higher propensity to consume than traffickers, could limit the impact of eradication on aggregate demand, or even result in an increase in aggregate demand.[23] Lastly, the decline in labor demand in the drug sector could put downward pressure on wages in the non-drug sector, affecting positively its competitiveness.

39. **In the medium term, the increase in farm gate prices may partly offset the impact of eradication on opium production.** As the scope for a drawdown of inventories fades, there will be a significant increase in farm gate prices. This increase could induce some farmers to return to opium cultivation, even in the face of a higher risk premium, especially if the eradication campaign is not accompanied by sustainable alternative livelihood programs. While export prices may increase, the overall drug revenue is likely to decline, squeezing further the share of revenue accruing to traders/traffickers.[24] Although the

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[22]Given its current share of world opium supply, Afghanistan can be considered, in the short-term, as a price-setter on the international opium market. In the medium- to long-term, given the opium industry's ability to relocate in response to changes in costs or counternarcotics policies, Afghanistan would become a price-taker.

[23]Considering the traders/traffickers' high propensity to invest, some sectors, such as construction and trade could, however, face substantially lower demand.

[24]To avoid such a decline in their income, the traffickers might try to discourage the government's eradication efforts, thereby triggering a deterioration of the security situation.

social impact on eradicated farmers will be significant, the overall adjustment of wages and prices should gradually contribute, along with alternative livelihood programs, to the development of on-farm and off-farm employment opportunities. At the same time the overall increase in farmers' revenue would contribute to an increase in aggregate demand and to a further deterioration of the trade balance. This deterioration would be partly offset by a substantial decline in the financial outflows corresponding to the traffickers' investments in foreign assets and by higher growth in the tradable goods sector.

Table III.7. Islamic Republic of Afghanistan: Simulation of the Potential Macroeconomic Impact of an Eradication Campaign, 2006–10 1/

	2006	2007	2008	2009	2010
	(Change relative to 2005; in percent)				
Cultivation (in hectares)	-5.0	1.9	0.6	6.4	8.6
Inventories	-25.0	-48.0	-75.1	-91.6	-97.8
Drug production	-20.0	-23.1	-34.4	-38.6	-41.4
Drug exports	-7.5	-11.6	-20.9	-30.4	-38.4
Drug export price	5.0	8.1	15.7	24.9	34.5
Farm gate price	38.3	51.3	99.1	136.3	172.4
Drug export value	-2.9	-4.4	-8.5	-13.0	-17.1
Opium trade revenue	-7.1	-11.0	-20.8	-31.3	-41.3
Farm gate revenue	10.7	16.4	30.6	45.1	59.6
Labor in opium economy	-20.0	-23.1	-34.4	-38.6	-41.4
Labor in tradable sector	0.6	1.2	2.2	3.3	4.5
Labor in nontradable sector	0.4	0.8	1.5	2.2	3.0
Total employment	-1.8	-1.7	-2.2	-1.8	-1.1
Wages	-1.9	-4.0	-7.2	-10.5	-14.0
Price of non tradables (i.e. real exchange rate)	-0.5	-1.0	-1.8	-2.8	-3.7
Real GDP (excl. opium)	0.5	1.0	1.9	2.8	3.7
Real GDP (incl. opium)	-5.1	-5.6	-8.1	-8.6	-8.7
	(Change relative to 2005; in millions of U.S. dollars)				
Impact on balance of payments	-4	-14	-23	-34	-47
Impact on trade balance	-65	-107	-200	-301	-399
Change in opium exports	-67	-104	-198	-305	-401
Change in licit trade balance	2	-3	-2	4	2
Change in demand for tradables	-19	-48	-82	-117	-162
Change in production of tradables	21	44	80	121	163
Change in capital outflows	61	94	177	267	352

Source: Fund staff simulations.

1/ Based on the assumption that 15 percent of cultivated areas would be eradicated in 2006, and then 25 percent in 2007, 35 percent in 2008, 45 percent in 2009 and 50 percent in 2010.

Interdiction

40. **Although targeted to traffickers, interdiction would also affect opium farmers through lower farm gate prices (Table III.8)**. By increasing the risk premium associated with opium trading activities and bringing to an end the activities of some traffickers, interdiction would contribute to a reduction of both demand at the farm gate and supply at the border. Overall, the traffickers able to continue their operations would benefit from higher border prices and see their revenue increase, especially if they dispose of inventories. On the contrary, the decline in demand at the farm gate would lead to a reduction in farmers' income.

41. **The interdiction campaign should lead to a substantial improvement of the balance of payments**. The decline in the farmers' income should result in a substantial reduction of aggregate demand, including for traded goods. Moreover, the decline in labor costs relative to the price of tradable goods should boost investment and production in the tradable goods sector. Overall, the resulting improvement in the licit trade balance would largely offset the deterioration of the illicit balance of payments stemming from the reduction of opium exports and the increase in opium-related outflows associated with the higher income obtained by traffickers.[25]

Policy response

A multi-pronged approach

42. **The successful implementation of the eradication and interdiction campaign is predicated on the authorities' making a serious effort to address corruption**. Corruption has been a major factor in explaining the limited success of the counternarcotics efforts thus far. The intensification of counternarcotics efforts could temporarily exacerbate the problem, as traffickers will be likely to use all means to oppose these efforts. Addressing this problem will require a strong political commitment from the government.

43. **Sustainable income generation programs must be put in place to support the eradication and interdiction campaigns.** The counternarcotics enforcement efforts will have a substantial social impact on some (eradication) or all (interdiction) opium-cultivating farmers. In particular, a campaign based solely on eradication and interdiction would result in a significant increase in unemployment (Table III.9). While the farmers may in the

[25]The threat of seizure could induce even further capital flight by encouraging some traffickers to move their existing assets abroad to protect them from increased scrutiny. This capital flight is, however, likely to be limited, as most of the traffickers' assets are either foreign assets or real estate, which might prove somewhat illiquid.

Table III.8. Islamic Republic of Afghanistan: Simulation of the Potential Macroeconomic Impact of an Interdiction Campaign, 2006–10 1/

	2006	2007	2008	2009	2010
	(Change relative to 2005; in percent)				
Cultivation (in hectares)	0.0	-1.8	-4.9	-9.1	-14.0
Inventories	-9.4	-25.6	-47.4	-71.6	-90.4
Drug production	0.0	-1.8	-4.9	-9.1	-14.0
Drug exports	-2.8	-6.2	-11.5	-19.5	-29.6
Drug export price	1.9	4.3	8.2	14.7	24.3
Farm gate price	-6.5	-17.0	-30.3	-44.2	-57.8
Drug export value	-1.0	-2.2	-4.3	-7.7	-12.5
Opium trade revenue	0.7	2.9	5.0	5.4	3.6
Farm gate revenue	-6.5	-18.5	-33.7	-49.2	-63.7
Labor in opium economy	0.0	-1.8	-4.9	-9.1	-14.0
Labor in tradable sector	0.1	0.2	0.5	1.0	1.6
Labor in nontradable sector	-0.2	-0.5	-0.8	-1.2	-1.6
Total employment	0.0	-0.2	-0.4	-0.7	-0.9
Wages	-0.2	-0.8	-1.8	-3.3	-5.3
Price of non tradables (i.e. real exchange rate)	-0.7	-1.8	-3.3	-5.4	-7.8
Real GDP (excl. opium)	-0.1	-0.1	-0.1	-0.1	0.0
Real GDP (incl. opium)	-2.1	-4.0	-6.3	-8.7	-10.7
	(Change relative to 2005; in millions of U.S. dollars)				
Impact on balance of payments	-2	-8	-15	-23	-30
Impact on trade balance	4	17	27	23	1
Change in opium exports	-23	-52	-100	-180	-293
Change in licit trade balance	27	69	127	203	293
Change in demand for tradables	25	61	108	167	234
Change in production of tradables	3	8	19	36	59
Change in capital outflows	-6	-24	-42	-46	-31

Source: Fund staff simulations.

1/ Based on the assumption that 15 percent of drug production would be seized in 2006, and then 25 percent in 2007, 35 percent in 2008, 45 percent in 2009 and 50 percent in 2010.

Table III.9. Islamic Republic of Afghanistan: Simulation of the Potential Macroeconomic Impact of a Counternarcotics Campaign Combining Eradication and Interdiction, 2006–10 1/

	2006	2007	2008	2009	2010
	(Change relative to 2005; in percent)				
Cultivation (in hectares)	-2.5	0.1	-2.3	-1.9	-3.2
Inventories	-17.2	-36.9	-62.0	-83.4	-95.5
Drug production	-10.0	-12.4	-19.8	-24.4	-28.2
Drug exports	-5.2	-8.8	-15.9	-24.9	-34.7
Drug export price	3.4	6.1	11.6	19.6	29.9
Farm gate price	15.9	14.3	22.1	22.1	17.6
Drug export value	-1.9	-3.2	-6.2	-10.2	-15.1
Opium trade revenue	-3.9	-4.3	-7.5	-11.1	-15.0
Farm gate revenue	4.3	0.2	-2.1	-7.6	-15.6
Labor in opium economy	-10.0	-12.4	-19.8	-24.4	-28.2
Labor in tradable sector	0.3	0.7	1.4	2.2	3.2
Labor in nontradable sector	0.1	0.2	0.3	0.4	0.5
Total employment	-0.9	-0.9	-1.3	-1.3	-1.1
Wages	-1.0	-2.4	-4.5	-7.1	-10.1
Price of non tradables (i.e. real exchange rate)					
Real GDP (excl. opium)	0.2	0.5	0.9	1.3	1.8
Real GDP (incl. opium)	-3.6	-4.8	-7.2	-8.8	-9.8
	(Change relative to 2005; in millions of U.S. dollars)				
Impact on balance of payments	-2	-10	-20	-32	-45
Impact on trade balance	-35	-47	-83	-126	-172
Change in opium exports	-44	-76	-144	-240	-354
Change in licit trade balance	9	29	61	114	181
Change in demand for tradables	-2	3	12	34	66
Change in production of tradables	11	26	49	80	115
Change in capital outflows	33	37	64	94	128

Source: Fund staff simulations.

1/ Based on the assumption that eradication and interdiction efforts are equivalent to 50 percent of those envisaged under Tables III.7 and III.8, respectively.

short-term implement coping strategies, such as borrowing and selling assets, their decision to remain outside the opium sector will depend, in the medium-term, on the development of sustainable alternative livelihoods. In the case of eradication, this will be compounded by the sharp increase in farm gate prices.

44. **In line with their National Drugs Control Strategy and I-ANDS, the authorities need to develop and implement, in collaboration with the donor community, programs to address these social needs (Table III.10).** While contributing to the growth of the licit economy, the development of credible and sustainable alternative livelihoods would help convince farmers to stay away from, or quit, opium production. By increasing the farmers' income, these programs would also limit the decline in aggregate demand. Rather than quick fixes seeking to provide short-term employment to farmers, these programs should aim at creating sustainable alternative livelihoods in the context of the government's medium-term development strategy. Given the limited capacity of line ministries and other implementing agencies, developing these programs will take time. This supports the argument for a gradual approach to combat the opium economy, which will allow the authorities to put in place the necessary sustainable income generation programs in support of the eradication and interdiction campaigns. Such an approach was advocated by Byrd et al. (2004), who argued for an "appropriately-sequenced" approach that focuses on interdiction first while working to improve alternative livelihoods, and subsequently focuses efforts on eradication against farmers who continue to cultivate opium poppy.

Implications for the Policy Mix

45. **As long as it remains consistent with their monetary policy objectives, the authorities should not resist a nominal depreciation of the currency.** Although prices and wages appear to have some downward flexibility in Afghanistan (see Box III.1), the depreciation of the real exchange rate associated with the elimination of drug-related activities, as demonstrated in these scenarios, might require a nominal depreciation of the Afghani. The authorities should, however, make sure that this depreciation does not trigger a marked and permanent increase in inflation.

46. **Assuming a gradual elimination of the opium economy and a strict implementation of the authorities' tax policy and administration reforms, the impact on fiscal revenues should be limited**. The decline in import duties should be partly offset by an increase in tax revenues stemming from the increase in licit activities.

Table III.10. Islamic Republic of Afghanistan: Simulation of the Potential Macroeconomic Impact of a Multi-Pronged Counternarcotics Campaign, 2006–10 1/

	2006	2007	2008	2009	2010
	(Change relative to 2005; in percent)				
Cultivation (in hectares)	-2.5	-0.5	-3.1	-3.1	-4.6
Inventories	-17.2	-37.6	-63.4	-85.2	-96.8
Drug production	-10.0	-13.0	-20.6	-25.6	-29.6
Drug exports	-5.2	-9.0	-16.4	-26.0	-36.3
Drug export price	3.4	6.3	12.0	20.6	31.8
Farm gate price	15.9	15.9	24.5	26.4	23.2
Drug export value	-1.9	-3.3	-6.4	-10.8	-16.1
Opium trade revenue	-3.9	-4.6	-8.1	-12.3	-17.0
Farm gate revenue	4.3	0.8	-1.1	-6.0	-13.3
Labor in opium economy	-10.0	-13.0	-20.6	-25.6	-29.6
Labor in tradable sector	0.8	1.8	3.0	4.4	5.9
Labor in nontradable sector	0.6	1.1	1.7	2.2	2.7
Total employment	-0.5	-0.1	0.0	0.4	1.1
Wages	0.6	0.8	0.2	-1.0	-2.6
Price of non tradables (i.e. real exchange rate)	-0.7	-1.6	-3.1	-5.1	-7.6
Real GDP (excl. opium)	0.7	1.4	2.3	3.3	4.3
Real GDP (incl. opium)	-3.3	-4.2	-6.3	-7.7	-8.4
	(Change relative to 2005; in millions of U.S. dollars)				
Impact on balance of payments	-13	-32	-53	-76	-99
Impact on trade balance	-46	-72	-122	-181	-244
Change in opium exports	-44	-78	-150	-252	-377
Change in licit trade balance	-2	6	28	72	133
Change in demand for tradables	-32	-58	-79	-86	-82
Change in production of tradables	30	64	107	158	214
Change in capital outflows	33	40	69	105	145

Source: Fund staff simulations.

1/ Based on the same assumptions as Table III.9 for eradication and interdiction efforts, and on the assumption that about 75,000 jobs would be created annually under the alternative livelihood programs.

Box III.1: Impact of the Counternarcotics Campaign in Nangarhar[1]

Combining moral suasion and eradication, the counternarcotics campaign was highly successful in reducing opium cultivation in the Nangarhar province. While Nangarhar was the largest opium producer in 2004,[1/] opium cultivation in the province declined by 96 percent, from 28,213 hectares in 2004 and to 1,093 hectares in 2005. Although eradication contributed directly with only 1,860 hectares, this sharp decline reflected mainly the decision of many farmers not to plant, owing primarily to fear of eradication or imprisonment, to the ban imposed by the authorities, and to relatively low farm gate prices (especially relative to wheat, whose prices had increased following the poor 2004 crop). The decline in opium cultivation was more pronounced than in the other provinces owing to the local authorities' strong involvement in the counternarcotics campaign, with particular emphasis on prevention. Informed by the provincial governor that they would be held responsible for the level of opium poppy cultivation in the areas under their responsibility, district administrators and security chiefs called tribal elders and the shura members from each village to the district centre and informed them that they should not cultivate poppy.[2/] These admonitions were accompanied by promises of development assistance.

The sharp decline in production had a substantial social and economic impact. While slightly offset by a rebound in yields, opium production declined by about 95 percent. This translated into a sharp decline in farmers' income, as the cash income from opium was only partly replaced by revenue from alternative crops. Moreover, as most farmers shifted to wheat cultivation (areas planted with wheat increased from 36,000 to 51,000 hectares), which is much less labor intensive than opium, the demand for hired labor fell sharply. The consequent decline in aggregate demand (see below) from farmers and other drug industry actors led to a sharp reduction in activity in other sectors, in particular construction. In response to the lower demand for labor and goods, wages and prices declined significantly, and some skilled workers moved to other provinces.

Many farmers had to rely on short-term coping strategies. The income loss attributable to the reduction in opium production was only partly offset by the revenue stemming from alternative crops and work opportunities, including by alternative livelihood programs. While this revenue was in some cases complemented by the sale of assets (primarily livestock) and, less often, by some borrowing, most farmers had to reduce consumption substantially, including for food and health expenditures.

In the absence of credible alternatives, many farmers might return to opium production in 2006. Most of the coping strategies implemented by the farmers, such as the sale of assets or borrowing to finance subsistence consumption, are not sustainable. Moreover, contrary to vineyards or orchards, which require multi-year investments, the planting of wheat does not entail sunken costs, which implies that returning to opium production would not be costly. Finally, most farmers consider that the opportunities provided by the alternative livelihood programs are largely insufficient and fall short of the authorities' promises. In this context, faced with the need to replenish their assets, service their debts and fund their spending, many farmers may choose to produce opium in 2006. Preventing such a backlash will depend crucially on the continued involvement of the local and central authorities by contributing to the development of credible and sustainable alternative sources of revenue.

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[1] Based on the estimates of UNODC (2005a) and the findings of Mansfield (2005).

[2] While cultivated areas were slightly higher in the Hilmand province, in Nangarhar higher yields translated into higher production.

Model of the Macroeconomic Impact of the Opium Economy

A model was developed to simulate the possible macroeconomic impact of the opium economy and counternarcotics efforts. This model is based in part on the Corden and Neary model of Dutch disease. There are three sectors, namely nontradable (NT), tradable (T) and a booming third sector, which in the case of Afghanistan is the opium sector (D). The production of opium is totally exported, and labor is perfectly mobile between all three sectors.[1] To be able to model the impact of different forms of counternarcotics efforts (eradication, interdiction, alternative livelihoods, prevention) on the licit economy, the drug sector was further divided between farmers and traffickers. Given its large share in the world supply of opium, Afghanistan is not considered a price taker on the opium market (i.e. the opium export price depends on the Afghan supply). The model is dynamic, allowing opium price developments to affect the farmer's decision to cultivate in the following year.

As in the Corden and Neary model, the opium economy influences the licit sector equilibrium through: (a) a resource movement which induces a reallocation of labor between sectors; and (b) a spending effect corresponding to the impact of change in opium-related income on the demand for tradables and nontradables. The traded good is the numeraire.

Exogenous variables:

rp_i: risk premium for traffickers, increasing function of interdiction efforts;
rp_e: risk premium for farmers, increasing function of eradication efforts;
alt: incentives related to the development of alternative livelihood programs;
eradication: opium directly eradicated;
interdiction: opium seized;
Yield: opium yield.

Endogenous variables:

P_D: opium price at the border (in terms of tradables);
Y_D: opium supply by the traders/traffickers;
Inv: opium inventories, which are assumed to be held by traders and traffickers;
D_D: Demand for opium outside Afghanistan;
P_{FG}: opium farm gate price(in terms of tradables);
Cult: opium cultivation;
Y_{fg}: opium supply at the farm gate;
D_{fg}: Demand for opium by the traffickers/traders (at the farm gate);
w: wage rate;
Y: real GDP, including opium income staying in Afghanistan;
L: total employment;

[1]Corden et al. (1982).

L_T, L_{NT}: labor in tradable and nontradable sectors, respectively;
P_{NT}: price of the nontradables (in terms of tradables—can be interpreted as the real exchange rate);

1. The opium sector

Equilibrium at the border

- The demand for opium declines with the opium export price:[2] $D_D(\overset{-}{P_D})$;
- The supply of opium at the border by traffickers increases with the opium export price and declines with the farm gate price and the risk premium (which is related to interdiction efforts): $Y_D(\overset{+}{P_D}, \overset{-}{P_{FG}}; \overset{-}{rp_i})$;
- The propensity of traffickers to deplete their inventories will depend on the level of current prices compared to average historical prices: $\Delta \text{Inv}(\overset{+}{P_D})$;
- The opium market equilibrium of the at the border reads: $D_D = Y_D + \Delta \text{Inv} - \text{interdiction}$.

Equilibrium at the farm gate

- The demand for opium by traffickers is equivalent to the amount they want to supply: $D_{FG}(\overset{-}{P_D}, \overset{-}{P_{FG}}; \overset{-}{rp_i}) = Y_D$;
- Cultivation rises with increases in farm gate prices and declines with the premium related to eradication efforts and with wages: $Cult(\overset{+}{P_{FG}}, \overset{-}{w}; \overset{-}{rp_e})$;
- The supply of opium at the farm gate increases with the cultivation and the yield, and declines with direct eradication. $Y_{fg} = Cult * Yield - eradication$;
- The opium market equilibrium at the farm gate reads: $D_{FG} = Y_{fg}$.

2. The licit economy (tradables and nontradables)

Tradable sector

- The demand for labor in the nontradable sector is an increasing function of nontradable prices and a declining function of wages: $L_{NT}(\overset{+}{P_{NT}}, \overset{-}{w})$
- The production of nontradables is an increasing function of labor employed in the sector: $Y_{NT}(\overset{+}{L_{NT}})$
- The demand for nontradables, which are consumed domestically, declines with nontradable prices and increases with the real income: $D_{NT}(\overset{+}{Y}, \overset{-}{P_{NT}})$
- The equilibrium in the nontradable sector reads: $D_{NT} = Y_{NT}$

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[2] While overall demand may be somewhat inelastic, Afghanistan is competing with other providers.

Tradable sector

- The demand for labor in the tradable sector is a declining function of wages:[3] $L_T(\overset{-}{w})$
- The production of tradables is an increasing function of labor employed in the sector: $Y_T(\overset{+}{L_T})$
- The domestic demand for nontradables increases with the real income, corrected for the share of the traffickers' revenue staying abroad: $D_T(\overset{+}{Y})$

3. Overall equilibrium

The completion of the model comes from the equilibrium of the labor market.

- It is assumed that, in the absence of alternative livelihoods, the farmers/workers leaving the drug sector will be likely to experience unemployment for some time. $\Delta L(\overset{-}{\Delta L_D}, \overset{+}{\Delta L_D}(-1), \overset{+}{\Delta L_D}(-2), \ldots)$
- The equilibrium on the labor market reads: $L_T + L_{NT} + L_D = L$

[3]The tradable good is used as the numeraire, which implies that is price is constantly equal to 1.

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Table 1. Islamic Republic of Afghanistan: Basic Data, 2001/02–2005/06

	Est. 2001/02	Est. 2002/03	Est. 2003/04	Est. 2004/05	Proj. 2005/06
	(Annual percentage change)				
Output and prices					
Real GDP (at market prices)	...	28.6	15.7	8.0	13.8
Consumer prices (end of period)	-43.4	52.1	10.2	16.3	10.0
Consumer prices (period average)	...	5.0	23.9	14.3	12.0
	(In percent of GDP)				
Investment and saving					
Gross domestic formation	...	34.5	42.0	45.2	43.1
Of which: nongovernment	...	7.5	8.1	10.3	10.9
Gross national savings	...	1.1	-8.9	0.3	0.7
Of which: nongovernment	...	5.7	-4.4	4.9	4.5
	(In percent of GDP)				
Public finances 1/					
Revenue (including grants)	...	8.4	9.0	9.8	10.0
Expenditure	...	8.5	9.8	9.4	9.4
Budget balance (including grants)	...	-0.1	-0.8	0.4	0.6
Primary balance (including grants)	...	-0.1	-0.8	0.4	0.6
Total government debt 2/	...	13.1	13.5	12.5	...
	(Annual percentage change; unless otherwise indicated)				
Monetary sector					
Credit to the private sector	...	...	...	...	...
Base money	...	20.1	40.9	37.5	27.8
Broad money	...	20.1	40.9	37.5	27.8
Velocity of broad money	...	8.8	7.8	7.3	7.2
One-month capital note interest rate (end-period, in percent)	...	...	...	4.27	...
	(In percent of GDP; unless otherwise indicated)				
External sector					
Exports of goods (in U.S. dollars, percentage change) 3/	...	...	36.1	25.0	20.1
Imports of goods (in U.S. dollars, percentage change) 3/	...	...	51.8	18.2	14.9
Merchandise trade balance	...	-29.8	-41.3	-37.0	-35.2
Current account balance, excluding official transfers	...	-33.4	-50.9	-44.8	-42.4
Current account balance, including official transfers	...	-3.5	3.1	1.9	1.7
Foreign direct investment	...	1.2	1.3	3.1	3.5
Total external debt 2/	...	13.1	13.5	12.5	...
Gross reserves (in millions of U.S. dollars)	...	426	816	1,261	1,730
In months of next year imports of goods and services 3/	...	1.8	3.4	4.0	4.8
In percent of short-term external debt (on remaining maturity basis)	...	...	...	...	...
Memorandum items:					
Nominal GDP (excluding opium production; in millions of U.S. dollars)	2,463	4,084	4,585	5,971	7,139
Opium production (in millions of U.S. dollars)	...	2,540	2,300	2,800	2,700
Unemployment rate (in percent)	...	...	...	...	...
Net imports of petroleum products (in millions of U.S. dollars)	...	13	24	77	...
Afghanis per U.S. dollar (period average)	54.4	44.8	49.0	47.7	...
Real effective exchange rate (annual average, percentage change)	31.0	52.6	50.3	48.7	...
Stock market index	...	...	...	...	...

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

1/ Operating budget. Does not include externally-financed development expenditures, which amounted to 40 percent of GDP in 2(

2/ Includes unreconciled debts. Excludes Russian claims.

3/ Excluding reexports.

Table 2. Islamic Republic of Afghanistan: Gross Domestic Product at Current Prices, 2001/02–2005/06

(In millions of Afghanis)

	2001/02	2002/03	2003/04	2004/05	Proj. 2005/06
Agriculture	...	89,834	106,890	103,674	125,152
Cereals	...	73,751	85,515	78,862	97,159
Other crops and nonfoods	...	4,652	4,266	4,713	5,444
Livestock	...	11,431	17,110	20,098	22,550
Industry	...	36,179	46,944	68,058	85,894
Mining	...	261	469	624	744
Manufacturing	...	27,151	33,330	43,879	52,321
Construction	...	8,700	12,205	21,872	30,823
Electricity and power	...	67	939	1,683	2,006
Services	...	54,278	66,559	106,765	135,924
Trade	...	18,167	20,386	29,698	35,380
Transport and telecommunications	...	17,343	24,856	42,877	55,775
Public administration	...	8,500	10,428	14,224	17,577
Other services	...	10,267	10,889	19,966	27,193
GDP at factor cost	...	180,292	220,392	278,496	346,971
Indirect taxes less subsidies	...	2,570	4,715	6,008	8,858
GDP at market prices (excluding opium)	...	182,862	225,108	284,504	355,829
GDP at market prices (excluding opium, annual change; in percent)	...	33.8	23.1	26.4	25.1

Sources: Data provided by the Afghan authorities; and Fund staff estimates and projections.

Table 3. Islamic Republic of Afghanistan: Gross Domestic Product at Constant Prices, 2001/02–2005/06

(In millions of Afghanis at 2002/03 prices)

	2001/02	2002/03	2003/04	2004/05	Proj. 2005/06
Agriculture	...	89,834	105,000	87,027	95,770
Cereals	...	73,751	85,442	67,752	75,882
Other crops and nonfoods	...	4,652	7,981	7,582	7,961
Livestock	...	11,431	11,577	11,693	11,927
Industry	...	36,179	40,495	53,617	62,480
Mining	...	261	250	315	347
Manufacturing	...	27,151	29,148	35,531	39,084
Construction	...	8,700	10,941	17,506	22,758
Electricity and power	...	67	156	265	292
Services	...	54,278	61,749	83,096	95,349
Trade	...	18,167	17,160	22,320	24,530
Transport and telecommunications	...	17,343	24,463	36,695	44,034
Public administration	...	8,500	9,704	12,033	13,718
Other services	...	10,267	10,422	12,048	13,068
GDP at factor cost	...	180,292	207,243	223,740	253,599
Indirect taxes less subsidies	...	2570	4,276	4,684	6,278
GDP at constant prices (excluding opium)	...	182,862	211,519	228,424	259,877
GDP at constant prices (excluding opium, annual percentage change)	...	29	16	8	14

Sources: Data provided by the Afghan authorities; and Fund staff estimates and projections.

Table 4. Islamic Republic of Afghanistan: Gross Domestic Product at Constant Prices, 2001/02–2005/06

(Annual percentage change)

	2001/02	2002/03	2003/04	2004/05	Proj. 2005/06
Agriculture	...	...	17	-17	10
Cereals	...	...	16	-21	12
Other crops and nonfoods	...	...	72	-5	5
Livestock	...	...	1	1	2
Industry	...	...	12	32	17
Mining	...	...	-4	26	10
Manufacturing	...	...	7	22	10
Construction	...	...	26	60	30
Electricity and power	...	...	133	70	10
Services	...	...	14	35	15
Trade	...	...	-6	30	10
Transport and telecommunication	...	...	41	50	20
Public administration	...	...	14	24	14
Other services	...	...	2	16	8
GDP at factor cost	...	...	15	8	13
Indirect taxes less subsidies	...	...	66	10	34
GDP at constant prices	...	29	16	8	14

Sources: Data provided by the Afghan authorities; and Fund staff estimates and projections.

Table 5. Islamic Republic of Afghanistan: Sectoral Shares of Gross Domestic Product, 2001/02–2005/06

(In percent of GDP at market prices)

	2001/02	2002/03	2003/04	2004/05	Proj. 2005/06
Agriculture	...	49	47	36	35
Industry	...	20	21	24	24
Services	...	30	30	38	38
GDP at factor cost	...	99	98	98	98
Indirect taxes less subsidies	...	1	2	2	2
GDP at market prices (excluding opium)	...	100	100	100	100

Sources: Data provided by the Afghan authorities; and Fund staff estimates and projections.

Table 6. Islamic Republic of Aghanistan: Savings-Investment Balances at Current Prices, 2002/03–2005/06

	Est. 2002/03	Est. 2003/04	Est. 2004/05	Proj. 2005/06
	(In millions of U.S. dollars)			
Domestic expenditures	5,447	6,919	8,647	10,165
Consumption	4,038	4,992	5,951	7,087
Public 1/	318	429	546	640
Private 2/	3,720	4,562	5,405	6,447
Gross fixed capital formation	1,409	1,928	2,696	3,078
Public	1,104	1,557	2,082	2,298
Private 3/	305	371	614	780
Net exports of goods and services	-1,364	-2,335	-2,676	-3,026
Exports of goods and services (excluding reexports)	328	482	564	686
Imports of goods and services (excluding reexports)	-1,691	-2,817	-3,239	-3,712
Domestic savings	45	-407	20	53
Public savings	-187	-203	-273	-266
Private savings	232	-204	293	319
GDP at market prices	4,084	4,585	5,971	7,139
	(In percent of GDP)			
Domestic expenditures	133.4	150.9	144.8	142.4
Consumption	98.9	108.9	99.7	99.3
Public	7.8	9.4	9.1	9.0
Private	91.1	99.5	90.5	90.3
Gross fixed capital formation	34.5	42.0	45.2	43.1
Public	27.0	34.0	34.9	32.2
Private	7.5	8.1	10.3	10.9
Net exports of goods and services	-33.4	-50.9	-44.8	-42.4
Exports of goods and services (excluding reexports)	8.0	10.5	9.4	9.6
Imports of goods and services (excluding reexports)	-41.4	-61.4	-54.3	-52.0
Domestic savings	1.1	-8.9	0.3	0.7
Public savings	-4.6	-4.4	-4.6	-3.7
Private savings	5.7	-4.4	4.9	4.5
Memorandum items:				
Real GDP growth (annual percentage change)	28.6	15.7	8.0	13.8
Nominal GDP growth (annual percentage change)	33.8	23.1	26.4	25.1
Sectoral shares of GDP (in percent)				
Agriculture	49.8	48.5	37.2	36.1
Industry	20.1	21.3	24.4	24.8
Services	30.1	30.2	38.3	39.2
GDP per capita (in U.S. dollars)	182	199	253	294
Domestic government revenue (in percent of GDP)	3.2	4.5	4.5	5.3

Sources: Data provided by the Afghan authorities; and Fund staff estimates and projections.

1/ Data originating from the fiscal accounts.
2/ Determined as a residual.
3/ Equivalent to foreign direct investment reported in the balance of payments, and new private investment.

Table 7. Islamic Republic of Afghanistan: Opium Production and Prices, 1994–2005

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Area under production (hectares)	71,000	54,000	57,000	58,000	64,000	91,000	82,000	8,000	74,000	80,000	131,000	104,000
Hilmand	...	...	...	...	...	...	...	...	29,950	15,371	29,353	26,500
Nangarhar	...	...	...	...	...	...	...	...	19,780	18,904	28,213	1,093
Badakhshan	...	...	...	...	...	...	...	...	8,250	12,756	15,607	7,370
Uruzgan	...	...	...	...	...	...	...	...	5,100	7,143	11,080	4,605
Ghor	...	...	...	...	...	...	...	...	2,200	3,782	4,983	2,689
Kandahar	...	...	...	...	...	...	...	...	3,970	3,055	4,959	12,989
Rest of the country	...	...	...	...	...	...	...	...	4,796	19,472	36,441	48,754
Percentage of World (in percent)	26	22	22	23	27	42	37	6	41	47	67	68
Potential opium production	3,400	2,300	2,200	2,800	2,700	4,600	3,300	200	3,400	3,600	4,200	4,100
Percentage of World (in percent)	60	52	50	58	62	80	70	13	76	75	87	87
Number of provinces where opium is produced (out of 32)	...	...	...	...	...	16	23	10	24	28	30	25
Area under cultivation for cereals (hectares)	...	...	...	...	...	...	...	...	...	2,819,000	2,221,000	3,003,000
Gross income of poppy cultivation (U.S. dollar/hectare)	...	1,000	...	...	...	...	1,100	7,400	16,200	12,700	4,600	5,400
Gross income of wheat cultivation (U.S. dollar/hectare)	...	...	...	...	...	...	...	...	...	470	390	550
Potential income from opium production (in billions of U.S. dollars)	...	...	...	...	...	...	1	...	3	2	3	3
Farm-gate prices	30	23	24	34	33	40	28	300	350	283	92	102
Estimate value of opium at farmgate level (in millions of U.S. dollars)	102	54	54	95	88	183	91	56	1,200	1,020	600	560

Sources: United Nations Office on Drugs and Crime, *Afghanistan Opium Survey for 2005* ; and FAO/WFP, Crop and Food Supply Assessment Mission to Afghanistan.

Table 8. Islamic Republic of Afghanistan: Agricultural Crop Production, 2001/02–2005/06

(In tons)

	2001/02	2002/03	2003/04	2004/05	2005/06 Prel.
Cereals	2,108,000	3,737,000	4,207,000	3,883,000	...
Wheat	1,597,000	2,686,000	3,480,000	2,884,000	3,400,000
Rice, paddy	242,000	388,000	260,000	325,000	...
Barley	87,000	345,000	240,000	337,000	...
Maize	160,000	298,000	210,000	315,000	...
Millet	22,000	20,000	17,000	22,000	...
Corn					
Potatoes and beets	274,000	269,000	434,000	339,000	...
Potatoes and beets	235,000	230,000	350,000	300,000	...
Sugar cane	38,000	38,000	83,000	38,000	...
Sugar beets	1,000	1,000	1,000	1,000	...
Nuts and Olives	68,700	68,900	58,400	74,900	...
Pulses nes	50,000	50,000	42,100	50,000	...
Almonds	9,000	9,000	7,000	15,000	...
Walnuts	5,000	5,000	3,900	5,000	...
Pistachios	2,800	2,800	2,200	3,000	...
Nuts nes	1,000	1,000	800	1,000	...
Olives	900	1,100	2,400	900	...

Source: Data provided by the Afghan authorities.

Table 9. Islamic Republic of Afghanistan: Land Use, 2001/02–2005/06

(In thousands of hectares)

	2001/02	2002/03	2003/04	2004/05	2005/06
Total land area	65,223	65,223	65,223	65,223.00	...
Permanent crops	70	75	138	115.00	...
Permanent pasture	30,000	30,000	30,000	30,000.00	...
Forests and woodland	1,700	1,700	1,700	1,700.00	...
All other land	25,770	25,770	25,613	25,800.00	...
Non-arable	54,470	54,470	55,613	56,000.00	...
Agricultural area	10,753	10,753	9,160	9,160.00	...

Source: Data provided by the Afghan authorities.

Table 10. Islamic Republic of Afghanistan: Cultivated Land Area for Fruits and Vegetables, 2001/02–2005/06

(In hectares)

	2001/02	2002/03	2003/04	2004/05	2005/06
Total fruits	101,960	101,960	142,706	116,590	...
Oranges	1,500	1,500	1,860	1,500	...
Citrus fruit nes	770	770	1,009	200	...
Apples	2,350	2,350	3,935	2,350	...
Pears	320	320	435	320	...
Apricots	5,100	5,100	7,007	5,500	...
Peaches and nectarines	1,920	1,920	2,611	1,920	...
Plums	4,500	4,500	6,119	4,500	...
Stone fruit nes (fresh)	3,000	3,000	5,579	5,000	...
Berries nes	6,600	6,600	8,975	9,000	...
Grapes	52,000	52,000	66,460	53,000	...
Watermelons	7,800	7,800	11,200	8,200	...
Cantaloupes and other melons	2,100	2,100	8,960	2,700	...
Figs	3,300	3,300	4,006	7,400	...
Fruit fresh nes	10,700	10,700	14,550	15,000	...
Oil seed					
Sunflower seed	11,500	11,500	15,750	12,000	...
Sesame seed	35,000	35,000	18,900	30,000	...
Seed cotton	60,000	60,000	30,000	37,000	...
Linseed	39,000	39,000	18,900	37,000	...
Vegetables fresh nes	57,000	57,000	22,949	57,000	...
Anise, Badian, Fennel	4,500	4,500	4,500	4,500	...

Source: Data provided by the Afghan authorities.

Table 11. Islamic Republic of Afghanistan: Cultivated Land Area
for Cereals and Others, 2001/02–2005/06

(In hectares)

	2001/02	2002/03	2003/04	2004/05	2005/06
Cereals	2,094,000	2,238,000	3,054,700	3,030,000	...
Wheat	1,779,000	1,742,000	2,320,000	2,342,000	...
Rice, paddy	121,000	135,000	195,000	160,000	...
Barley	87,000	236,000	270,000	240,000	...
Maize	80,000	100,000	250,000	261,000	...
Millet	27,000	25,000	19,700	27,000	...
Potatoes and beets	16,070	16,070	23,370	22,070	...
Potatoes and beets	14,000	14,000	21,000	20,000	...
Sugar cane	2,000	2,000	2,300	2,000	...
Sugar beets	70	70	70	70	...
Nuts and olives	49,500	49,500	54,600	55,420	...
Pulses nes	37,000	37,000	39,300	40,000	...
Almonds	5,500	5,500	5,700	9,000	...
Walnuts	2,300	2,300	3,100	2,300	...
Pistachios	2,700	2,700	3,200	1,920	...
Nuts nes	700	700	900	900	...
Olives	1,300	1,300	2,400	1,300	...

Source: Data provided by the Afghan authorities.

Table 12. Islamic Republic of Afghanistan: Crop Yields, 2000/01–2005/06

(In kilograms per hectare)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Cereals	1,084	1,007	1,670	1,377	1,738	...
Wheat	724	898	1,542	1,500	1,822	...
Rice, paddy	2,000	2,000	2,874	1,333	2,031	...
Barley	5,976	1,000	1,462	889	1,404	...
Maize	1,198	2,000	2,980	840	1,207	...
Millet	815	815	800	858	815	...
Potatoes and beets	17,050	17,050	16,739	17,809	15,360	...
Potatoes and beets	16,786	16,786	16,429	16,667	15,000	...
Sugar cane	19,000	19,000	19,000	25,000	19,000	...
Sugar beets	14,286	14,286	14,286	14,286	4,286	...
Nuts and Olives	1,388	1,388	1,392	1,070	1,351	...
Pulses nes	1,351	1,351	1,351	1,071	1,250	...
Almonds	1,636	1,636	1,636	1,228	1,667	...
Walnuts	2,174	2,174	2,174	1,258	2,174	...
Pistachios	1,037	1,037	1,037	688	1,563	...
Nuts nes	1,429	1,429	1,429	889	1,111	...
Olives	692	692	846	1,000	692	...

Source: Data provided by the Afghan authorities.

Table 13. Islamic Republic of Afghanistan: Cereal Balance Sheet, 2000/01–2005/06

(In thousands of tons)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Domestic availability	...	...	2,685	4,190	5,265	5,363
Stock draw-down	...	...	0	0	0	...
Domestic production	...	...	2,685	4,190	5,265	5,243
Total utilization	...	...	4,018	4,825	5,703	5,803
Food use	...	...	3,467	3,952	4,149	4,149
Animal feed	...	...		397	444	444
Seed provision	...	...	282	210	348	348
Losses	...	...	269	266	762	762
Import requirements	...	...	1,333	635	438	440
Commercial import capacity	...	...	865	416	318	320
Food aid currently in stock and pipeline (World Food Program)	...	...	219	219	120	12

Source: Data provided by the Afghan authorities.

Table 14. Islamic Republic of Afghanistan: Livestock,
2001/02–2005/06

(In thousands of heads)

	2001/02	2002/03	2003/04	2004/05	2005/06
Cattle	2,249	3,715	3,829	...	...
Sheep	13,955	8,773	9,074	...	...
Goats	5,003	7,281	7,425	...	...
Chickens	6,844	12,156	12,402	...	...
Horses	162	141	144	...	...
Asses	682	1,588	1,598	...	...
Mules	25	25	25	...	...
Camels	224	175	181	...	...

Source: Data provided by the Afghan authorities.

Table 15. Islamic Republic of Afghanistan: Agricultural Cooperatives, 2001/02–2005/06

(In units as stated)

	2001/02	2002/03	2003/04	2004/05	2005/06
Number of agricultural cooperatives (in units)	744	52	243	597	597
Number of member in active cooperatives (in units)	113,000	7,400	30,000	74,423	74,800
Total area which is under control of cooperatives (in hectares)	171,000	13,000	77,000	68,500	68,500
Selling of products in foreign markets (in tons)	...	7	36	100	100

Source: Data provided by the Afghan authorities.

Table 16. Islamic Republic of Afghanistan: Production and Consumption of Electricity, 2001/02–2005/06

(In units as stated)

	2001/02	2002/03	2003/04	2004/05	2005/06 1/
	(In millions of kilowatt-hour)				
Production of electricity	489.72	557.30	827.13	782.73	365.99
Hydro	488.22	556.15	631.70	564.49	340.93
Diesel	1.50	1.15	1.41	3.10	25.06
	(In millions of Afghanis)				
Consumption of electricity	264.35	301.32	741.22	623.41	...
Hydro	263.55	300.70	558.41	444.65	...
Diesel	0.80	0.62	1.03	1.35	...
	(In Afghanis per kilowatt-hour)				
Price	0.54	0.54	0.54	0.54	...

Source: Data provided by the Afghan authorities.

1/ For the first nine months of the year.

Table 17. Islamic Republic of Afghanistan: Production and Imports of Cement, 2000/01–2005/06

(In units as stated)

	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06
Total						
Quantities (in thousand of tons)	...	43.5	89.1	378.5	615.5	...
Value (in millions of Afghanis)	...	184.7	622.0	1,441.6	1,731.2	...
Unit price (in Afghanis per ton)	...	4,252	6,981	3,809	2,810	...
Domestic Production						
Quantities (in thousands of tons)	...	16.2	26.8	24.0	15.2	...
Value (in millions of Afghanis)	...	61.4	26.6	62.3	49.3	...
Unit price (in Afghanis per ton)	...	3,799	992	2,600	3,249	...
Of which: Gory Factory (Baglan)						
Quantities (in thousands of tons)	...	...	24.5	22.8	15.2	...
Value (in millions of Afghanis)	...	...	23.8	59.2	54.6	...
Unit price (in Afghanis per ton)	...	...	970	2,600	3,594	...
Jabusarg factory (Parwan)						
Quantities (in thousands of tons)	...	...	2.2	1.2	...	...
Value (in millions of Afghanis)	...	...	2.7	3.1	...	...
Unit price (in Afghanis per ton)	...	...	1,241	2,610	...	...
Imports						
Quantities (in thousands of tons)	...	27.3	62.4	354.5	600.3	...
Value (in thousands of U.S. dollars)	...	2,015.0	7,733.3	29,449.5	35,023.8	...
Unit price (in U.S. dollar per ton)	...	73.9	124.0	83.1	58.3	...
Exchange rate: Afghanis per U.S. dollar	...	56.2	43.9	49.0	48.0	...

Source: Data provided by the Afghan authorities.

Table 18. Islamic Republic of Afghanistan: Private Industrial Production, 2001/02–2005/06

(In units as stated)

	Units	2001/02	2002/03	2003/04	Prov. 2004/05	Proj. 2005/06
Shoes and plastic sandals	Million pairs	1	1	1	3	6
Plastic dishes	Ton	...	11,284	15,293	60,960	96,000
Other plastic things	Ton	...	...	6,400	73,500	124,000
Musaic and taraso	Cubic meter	...	...	...	14	17
Batteries	Unit	...	...	...	85,000	15,436
Metal	Ton	28,484	9,008	418	740	1,820
Profeel metal	Ton	28,484	9,008	418	740	1,640
Carton	2000	...	...	...	198	123
Medicines	Million Afghanis	...	...	...	30	38
Wood production	Million Afghanis	...	...	8	22	207
Flax production	Million Afghanis	...	...	...	3	...
Wool production	Million meters	...	...	14	35	...
Rugs	Thousand meters	...	...	12	16	25
Socks	Thousand pairs	18	23	...	...	...
Vegetable oil	Ton	...	19	7,464	200	1,872
Sweet	Ton	10	2	...	168	200
Raisins processing	Thousands of tons		2	1	2	2
Ice	Thousands of tons	0	2	9	30	61
Non-alcoholic beverages	Millions of letters	0	0	1	1	4
Batteries	Ton	...	...	279	...	211
Chalk	Carton	...	...	1,149	4,596	...
Print industry	Thousand sheets	...	...	4	18	41
Metal production	Thousands of meters	...	...	80,000	240	760

Source: Data provided by the Afghan authorities.

Table 19. Islamic Republic of Afghanistan: Main Industrial Organizations, 2001/02–2005/06

	2001/02	2002/03	2003/04	Prov. 2004/05	2005/06
Electricity	16	16	17	20	...
Charcoal	3	2	6	6	...
Gas and oil	1	1	2	2	...
Chemical sector	56	69	52	74	...
Construction material	4	5	48	36	...
Machinery and metal	17	32	58	68	...
Pharmacy	2	5	6	6	...
Publishing	12	33	34	44	...
Carpentry and paper	2	14	10	18	...
Light industries	6	11	22	18	...
Food industries	33	57	68	90	...
Other industries	1	6	14	35	...
Total	153	251	337	417	...

Source: Data provided by the Afghan authorities.

Table 20. Islamic Republic of Afghanistan: Land Transportation, 2001/02–2005/06

(In units as stated)

	Units	2001/02	2002/03	2003/04	Prov. 2004/05	2005/06
Total	Number	97,731	175,355	339,601	402,409	...
Government sector	Number	21,791	22,459	22,969	25,003	...
Private sector	Number	75,940	152,896	313,362	377,406	...
Lorries	Number	29,535	51,527	76,236	83,347	...
Government sector	Number	10,200	10,913	11,151	10,840	...
Private sector	Number	19,335	40,614	65,085	72,534	...
Lorries' capacity	Thousand tons	164	577	754	970	...
Government sector	Thousand tons	61	100	103	100	...
Private sector	Thousand tons	103	477	651	870	...
Buses	Number	15,389	29,098	40,042	40,590	...
Government sector	Number	1,731	2,741	2,947	2,957	...
Of which: Milli Bus Enterprise	Number	75	230	336	676	...
Private sector	Number	13,658	26,357	37,095	37,633	...
Buses capacity	Thousand tons	443	960	1,667	2,003	...
Government sector	Thousand tons	61	96	123	121	...
Of which: Milli Bus Enterprise	Thousand tons	4	10	14	28	...
Private sector	Thousand tons	382	864	1,554	1,882	...
Passenger cars	Number	49,114	71,222	176,723	197,449	...
Government sector	Number	9,276	8,162	8,228	10,986	...
Private sector	Number	39,838	63,060	168,495	186,463	...
Of which: Taxis	Number	19,209	33,057	52,392	49,414	...
Motorcycle	Number	3,693	13,189	33,098	62,417	...
Government sector	Number	584	643	643	233	...
Private sector	Number	3,109	12,546	32,455	62,184	...
Rickshaws	Number	...	419	3,044	6,355	...
Foreign vehicles	Number	...	9,900	10,458	12,237	...

Source: Data provided by the Afghan authorities.

Table 21. Islamic Republic of Afghanistan: Air Transportation, 2001/02–2005/06

(In units as stated)

	Units	2001/02	2002/03	2003/04	Prov. 2004/05	2005/06
Air plane	Number	8	6	7	7	...
Total capacity	Seats	610	1,128	1,192	1,192	...
Total flights	Hours	552	1,563	4,054	7,735	...
Total length of flights	Thousand kilometers	1,821	2,986	9,714	12,898	...
Goods	Ton	63	4,042	16,545	15,936	...
Of which: international airlines	Ton	47	3,972	16,590	15,882	...
Circulation of goods	Thousand tons per kilometer	18	6,214	23,496	20,624	...
Of which: international airlines	Thousand tons per kilometer	11	6,166	18,545	20,586	...
Passengers	Thousand passengers	100	161	296	333	...
Of which: international airlines	Thousand passengers	29	127	185	206	...
Circulation of passengers	Million per kilometer	122	325	552	681	...
Of which: international airlines	Million per kilometer	92	305	495	244	...
Total number of staff	Number	1,360	1,455	1,599	1,599	...
Pilots	Number	60	65	140	98	...
Engineers and mechanics	Number	260	327	356	311	...
Flight engineers	Number	145	145	69	170	...
Flight attendants	Number	97	82	93	76	...
Administrative staff	Number	482	537	632	632	...
Others	Number	316	299	309	312	...

Source: Data provided by the Afghan authorities.

Table 22. Islamic Republic of Afghanistan: Number of Post Offices, 2001/02–2005/06

	2001/02	2002/03	2003/04	2004/05	Prov. 2005/06
Total	301	373	373	460	518
Kabul	28	40	40	41	52
Parwan	15	13	13	10	11
Kapisa	5	6	6	9	10
Logar	4	7	7	7	8
Wardak	9	8	8	9	10
Ghazni	21	16	16	19	21
Paktya	23	14	14	15	17
Pakuka	15	15	15	25	27
Khost	6	12	12	13	15
Nangarhar	20	24	24	26	29
Kunarha	6	9	9	15	16
Nooristan	4	6	6	11	12
Laghman	4	5	5	5	6
Badakhshan	13	22	22	29	31
Takhar	10	17	17	17	18
Kunduz	9	7	7	7	9
Baghlan	11	13	13	15	16
Samangan	6	5	5	6	7
Balkh	10	17	17	18	21
Sar-e-Pul	2	5	5	9	10
Juzjan	8	8	8	15	16
Faryab	7	13	13	14	15
Badghis	5	7	7	8	9
Farah	9	11	11	11	12
Nimroz	4	5	5	5	6
Helmand	2	13	13	15	16
Kandahar	12	21	21	18	21
Zubul	9	10	10	13	14
Urizan	9	9	9	5	6
Ghor	7	8	8	10	11
Bamyan	8	7	7	8	9
Heart	...	...	...	20	23
Day Kundi	...	...	...	6	7
Panj Shir	...	...	...	6	7

Source: Data provided by the Afghan authorities.

Table 23. Islamic Republic of Afghanistan: Telephone Services, 2001/02–2005/06

	2001/02	2002/03	2003/04	2004/05	2005/06
	(Number of lines)				
Total fixed line telephones	35,200	154,700	141,328	165,657	...
Private	25,477	85,214	77,936	94,034	...
Official	9,723	69,486	63,392	71,623	...
	(In thousands of Afghanis)				
Revenue of telephone services 1/	28,837	53,904	77,224	616,214	...
Private	7,896	18,937	50,528	137,852	...
Official	20,941	34,967	26,696	478,362	...

Source: Data provided by the Afghan authorities.

1/ Including wireless.

Table 24. Islamic Republic of Afghanistan: Sectoral Distribution of Active Population, 2001/02–2005/06

(In thousands)

	2001/02	2002/03	2003/04	2004/05	Prel. 2005/06
Population (excluding nomads)	19,911	20,298	24,000	24,500	24,800
Number of workers	7,588	7,736	...	...	...
Agriculture, forest, livestock	5,083	5,181	...	...	...
Government sector	28	28	...	...	...
Industries including mining	355	362	...	...	...
Constructions sector	97	99	...	...	...
Of which : governmental projects	78	80	...	...	...
Transport and communications	166	170	...	...	...
Of which : public enterprises	54	55	...	...	...
Commerce	500	510	...	...	...
Of which : public enterprises	61	62	...	...	...
Other services	1,105	1,127	...	...	...
Education	75	76	...	...	...
Public health	21	22	...	...	...
Information and culture	10	10	...	...	...
Governmental institutions	154	157	...	...	...
Public services	204	208	...	...	...
Other fields	641	654	...	...	...
Undistributed employees	255	260	...	...	...

Source: Data provided by the Afghan authorities.

Table 25. Islamic Republic of Afghanistan: Consumer Price Index for Kabul, January 2003–December 2005

	Indices (Dec 2002=100)			Monthly Percentage Changes			12-month Percentage Changes
	General	Food	Nonfood	General	Food	Nonfood	General
2003							
January-03	96.5	95.3	98.2	-3.5	-4.7	-1.8	67.2
February-03	93.9	92.3	96.3	-2.6	-3.2	-1.9	57.6
March-03	96.0	95.9	96.3	2.3	3.9	-0.1	52.3
April-03	97.8	97.7	97.8	1.8	1.9	1.6	53.9
May-03	97.0	96.2	98.3	-0.7	-1.5	0.5	46.1
June-03	97.9	97.1	99.3	0.9	0.8	1.0	52.9
July-03	98.3	97.1	100.1	0.4	0.0	0.9	41.7
August-03	98.7	97.0	101.4	0.4	-0.1	1.2	51.0
September-03	100.5	97.5	105.1	1.8	0.6	3.7	32.5
October-03	101.0	98.6	104.6	0.5	1.1	-0.4	18.5
November-03	103.8	102.1	106.5	2.8	3.5	1.8	-0.8
December-03	106.5	106.1	107.2	2.6	3.9	0.7	**6.5**
2004							
January-04	105.7	105.8	105.4	-0.8	-0.3	-1.6	9.5
February-04	105.5	107.1	103.2	-0.1	1.2	-2.1	12.4
March-04	105.9	107.3	103.8	0.3	0.2	0.6	10.3
Apr-04	108.5	109.8	106.6	2.5	2.3	2.6	11.0
May-04	110.3	110.9	109.4	1.6	1.0	2.7	13.6
Jun-04	113.1	111.4	115.9	2.6	0.5	5.9	15.5
Jul-04	113.7	110.8	118.3	0.5	-0.5	2.1	15.7
Aug-04	114.7	108.7	123.8	0.8	-1.8	4.6	16.2
Sep-04	114.7	106.9	126.5	0.0	-1.6	2.2	14.1
Oct-04	115.7	109.1	125.7	0.9	2.0	-0.6	14.6
Nov-04	116.9	110.8	126.3	1.1	1.5	0.4	12.6
Dec-04	119.1	113.7	127.4	1.9	2.6	0.9	11.8
2005							
Jan-05	119.4	114.4	127.0	0.2	0.6	-0.3	13.0
Feb-05	120.8	116.8	127.0	1.2	2.1	0.0	14.5
Mar-05	123.0	120.3	127.0	1.8	3.0	0.0	16.1
Apr-05	123.7	121.1	127.8	0.6	0.6	0.6	14.0
May-05	124.9	122.3	129.0	1.0	1.0	0.9	13.3
Jun-05	125.9	122.8	130.8	0.8	0.3	1.5	11.3
Jul-05	126.2	122.5	132.1	0.2	-0.2	0.9	11.0
Aug-05	126.9	122.7	133.4	0.5	0.2	1.0	10.7
Sep-05	129.3	124.1	137.2	1.9	1.2	2.8	12.7
Oct-05	130.6	125.4	138.7	1.1	1.1	1.0	12.9
Nov-05	132.0	125.9	141.4	1.0	0.4	1.9	12.9
Dec-05	133.7	126.3	145.0	1.3	0.3	2.6	12.2

Source: Data provided by the Afghan authorities.

Table 26. Islamic Republic of Afghanistan: National Consumer Price Index, 2004–05
(March 2004 = 100)

	Weight	Mar-04	Oct-04	Nov-04	Dec-04	Jan-05	Feb-05	Mar-05	Apr-05	May-05	Jun-05	Jul-05	Aug-05	Sep-05	Oct-05	Nov-05	Dec-05
Overall Index	**100.0**	**100.0**	**106.3**	**106.8**	**108.4**	**109.3**	**110.4**	**111.6**	**111.9**	**113.1**	**113.9**	**114.3**	**114.8**	**116.4**	**117.9**	**119.2**	**120.7**
Food	**60.6**	**100.0**	**102.2**	**102.6**	**104.1**	**104.9**	**106.7**	**108.7**	**109.1**	**110.6**	**111.5**	**111.4**	**111.9**	**113.0**	**114.3**	**114.4**	**115.0**
Breads and cereals	25.2	100.0	102.7	103.7	105.9	107.7	111.4	114.9	113.8	116.6	118.6	118.9	119.5	122.5	123.9	123.6	124.5
Meat	5.1	100.0	100.8	101.3	102.7	105.0	106.8	108.8	106.6	107.0	107.3	107.3	107.6	108.2	108.3	109.1	110.6
Milk, cheese and eggs	5.4	100.0	103.4	102.4	104.0	104.6	104.5	103.4	105.2	104.7	105.1	106.4	107.0	108.2	111.3	112.1	112.1
Oils and fats	5.9	100.0	95.4	94.5	95.2	95.3	96.0	95.4	95.4	94.8	93.8	94.3	94.6	95.2	96.1	94.9	94.4
Fresh and dried fruits	5.6	100.0	109.5	108.8	107.5	105.1	101.5	102.7	104.8	106.2	106.9	108.3	107.6	104.4	107.1	106.5	106.7
Vegetables, Including tubers	6.6	100.0	103.4	105.5	108.4	107.7	110.7	112.6	117.3	119.9	119.2	114.9	115.4	116.0	116.7	118.3	118.5
Sugar and sweet	1.8	100.0	99.7	102.1	104.2	104.7	106.1	108.5	110.6	111.6	112.0	113.1	115.0	115.9	115.5	116.5	116.5
Spices	1.2	100.0	99.5	99.7	100.1	100.2	99.9	104.5	105.2	105.9	106.3	107.3	106.2	106.7	107.3	110.0	110.9
Nonalcoholic beverages	2.0	100.0	100.3	100.2	99.7	99.8	99.6	100.2	101.3	101.6	102.4	102.4	102.5	101.5	100.8	101.0	102.4
Cigarettes and tobaccos	1.8	100.0	95.9	94.9	94.1	94.7	95.9	96.7	98.6	98.6	98.6	98.2	98.9	96.9	96.4	96.8	98.0
Non-Food	**39.4**	**100.0**	**112.6**	**113.1**	**115.0**	**116.1**	**116.0**	**116.1**	**116.1**	**116.8**	**117.7**	**118.7**	**119.4**	**121.4**	**123.6**	**126.6**	**129.5**
Clothing	9.1	100.0	102.5	101.1	100.1	101.9	102.7	102.6	103.4	103.5	104.1	103.5	103.0	103.4	104.1	105.3	105.8
Housing	16.5	100.0	124.1	126.1	130.2	131.8	131.6	131.4	130.3	131.1	132.5	135.2	136.5	140.2	143.3	148.7	154.1
Of which: Rents	6.8	100.0	146.2	149.2	153.7	152.0	155.7	159.3	159.1	160.6	164.4	171.9	173.1	175.0	175.8	177.2	181.8
Maintenance	3.0	100.0	107.7	106.7	108.5	108.0	110.1	111.2	111.8	111.8	112.0	113.6	117.4	117.1	117.8	118.0	119.6
Electricity and fuels	6.6	100.0	108.7	111.1	115.8	121.9	116.6	111.8	108.9	109.4	108.9	107.1	107.4	114.8	121.5	133.3	141.3
Household goods	7.2	100.0	101.3	100.8	101.9	102.0	102.0	102.6	102.0	102.0	102.6	102.4	102.4	102.6	103.4	103.9	104.1
Health	1.7	100.0	108.2	107.6	106.1	106.4	105.7	106.6	108.9	108.4	109.6	111.0	111.5	112.3	114.0	114.7	114.8
Transportation	2.1	100.0	125.2	127.5		130.8	126.1	126.7	128.5	134.3	135.1	134.1	139.2	145.2	152.9	160.5	167.4
Communication	1.0	100.0	100.4	100.8	100.4	100.4	100.6	100.6	107.6	107.3	107.3	107.3	107.3	107.3	107.3	107.3	108.3
Education	1.3	100.0	99.2	97.5	97.9	98.5	99.2	100.1	102.0	102.4	102.2	102.1	102.0	101.0	101.4	101.1	100.9
Miscellaneous	0.6	100.0	100.6	101.9	101.9	106.7	110.2	111.3	110.8	110.8	110.3	110.7	110.2	112.0	112.3	112.3	119.0

Source: Data provided by the Afghan authorities.

Table 27. Islamic Republic of Afghanistan: General Government Employment, 2001/02–2005/06

(Number of employees)

	2001/02	2002/03	2003/05	2004/05	2005/06 8 months
Total (excluding defense and security)	...	239,081	234,141	247,827	263,576
President's Office	...	794	1,473	422	437
National Assembly					147
Administrative Affairs	...	944	...	783	738
Defense	...		11,505	10,690	4,558
Foreign Affairs	...	985	856	1,193	1,247
Interior	...	70,481	9,613	9,595	10,333
Justice	...	2,729	1,764	2,225	2,210
Finance	...	4,275	5,635	4,716	4,465
Education	...	72,000	115,659	140,113	164,850
Higher Education	...	5,090	4,647	4,579	4,966
Refugees Return	...	829	1,047	1,057	1,036
Religious Affairs and Hajj	...	8,000	7,142	6,233	5,950
Planning	...	424	457	464	...
Economy	...	...	...	...	1,464
Mines and Industries	...	291	2,646	2,283	3,123
Light Industries	...	272	421	742	...
Commerce	...	449	851	663	642
Communications	...	2,869	3,464	3,634	3,597
Reconstruction	...	416	347	350	...
Information and Culture	...	4,514	3,731	4,020	3,841
Public Health	...	23,540	17,891	15,307	12,647
Women's Affairs	...	1,341	902	846	799
Supreme Court	...	3,224	3,190	3,554	3,467
Agriculture	...	11,309	9,699	9,947	9,734
Irrigation and Water Resources	...	2,167	2,145	2,027	...
Public Works	...	2,972	2,500	2,515	2,400
Rural Development	...	1,895	1,458	1,681	1,973
City Construction/Urban Development	...	...	421	491	466
Martyrs and Disabled	...	1,605	1,383	1,402	1,369
Transport and Aviation	...	882	1,058	1,089	1,981
Borders/Frontiers	...	750	768	1,067	1,180
Labour and Social Affairs	...	5,761	5,595	6,043	5,920
Water and Power	...	542	517	507	2,132
Civil Aviation	...	1,050	967	1,069	...
Geodesy and Cartography	...	660	635	688	635
Attorney General	...	4,540	3,532	3,748	3,510
Central Statistics Office	...	413	672	708	...
Da Afghanistan Bank	...	125	4,069	...	...
Science Academy	...	567	382	436	374
Sports (Olympic)	...	...	287	321	315
National Security	...	...	203	2	0
Cooperative Agriculture	...	376	...	...	...
Civil Service Commission	...	...	36	167	193
Narcotics Eradication/Counter Narcotics	...	...	85	...	48
Repatriates	...	...	18	29	19
Audit Office	...	...	...	239	245
Disaster Management Organisation	...	...	...	104	110
Commission for Evaluation of SOE	...	...	...	24	...
Anti- Corruption Commission	...	...	...	39	113
Office of the Father of the Nation	...	...	...	15	13
Municipalities	...	...	...	...	15
Youth	...	...	...	...	52
Directorate of Environment	...	...	...	...	265

Source: Data provided by the Afghan authorities.

Notes: The data for 1382-1384 are reported as average payroll figures.

Table 28. Islamic Republic of Afghanistan: Core Budget, 2003/04–2005/06

(In millions of Afghanis)

	Est. 2003/04	Est. 2004/05	Revised MYR 1/ 2005/06	YTD Prov. 2005/06	Proj. 2/ 2005/06
Domestic revenue	**10,168**	**12,800**	**18,735**	**8,752**	**18,776**
Tax revenues	6,262	9,546	13,128	5,670	12,705
Taxes on income, profits and capital gains	363	995	3,789	428	1,738
Taxes on international trade and transactions	5,369	7,247	8,917	4,573	9,323
Other taxes	531	1,304	422	669	1,643
Non tax revenues	3,906	3,254	5,607	3,082	6,072
Donor assistance grants (to operating budget)	**10,074**	**14,984**	**16,878**	**8,588**	**16,878**
ARTF (recurrent window)	8,182	12,319	13,580	7,257	13,580
LOTFA	1,892	2,583	3,298	1,331	3,298
Other grants		83	0	0	0
Donor assistance grants (core development budget)	**4,569**	**8,250**	**29,013**	**8,008**	**20,019**
Total core budget expenditure	**31,606**	**39,550**	**83,666**	**23,586**	**55,865**
Operating expenditure	**22,151**	**26,716**	**33,601**	**14,680**	**33,601**
Wages and salaries	14,660	18,902	20,788	9,347	20,972
Purchase of goods and services	4,653	4,182	6,609	3,233	6,609
Transfers and Subsidies	652	764	2,293	0	2,109
Pensions	177	889	1,659	782	1,659
Capital expenditure	2,009	1,979	1,847	1,222	1,847
Interest			404	96	404
Core budget development spending 3/	**9,455**	**12,834**	**50,066**	**8,906**	**22,265**
National programs	**3,339**	**12,070**	**44,351**	**8,228**	**20,571**
1.4 Livelihoods and Social Protection	159	560	13,585	3,997	9,992
1.5 Culture, Media, Sport	0	0	284	3	7
2.1 Transport	75	2,173	9,893	1,982	4,954
2.2 Energy, Mining, and Telecommunications	852	932	7,992	931	2,329
2.3 Natural Resources Management	449	4,609	2,775	21	53
2.4 Urban Management	394	0	2,253	274	684
3.1 Trade and Investment	95	0	386	3	7
3.2 Public Administration and Economic Management	598	61	4,629	758	1,896
3.3 Justice	0	2,581	41	2	4
3.4 National Police, Law Enforcement and Stabilization	319	1,153	2,512	258	644
3.5 Afghan National Army	399	0	0	0	0
National priority programs	**6,115**	**765**	**5,715**	**678**	**1,694**
Education and Vocational Training	289	172	3,147	243	608
Health and Nutrition	508	579	1,583	421	1,052
Other programs	5,318	13	985	14	34
Operating budget balance (excluding grants)	**-11,983**	**-13,916**	**-14,866**	**-5,929**	**-14,824**
Operating budget balance (including grants)	**-1,910**	**1,068**	**2,012**	**2,660**	**2,054**
Core budget balance	**-6,795**	**-3,516**	**-19,040**	**1,761**	**-192**
Float and adjustment 4/	**1,693**	**357**	**0**	**-1,630**	**0**
Sale of nonfinancial assets 5/	**0**	**0**	**3,987**	**0**	**3,987**
Financing	**5,102**	**3,158**	**15,054**	**-131**	**-3,795**
External loans (net)	4,886	14,754	23,946	2,701	4,236
Domestic (net), *of which:*	217	-11,596	-8,892	-2,832	-8,031
Change in foreign currency deposits 6/	396	-10,457	na	-3,313	-5,718
Change on domestic currency deposits 6/	-179	-1,139	na	481	-2,313
Memorandum item:					
Domestic revenue (government medium-term targets) 7/	...	...	...	...	18,842
External budget expenditure 8/	74,528	100,225	105,394	na	102,958
GDP	225,108	284,504	...	...	355,829
Real GDP growth rate (in percent)	15.7	8.0	...	...	13.8

Sources: Ministry of Finance (MoF) and Da Afghanistan Bank (DAB); and Fund staff estimates and projections.

1/ November 2005 supplementary budget relased following the midyear budget review (MYR).

2/ Staff projections. Operating budget expenditure is consistent with the authorities medium-term fiscal framework (MTFF) but domestic revenue, development spending and funding/financing are lower.

3/ Government program classification.

4/ Variation between the fiscal position recorded at MoF and DAB. This discrepancy is partially due to the difference ("float") between checks issued and checks cashed.

5/ For 2005/06 this includes $80 million in revenue from the sale of telecommunications licenses.

6/ Net transfers from government deposits with DAB. A positive sign corresponds to a decline in balances and a negative sign to an increase in balances.

7/ Government revenue projections from the MTFF, which assume considerable policy changes and new measures.

8/ For 2005/06 the budget estimate includes only the funded portion of expected expenditure.

Table 29. Islamic Republic of Afghanistan: Core Budget, 2003/04–2005/06

(In percent of GDP)

	Est. 2003/04	Est. 2004/05	Revised MYR 1/ 2005/06	H1 Prov. 2005/06	Proj. 2/ 2005/06
Domestic revenue	**4.5**	**4.5**	**5.3**	**2.5**	**5.3**
Tax revenues	2.8	3.4	3.7	1.6	3.6
Taxes on income, profits, and capital gains	0.2	0.3	1.1	0.1	0.5
Taxes on international trade and transactions	2.4	2.5	2.5	1.3	2.6
Other taxes	0.2	0.5	0.1	0.2	0.5
Non tax revenues	1.7	1.1	1.6	0.9	1.7
Donor assistance grants (to operating budget)	**4.5**	**5.3**	**4.7**	**2.4**	**4.7**
ARTF (recurrent window)	3.6	4.3	3.8	2.0	3.8
LOTFA	0.8	0.9	0.9	0.4	0.9
Other grants	0.0	0.0	0.0	0.0	0.0
Donor assistance grants (core development budget)	**2.0**	**2.9**	**8.2**	**2.3**	**5.6**
Total core budget expenditure	**14.0**	**13.9**	**23.5**	**6.6**	**15.7**
Operating expenditure	**9.8**	**9.4**	**9.4**	**4.1**	**9.4**
Wages and salaries	6.5	6.6	5.8	2.6	5.9
Purchase of goods and services	2.1	1.5	1.9	0.9	1.9
Transfers and subsidies	0.3	0.3	0.6	0.0	0.6
Pensions	0.1	0.3	0.5	0.2	0.5
Capital expenditure	0.9	0.7	0.5	0.3	0.5
Interest	0.0	0.0	0.1	0.0	0.1
Core budget development spending 3/	**4.2**	**4.5**	**14.1**	**2.5**	**6.3**
National programs	**1.5**	**4.2**	**12.5**	**2.3**	**5.8**
1.4 Livelihoods and Social Protection	0.1	0.2	3.8	1.1	2.8
1.5 Culture, Media, Sport	0.0	0.0	0.1	0.0	0.0
2.1 Transport	0.0	0.8	2.8	0.6	1.4
2.2 Energy, Mining, and Telecommunications	0.4	0.3	2.2	0.3	0.7
2.3 Natural Resources Management	0.2	1.6	0.8	0.0	0.0
2.4 Urban Management	0.2	0.0	0.6	0.1	0.2
3.1 Trade and Investment	0.0	0.0	0.1	0.0	0.0
3.2 Public Administration and Economic Management	0.3	0.0	1.3	0.2	0.5
3.3 Justice	0.0	0.9	0.0	0.0	0.0
3.4 National Police, Law Enforcement and Stabilization	0.1	0.4	0.7	0.1	0.2
3.5 Afghan National Army	0.2	0.0	0.0	0.0	0.0
National priority programs	**2.7**	**0.3**	**1.6**	**0.2**	**0.5**
Education and Vocational Training	0.1	0.1	0.9	0.1	0.2
Health and Nutrition	0.2	0.2	0.4	0.1	0.3
Other programs	2.4	0.0	0.3	0.0	0.0
Operating budget balance (excluding grants)	**-5.3**	**-4.9**	**-4.2**	**-1.7**	**-4.2**
Operating budget balance (including grants)	**-0.8**	**0.4**	**0.6**	**0.7**	**0.6**
Core budget balance	**-3.0**	**-1.2**	**-5.4**	**0.5**	**-0.1**
Float and adjustment 4/	**0.8**	**0.1**	**0.0**	**-0.5**	**0.0**
Sale of nonfinancial assets 5/	**0.0**	**0.0**	**1.1**	**0.0**	**1.1**
Financing	**2.3**	**1.1**	**4.2**	**0.0**	**-1.1**
External loans (net)	2.2	5.2	6.7	0.8	1.2
Domestic (net), *of which:*	0.1	-4.1	-2.5	-0.8	-2.3
Change in foreign currency deposits 6/	0.2	-3.7	na	-0.9	-1.6
Change on domestic currency deposits 6/	-0.1	-0.4	na	0.1	-0.7
Memorandum item:					
Domestic revenue (government medium-term targets) 7/	...	...	...	...	5.3
External budget expenditure 8/	33.1	35.2	29.6	na	28.9

Sources: Ministry of Finance (MoF) and Da Afghanistan Bank (DAB); and Fund staff estimates and projections.

1/ November 2005 supplementary budget relased following the midyear budget review (MYR).

2/ Staff projections. Operating budget expenditure is consistent with the authorities medium-term fiscal framework (MTFF) but domestic revenue, development spending and funding/financing are lower.

3/ Government program classification.

4/ Variation between the fiscal position recorded at MoF and DAB. This discrepancy is partially due to the difference ("float") between checks issued and checks cashed.

5/ For 2005/06 this includes US80 million in revenue from the sale of telecommunications licenses.

6/ Net transfers from government deposits with DAB. A positive sign corresponds to a decline in balances and a negative sign to an increase in balances.

7/ Government revenue projections from the MTFF, which assume considerable policy changes and new measures.

8/ For 2005/06 the budget estimate includes only the funded portion of expected expenditure.

Table 30. Islamic Republic of Afghanistan: Revenue and Expenditures by Provinces and Central Ministries, 2003/04–2005/06 1/

(In Afghanis)

	2003/04				2004/05		
	Revenue Est.	Expenditure Est.	Balance Est.		Revenue Est.	Expenditure Est.	Balance Est.
Total	10,167,915,284	22,001,215,195	-11,833,299,910	Total	12,799,655,081	26,715,576,134	-13,915,921,053
Central Ministries	2,959,313,838	11,933,876,213	-8,974,562,374	Central Ministries	2,666,042,215	15,113,800,494	-12,447,758,279
1 Kabul	475,637,438	250,902,490	224,734,948	1 Kabul	635,200,011	320,171,566	315,028,445
2 Kapisa	2,802,030	172,089,146	-169,287,116	2 Parwan	23,803,357	796,417,238	-772,613,881
3 Parwan	8,941,678	619,021,308	-610,079,630	3 Wardak	3,118,457	206,984,932	-203,866,475
4 Wardak	1,938,344	137,086,310	-135,147,966	4 Logar	8,361,948	202,878,047	-194,516,099
5 Logar	3,953,715	105,730,748	-101,777,033	5 Ghazni	33,496,797	322,316,460	-288,819,663
6 Ghazni	17,734,670	193,040,645	-175,305,975	6 Paktiya	76,918,794	237,408,635	-160,489,841
7 Paktiya	23,800,377	167,374,086	-143,573,709	7 Paktika	42,277,068	218,110,030	-175,832,962
8 Nangarhar	686,441,649	740,929,182	-54,487,533	8 Khost	254,107,905	244,802,488	9,305,417
9 Laghman	5,680,396	136,995,601	-131,315,205	9 Samangan	10,118,721	140,427,358	-130,308,637
10 Kunar	258,661,638	161,707,499	96,954,139	10 Balkh	1,138,647,846	889,337,287	249,310,559
11 Badakhshan	6,366,145	285,630,755	-279,264,610	11 Jawzjan	185,883,290	494,484,181	-308,600,891
12 Takhar	22,514,002	215,102,937	-192,588,935	12 Faryab	12,965,337	315,476,010	-302,510,673
13 Baghlan	18,567,220	278,334,561	-259,767,341	13 Bamayan	6,201,824	221,240,798	-215,038,974
14 Kunduz	41,348,952	487,261,847	-445,912,895	14 sar-e-pul	5,156,468	164,286,113	-159,129,645
15 Samangan	4,499,900	96,442,831	-91,942,931	15 Kapisa	6,662,043	286,798,455	-280,136,412
16 Balkh	319,557,706	721,555,727	-401,998,021	16 Nangahar	1,559,667,055	826,106,202	733,560,853
17 Jawzjan	74,517,228	429,760,032	-355,242,804	17 Laghman	11,906,292	229,738,115	-217,831,823
18 Faryab	8,308,258	173,896,497	-165,588,239	18 Kunar	25,144,155	255,924,114	-230,779,959
19 Badghis	2,874,334	95,795,384	-92,921,050	19 Nooristan	1,660,760	149,367,528	-147,706,768
20 Herat	4,191,807,245	2,215,230,623	1,976,576,622	20 Nimroz	102,414,769	102,728,540	-313,771
21 Farah	43,803,594	133,193,902	-89,390,308	21 Helmand	23,016,354	318,145,197	-295,128,843
22 Nimroz	83,416,590	72,067,680	11,348,910	22 Kandahar	1,409,693,020	989,995,483	419,697,537
23 Helmand	13,562,055	191,138,359	-177,576,304	23 Zabul	4,585,141	152,295,844	-147,710,703
24 Kandahar	726,044,309	1,165,203,525	-439,159,216	24 Uruzgan	4,186,127	81,892,310	-77,706,183
25 Zabul	5,860,515	64,735,155	-58,874,640	25 Badakhshan	14,969,043	525,602,729	-510,633,686
26 Uruzgan	7,598,174	45,223,519	-37,625,345	26 Takhar	33,135,382	342,349,725	-309,214,343
27 Ghor	4,712,073	122,903,091	-118,191,018	27 Baghlan	28,109,274	545,886,195	-517,776,921
28 Bamyan	3,647,063	145,541,988	-141,894,925	28 Kunduz	44,562,599	642,834,543	-598,271,944
29 Paktika	32,254,547	104,479,675	-72,225,128	29 Badghis	11,043,190	138,634,048	-127,590,858
30 Nooristan	0	58,320,365	-58,320,365	30 Herat	4,359,727,240	763,555,515	3,596,171,725
31 Sar-e-Pul	1,779,518	102,307,823	-100,528,305	31 Farah	49,436,014	193,350,072	-143,914,058
32 Khost	109,970,083	178,335,691	-68,365,608	32 Ghor	6,419,612	204,261,018	-197,841,406
				33 Panjshair	949,571	49,497,075	-48,547,504
				34 Daikondi	67,403	28,471,789	-28,404,386

Sources: Data provided by the Afghan authorities; and Fund staff estimates.

1/ Provinces are part of a deconcentrated central government system and not a separate subnational tier of government.

Table 31. Islamic Republic of Afghanistan: Core Development Budget Expenditures, 2001/02–2005/06 1/

(In millions of U.S. dollars) 2/

	Est. 2001/02–2003/04	Est. 2004/05	Est. First nine months 2005/06
National programs	**19.8**	**242.2**	**235.3**
Refugee and Internally Displaced People Return	0	0	0
Livelihoods and Social Protection	0	11.2	114.4
Culture, Media, and Sport	0	0.0	0.1
Transport	0	43.6	48.2
Energy, Mining, and Telecommunications	9.2	18.7	36.3
Natural Resources Management	2.8	92.5	0.5
Urban Management	0	0.0	5.9
Trade and Investment	0	0.0	0.3
Public Administration Reform and Economic Management	7.8	1.2	18.4
Justice	0	51.8	0.0
National Police, Law Enforcement and Stabilization	0	23.1	11.2
Afghan National Army	0	0.0	0.0
Mine Action	0	0.0	0.0
Disarmament, Demobilization and Reintegration	0	0.0	0.0
National priority programs	**173.2**	**15.1**	**17.8**
Education and Vocational Training	5.7	3.5	6.5
Health and Nutrition	10.5	11.6	11.4
National Emergency Employment Program	46.8	0.0	0.0
National Solidarity Program	32.4	0.0	0.0
Afghanistan Stabilization Program	0	0.0	0.0
National Transportation Program	28	0.0	0.0
National Irrigation Program	39	0.0	0.0
National Feasibility Studies Program	5	0.0	0.0
Other programs	5.8	0.3	2.6
Total	**193.0**	**257.3**	**253.2**

Sources: Data provided by the Afghan authorities; and Fund staff estimates.

1/ Core budget development expenditures are disbursed through the government's treasury accounts.
2/ Conversion from Afghani using the exchange rate of 49.84 Afghanis per U.S. dollar.

Table 32. Islamic Republic of Afghanistan: External Development Budget Expenditures, 2001/02 – 2005/06 1/

(In millions of U.S. dollars)

	Est.	Est.	Est. 2/
	2001/02–2003/04	2004/05	First five months 2005/06
National programs	**3,082.3**	**1,863.7**	**203.4**
Refugee and Internally Displaced People Return	157.7	103.6	50.7
Livelihoods and Social Protection	757.5	113.3	11.1
Culture, Media, Sport	27.4	7.1	0.0
Transport	522.1	477.9	8.7
Energy, Mining, and Telecommunications	73.6	65.9	0.0
Natural Resources Management	166.9	21.2	5.2
Urban Management	105.1	2.8	0.0
Trade and Investment	13.8	11.2	1.4
Public Administration Reform and Economic Managemen	178.5	172.3	10.8
Justice	15.8	15.3	0.2
National Police, Law Enforcement and Stabilization	77.1	62.4	13.0
Afghan National Army	771.6	694.5	na
Mine Action	161.7	83.3	63.8
Disarmament, Demobilization and Reintegration	53.5	32.9	38.6
National priority programs	**405.9**	**147.2**	**22.5**
Education and Vocational Training	136.7	80.7	1.0
Health and Nutrition	269.2	66.5	21.5
Total	**3,488.2**	**2,010.9**	**225.9**

Sources: Data provided by the Afghan authorities; and Fund staff estimates.

1/ External budget development expenditures are funded directly by donors and reported to the government.
2/ The preliminary estimates exclude significant expenditures not reported to the government, such as for the Afghan National Army

Table 33. Islamic Republic of Afghanistan: Monetary Program (Da Afghanistan Bank), 2002/03–2005/06

	Est. Mar. 20 2002/03	Est. Mar. 19 2003/04	Est. Mar. 20 2004/05	Est. Sep. 20 2005/06
	(In millions of Afghanis)			
Net foreign assets 1/	17,934	39,199	61,612	71,834
Foreign assets	19,602	41,169	63,582	73,803
Foreign exchange reserves	19,602	40,665	62,861	72,703
Gold 1/	9,030	14,015	14,015	14,015
Other	10,572	26,650	48,846	58,687
Other foreign assets	0	503	721	1,101
Foreign liabilities	-1,668	-1,970	-1,970	-1,970
Net domestic assets	2,742	-8,075	-20,549	-27,295
Domestic assets	14,361	6,795	-19,751	-22,627
Net claims on general government	14,361	6,795	-19,751	-22,627
Net claims on government before 2002/03	14,951	14,951	0	0
Net claims on government in 2002/3-2004/05	-590	-8,155	-19,751	-22,627
Domestic currency deposits	-344	-1,984	-3,123	-2,686
Foreign currency deposits	-245	-6,171	-16,628	-19,941
Other claims	0	0	0	0
Other items net	-11,618	-14,870	-799	-4,668
Reserve money	20,676	31,124	41,063	44,538
Currency in circulation 2/	20,676	28,801	38,763	42,997
Banknotes and coins issued	21,302	29,726	41,228	45,823
less cash holdings 2/	626	925	2,465	2,825
Bank deposits with DAB and capital note holdings	0	2,323	2,300	1,541
	(In units as stated)			
Memorandum items:				
Currency in circulation (year-on-year percentage change)	20.1	40.9	37.5	25.3
Gross international reserves (end-of-period level; in millions of U.S. dollars)	426.1	815.9	1,261.3	1,458.7

Sources: Da Afghanistan Bank (DAB) and Central Statistics Office.

1/ Foreign currency amounts converted into Afghani at the program exchange rate (49.84 Afghanis per U.S. dollar in 2004/05-05/06). The gold holdings do not include the gold held in the palace vaults and is valued at US$400 per ounce in 2004/05-05/06.

2/ In 2003/04-04/05, cash holdings only include cash in DAB's Treasury vaults and in DAB's six major provincial branches. In 2005/06-2006/07, they include cash in DAB's Treasury vaults and in all DAB's provincial branches.

Table 34. Islamic Republic of Afghanistan: Monetary Survey, 2005/06

(In millions of Afghanis)

	Est. Mar-05	Est. Jun-05	Est. Sep-05
Net foreign assets	68,357	74,291	80,512
Foreign assets	72,660	78,735	86,834
DAB Foreign exchange reserves	62,861	67,073	72,703
Gold	14,015	14,015	14,015
Other	48,846	53,058	58,687
Other foreign assets	9,799	11,662	14,131
Foreign liabilities	-4,303	-4,444	6,322
Net domestic assets	-17,306	-20,298	23,865
Net claims on general government	-19,751	-19,576	22,627
Claims on other sectors	1,744	4,006	4,679
Other items net	701	-4,727	5,917
Broad money	51,052	53,993	56,647
Money	49,932	52,200	54,557
Currency in circulation	38,487	39,763	42,577
Banknotes and coins issued	41,228	42,758	45,823
Less cash holdings	2,742	2,995	3,246
Transferable deposits	11,445	12,437	11,980
Quasi-Money	1,120	1,793	2,090

Source: Data provided by the Afghan authorities; and Fund staff estimates.

Table 35. Islamic Republic of Afghanistan: Number of Banks

(As of December 2005)

Name of Institution	Share of Shareholders In percent	Type of License	Date of License
State-owned banks			
Bank Millie Afghan		Relicensed	Jun. 26, 2004
Pashtany Tejaraty Bank		Relicensed	Jun. 26, 2004
Export Promotion Bank		Relicensed	Sep. 25, 2004
Foreign-owned banks incorporated in Afghanistan			
Afghanistan International Bank (AIB)		Licensed	Mar. 22, 2004
Asian Development Bank	25.0		
ARC Companies	25.0		
Constellation	16.7		
Marco Polo	16.7		
Rahmat Group	16.7		
First Micro Finance Bank (FMFB)		Licensed	Mar. 18, 2004
Agha Khan Fund for Economic Development	52.0		
KFW	31.0		
IFC	17.0		
Kabul Bank (KB)		Licensed	Jun. 26, 2004
Sherkhan Farnood	57.0		
Haji Obaidullah	26.0		
Sherin Khan	10.0		
Ahmad Jawid	5.0		
Fridoon Noorzad	2.0		
Arian Bank		Preliminary approval	Jul. 26, 2004
Bank Melli Iran	50.0		
Bank Saderat Iran	50.0		
Branches of foreign banks			
Standard Chartered Bank		Permitted	Sep. 18, 2003
National Bank of Pakistan		Permitted	Oct. 01, 2003
Habib Bank Ltd.		Permitted	Feb. 18, 2004
Punjab National Bank of India		Permitted	May 11, 2004

Source: Data provided by the Afghan authorities.

Table 36. Islamic Republic of Afghanistan: Balance Sheets of Commercial Banks, September 30, 2005

(In thousands of Afghanis)

	Private banks	Branches of foreign banks	State-owned banks	Total Commercial banks
Net foreign assets	2,329,915	2,959,140	3,141,504	8,430,559
Claims on nonresidents	2,973,950	3,907,933	5,439,218	12,321,101
Foreign currency	378,107	288,733	305,278	972,118
Deposits	2,486,007	2,843,738	5,133,940	10,463,685
Loans	46,012	770,126	0	816,138
Other	63,824	5,336	0	69,160
less: liabilities to nonresidents	644,035	948,793	2,297,714	3,890,542
Deposits	603,238	604,941	2,213,767	3,421,946
Loans	0	343,852	83,947	427,799
Other	40,797	0	0	40,797
Net domestic assets	1,772,480	150,592	-2,692,458	-769,386
Net claims on government	0	0	0	0
Claims on government	0	0	0	0
Liabilities to government	0	0	0	0
Net Claims on central bank	507,795	749,789	938,198	2,195,781
Gross claims on the central bank	507,795	749,789	938,198	2,195,781
Currency	53,850	118,286	248,546	420,682
Bank reserves	433,944	474,975	459,652	1,368,571
in local currency	66,329	236,219	142,267	444,816
in foreign currency	367,615	238,756	317,385	923,756
Other claims	20,000	156,528	230,000	406,528
Liabilities to the central bank	0	0	0	0
Claims on other sectors (nonbanks)	2,819,838	64,535	1,452,510	4,336,883
In domestic currency denomination				
Claims on nonbanks	43,005	29,762	894,568	967,335
Private	43,005	29,762	894,405	967,172
Public	0	0	163	163
Credit to nonbanks	0	0	894,405	894,405
Private	0	0	894,405	894,405
Public	0	0	0	0
Other claims on nonbanks	43,005	29,762	163	72,930
Private	43,005	29,762	0	72,767
Public	0	0	163	163
In foreign currency denomination				
Claims on nonbanks	2,776,833	34,773	557,942	3,369,548
Private	2,767,321	34,773	557,942	3,360,036
Public	9,512	0	0	9,512
Credit to nonbanks	2,722,591	25,841	557,942	3,306,374
Private	2,713,079	25,841	557,942	3,296,862
Public	9,512	0	0	9,512
Other claims on nonbanks	54,242	8,932	0	63,174
Private	54,242	8,932	0	63,174
Public	0	0	0	0
Other Items (net)	-1,555,152	-663,732	-5,083,166	-7,302,050
Deposits	4,102,395	3,109,732	449,046	7,661,173
Transferable deposits	3,257,665	2,997,755	104,728	6,360,148
In local currency	89,442	91,265	37,076	217,783
In foreign currency	3,168,223	2,906,490	67,652	6,142,365
Non-transferable deposits	844,729	111,977	344,318	1,301,024
In local currency	63,009	327	334,210	397,546
In foreign currency	781,720	111,650	10,108	903,478

Source: Data provided by the Afghan authorities.

Table 37. Islamic Republic of Afghanistan: Short-term Capital Note Auctions, 2004–06

(Overnight Capital Note Auctions)

Date	Auction Amount (in Afghanis)	Bids Received (in Afghanis)	High Bid (in percent)	Low Bid (in percent)	Weighted Average (in percent)
Sep 04 - Dec 04	4,350,000,000	6,171,500,000	7.50	0.99	1.51
Jan 05 - Sep 05	11,250,000,000	17,229,000,000	17.00	0.75	1.48
Oct-05					
10/5/05	125,000,000	45,000,000	4.30	4.30	4.30
10/12/05	125,000,000	70,000,000	5.20	4.10	4.26
10/26/05	125,000,000	125,000,000	6.00	5.10	5.28
Nov-05					
11/2/05	125,000,000	40,000,000	6.00	6.00	6.00
11/9/05	125,000,000	50,000,000	6.20	5.99	6.16
11/23/05	125,000,000	50,000,000	5.80	5.80	5.80
Dec-05					
12/7/05	125,000,000	50,000,000	6.00	6.00	6.00
12/14/05	125,000,000	30,000,000	6.00	6.00	6.00
12/21/05	125,000,000	30,000,000	6.00	6.00	6.00
12/28/05	125,000,000	50,000,000	6.00	6.00	6.00
Jan-06					
1/4/06	125,000,000	125,000,000	6.00	4.50	4.50
1/18/06	125,000,000	125,000,000	6.00	5.30	5.76
1/25/06	125,000,000	125,000,000	6.00	4.40	4.40

Sources: Data provided by the Afghan authorities.

Table 38. Islamic Republic of Afghanistan: Da Afghanistan Bank
Foreign Currency Auctions, 2003–05

Date	Average Auction Rate (In Afghanis per dollar)	Amounts Auctioned (In millions of dollars)	Amounts Received (In millions of Afghanis)
2003			
March	51.3	28.0	1,436.1
April	49.5	39.0	1,930.1
May	na	0.0	0.0
June	48.9	3.0	146.6
July	na	0.0	0.0
August	48.4	5.0	242.0
September	49.3	10.0	492.6
October	48.8	10.0	488.3
November	48.7	8.3	401.7
December	48.3	10.8	520.8
2004			
January	49.0	30.9	1,510.4
February	49.7	18.9	936.8
March	49.9	57.2	2,853.0
April	50.3	21.2	1,063.0
May	50.0	24.8	1,239.3
June	48.6	36.5	1,773.6
July	46.8	34.4	1,611.7
August	44.9	13.3	595.3
September	45.2	24.9	1,125.1
October	45.7	16.9	769.3
November	46.5	20.3	943.7
December	47.9	28.0	1,339.9
2005			
January	49.3	25.0	1,233.5
February	49.6	45.0	2,232.2
March	48.7	39.5	1,924.8
April	49.2	28.0	1,376.6
May	49.9	49.9	2,486.7
June	50.1	48.0	2,405.3
July	49.8	39.7	1,977.3
August	49.2	36.0	1,770.1
September	49.2	46.6	2,288.8

Source: Data provided by the Afghan authorities.

Table 39. Islamic Republic of Afghanistan: Balance of Payments, 2002/03–2005/06
(In millions of U.S. dollars)

	Est. 2002/03	Est. 2003/04	Est. 2004/05	Proj. 2005/06
Trade balance	-1,217.6	-1,892.0	-2,210.8	-2,515.1
Exports of goods 1/	1,290.6	1,893.9	1,656.1	1,893.3
Domestic exports	276.8	376.8	471.0	565.5
Reexports	1,013.9	1,517.1	1,185.1	1,327.8
Imports of goods	2,508.2	3,785.9	3,866.9	4,408.5
Recorded imports	1,142.3	1,688.5	1,993.1	2,328.7
Duty Free	840.8	1,001.0	1,203.3	1,348.0
Of which: Commodity food aid	94.0	40.9	107.8	0.0
Other	525.1	1,096.4	670.5	731.8
Services	-145.1	-439.3	-480.8	-542.3
Receipts	50.8	105.5	92.5	120.5
Payments	195.9	544.8	573.3	662.8
Income (net)	-1.1	-3.4	15.7	31.6
Interest receipts	0.0	4.9	25.4	35.1
Interest payments 2/	1.1	8.3	9.7	3.5
Current transfers	1,221.8	2,475.9	2,787.1	3,148.5
Public	1,170.2	2,420.9	2,477.0	2,806.0
Commodity food aid	94.0	40.9	107.8	0.0
Other	1,076.2	2,380.0	2,369.2	2,806.0
Private 3/	51.6	55.0	310.1	342.5
Current account (including grants)	-141.9	141.2	111.1	122.7
Current account (excluding grants)	-1,363.7	-2,334.7	-2,676.0	-3,025.8
Capital and financial account	144.0	147.7	476.7	334.8
Capital account	0.0	0.0	17.6	0.0
Debt forgiveness	0.0	0.0	17.6	0.0
Financial account	144.0	147.7	459.1	334.8
Foreign direct investment	50.0	57.8	186.9	253.3
Public loans	94.0	89.9	289.8	81.5
Disbursement	100.2	96.1	296.0	85.0
Amortization paid 2/	6.2	6.2	6.2	3.5
Net errors and omissions	153.2	90.1	-99.3	0
Overall balance	155.3	379.0	488.5	457.8
Financing	-155.3	-379.0	-488.5	-457.8
Changes in reserve assets				
Foreign exchange of the DAB	-101.0	-389.4	-499.1	-468.5
Fund credit (net)	0.0	0.0	0.0	0.0
Exceptional financing	-54.3	10.4	10.6	10.7
Arrears	-54.3	10.4	10.6	10.7
Memorandum Items:				
Official foreign exchange reserves				
In millions of U.S. dollars	426	816	1,261	1,730
In months of imports 4/	1.8	3.4	4.0	4.8
Exports of goods and nonfactor services	1,341	1,999	1,749	2,014
Imports of goods and nonfactor services	2,704	4,331	4,440	5,071
Trade balance (in percent of GDP)	-29.8	-41.3	-37.0	-35.2
Current account balance (in percent of GDP)				
Including grants	-3.5	3.1	1.9	1.7
Excluding grants	-33.4	-50.9	-44.8	-42.4
GDP (in millions of U.S. dollars)	4,084	4,585	5,971	7,139

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

1/ Excludes opium exports and because information is unavailable, flows associated with U.S. Army and most ISAF
2/ Debt service projections are based on recognized obligations, reconciled with creditors. Arrears shown here represent an estimate by Fund staff, on the basis of loans which have been verified with creditors, but are not being
3/ Includes foreign transactions recently reported by licensed money changers.
4/ In months of imports of goods and services, excluding imports for reexports.

Table 40. Islamic Republic of Afghanistan: Direction of Trade, 2001/02–2005/06

(In millions of U.S. dollars)

	2001/02	2002/03	2003/04	2004/05	2005/06
Exports, f.o.b.	68	100	144	305	...
Pakistan	26	26	99	258	...
India	10	27	11	20	...
Belgium	4	3	0	0	...
United States	1	4	0	0	...
France	0	0	0	0	...
Germany	7	6	2	1	...
Finland	6	9	1	0	...
Russia	3	3	8	4	...
United Kingdom	1	0	3	1	...
United Arab Emirates	5	5	0	0	...
Other	6	16	20	21	...
					...
Imports, c.i.f.	1,696	2,452	2,101	2,177	...
Pakistan	157	207	181	326	...
Japan	594	999	299	353	...
Korea	105	113	22	79	...
Kenya	52	57	55	22	...
Turkmenistan	46	50	14	26	...
Singapore	3	1	1	1	...
India	25	37	122	83	...
China, PRC	35	20	382	385	...
Kazakhstan	20	22	7	13	...
Germany	16	49	84	182	...
Other	644	898	934	707	...

Source: Data provided by the Afghan authorities.

Table 41. Islamic Republic of Afghanistan: Direction of Trade, 2001/02–2005/06

(In percent of total)

	2001/02	2002/03	2003/04	2004/05	2005/06
Exports, f.o.b.	100	100	100	100	100
Pakistan	39	26	69	85	85
India	15	27	8	7	7
Belgium	7	3	0	0	0
United States	1	4	0	0	0
France	0	0	0	0	0
Germany	10	6	1	0	0
Finland	9	9	1	0	0
Russia	4	3	6	1	1
United Kingdom	1	0	2	0	0
United Arab Emirates	7	5	0	0	0
Other	8	16	14	7	7
Imports, c.i.f.	100	100	100	100	100
Pakistan	9	8	9	15	15
Japan	35	41	14	16	16
Korea	6	5	1	4	4
Kenya	3	2	3	1	1
Turkmenistan	3	2	1	1	1
Singapore	0	0	0	0	0
India	1	1	6	4	4
China, PRC	2	1	18	18	18
Kazakhstan	1	1	0	1	1
Germany	1	2	4	8	8
Other	38	37	44	32	32

Source: Data provided by the Afghan authorities.

Table 42. Islamic Republic of Afghanistan: Composition of Trade, 2001/02–2005/06
(In millions of U.S. dollars)

	2001/02	2002/03	2003/04	2004/05	2005/06
Exports	68	100	144	305	...
Fresh fruits	4	9	8	13	...
Dried fruits	23	57	59	81	...
Medicinal plants	2	5	9	14	...
Spices	1	1	3	3	...
Seeds	0	1	6	5	...
Skins	14	9	29	22	...
Wool	3	4	7	8	...
Sausages and chemicals	0	0	0	0	...
Carpets and handicrafts	21	14	21	156	...
Other	0	0	2	3	...
Imports	1,696	2,452	2,101	2,177	...
Machinery and equipment	509	856	478	528	...
Petroleum and petroleum products	12	14	41	77	...
Metals	4	16	86	85	...
Chemicals	40	173	220	3	...
Construction materials	4	54	45	58	...
Paper	0	0	0	0	...
Clothing materials (textiles)	22	14	18	16	...
Food	214	222	309	404	...
Cigarettes and drinks	23	52	40	47	...
Fabrics, clothing, footwear	473	344	340	330	...
Household items and medicine	144	501	189	241	...
Other	251	206	334	388	...

Source: Data provided by the Afghan authorities.

Table 43. Islamic Republic of Afghanistan: External Debt, 2004/05

	(In millions of U.S. dollars)
Total external debt	749
Multilateral debt	455
World Bank	233
Asian Development Bank	222
Bilateral debt 1/	294
Verified claims	137
United States	82
USAID	57
USDA	25
Former GDR	40
OPEC Fund	2
China	0
Kuwait Development Fund	13
Unverified claims	157
Bulgaria	47
Saudi Arabia	30
Iraq	6
Former Czechoslovakia	75
	(In percent of GDP)
Memorandum item:	
Total external debt	12.5
Total multilateral debt	7.6
Total verified bilateral debt	2.3
Total unverified bilateral debt	2.6

Sources: Data provided by the Afghan authorities; and Fund staff estimates.

1/ Excludes Russian claims. Staff estimate these claims to be over $10 billion.

Table 44. Islamic Republic of Afghanistan: Real and Nominal Effective Exchange Rates, 2002–05
(March 2004 = 100)

	Q1	Q2	Q3	Q4
	Real Effective Exchange Rate			
2002	102	98	90	97
2003	102	101	102	104
2004	102	106	117	114
2005	108	109	…	…
	Nominal Effective Exchange Rate			
2002	163	147	126	100
2003	108	106	105	104
2004	101	102	112	108
2005	100	100	…	…

Sources: Data provided by Afghan authorities; and Fund staff estimates.

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
1. Taxes on income, profits and capital gains/losses			
1.1 Individual income tax Law of Income Tax 2005 (1965 Law and subsequent amendments consolidated in 2005) Last modification: November 2005	Income tax imposed on individuals earning salaries or wages, net income from self-employment, and investment income. The tax is imposed on net income, defined as the difference between gross income and deductions permitted by law. *Residents* (natural persons and legal persons such as companies etc.) are taxed on income from all sources (including from abroad). *Nonresidents* are taxed on income from Afghanistan sources. Wage withholding tax was restored from 23 September 2005 (Art. 58), with the withholding being a final tax in the case of employees with no other sources of income. A wage earner who has a single employer is not required to file a tax declaration. A wage earner with two or more employers or with other sources of income will be required to file an annual declaration. Annual lodgment and payment within 3 months of year end. Dividends and other distributions of profit are taxed at the individual level in Afghanistan.	Exemptions: Non-resident employees of foreign governments and international orgs in accordance with existing treaties and contracts with the State of Afghanistan. (Art. 9) Non-residents provided that the respective foreign country grants a similar exemption to residents of Afghanistan. (Art. 6) Staff of foreign airlines if reciprocal exemption for Afghan airlines in the respective foreign jurisdiction. (Art. 8 (3)) Deductions: Most expenses incurred to derive gross income are deductible when computing taxable income. (Arts. 18 and 19) Withholding taxes on wages (Art. 58), rents (Art. 59), dividends (Art. 46), interest (from 21 March 2006–Art. 46) and royalties (from 21 March 2006–Art. 46) and fixed taxes on imports and exports (Arts. 70(1) & 71(1)) are creditable against annual income tax liability	Taxable annual income (in Afs) — Marginal Tax rates (percent): 0 to 150,000 — 0 150,001 to 1,200,000 — 10 1,200,000 and above — 20 The calculations of tax withholding spread the income tax applicable to wage income over each pay period (Art. 58).

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
<u>1.2 Corporate income tax</u> Law of Income Tax 2005 Last modification: November 2005	A flat rate income tax imposed on legal persons—corporations, limited liability companies, and some types of partnerships. The tax is imposed on taxable (net) profits, defined as the difference between gross income and deductions permitted by law. Special provisions apply to insurance companies (Chapter VII), banks (Chapter VIII) and certain taxpayers involved in the mining and hydrocarbons industries (Chapter XII).	<u>Exemptions:</u> Foreign governments and international organizations in accordance with existing treaties and contracts with the State of Afghanistan. (Art. 9) Approved applicants for exemption being organizations legally organized under Afghan law and organized and operated exclusively for educational, cultural, literary, scientific or charitable purposes. (Art. 10) Agencies and departments of the State and municipalities. (Art. 11) Non-residents provided that the respective foreign country grants a similar exemption to residents of Afghanistan. (Art. 6) Foreign airlines if reciprocal exemption for Afghan airlines in the respective foreign jurisdiction. (Art. 8 (3)) <u>Deductions:</u> Expenses incurred to derive gross income are deductible when computing taxable income. (Arts. 18 & 19) The Income Tax Law contains provisions for depreciation of	Taxable annual income (in Afs) / Marginal Tax rates (percent) Afs1 and above: 20

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
		buildings and other capital assets, and loss carryover (Art. 47). For qualifying businesses, accelerated depreciation and losses carried forward indefinitely apply. Withholding taxes on rents (Art. 59), dividends (Art. 46), interest (from 21 March 2006 – Art. 46) and royalties (from 21 March 2006 – Art. 46) and fixed taxes on imports and exports (Arts. 70(1) & 71(1)) are creditable against annual income tax liability.	
<u>1.3 Taxation of Capital Gains/Losses</u> Law of Income Tax 2005 (Chapter III) Last modification: November 2005	For corporations or limited liability companies, the sale price from disposal of property less the cost not depreciated and other expenses. Capital losses are deductible. For individuals, the sale price of a trade or business, a factory or shares in corporations will be taxable. A fixed tax also applies to the sale of immovable and movable property by individuals (Art. 30). This is a final tax in lieu of income tax.	<u>Exemptions:</u> Immovable property that is inherited. <u>Deductions:</u> Cost of the asset sold, reduced by depreciation since its acquisition and expenses of sale (Art. 24)	Corporate tax rate–20 percent Individuals–gain taxable in full at marginal income tax rates. If the property is held 18 months or more, the gain is averaged over the period held and taxed at the average rate applicable (minimum of 10 percent) for that part of the gain in the year of disposal. Sale of immovable property by individuals–1 percent of market value

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
			Sale of movable property by individuals–2 percent of market value
2. Taxes on goods and services			
<u>2.1 Business receipts tax (BRT)</u> Law of Income Tax 2005 (Art. 64(1)) Last modification: November 2005	A cascading turnover tax, levied on limited liability companies, corporations, partnerships and organizations on gross receipts (before deductions) from the provision of goods and services whether or not a profit or loss is made during the year. (Art. 66) From 21 March 2006, BRT is to be paid quarterly and is due by the 15th day of the month following the quarter. (Art. 93(5))	<u>Exemptions:</u> BRT applies only to legal persons and not individuals. Agencies and departments of State and of municipalities are exempt, except income derived from commercial activities. (Art. 11) Receipts from sales of mineral substances, hydrocarbons and mining licenses and authorizations. (Art. 85) <u>Deductions</u>: No deductions are allowed. However, BRT is deductible when calculating the taxable income of a legal person for annual income tax. (Art. 67)	2 percent rate on sales of all goods and services (unless covered by 5 percent or 10 percent rate–see below) Receipts of commissions, fees, interest, dividends, rent, royalties, and similar incomes are taxed at 5 percent
<u>2.2 BRT on selected services</u> Law of Income Tax 2005 (Art. 64(2)) Last modification: November 2005	This measure imposes a BRT on the gross income derived by service providers (including individuals) in telecommunications, international airlines, restaurants, cafes and bars and hotels and guest houses where the threshold of Afs 100,000 per	<u>Exemptions:</u> Income from services other than designated services is not included in the calculation when considering if a taxpayer has met or exceeded the threshold. If the taxpayer is a legal person and derives less than the Afs 100,000	Businesses with gross income derived (turnover) per month on designated services at the following rates: Afs 1 – 100,000: 2 percent (legal persons)

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
	month has been met. Paid quarterly (by the 15th day of the month following the quarter) but calculated on a monthly basis.	threshold in a month from providing designated services, the existing 2 percent BRT will apply. If the taxpayer is an individual and derives less than Afs 100,000 in a month from providing designated services, no BRT is payable on the receipts from those services. Deductions: As above	or 0 percent (individuals) over Afs 100,000: 10 percent
2.3 Rent Withholding Tax Law of Income Tax 2005 (Art. 59) Last modification: November 2005	Withholding tax payable on the gross rent from rental services provided by a landlord for the use of land and/or buildings where the payment for the service exceeds Afs 15,000 per month. The tax is imposed on the landlord who is entitled to receive payment for the rental services but the tenant withholds the tax from the rent or lease payment and pays it on behalf of the landlord to the government.[59] Rental services for the provision of land and buildings includes, but is not limited to, rental or lease payments made for the rental or lease of land, houses, guest houses, office buildings, office-cum-living space, shops, shops-cum-houses, warehouse and industrial space. The renting, leasing or subleasing of any of these properties will give rise to a rent withholding obligation.	Exemptions: Rent income not taxed under this provision, because it falls below the monthly threshold of Afs 15,000, remains taxable under the income tax law. Deductions: No deductions As a non-final withholding, the landlord is required to file an annual income tax return declaring gross rental income, and may claim deductions and credit for the amounts withheld.	20 percent of gross payments for rental services where those rental services exceed Afs 15,000 per month. Example: A landlord receives Afs 40,000 per month for rental services. Additionally, the tenant has made Afs10,000 in repairs and improvements to the property during the month. The rent withholding tax is calculated as follows: Monthly rental income: 40,000 Plus: Repairs and improvement: 10,000 Amount subject to tax: 50,000 Rent withholding tax 20 percent X Afs50,000: Afs10,000

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
2.4 Fixed taxes Law of Income Tax (Art. 68–81) Last modification: November 2005	The Income Tax Law provides for a variety of taxes, usually referred to as fixed taxes. They comprise presumptive taxes on small business (sometimes expressed as fixed amounts, but also as percentages of presumed turnover); a tax on the value of imports and exports for all traders (which is in addition to the BRT on international trade for legal persons); and a sales tax in lieu of income tax for persons who supply goods and services to the government. There are identified in the current law 170 tax categories of business establishments. The fixed tax of business establishments is set by a committee and is approved by the Minister of Finance every three years. A fixed tax is also imposed on business establishments which do not have complete accounting documents.	Exemptions: None All businesses selling goods and services from established places of business are subject to taxes specified in the schedule of tax categories of businesses. These taxes (except for the fixed tax on importers and exporters who have a business license) are in lieu of income taxes from the sale of such goods and services. The tax due from a business owner (or owners) of a fixed place of business is the amount specified for the related category and grade of such establishment.	Fixed taxes are levied on importers and exporters who have a business license at the rate of 2 percent of the cost of the goods inclusive of customs duties. This tax is a creditable withholding tax and is applied against annual income tax liability (Arts. 70(1) and 71(1)). Fixed taxes are also levied on importers and exporters without a business license (or those with an interim business license that do not provide a business declaration form to the MoF) at a percent of the cost of the goods inclusive of customs duties. On the former, the rate is 3 percent and on the latter, the rate is 2 percent. This tax is in lieu of income tax (Arts. 70(2) & (3) and 71(2) & (3)). Presumptive taxes in lieu of income tax also include: 1. Tax on shops and traders (Arts. 76, 77, 80 and 81): The rules for imposing fixed tax on shops are complex, based on the classification of a business by reference to a list of more than 170 categories of taxpayers. The amount of tax levied on each category is determined using a range of factors including

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
			the type of goods sold and the size and location of businesses. A committee comprising representatives from the provincial Mustofiat, the Ministry of Commerce, and municipalities decides upon the level of presumptive tax to be levied on each category. Fixed tax applicable to traders with no fixed place of business is levied according to the type and size of the business. 2. Tax on turnover (Arts. 74, 75(1)): This tax is applied to specific businesses (e.g., cinemas) at a rate of 10 percent on turnover. 3. Lump sum tax (Arts. 72, 75(2) and 78 of the Income Tax Law and the Income Tax Manual): It is applied on selected businesses (e.g., transportation businesses, kilns, mills and medical practitioners) at very low to moderate amounts. 4. Tax on government contracts (Art. 73): When the government purchases goods or services (including construction services), fixed tax of 7 percent of the purchase price is payable.
<u>2.5 Fixed taxes for money changers</u> Last modification: Presidential	As with shopkeepers, there is a schedule of fixed taxes for moneychangers (Art. 81). A new	<u>Exemptions:</u> None	The Minister of Finance determines the rates. The highest level is currently Afs 93,320 per day and

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
Decree of December 2003 This measure is yet to be fully implemented.	fixed tax on money changers, with 10 classifications, was passed in June 2004 to simplify compliance with the law.		above paying an annual fixed tax of Afs 700,000.
2.6 Sales tax on consumable goods of domestic manufacturing organizations Law on Consumable Material Tax 1980 Last modification: 1982 (?)	Manufacturing organizations are required to pay an ad-valorem tax on income they receive from the sale of their products inside Afghanistan. All organizations including corporations, general partnerships, limited liability companies and state owned enterprises that manufacture, process, assemble or undertake gold, silver and gemstone activities are subject to the provisions of this Law. Organizations approved and established under the Foreign and Domestic Private Investment Law are required to pay tax.	Exemptions: Bread, flour, stationery, forms, books, notebooks, ink, chalk, pencils, movies, newspaper, magazines, coal, medications, medical items and chemical fertilizer are exempted from payment of the consumable goods tax.	Consumable goods tax collected as an ad valorem tax on the sales price of various manufactured goods according to a schedule. The tax rates range from 1 percent to 15 percent of the sales price.

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

<table>
<tr><th>Tax</th><th>Nature of Tax</th><th>Exemptions and deductions</th><th>Rates</th></tr>
<tr><td>3. Taxes on international trade transactions</td><td></td><td></td><td></td></tr>
<tr><td><u>3.1 Customs duties</u>

Customs Code 2005

Last modification: March 2005</td><td>An ad-valorem export and import duty.

The Customs Tariff is a document enacted in accordance with this law which determines the import and export duty of goods based on their classification. The Customs Tariff is approved by the Minister of Finance, upon the recommendation of the Director-General of Customs.

Pursuant to Presidential Decree of July 14, 2003, only Customs Brokers licensed by the Ministry of Finance are authorized to clear imported or exported goods through Customs in Afghanistan.</td><td><u>Exemptions:</u> Exemptions based on treaty, international law, law, regulation etc shall be implemented through an amendment or annex to the tariff. The following imported goods are exempt from customs duty:
1- goods imported by officials of the State during official travels not in excess of Afs 100,000 as provided by the Customs tariff;
2- office materials and equipment of political representatives and International Agencies, materials intended to be used in residency of representatives of foreign countries in Afghanistan, after confirmation of competent authorities;
3- items intended for personal use by foreigners working in Afghanistan according to the terms and conditions of their contract;
4- permitted books, gazettes, magazines and newspapers;
5- goods provided for government projects funded by loans or imported to the country by or for public and private foreign and International relief and development agencies;
6- personal effects used by Afghan</td><td><table>
<tr><th>Rate (percent)</th><th>Type of product (Broad categories)</th></tr>
<tr><td>2.5</td><td>essential food and non-food products</td></tr>
<tr><td>4</td><td>Capital goods, Machinery</td></tr>
<tr><td>5</td><td>raw materials and capital good</td></tr>
<tr><td>8</td><td>Petroleum, diesel, aviation fuel</td></tr>
<tr><td>10</td><td>semi-manufactured products</td></tr>
<tr><td>16</td><td>non-priority products, luxury products, arms and ammunition</td></tr>
</table>
The tariff uses the single national official exchange rate published by Da Afghanistan Bank for the purpose of valuation of goods.

The General Directorate of Customs is responsible for carrying out the tariff classification of goods concerning description and coding in accordance with the Harmonized System of the World Customs Organization and for assessing any corresponding duty under the</td></tr>
</table>

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
		delegations or Afghan international workers and their family members abroad; 7- travelers' personal goods in accordance with the Customs Tariff; 8- commercial samples and advertising gifts; 9- post parcels valued at Afs 5000 or less; 10- honorary decorations or awards; 11- samples sent to organizations protecting copyrights or industrial or commercial patent rights; 12- used movable property belonging to natural persons, who transfers their normal place of residence from another country to the State, as provided in the Customs Tariff; 13- a consignment of less than Afs 1000 value; 14- pure-bred breeding animals and insects and laboratory animals, biological or chemical substances needed for scientific researches; 15- therapeutic substances of human origin and blood grouping and tissue typing reagents; 16- substances for the quality control of medicinal products; 17- fuels, lubricants and equipments carried with and necessary for the normal functioning of transport vehicles in accordance with the relevant procedure;	Customs Tariff. In order to combat false valuation of certain goods with suspicious values, their minimum value shall be determined by General Directorate of Customs-based on international norms.

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
		18- other goods may be exempted upon recommendation of Minister of Finance and approval of Council of Ministers. E.g. import duties on dye and yarn were removed to protect domestic carpet producers.	
<u>3.2 Excise taxes</u>	There are currently no excise taxes in Afghanistan but consideration is being given to the introduction of excise taxes during 2006		
4. Other taxes			
<u>Sukooks</u> (a form of stamp duty or transaction fee)	Various fees are charged as sukooks whose authority comes from Presidential decrees, including: - shopkeepers' tax sukook (1.5 percent); - rental tax sukook (0.5 percent); - sukook on Government contracts (1 percent); - sukook on cinema lease contracts (1.5 percent); - concert tickets sukook (1 percent); - snuff distribution lease rights sukook (1 percent); - vehicle lease sukook (1 percent);		

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
	- sukook on vehicle income tax and license fee (1.5 percent); - sale of a vehicle sukook (2 percent). The future of these sukooks is under review.		
Land Taxes	Land assessed according to grade and size. Cultivated land divided into 3 categories and 7 grades. Because of drought conditions and compliance problems, this tax has yielded zero for the past 10 years. Consideration is being given to re-introducing this tax	Exemptions: Land of less than half an acre, land uncultivated or ruined by unexpected circumstances, land owned by agricultural co-operatives, or government, or used for religious, educational, or research activities. Land used as a cemetery. Deductions - none	Acres — Afs/acre 2 to 10 — 45 11 to 20 — 60 21 to 50 — 85 51 to 100 — 120 101 to 200 — 175 201 to 500 — 400 A co-efficient of 1 is used for prime land. The co-efficient is reduced depending on the category and grade of the land.
Municipality taxes Municipality Law Law on Urban Service Charges	Various taxes and fees are collected at the municipal level by municipalities The Kabul Municipality for example collects: - a 1 percent net profit charge on banks, businesses operating in its municipality (USC Law Art. 19); - a 1 percent charge on ownership deeds (USC Law Art. 22);		

Afghanistan: Tax Summary as of January 2006
(All amounts in Afghani)

Tax	Nature of Tax	Exemptions and deductions	Rates
	- a one month rent charge on renters of property to foreigners, international NGOs, organizations and companies (Presidential Decree 1720 dated July 2004); - various other fees.		

Source: Islamic Republic of Afghanistan, Ministry of Finance: http://www.mof.gov.af/english/index.htm

Islamic Republic of Afghanistan: List of State-Owned Enterprises by Ministry, 2005

Ministry of Transportation
- Millie Bus
- Center Kamaz Enterprise
- Kamaz Enterprise (5)
- Kamaz Enterprise (6)
- Kamaz Enterprise (7)
- Kamaz Enterprise (8)
- Kamaz Enterprise (9)
- Technical Services Enterprise
- Hotels Enterprise

Ministry of Public Health
- Pharmacy Department

Ministry of Commerce
- Foodstuff Enterprise
- Fuel and Liquid Gas Enterprise
- Cooperative and Commercial
- Plant Export Enterprise
- Samon Dried Fruit Enterprise
- Shir Khan Bandar Enterprise

Ministry of Education
- Education Printing Enterprise

Ministry of Urban Development and Housing
- Macrurayan Maintenance
- Water Supply and Canalization
- Banaye Construction
- Afghani Construction
- Housing Construction

Ministry of Justice
- Prison Industry Enterprise

Ministry of Mines and Industry
- Balkh Gin and Press Enterprise
- Kandhar Textile Yam Enterprise
- Medical Supplementary and Technical
- Wool Weaving
- Afghan Industry Enterprise
- Bagrami Textile Enterprise
- Kandahar Wool Weaving
- Helmand Bust Enterprise
- Kunduz Spin Zar Enterprise
- Balkh Textile Enterprise
- Engineering Research
- Mines Extraction
- Jangalak Enterprise
- Rokham Marble Enterprise
- North Coal Enterprise
- North Power and Fertilizer Enterprise
- Ghuri Coment Enterprise
- Afghan Gas Enterprise
- Jabal Seraj Cement Enterprise
- Afghan Carpentry

Ministry of Defense
- Slaughterhouse Enterprise
- Construction Material Production

Ministry of Culture and Information
- Afghan Advertisement
- Azadi Printing Enterprise
- Ariana Printing Enterprise
- Afghan Tour Enterprise

Ministry of Energy and Water
- Brishna Organization
- Spin Ghar Construction
- Power Construction
- Jadid Entergy Enterprise
- Helmand Construction
- Metal Components Production

Ministry of Finance:
- Security (Sukuk) Printing Enterprise

Ministry of Agriculture:
- Improved Seed Enterprise
- Pule-e-Khumri Silo Enterprise
- Kabul Silo Enterprise
- Slaughter and Livestock of Hirat
- Baghlan Sugar Enterprise
- Kandahar Fruit Enterprise
- Fertilizer and Agro-Services
- Balkh Silo Enterprise

Source: Data provided by the Afghan authorities.