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EX POST ASSESSMENT OF LONGER-TERM PROGRAM ENGAGEMENT

This Ex Post Assessment of Longer-Term Engagement on the Islamic Republic of Afghanistan was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on June 23, 2015.

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EXECUTIVE SUMMARY

Afghanistan's 2006 and 2011 Fund-supported programs were part of a broad reconstruction effort aimed at establishing macroeconomic stability and laying foundations for structural reforms. Decades of conflict eroded societal order and trust in government, and limited public institutions' implementation capacity. Both arrangements faced the challenges of dealing with unprecedented inflows of international aid and scaling up of public investment against the background of increasing nonsecurity.

There were notable successes during the two programs, even though both fell short of their initial goals. On the one hand, supported by aid inflows, the economy grew fast, inflation declined, and international reserves increased. Afghanistan successfully completed the debt relief process under the Heavily Indebted Poor Countries Initiative. Selected structural reforms also advanced, particularly during the Poverty Reduction and Growth Facility arrangement, especially in the area of public financial management. Afghanistan made impressive strides toward meeting the Millennium Development Goals. On the other hand, fiscal sustainability remained elusive as the tax-to-GDP ratio declined and expenditures increased sharply owing to rising security and maintenance costs. Fiscal reforms, such as the VAT, remained incomplete. Despite progress in financial system oversight and governance, some financial sector reforms are still pending. The legislative framework and its enforcement remain to be completed.

Aid had both positive and negative effects. The large annual inflows, estimated at around ½ of GDP, played a critical role in stabilizing Afghanistan. Volatility and unpredictability of aid complicated macroeconomic forecasting and policymaking, however. Significant off-budget spending by donors contributed to the buildup of a better-paid "parallel" civil service, which demotivated the regular civil service and weakened program ownership.

Potential gains from a new Fund arrangement need to be assessed in the context of rising civil insecurity and political instability. The Fund experience of working in conflict situations is mixed, as reforms struggle to gain traction and to catalyze private sector-led growth. With long-term aid inflows set to decline to a lower level, Fund engagement can at best help manage the transition while maintaining macroeconomic stability. Retaining

donor support, while lowering aid volatility and improving its predictability, will be essential.

Drawing on past lessons can improve the effectiveness of future program engagement. These lessons include: basing the macro framework on more realistic assumptions of aid flows and security and other expenditures; focusing on macro-critical structural reforms while giving explicit consideration to the implementation capacity of the authorities; stronger coordination on policies and capacity building efforts; increasing reliance on the Afghan civil service for public service delivery; and promoting ownership of the reform agenda by key stakeholders. Even under the most optimistic circumstances, the program will carry substantial risks, related primarily to weak security and governance gaps.

Authorized for distribution by
Middle East and Central Asia, and Strategy, Policy, and Review Departments

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INTRODUCTION

1. **An assessment of the Fund's engagement with Afghanistan is timely.** Since late 2001, after the NATO forces toppled the Taliban, the country received unprecedented support from the donor community in the context of two Fund-supported programs. To this end, the country received financial support through a Poverty Reduction and Growth Facility (PRGF) arrangement (2006–10) and an Extended Credit Facility (ECF) arrangement (2011–14). Under the Fund's policy on Longer Term Program Engagement (LTPE), an Ex Post Assessment (EPA) is required for Afghanistan as the country has been under a Fund-supported financial arrangement for more than seven of the past ten years, and such an EPA report would needed to be prepared for Board discussion before the authorities can request a new Fund arrangement. This is the first EPA report prepared for Afghanistan.

2. **The EPA aims to provide a frank review of progress during the 2006 and 2011 programs, and a forward-looking assessment that takes into account lessons learned.** It begins by providing the background and context for the two programs. It then discusses their overall objectives, how the programs were designed to achieve these objectives, and program performance. After outlining the key issues, it concludes with some lessons, including for Afghanistan's future engagement with the Fund.

Table 1. Afghanistan: Arrangements with the Fund, 2006–14

Facility	Date of Arrangement	Expiration Date	Extended Expiration Date	Original Duration (Months)	Actual Duration (Months)	Quota at Approval (SDR million)	Amount Approved (SDR million)	Actual Amount Drawn (SDR million)
PRGF	Jun 26, 2006	Jun 25, 2009	Sep 25, 2010	36	51	161.9	81.0	75.4
ECF	Nov 14, 2011	Nov 13, 2014	NA	36	36	161.9	85.0	24.0

Sources: MONA Database, SPR; FIN.

BACKGROUND AND MAIN CHALLENGES

3. **Afghanistan's fragility was rooted in a long-lasting internal conflict.** The 1974 coup d'état was followed by the Soviet invasion and a 25-year civil war that was partly fought along ethnic lines. The conflict isolated the country and contributed to a brain drain. By the late 1990s most of Afghanistan territory was controlled by the Taliban, with the Northern Alliance controlling the rest. The Taliban regime was toppled in December 2001 and the International Security Assistance Force (ISAF) was established by the UN Security Council to help assist the new administration and provide basic security. More than 50 countries, all major international financial institutions (IFI), and nongovernmental organizations (NGO) joined the reconstruction effort.

4. **The challenges faced by the authorities were formidable as Afghanistan was an outlier even among fragile and post-conflict states.** A strong central government envisaged under the

2003 constitution (Barfield, 2011) was to be complemented by prudent macroeconomic policies and long-term donor support in the form of financial aid and capacity building. Afghanistan's mineral resources, trade along the Silk Road, and emerging private sector were to diminish the role of the opium economy (Box 1). The overarching strategy was defined in IMF (2003): following security improvement, donors were to focus on rehabilitating key economic institutions, such as the ministry of finance and the central bank. The Fund's technical assistance was to be aimed at improving expenditure management and the tax system, the introduction of the new currency, central bank modernization, the preparation of new financial sector legislation, and the development a new framework for macroeconomic statistics.

5. The international community provided unprecedented political, military, and financial support that transcended the traditional links (Alesina and Dollar, 2000) (Box 2). The resulting aid dependency—at around ½ of GDP—was virtually unparalleled (Bulíř and Hamann, 2008), with the usual aid-related Dutch disease (Arellano and others, 2009) and voracity effects (Tornell and Lane, 1999; Celasun and Walliser, 2008).

6. Afghanistan achieved impressive macroeconomic stabilization gains. The aid-fueled economy grew twice as fast as the so-called fragile states defined in IMF (2011a) (Figure 1). Spending on health, education, and social protection averaged almost 9 percent of GDP, including on- and off-budget expenditures, and the country made gains toward meeting the Millennium Development Goals, particularly in the health area. These gains are far from secure, however, as the economy remains highly vulnerable to a sudden stop in aid inflows. Afghanistan benefited from debt relief, lowering its debt burden.

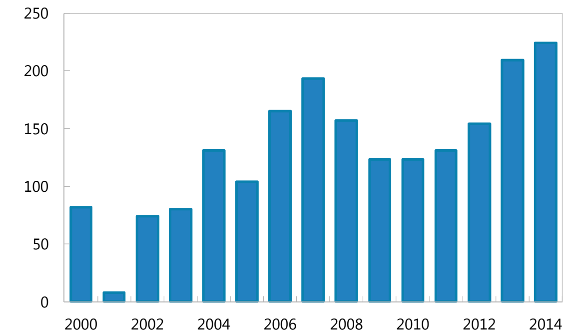
7. Macroeconomic stability and development remained inseparable from the security situation and weak institutions. No other fragile state with a Fund program was comparable in terms of the incidence of civil insecurity: the 2011–12 count of battle-related deaths was second only to Syria, a country with an open conflict (Figure 2). The frequency of terrorist attacks increased sharply since the late 2000s and the process of forming a new government after the 2014 elections took longer than expected.[1] While the authorities should be commended for preserving macroeconomic stability under these conditions, their ability to implement reforms and restore private sector confidence was low. Security concerns led to fewer and shorter Fund missions in third countries since September 2013, reducing the effectiveness of its policy and technical assistance work. Informal networks based on ethnic ties remained strong conduits for patronage and protection, weakening governance; and corruption remained an intractable problem (Charap and Harm, 1999; SIGAR, 2014a). Afghanistan's rule of law and regulatory quality was below the average of other fragile states and the country ranked near the bottom in the Ease of Doing Business survey.

[1] The Fund has maintained a local presence in Kabul for much of its engagement at great cost to its staff. Wabel Abdallah, the Fund's Resident Representative in Kabul, tragically died in a bombing in 2014, the first time that the Fund has lost a staff member in this way. His predecessor, Joshua Charap, narrowly survived an attack in 2007.

Box 1. The Drug Industry and its Economic and Regional Spillovers

Opium production in Afghanistan remained an intractable problem, with negative spillovers into the domestic economy and social and political developments. Beginning from the 1990s, the country supplied more than 90 percent of world illicit opiates (Ward and others, 2008), drawing on ⅓ of the arable land, employing a sizable share of the available labor force, and crowding out the traditional agricultural production (Glaze, 2007). It was estimated that the sector directly provides up to 400,000 jobs, more than the Afghan National Security Forces (SIGAR, 2014b). Although opium exports as a share of non-opium GDP have declined from their peak of 50 percent in 2004, recent exports are estimated at 15 percent of non-opium GDP or about as large as the licit agriculture (Cordesman, 2013). Eradication efforts were largely ineffective as they failed to provide viable planting alternatives (SIGAR, 2014b). Opium remained in many Southern provinces the main cash crop; however, the drug trade did little to narrow the income equality gap as large landowners reaped much higher profits than smallholders. It was estimated that ¾ of export proceeds were concentrated in the hands of regional strongmen, who provided security support for opium production and facilitated transportation (UNODC, 2014). While some stakeholders argued that legalizing opium production and trade would bring in additional fiscal revenues and increase global supply of opium for medicinal use, opponents of legalization highlighted the practical challenges thereof (USDOS, 2007). For example, legalization may end up encouraging higher drug production or flow into the illicit market because Afghanistan does not have the necessary law enforcement and control mechanisms for regulating and safeguarding the industry.

Opium Cultivation, 2000-14
(Thousands of hectares)

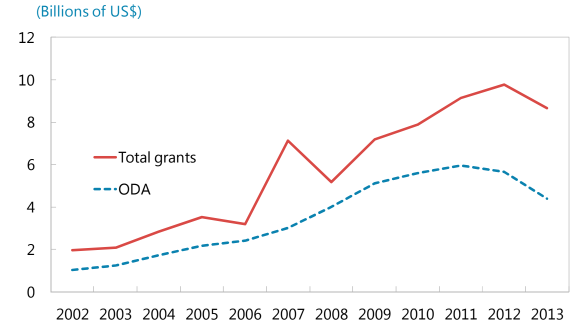


Source: Afghanistan Opium Survey 2014, UNODC

Box 2. The Economics of Large Aid

The magnitude of Afghanistan's aid dependency was unprecedented and so were the aid measurement issues. During 2002–13 aid averaged 53 percent and 33 percent of GDP according to IMF staff and OECD estimates, respectively.[1] The annual difference between these sources widened in 2012–13 to more than US$4 billion or about 20 percent of GDP and is mostly attributable to a differential treatment of security-related inflows. The authorities' grant series published in the Government Finance Statistics database provide yet another set of estimates, with a somewhat different disbursement profile.

Gross Aid Inflows, 2002-13
(Billions of US$)



Sources: *Total ODA* is based on OECD's DAC database (total ODA gross flows); *Total grants* correspond to IMF staff reports.

The share of security-related flows—more than 50 percent of all foreign assistance—raises a question what exactly is aid in the case of Afghanistan. Should the whole security effort be recognized as a de facto development operation aimed at creating a basis for sustainable development? Or, if we were to exclude military spending, where exactly should one draw the line? For example, is funding to reduce support for rebels, the so-called "winning of hearts and minds," military spending, or development aid? Most analyses of aid struggled with this issue.

Box 2. The Economics of Large Aid (concluded)

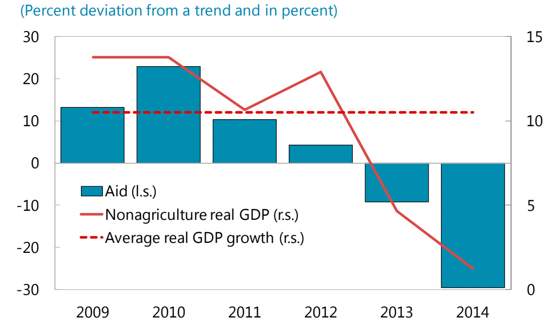
The assessment of the economic impact of aid was complicated. First, the authorities had limited control over the aid flows. Most of security-related aid and much of the development aid remained off-budget (Table 3). Second, the Afghan authorities had little say in aid allocation: for only 1⁄10 of disbursed aid in 2011 the authorities were informed of the provincial distribution (GOA, 2012). Finally, relatively little was known about how much of the aid spent *on* Afghanistan was actually spent *in* Afghanistan and the estimates varied widely by donor and by the type of aid. Bontjer, Holt, and Angle (2010) estimated the domestic content from nonsecurity trust funds and budget support at around 70–80 percent against 10–20 percent for international contracts, resulting in an overall average of domestic content of about 2⁄5. In other words, less than 40 cents of every aid dollar reached the Afghan economy. Domestic content of security spending was estimated at only 15–25 percent (Hogg and others, 2013).

Measurement issues aside, aid flows have been procyclical, volatile, and unpredictable. Aid disbursements varied substantially year-by-year in a procyclical manner during the sample period, that is, they were rising/falling when domestic revenues were rising/falling.[2] Despite unusually volatile domestic revenues, volatility of aid was still higher than that of revenues by about ¼. Regarding aid unpredictability, pledges and commitments of aid exceed disbursements by some 70 percent and 20 percent, respectively, (GOA, 2012), which is a much higher number than reported in the literature for aid-dependent countries (Bulíř and Hamann, 2008; Celasun and Walliser, 2008).

The positive impact of increasing aid on economic growth was sizable and so was the negative impact of declining aid.[3] As aid financed much of capital accumulation, the investment-to-GDP ratio averaged 30 percent and construction grew by 20 percent annually during 2004–13, directly contributing to economic growth. When the aid-fueled growth impulse began to ebb in 2012, driving the 2014 aid-to-GDP ratio more than 15 percentage points below the 2010 peak, nonagricultural real GDP growth decelerated to close to 1 percent.

Large aid led to the so-called Dutch disease and voracity effects. First, aid inflows spent on nontradable goods and services increased prices thereof and inflated the real wage (Arellano and others, 2009). Regarding the former, real estate prices increased greatly in Kabul and other regional centers. Regarding the latter, NATO forces and donors were estimated to employ, directly or indirectly, up to 10 percent of the working population, raising the real wage in the process and crowding out both the private sector and the civil service (Cordesman, 2013). Donor-paid salaries in the "parallel civil service" were reportedly 10 times the highest rate in regular civil service (Sud, 2013). Second, Celasun and Walliser (2008) showed that aid windfalls tend to be associated with revenue side adjustments. Given that aid was "impossible to save," the availability of external financing created incentives for the Afghan government to relax its revenue mobilization efforts in the face of increasing on-budget aid inflows. Third, while underpinning much of the post-2001 progress, aid was linked to corruption, fragmented and parallel delivery systems, and weakened governance: "Massive military and aid spending overwhelmed the Afghan government's ability to absorb it. This, coupled with weak oversight, created opportunities for corruption," SIGAR (2014a, p.13).

Lagged Aid and Real GDP Growth
(Percent deviation from a trend and in percent)



Sources: OECD and IMF.
Notes: Aid is a deviation from a Hodrick-Prescott filter, lagged by one year; the real GDP series exclude agriculture.

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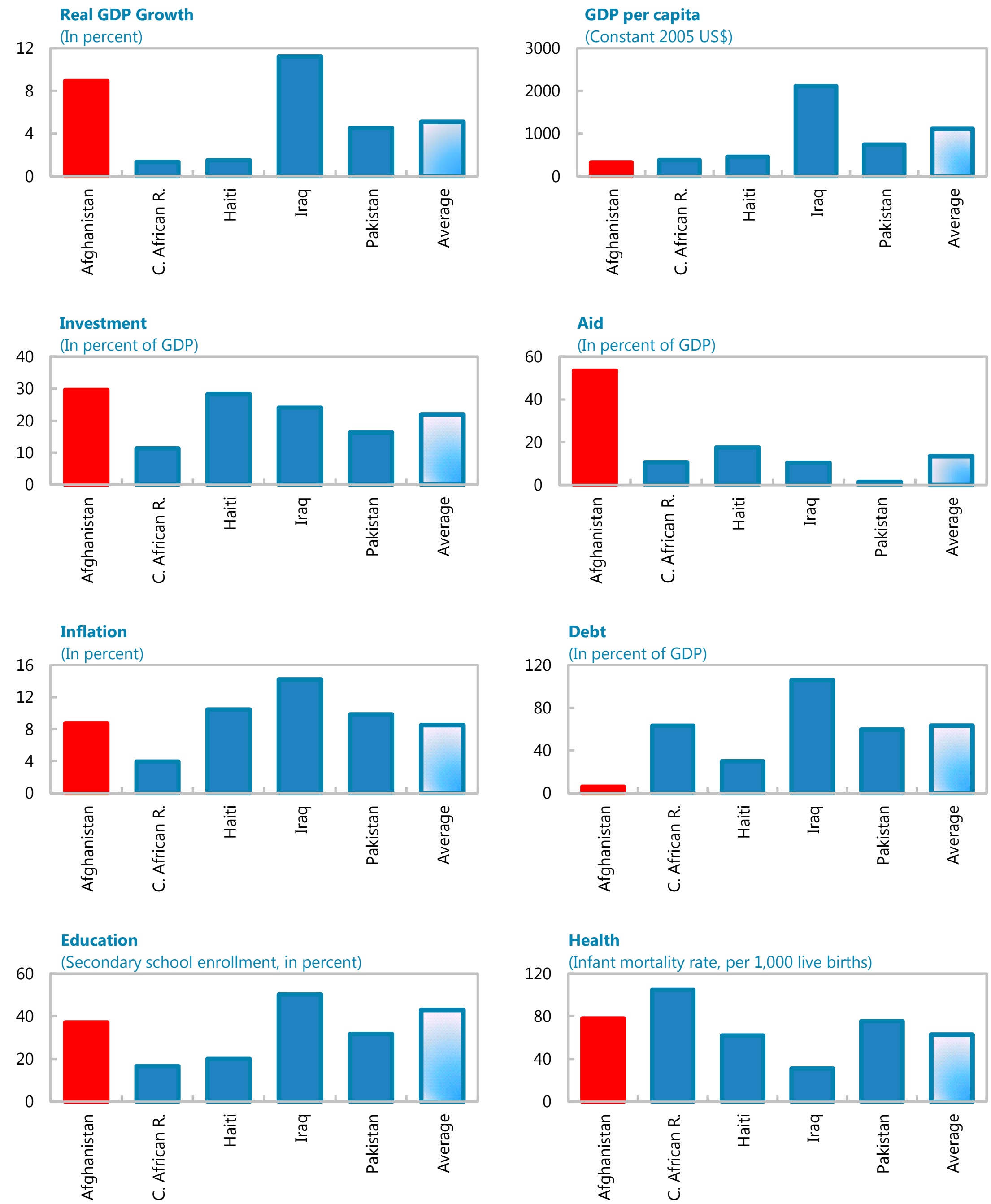
[1] Aid expressed in 2000 US$ per capita terms was six times larger than the average in the Bulíř and Hamann (2008) sample.

[2] Following Bulíř and Hamann (2008), we took natural logarithms of the aid- and revenue-to-GDP ratios and de-trended the series. The correlation coefficient was 0.45. For the measures of relative volatility, we compared the estimates of sample variances.

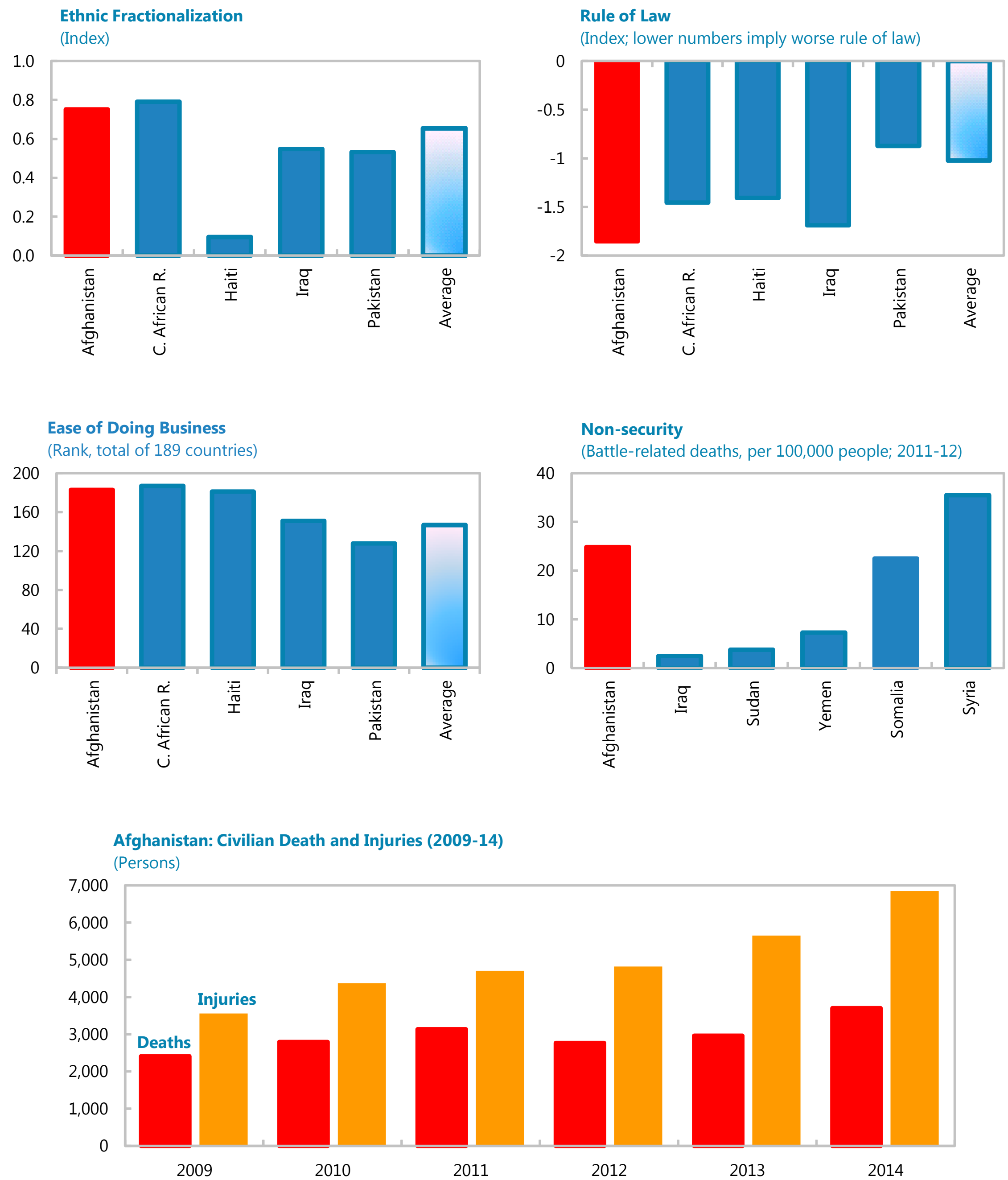
[3] At the 2014 London conference the donors reaffirmed their commitment of sustaining development aid, through 2017, at or near the levels of the past decade. Going forward, such support was described as "significant and continuing but declining" (DFID, 2014). Security-related financial support is set to expire by 2024 (NATO, 2012).

Figure 1. Afghanistan: Development Indicators, 2004–13 Average



Notes: Average refers to the sample of 48 fragile states (IMF, 2011).
Sources: World Economic Outlook; World Development Indicators for Education and Health.

Figure 2. Afghanistan: Development Challenges, 2004–13 Average



Notes: Average refers to the sample of 48 fragile states (IMF, 2011).
Sources: Ethnic Fractionalization: Fearon (2003); Rule of Law, Regulatory Quality: World Bank World Governance Indicators; Ease of Doing Business: World Development Indicators; Death and Injuries: UNAMA (2014).

PROGRAM OBJECTIVES AND DESIGN

A. Context for the 2006 PRGF-Supported Program

8. The June 2006 PRGF-supported program was a vehicle to implement a broad structural reform agenda and access debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative on the back of a staff-monitored program (SMP).[2] The program aimed at solidifying macroeconomic stability and creating conditions for private sector-led development. To this end, it aimed at sustaining real GDP growth of about 10 percent a year, reducing inflation to 5 percent, further strengthening the external position, and accelerating institutional and structural reforms, such as improvements to the fiscal and monetary policy frameworks, restructuring of state-owned banks, and improvement of the business environment.

B. Context for the 2011 ECF-Supported Program

9. The ECF-supported program was approved in November 2011 against a background of the impending drawdown of international troops, the 2012 Tokyo donor conference, and the Kabul Bank crisis. The overarching objective was to maintain macroeconomic stability, while managing the dual challenge of security "transition" and declining aid. While the troop withdrawal necessitated higher domestic security spending, smaller projected aid was expected to lower GDP growth. A staff-level agreement on a successor program to the PRGF arrangement was reached in 2010; however, the program was quickly recast in light of the Kabul Bank crisis (Box 3). The arrangement further aimed at strengthening financial sector supervision and overall economic governance, and improving the transparency and efficiency of public spending.

C. Program Design

10. The design of quantitative and structural targets was consistent with programs' objectives and aimed at "quick wins," taking into account the authorities' capacity (Box 4).[3] Both Fund-supported arrangements focused on the fiscal area with the objective of rebuilding institutions to provide basic government services. In hindsight, the PRGF arrangement downplayed risks to financial stability. In contrast, the ECF arrangement greatly expanded structural conditionality linked to the financial system following the 2010 banking crisis. As the central bank's ability to manage liquidity and control inflation improved, the monetary program changed from targeting currency in circulation to reserve money. Macroeconomic and structural objectives were supported with capacity-building efforts from the Fund and other donors.

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[2] The 12-month SMP was approved in March 2004 and extended to 24 months. It aimed at maintaining financial stability, while laying the groundwork for a Fund-supported program. Its other objectives were to strengthen the economic database, reinforce the capacity to monitor economic developments, and undertake key structural reforms. Fund engagements in post-conflict countries are to focus initially on technical advice, with Fund-supported arrangements conditional on security situation improvements (IMF, 1995 and 2008b).

[3] Fund-supported arrangements with fragile countries are to reflect their "limited implementation capacity, as well as the importance of delivering 'quick wins' to populations" (IMF, 2011a).

Box 3. The 2010 Kabul Bank Crisis and the Challenge of Banking Supervision

The Kabul Bank fraud threatened the stability of the domestic financial system and damaged credibility of banking supervision. The crisis emerged in September 2010 after rumors that two major shareholders had left the bank. Although the run was stopped quickly, the authorities' failure to address the causes of the crisis cast a shadow over their ability to supervise the banking system.

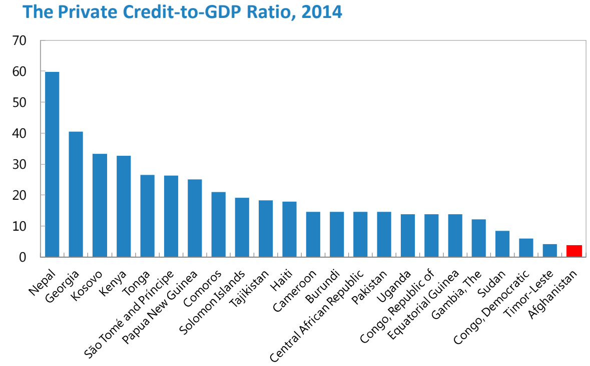
Poor licensing and supervision and a general lack of independence of the central bank were at the root of the problem. After ceasing to operate during the Taliban era, banks grew rapidly afterward and by 2005 there were 11 licensed banks. The licensing process was hasty: the founder of Kabul Bank was a former international poker player and was later joined by major shareholders linked to the former president and vice-president, all without relevant financial sector experience. Bank supervision lacked teeth and Kabul Bank management engaged with impunity in unsound practices, such as connected lending, loans to shareholders to buy equity stakes in the bank, and offshore speculative real estate investments (SIGAR, 2014c). The inexperienced and underpaid domestic supervisory staff lacked political support to undertake effective on- and off-site supervisions, while donor-paid international experts received threats for carrying out their work. Subsequent investigations revealed that enforcement of prudential requirement was absent and commonly agreed accounting standards were not followed (IMF, 2003; Charap and Pavlović, 2009).

The authorities reacted quickly to contain the run. Kabul Bank had the largest branch network in the country and accounted for ⅓ of domestic banking assets, a half of which was withdrawn during the ensuing run. The central bank guaranteed all deposits at Kabul Bank, put the bank into conservatorship, and extended a lender-of-last-resort facility of US$825 million. Kabul Bank was subsequently put into receivership and all deposits and good assets were transferred to a bridge bank that was prepared for sale (IMF, 2011b). Total loss was estimated at almost US$1 billion, or 70 percent of Kabul Bank assets (SIGAR, 2014c). To date, total cash recoveries amounted to almost ⅕ of the initial loss, with additional non-cash recoveries. Most of the remaining assets—about ⅔ of the total—are located in foreign jurisdictions and thus pursued through legal and diplomatic channels.

The handling of the affair caused long-lasting damage. The interviewed stakeholders suspected that the former president and other officials continued to protect some of the main suspects, while going after the supervisors. The banking supervision department has been only slowly rebuilding its clout, concentrating on a move from compliance-based supervision to risk-based supervision by 2018.

The role of the Fund before the crisis. USAID was the major provider of technical assistance in support of supervision, while the role of the Fund was limited to monitoring of the financial sector. The PGRF arrangement had little conditionality on the banking sector (Annex III) and early warnings on the weaknesses in the supervision department—such as those reported in IMF (2008a) or Charap and Pavlović (2009)—were seen as being addressed. To this end, the Fund recommended putting in place regulations on credit risk management and setting limits on sectoral loan concentration and the central bank completed a self-assessment against the Basel Core Principles for Effective Bank Supervision and prepared a roadmap for addressing the weaknesses. The associated benchmarks were met and the staff assessment was broadly positive (IMF, 2008a). The forbearance reflected the desire to establish a financial system that could compete with the Hawala system and the belief that the banks were systemically unimportant (the loan-to-GDP ratio averaged 7 percent during 2006–08). In hindsight, more careful scrutiny of the 2007–08 steps taken by various stakeholders would have been appropriate.

The Private Credit-to-GDP Ratio, 2014



Sources: World Economic Outlook; and International Financial Statistics.

Box 3. The 2010 Kabul Bank Crisis and the Challenge of Banking Supervision (concluded)

Limits of Fund conditionality. Financial sector conditionality increased significantly in the ECF arrangement to shore up confidence and minimize spillovers and was directed primarily toward resolving the bank crisis, with a number of prior actions (Annex III). While most of the structural conditions were met, the progress toward a functioning supervisory environment was mixed (SIGAR, 2014c). Fund conditionality could not address either personal security of supervisory staff or political connectedness of shareholders, however, and such issues will continue to make bank oversight a challenging task.

Box 4. Political Economy and Reforms

Afghanistan's long history of political turmoil made implementation of reforms challenging. The country went through many episodes of political conflict and instability—two coups in the 1970s followed by the Soviet invasion, a long civil war that fractured the society along ethnic lines, the rise of the Taliban, and the eventual deployment of the UN-led International Security Assistance Force (Barfield, 2011). The long history of conflict wiped out institutions, physical and human capital, and trust in society and government.

After 2001, efforts were made to create a stable political system. With the help of the international community, Afghanistan gradually transitioned to a democratic system of government with a directly elected president and a two-chamber legislature. The constitution envisioning a strong centralized system of government with broad presidential powers was put in place to counteract ethnic fractionalization pressures, with various ministries allocated to different ethnic groups as a power-sharing arrangement.[1]

Endemic corruption continued to reduce confidence in public institutions and services. The profitable narcotics trade undermined law and order and the financial system through illegal trade networks and money laundering. Foreign aid contributed to the fraud problem—the sheer magnitude of inflows combined with weak oversight contributed to waste of public resources and corruption (SIGAR, 2014a). Bribes paid to public officials were estimated to almost US$4 billion or about 20 percent of GDP in 2012 (UNODC, 2013). Transparency International's Corruption Perceptions Index 2014 ranked Afghanistan as fourth to the last of all countries.

Concerns remained over effectiveness and legitimacy of the government. Resurgent regional and ethnic ties became conduits for political patronage. The gradual withdrawal of NATO troops worsened the security situation, allowing the Taliban to regain a foothold in many provinces, and putting a significant part of the country outside of government control. Allegations of fraud surrounded both the 2009 and 2014 elections, the latter resulting in a political stalemate eventually resolved through a power-sharing agreement between the two leading candidates. This arrangement led to considerable delays in key decisions, however, including cabinet appointments, calling into question the ability of the government to function effectively.

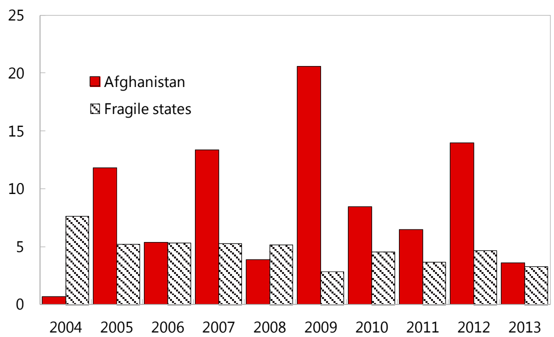
Going forward, political economy risks to program implementation remain high. Ongoing internal conflict, ethnic and cultural divisions, weak institutions, and corruption have contributed to weak program ownership and implementation in the past, and are likely to continue to play an important role in the future.

[1] The share of the five main ethnic groups, estimated by the CIA World Factbook, is as follows: Pashtuns (42 percent), Tajiks (27 percent), Hazaras (9 percent), Uzbeks (9 percent), and Aimaqs (4 percent).

D. Performance Under the Fund-Supported Programs

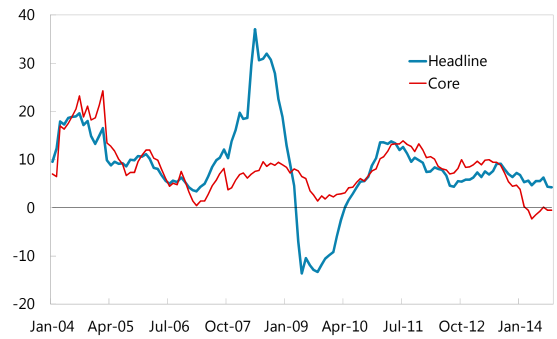
11. Afghanistan achieved macroeconomic stabilization gains on the back of massive aid inflows. Economic performance was strong, albeit volatile. Real overall and nonagricultural GDP growth averaged more than 8¼ percent and 10½ percent since 2003, nearly twice the fragile-country average growth rate. Growth was narrow-based, with minimal contribution from the private sector, and highly volatile due to aid and agricultural output fluctuations (Box 2). As aid inflows began to ebb in 2013, real GDP growth slowed down. The financial sector remained small, with a single-digit loan-to-GDP ratio (Box 3). Average headline inflation, at about 10 percent, was marginally higher than in the comparator group, mostly due to food price fluctuations.

Annual Real GDP Growth, 2004-13
(In percent)



Source: IMF.

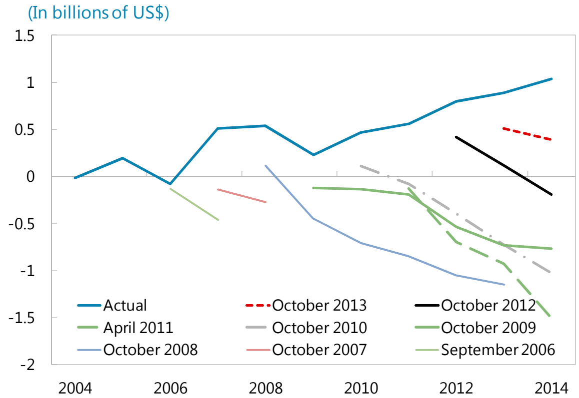
Consumer Price Inflation, 2004-14
(In percent, year-on-year)



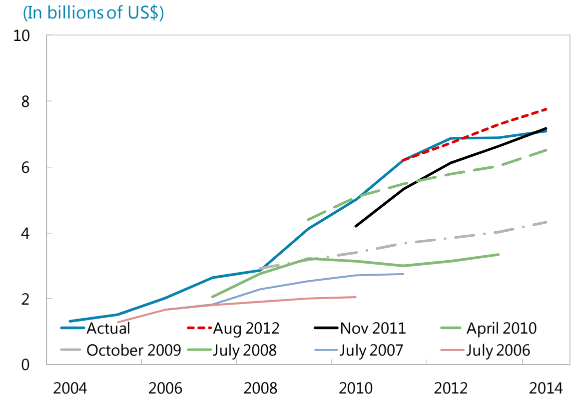
Source: IMF.

12. The external position remained comfortable. Aid inflows averaged more than 50 percent of GDP, often surprising on the upside, and the current account, after official transfers, was in surplus. International reserves grew, covering seven months of imports. Aid-financed imports led to trade balance deficits of about 40 percent of GDP, with exports stagnating at about 2½ percent of GDP. Afghanistan completed in 2010 the HIPC debt relief that resulted in debt reduction equivalent to US$11 billion in NPV terms (http://www.imf.org/external/np/sec/pr/2010/pr1015.htm).

Current Account Balance
(In billions of US$)

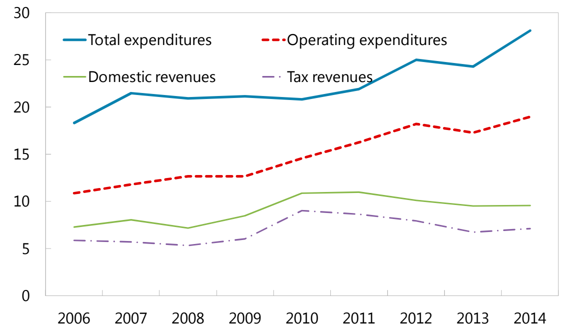


International Reserves
(In billions of US$)



13. The domestic fiscal gap[4] widened during the ECF arrangement, owing to both expenditure and revenue developments. After narrowing to about 10 percentage points of GDP in 2010, it expanded to 18 percentage points of GDP in 2014. Security expenditures contributed almost ¾ of the gap expansion and the remainder was due to falling domestic revenues. Larger than anticipated on-budget grants closed the gap, however, and kept government debt unchanged at about 5 percent of GDP (Figure 3).

Fiscal Developments
(In percent of GDP)

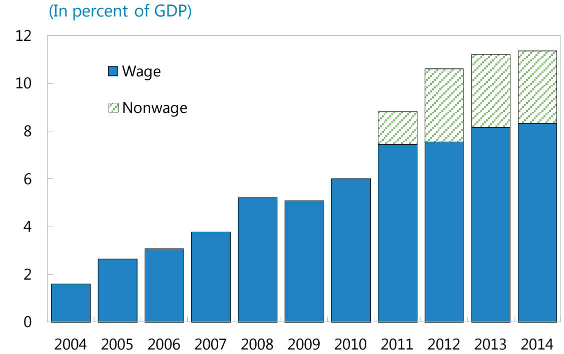


Source: IMF World Economic Outlook database.

14. The 2013–14 drop in the revenue-to-GDP ratio is poorly understood; however, it can be traced to three main factors. First, a slower pace of economic activity—real GDP and imports—explains only a minor part of the revenue decline. Calculations of the tax revenue buoyancy suggest that at most 2⁄5 of the decline may be related to slower growth of income and imports (Box 5), with the remainder attributable to noncyclical factors. Second, security and political uncertainties complicated tax collection. Third, declining revenues and increasing on-budget grants were likely related—pre-announced aid increases are known to increase spending and reduce the motivation to collect domestic revenue (Celasun and Walliser, 2008). The impact of the above factors on revenue projections was underestimated and the medium-term fiscal forecasts were mostly off mark (Figure 3).

15. The public finance sustainability objective was pushed farther into the future (Table 2). The planned balance between domestic revenues and operating expenditure was postponed repeatedly, from 2009/10 at the time of the PRGF arrangement request in 2006 to after 2030 in the 2014 Article IV consultation. In particular, the high and rising level of security-related domestic expenditures both jeopardized fiscal sustainability and entrenched aid dependency—as Afghan National Security Forces grew to more than 350,000 in 2014, the on- and off-budget security-related costs exceeded 10 percent and 40 percent of GDP during 2010–13, respectively.

Composition of On-Budget Security Expenditures
(In percent of GDP)

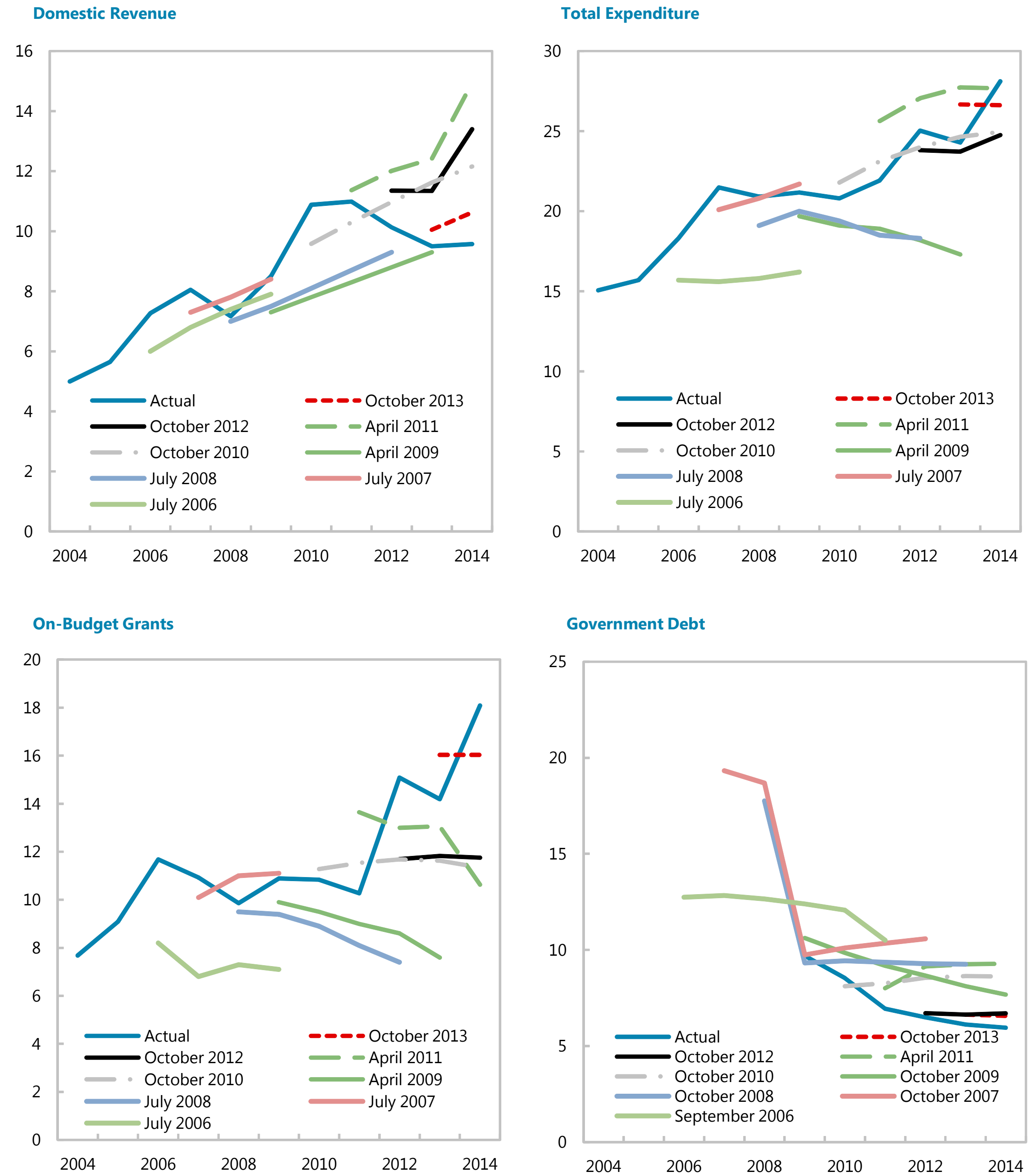


Source: IMF staff estimates.

[4] The domestic fiscal gap equals total on-budget expenditures minus domestic revenues.

Figure 3. Afghanistan: Fiscal Variables and Their Forecasts

(In percent of GDP)

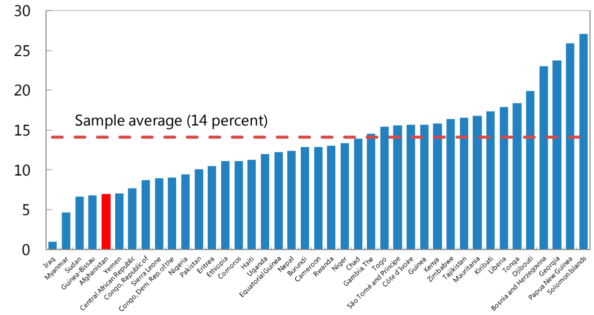


Sources: Staff reports, various vintages; World Economic Outlook.

Box 5. Fiscal Revenue Reforms: Limited Achievements and Unfinished Agenda

Afghanistan's tax collection remained weak and its improvement was one of the key objectives of the Fund-supported programs. The 2006–14 average tax-to-GDP ratio of 7 percent was ½ of the average of other fragile states, falling short of the wage bill of the security forces. To address low revenue collection, the two arrangements included some 24 structural conditionality measures (Annex III) and generated significant technical assistance. While some of these measures, such as an introduction of business receipt tax on imports, were expected to have significant effects, others were geared more toward simplifying the tax system. Tax and customs administration reforms were to increase revenues efficiently and address corruption at the point of collection.

The Tax-to-GDP Ratio, 2006-14



Source: WEO.
Note: Angola's tax-to-GDP ratio of 42 percent is included in the sample average.

Tax collection increased during the PRGF arrangement. The tax-to-GDP ratio—which was below 2 percent in 2002—rose from about 6 percent to 9 percent during the PRGF arrangement. While strong GDP growth contributed to the revenue performance, tax base broadening measures and enforcement played a major role.[1]

The subsequent drop in the revenue-to-GDP ratio is poorly understood. By 2013 the tax-to-GDP ratio fell by about 2½ percentage points relative to the peak, and taxes on international trade and transactions declined by 1½ percentage points of GDP. While the latter decline was attributed to slower growth of dutiable imports, a shift away from high-tariff imports, as well as lower compliance and enforcement, the importance of individual factors was uncertain (IMF, 2014). Simple estimates of revenue buoyancy suggest that the role of economic and import growth was minimal.[2] The estimated buoyancies are small and when interacted with real GDP, excluding agriculture, and real imports, the changes in the tax base explain no more than ⅖ of the actual decline in tax revenue and international trade taxes, respectively. The residual is then attributable to a shift away from high-tariff imports and significantly lower collection efforts.

Afghanistan: Central Government Tax Revenue, 2006–13

	2006	2007	2008	2009	2010	2011	2012	2013
				(Percent of GDP)				
Taxes	5.9	5.7	5.3	6.1	9.1	8.7	8.0	6.7
Income, profits, and capital grants	1.9	1.8	1.5	1.1	2.6	2.6	2.8	2.4
Goods and services	0.7	0.6	1.1	1.7	2.1	2.1	2.0	1.5
International trade and transactions	3.0	3.2	2.4	3.0	3.9	3.6	2.8	2.4
Other taxes	0.2	0.2	0.3	0.2	0.4	0.4	0.3	0.5

Source: IMF World Economic Outlook database.

Two key tax reform measures remained unfinished:

1. *The value added tax (VAT)*. The transformation of the business receipt tax into a broad-based consumption tax was envisaged in the PRGF arrangement. Overcoming the vested interests turned out to be more difficult than expected and implementing VAT was seen as a challenge given the limited capacity.

2. *A reform of the fiscal regime for natural resources*. A new mining law was enacted in 2014; however, amendments to the income tax law, oil and gas law, and customs code were still pending.

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[1] Crivelli and Gupta (2014) provide evidence of a positive relationship between revenue conditionality and tax revenues.

[2] The estimated buoyancies were based on the 2010–14 sample, using CPI-deflated tax revenues, and followed the alternative methodologies proposed by Haughton (1998).

Table 2. Afghanistan: Target Years for Achieving Fiscal Sustainability

Timing of Assessment	Target Year	Reasons for Change
2006 PRGF Request (May 2006)	2009/10	NA
2007 Article IV (January 2008)	2012/13	• Operating expenditures revised upward
2009 Sixth PRGF Review (December 2009)	2023/24	• Worse-than-expected revenue performance during 2007–09 • Security spending revised upward
2011 Article IV, ECF request (November 2011)	2024/25	• Multiple revisions to underlying fiscal assumptions
2014 Article IV (April 2014)	After 2030	• Poor revenue performance during 2012–13 • Previously grant-funded, off-budget expenditures transferred to the budget

Sources: IMF Country Reports for Afghanistan; various volumes.

16. International aid remained mostly off-budget, was largely spent on maintaining security, and fell sharply after 2012 (Table 3).[5] While grants peaked at 80 percent of GDP in 2011/12, less than ⅕ were recorded on-budget, with an increase to about ¼ in 2012/13 and 2013/14 (Figure 4). The post-2012 aid decline brought grants some ⅓ below the peak level, affecting all off-budget spending. In terms of functional classification, some ¾ of off-budget grants were allocated to defense and public order, and less than ⅒ to health, education, and social protection. Off-budget investment was equivalent to 20–30 percent of GDP, contributing to an unsustainable buildup of public capital: at the present level, Afghanistan's capital stock cannot be maintained with domestic resources (IMF, 2011b and 2014).

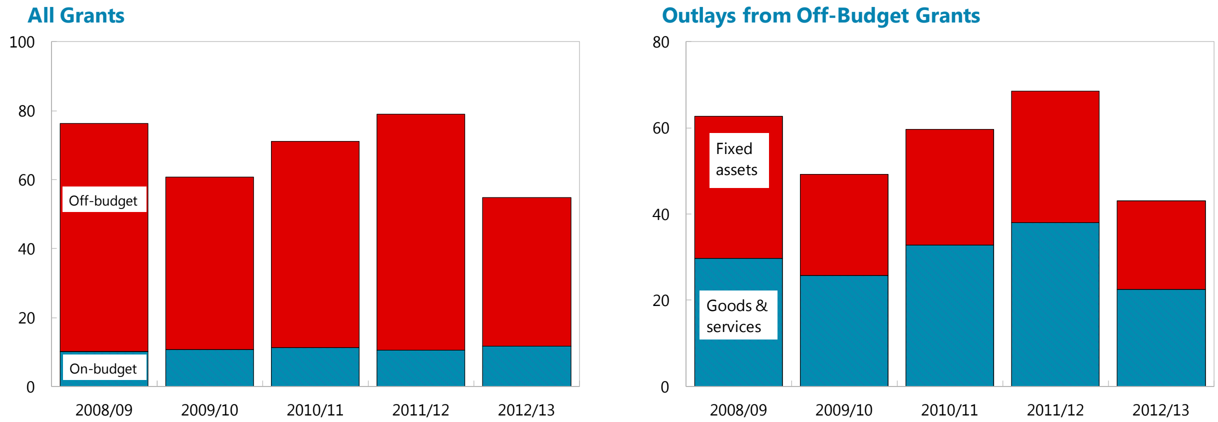
17. The comparatively limited social objectives of the PRGF arrangement were strengthened somewhat in the ECF arrangement by including a floor on pro-poor spending; however, progress on social indicators was mixed. The various program documents addressed the social objectives mostly in the context of improvements to governance to raise growth rather than by targeting specific Millennium Development Goals (MDG), with other institutions, such as the World Bank, taking lead on policies. Despite high growth, the poverty rate remained at around 36 percent in 2011–12, or about the same as in 2007-08, and inequality increased (World Bank, 2014). The incidence of poverty was particularly high in rural areas, with contributions from high dependency ratios, low levels of female labor force participation, and low labor productivity in the agricultural sector. In contrast, Afghanistan outperformed most other fragile states in the education

[5] The grant estimates in the Government Finance Statistics database are higher than those published in staff reports, primarily on the account of funds disbursed to contractors outside of the country.

and health sectors (Figure 1). Despite impressive gains in elementary school enrollment, in particular by girls, and a sharp mortality declines, sustained efforts will be needed to meet the MDG.

Figure 4. Afghanistan: Official Grants, 2008/09–2012/13

(In percent of GDP; fiscal years)



Notes: Off-budget grants are calculated as a difference between the Central Government, which includes off-budget items, and Budgetary Central Government (on-budget) definitions.

Sources: IMF, Government Finance Statistics database.

Table 3. Afghanistan: Off-Budget Grants and Expenditures, 2008/09–2012/13

(In percent of GDP, fiscal year)

	2008/09	2009/10	2010/11	2011/12	2012/13
Grants	66.2	50.2	59.7	68.5	43.2
Expenditures	65.9	50.1	59.7	68.5	43.2
Of which:					
Goods and services	29.8	25.8	32.8	38.1	22.5
Net acquisition of nonfinancial assets	32.9	23.4	27.0	30.4	20.7
Functional classification:					
Of which:					
Defense and public order	55.7	39.4	38.7	48.7	30.5
Economic affairs	5.3	4.7	9.6	10.0	5.7
Health, education, social protection	3.1	2.7	8.0	4.9	3.0

Sources: IMF, Government Finance Statistics database.

E. Capacity Development

18. The Afghan government and donors disagreed on the effectiveness of capacity development. While being an important part of the overall engagement, the sheer volume thereof and the multitude of providers made any summary assessment difficult. While the government thought that "many donors continue to follow their own agendas while claiming they are aligned with Afghan government priorities" (GOA, 2010, p.16), the donors generally saw their efforts well aligned. This disconnect seemed related to the inherent difficulty of measuring development outcomes observed in other aid-dependent countries: where donors see a gleaming new hospital, the local authority may see an unsustainable burden on its budget or a project designed without much input from the local population. To administer off-budget support, donors often relied on an unofficial "parallel civil service" that had an uneasy relationship with the regular civil service (Box 2).

19. The Fund was engaged in a small subset of capacity development efforts, focused on its core competencies and "quick wins." Fund technical assistance (TA), mostly delivered in Afghanistan, was ⅓ larger than that provided to other fragile states (Table 4). Only a minor part of overall TA was delivered by the Fund, however, and the rest was delivered by individual donors who occasionally overlapped, for example, in the area of banking supervision (IEG, 2013). Major areas of Fund TA included public financial management (PFM) and revenue collection (provided by FAD), statistics (STA), and bank supervision and restructuring (MCM), Figure 5. The Kabul Bank crisis sharply increased delivery of the latter and the Fund staff began to play more of a coordinating role in the financial area, including providing resident advisors. There is evidence of improved capacity in PFM (Symansky, 2010; IEG, 2013) and statistical services. Deteriorating security and the detrimental impact of corruption (e.g., Kabul Bank) and vested interests (e.g., tax collection or the opium economy) reversed some of the gains and imperiled the effectiveness of capacity building.

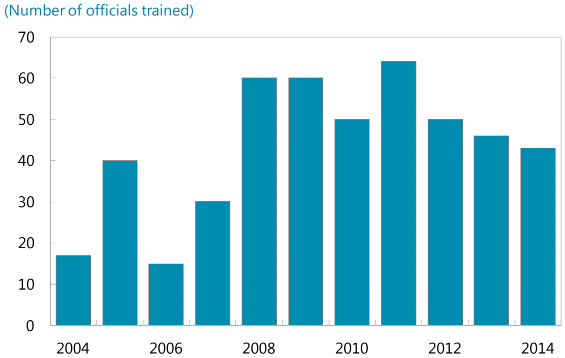
Table 4. Afghanistan: Fund Technical Assistance, 2009–14
(Total field time in years; IMF fiscal years)

Country	Afghanistan	C. African R.	Haiti	Iraq	Pakistan	All fragile state average
TA provided	13.1	10.5	10.0	6.5	1.5	9.7

Source: ICD.

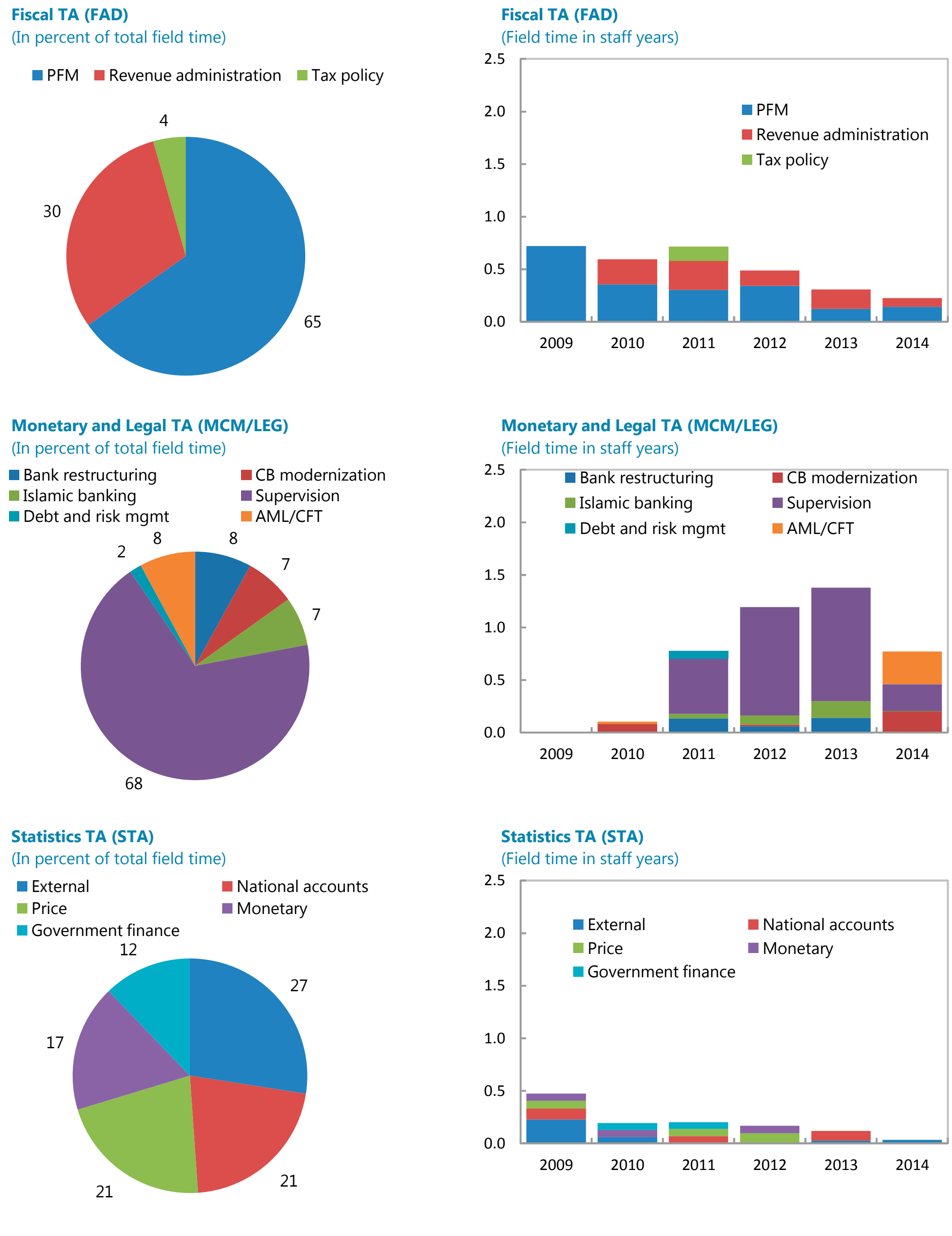
20. Capacity building efforts were supported with Fund training. The IMF Institute organized five stand-alone courses for Afghan officials, training more Afghan officials than in other fragile states, despite the security and travel limitations. Afghan officials received training at Beirut, Kuwait, Singapore, and Vienna regional training centers.

Capacity Building: IMF Institute Course Participation
(Number of officials trained)



Source: PATS database.

Figure 5. Afghanistan: IMF Technical Assistance, 2009–14



Notes: Missions with IMF staff participation.
Source: ICD database.

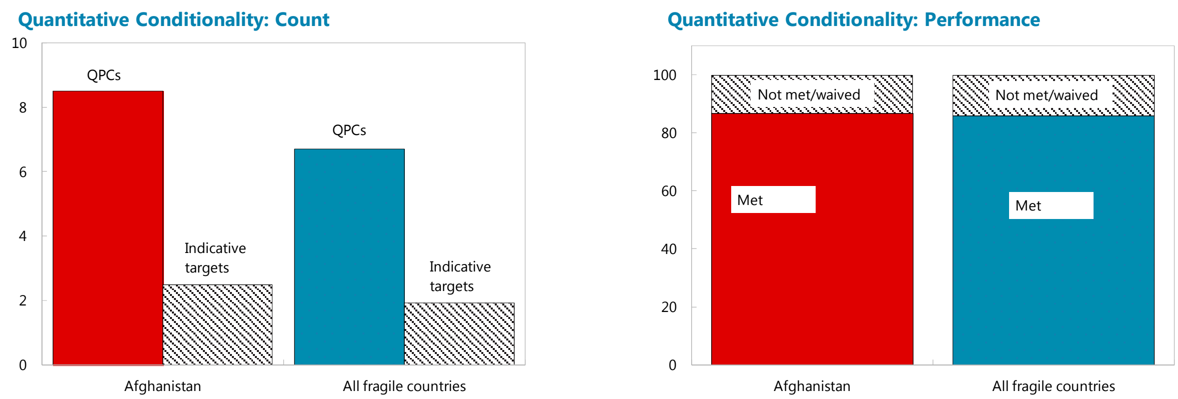
CONDITIONALITY AND OUTCOMES

21. Even though both programs fell short of the stated goals, macroeconomic stability was maintained and some of the key reforms were advanced. A number of reforms from the previous programs remain outstanding, such as, improvements to the revenue collection mechanism, the introduction of a VAT, and the privatization of New Kabul Bank, and decisive improvements to central bank supervisory capacity. Specifically, although most conditions related to banking supervision were met and capacity improved, weaknesses remained. These included absence of a comprehensive legal infrastructure, limited institutional capacity, nascent AML/CFT framework, and regulatory and supervisory forbearance.

22. Both arrangements had a slightly higher number of quantitative performance criteria (QPCs) than usual (Figure 6). The additional QPCs were connected to program objectives of raising revenue and reducing contingent risks from state-owned enterprises and banks. The ECF arrangement contained also a floor on social spending. For the completed reviews, Afghanistan's performance was in line with that of other fragile, low-income economies.

Figure 6. Afghanistan: Quantitative Conditionality, 2005–11

(Number of conditions; per review)



Notes: The first column indicates that the Fund-supported arrangement for Afghanistan had annual average of 8.5 quantitative performance criterions (QPC), of which almost 9⁄10 were met.

Source: MONA database.

23. Quantitative performance was stronger during the PRGF arrangement than during the completed ECF reviews (Table 5). For example, the PRGF arrangement aimed at increasing fiscal revenues from 5½ percent to more than 8 percent of GDP by the fiscal year 2010/11 and the eventual outcome was stronger at about 11 percent of GDP. The ECF-supported program went off-track only after the first review in part owing to missed fiscal revenue QPCs.

24. The PRGF arrangement had a higher number of structural conditions than the ECF arrangement and arrangements in other fragile countries. The overall number of structural conditions averaged 12¼ per year and 10⅔ per year, respectively, as compared to 10¼ per year for other fragile countries (Figure 7). While detailed structural conditionality may have limited program flexibility somewhat, it seemed to reflect the authorities' implementation capacity and simplified the communication of outcomes.[6]

Table 5. Afghanistan: Calendar of Program Reviews

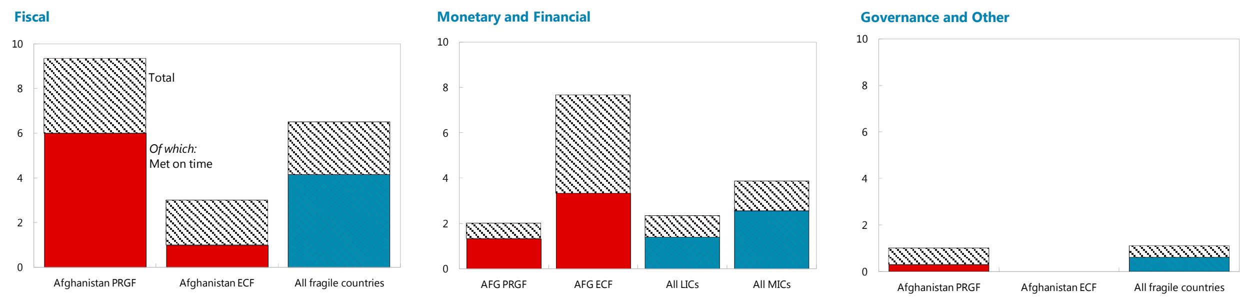
Arrangement	Reviews	Original review date	Actual review date	Disbursement (SDR million)	Comment
PRGF	Program Approval	May 2006	NA	13.2	From May 2006 to March 2009 with scheduled disbursements of SDR 81 million.
	First	January 2007	March 2007	11.3	All QPC, IT and SPC were met. All SB, except that related to a state-owned bank reform were met.
	Second	May 2007	July 2007	11.3	All QPC, IT and SPC were met. SB on adopting a restructuring plan for public entities was unmet.
	Third	January 2008	February 2008	11.3	All QPC, IT and SPC were met. SB on adopting a restructuring plan for public entities was unmet. Legal framework reform progressed slowly.
	Fourth	May 2008	July 2008	11.3	Most QPC and IT were met, but the revenue target and several structural benchmarks were missed.
	Fifth	January 2009	April 2009	11.3	IMF Board approved a nine-month extension to March 2010, granting waivers for nonobservance of QPC on fiscal revenue and an SPC.
	Sixth	May 2009	January 2010	5.65	IMF Board approved a three-month extension to June 2010, granting waivers for nonobservance of QPC on international reserves.
ECF	Program Approval	November 2011	NA	12.0	From November 2011 to November 2014 with scheduled disbursements of SDR 85 million.
	First	May 2012	August 2012	12.0	Most QPC and IT were met. IMF Board approved the request for a waiver and modification of QPC on fiscal revenue.
	Second through Sixth	Not completed		NA	NA

Notes: The following acronyms are used in the table: QPC stands for a Quantitative Performance Criterion; IT stands for an Indicative Target; and SPC and SB stand for a Structural Performance Criterion and Structural Benchmark.

[6] Mission chiefs indicated that the authorities preferred having well-specified, step-by-step conditions as opposed to broadly defined conditions.

Figure 7. Afghanistan: Structural Conditionality, 2005–11

(Average number of conditions; per year)



Notes: The first column indicates that the PRGF arrangement for Afghanistan had annual average of 9.3 structural conditions in the fiscal area, of which 6 were met on time.

Source: MONA database.

25. Structural conditionality under the PRGF arrangement was concentrated on macro-critical areas, and the performance was broadly satisfactory. The main areas included institution building, improvements in revenue collection and fiscal transparency, central bank modernization, and public enterprise reform. Fiscal measures—including governance—comprised ¾ of all structural conditions (Annex III). Afghanistan implemented on average as many conditions as other fragile states, with some unmet conditions related to enterprise restructuring and transparency. The program contained also measures aimed at addressing gaps in the legal framework of the financial system (Box 3). The banking-related benchmarks were met and the subsequent Fund documents noted progress in the targeted areas.

26. The structural agenda under the ECF arrangement was focused on the resolution of the Kabul Bank crisis, with generally weaker performance. Most structural conditions—almost ¾—were linked to the financial sector, as compared to an average of ⅕ in fragile countries. A number of prior actions were directed toward orderly resolution of the Kabul Bank crisis, with additional measures aimed at improving bank governance and strengthening legislation related to bank supervision and regulation. Closely linked to financial stability was the introduction of the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) provisions. However, the September 2012 benchmark was missed, partly owing to a tight deadline for introduction. Fiscal structural conditionality was built around the same policies as in the PRGF arrangement. The overall performance under the program was mixed; with only ⅖ of structural conditions met on time. The conditions seem to have exceeded Afghanistan's ownership and implementation capacity and underestimated the impact of the protracted political and security uncertainties during the 2012–14 transition. Although some of the reforms were introduced after the program went off-track, many remained outstanding (IMF, 2014; Annex III).

KEY ISSUES IN FUND ENGAGEMENT

A. How Much Did the Security Situation Affect Fund Work?

27. Over time, the lack of security emerged as a key constraint to engagement. Afghanistan in the mid-2010s is no longer a post-conflict country, but rather one experiencing an escalating domestic conflict, fueled in part by rising levels of opium production. Increasingly curtailed field presence limited Fund contacts with the authorities, including TA delivery and progress monitoring. We are not aware of any other country with similar security conditions—no Resident Representative, limited country visits—that had a successful Fund-supported arrangement (IMF, 1995 and 2008b).

28. While the ECF arrangement documents recognized the security-related risks, the debt sustainability baseline scenarios were predicated on security improvements and modest security costs. The baseline-scenario optimistic bias vis-à-vis security improvements is understandable, to the extent a pessimistic one would send a wrong signal to the public and donor community, creating self-fulfilling prophecies. In hindsight, however, even the alternative scenarios appeared too sanguine as some of the actual aid fluctuations exceeded the alternative scenario amounts (IMF, 2011b, 2012). Needless to say, the international community underestimated the task of rebuilding Afghanistan, in particular the cost of the Afghan National Security Forces.

29. Security constraints and staff workload negatively affected outreach. The steadily deteriorating security situation adversely affected staff's ability to engage with the key technical staff, broader government outside of the central bank and ministry of finance, civil society, and NGOs. Even before the 2014 bombings, the missions were mostly confined to the Kabul guesthouse. Moreover, given the constant negotiating mode, the team was stretched. Presentations of analytical papers in the context of Article IV consultations were few—six Article IV consultations took place between 2003 and 2014 and three sets of Selected Issues Papers (SIP) were published, the last one in 2008.[7] Three SIPs, one of them extending the analytical paper by Aslam and others (2013), were presented to the IMF Executive Board in 2014, but they were not published.

B. Did the Partnership With the International Community Work Well?

30. Data deficiencies on aid flows severely complicated assessments of economic developments. Some 4⁄5 of all aid inflows remained off-budget and donors reported disbursements and commitments with long lags. Predictability of aid disbursements was unusually poor and, similar to other fragile states, Fund staff were constrained in their key aid assumptions and consequently struggled with the corresponding macroeconomic projections (Figure 3). Although core fiscal data

[7] Program countries are automatically placed on the 24-month Article IV cycle.

improved, little is known about the regional allocation and impact of off-budget donor spending, including the impact of foreign troop presence.

31. Although aid enabled progress on development and security needs, it created a multitude of challenges (Box 2). First, the authorities had a hard time acquiring ownership of some of the projects: off-budget, donor-provided public services were 2–3 times larger than those provided by the government. Furthermore, a considerable portion of aid-financed capacity building was contracted outside of the country, limiting aid's visibility. Similarly, it was difficult for the Afghans to appreciate the work of government when the bulk of public services was delivered by the donors. Second, as the share of on-budget development aid started to increase recently, it is likely to have generated perverse incentives against domestic revenue collection efforts (Box 5). Third, massive changes in the aid-to-GDP ratio amplified macroeconomic volatility. Fourth, the level of long-term aid inflows remained the subject of political negotiations between the authorities and the donor community, making technical discussions of a sustainable public investment program difficult. Fifth, massive aid coupled with weak oversight engendered corruption and rent-seeking.

32. Timelines associated with donor involvement occasionally challenged program design. The scale and intensity of donor involvement (Box 6) built pressure on the Fund to stay engaged, while limiting its leverage vis-à-vis the authorities (Annex II). The Kabul Bank events illustrate this. Internal documents and interviews with former team members suggest that in 2007 the staff communicated their concerns about Kabul Bank to the authorities and the donor community to little effect. When the crisis erupted, the preliminary design of the ECF-supported program agreed at the staff level was quickly recast to include measures addressing resolution of failed-banks and AML/CFT issues with tight deadlines. While the donor conferences created a momentum for program discussions and the Kabul Bank resolution process followed best practice, the pressure to

Box 6. Donor Conferences

Between 2001 and 2014 the donor community held 16 major conferences, presented 5 different development strategies, and held dozens of other regional and thematic conferences around the globe (Asey, 2014).

Location	Year	Location	Year
Bonn	2001	Kabul	2010
Tokyo	2002	London	2010
Berlin	2004	Bonn	2011
London	2006	Istanbul	2011
Rome	2007	Chicago	2012
Paris	2008	Tokyo	2012
The Hague	2009	Beijing	2014
Moscow	2009	London	2014

conclude the program negotiations to meet conference timelines adversely affected both the strength of program design and authorities' ownership. In contrast, the Fund leverage seemed to have increased during 2013–14 when the program was off track and donor pressure declined.

C. Was Capacity Building Under Fund-Supported Arrangements Sufficient to Put Afghanistan on a Sustainable Path?

33. The needs of the country go well beyond the timeframe of two Fund-supported programs. The Fund initially chose to focus on its core expertise and limited its coordination role in noncore areas. While the capacity building efforts of bilateral donors, IFIs, and NGOs generally targeted the right institutions, they did not sufficiently coordinate, occasionally duplicating their support or providing conflicting policy messages. In their work, the international community frequently relied on structures parallel to the civil service and these better-paid, donor-funded staff demotivated and undermined capacity in the civil service. With donor funding set to decline, much of the capacity in the parallel civil service may get lost unless the current efforts to absorb these workers in the formal civil service are accelerated.

34. The focus on creating sound fiscal institutions yielded early gains, but these were not sustained. Improvements in revenue collection and the implementation of the PFM framework during the PRGF arrangement were the high watermarks of the capacity building efforts (IEG, 2013). Even these gains were not sustained during the ECF arrangement and the progress toward a broad-based indirect taxation system and a modern system of mineral taxation stalled (Box 5). The prolonged run-up to the 2014 elections—and drawn-out process of forming a new administration—further dented the authorities resolve to proceed with reforms.

35. Inadequately coordinated technical assistance in the area of financial supervision against the background of political interference during the PRGF arrangement failed to address emerging risks in the banking sector (Box 3). Hasty licensing, weak supervision, and continued forbearance by the authorities fueled rapid growth of the banking system. Politically connected bank owners were allowed to interfere and intimidate supervisors, undermining the efforts to build capacity. The multi-donor capacity building response to the 2007 Fund staff warning was neither sufficiently coordinated nor adequately backed by the authorities.

36. The highly politicized attention paid to Kabul Bank diverted authorities' attention from financial sector regulation and supervision. The ECF arrangement introduced extensive financial sector conditionality (Annex III) mostly related to Kabul Bank and supported financial sector supervision and AML/CFT efforts with TA. In hindsight, much of these efforts met with resistance from the authorities (SIGAR, 2014c) and the new AML and CFT laws were enacted only in mid-2014. The financial sector remained underdeveloped and its regulation weak, partly as the bank supervisors received minimal political backing.

D. Was There Sufficient Ownership of and Capacity for Reforms?

37. Program ownership was stronger during the PRGF arrangement than the ECF arrangement. Given the scope of the reconstruction efforts and the plethora of donors, IFIs, and NGOs involved, some limits to ownership were to be expected. Performance on quantitative and structural conditionality was stronger during the PRGF, especially given that quick wins, such as PFM, could be realized. Afterward, authorities' ownership of the ECF-supported program was overestimated as evidenced by the decline in fiscal revenues, repeated delays in key fiscal reforms, and the handling of the Kabul Bank cleanup.

38. A number of factors interacted to dilute ownership, in addition to the broad political and security developments. First, weaknesses persisted in public institutions, governance, and security. Increasing opium cultivation fueled corruption and hampered efforts to develop a licit agricultural sector. Second, aid management problems reduced support for reforms among the population and authorities. Third, the fallout between the donors and the Karzai government over the Kabul Bank crisis and tight timelines for ECF-supported program conditionality affected the quality of engagement. Finally, following Fund staff advice, donors continued to disburse during the time the ECF-supported program was off track. While the decisions to continue disbursements were not taken lightly—a break in donor engagement would have destabilized the fiscal position quickly—they created a moral hazard problem.

E. Did the Fund-Supported Programs Have Sufficient Catalytic Effects?

39. The Fund engagement provided useful signaling vis-à-vis the donor community; however, the impact on private sector was minimal. The Fund's presence in Afghanistan galvanized donor financial support and helped to maintain the overall reform momentum. The donors appreciated the signaling effects of Fund-supported programs, and occasional tensions between donors' high expectations of Fund conditionality and the legal limitations thereof appeared to play a minor role, e.g., in the case of Kabul Bank. The Fund's coordinating role became more challenging as its field presence in Kabul declined gradually, and after January 2014 had to be done from headquarters. In contrast, there is little evidence that Fund-supported programs attracted foreign direct investment or spurred private sector development. A longer period of security and political stability is needed to set Afghanistan on a path toward increasing private sector activity.

LESSONS LEARNED AND POLICY CHALLENGES GOING FORWARD

40. Given the rising insecurity, authorities' ability to implement a Fund-supported program should be assessed realistically. The domestic conflict makes it difficult to conduct outreach to build program ownership, strengthen capacity, and implement reforms. In the absence of security improvements, a Fund-supported program is unlikely to catalyze investor confidence and private sector-led growth necessary for achieving Afghanistan's long-term development goals (IMF, 2006). Progress in the security area may require bold political actions, such as, reconciliation with the

Taliban, satisfying the ambitions of minorities, and so on. Further worsening of the security situation may push the country closer toward the vicious circle of weaker institutions, underdevelopment, and internal conflict (IMF, 2012).

41. The challenges of a long-term development project are formidable and the mode of engagement should be carefully reviewed. The Fund does not have a facility designed for a multi-decade engagement in a challenging security situation. The available options include an Extended Credit Facility and a Staff-Monitored Program. Given the minimal role Fund resources played in Afghanistan[8] and limited ownership, the benefits of a longer term staff-monitored program should be considered. Irrespective of the choice of facility, it will be important to link program targets with credible long-term development objectives in order to get traction for the Fund's policy advice, striking a careful balance between program ambitions and authorities' buy-in and implementation capacity.

42. The new administration of President Ghani and Chief Executive Abdullah and its national reconciliation efforts present the Fund with an opportunity to reconsider both the appropriate priorities and pace of reforms and strengthen outreach. An SMP, without heavy front-loaded conditionality, may help to build ownership and establish a track record. The priority should be on capacity building, targeting reforms with most traction. Appropriately ambitious targets and a record of reform implementation, would allow authorities to demonstrate ownership program before progressing to a Fund-supported arrangement. The eventual Fund-supported arrangement will need to chart a long-run development path and demonstrate "quick wins." At the same time, such a path—particularly in the fiscal area—is to be realistic, respecting the security and political reality. While aware of the uncertainties surrounding the estimation of long-term security and development costs, we see such a plan as a useful underpinning of future Fund engagement. To this end, greater research and outreach efforts will be needed to reach agreement on desirable policies.

43. The Fund documents need to present a credible, even if remote, exit strategy from aid dependence. First, the donor community committed to providing financial support beyond 2017 at a new, yet-to-be-established long-term level (Box 2).[9] Making aid less volatile and more predictable would go a long way toward minimizing its adverse side effects. It may be useful for some of the planned aid to be saved and set aside, to help smooth fiscal expenditures and reduce macroeconomic volatility (Berg and others, 2010). Second, stronger oversight on strategic objectives and outcomes of capacity development would boost effectiveness and sustainability of these efforts

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[8] The approved amount under the ECF arrangement was equivalent to less than 2 percent of 2011 gross international reserves.

[9] Donor financial commitment to the Afghan National Security Forces—as confirmed at the 2012 Chicago summit—is set to decline gradually, and by 2024 the Afghan government is expected to assume full financial responsibility for its own security forces (NATO, 2012).

(Annex II). To this end, a more robust process for donor coordination may be needed. Two basic options can be considered. For example, the Fund could allocate more functional department staff to the Afghanistan team, who would provide oversight in their areas of expertise. This option would require additional Fund resources. Or, preferably, the authorities can take on a greater coordinating role, similar to that played recently by governments of Mozambique and Rwanda. The latter option is likely to strengthen ownership and, at least partly, address the aid-management conflict of interest (Box 2).

44. **This report sees scope for the Fund to rally donor and domestic support around candid policy scenarios.** An important part of the Fund engagement should focus on analyzing realistic macroeconomic scenarios and risks around sustainable public service delivery. Particular questions asked in such scenarios may include the policy mix in response to the ebbing bilateral support; the trade-offs between revenue and expenditure adjustment to aid decline; the reasons for tax revenue volatility and how much domestic revenue can be optimally raised; and so on. To this end, policy scenarios grounded in solid research, of the type presented in Aslam and others (2013) or Hogg and others (2013), would be useful. The Fund should consider reassigning staff to such tasks, preferably with support from functional departments, to facilitate the process of consensus building, both on macroeconomic and structural issues. Greater outreach efforts need to be conditional, however, on security improvements.

45. **Structural conditionality should be focused and coordinated with donor capacity-building efforts.** This report would recommend focusing on the following elements:

- Prioritization of macro-critical fiscal and financial sector measures to maximize ownership;
- Strengthening of the legal infrastructure, in particular targeted AML/CFT and anti-corruption measures to improve governance and promote financial stability;
- Jointly with the World Bank, scaling up of capacity and project delivery through the regular civil service;
- Reforms to boost the efficiency of public spending and create conditions for private sector productivity improvements.

46. **Risks to a Fund-supported program remain high**. First, without lasting security the stabilization gains will not be sustained and Fund engagement is unlikely to be effective. Second, the political and ethnic fractionalization of the Afghan society (Barfield, 2011; Cordesman, 2013) may counteract attempts at reform ownership and a strong central government. Third, disorderly donor disengagement would deal a fatal blow to the aid-dependent economy.

Table 6. Afghanistan: Selected Economic Indicators, 2005–14

(Quota: SDR 161.9 million)
(Population: approx. 30.6 million)
(Per capita GDP: approx. US$660; 2013)
(Poverty rate: 35.8 percent; 2011)
(Main exports: opium, US$2.0 billion; carpets, US$86.3 million; 2013)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
	Actual								Est.	
	(Annual percentage change, unless otherwise indicated)									
Output and prices 1/										
Real GDP	11.8	5.4	13.3	3.9	20.6	8.4	6.5	14.0	3.7	1.5
Nominal GDP (in billions of U.S. dollars)	6.2	6.9	8.6	10.3	12.1	15.3	17.9	20.3	20.1	20.3
Consumer prices (period average)	10.6	6.8	8.7	26.4	-6.8	2.2	11.8	6.4	7.4	4.6
Consumer prices (end of period)	10.6	4.3	16.1	18.8	-9.8	10.2	9.3	5.9	7.2	1.4
	(In percent of GDP)									
Investment and savings										
Gross domestic investment	37.1	29.5	55.9	30.2	36.7	30.4	26.5	25.3	22.6	20.4
Of which: Private	10.1	8.7	8.1	7.8	6.9	7.8	7.3	7.2	6.6	5.9
Gross national savings	54.5	31.5	96.4	32.9	49.7	38.7	32.9	31.7	30.1	27.3
Of which: Private	28.5	10.1	51.2	14.4	21.8	15.2	14.3	13.3	14.8	15.0
Public finances (central government) 2/										
Domestic revenues and grants	14.7	18.9	19.0	17.0	19.4	21.7	21.3	25.2	24.4	24.1
Domestic revenues	5.6	7.3	8.1	7.2	8.5	10.9	11.0	10.1	9.8	8.6
Grants	9.1	11.7	10.9	9.9	10.9	10.8	10.3	15.1	14.6	15.5
Expenditures	15.7	18.3	21.5	20.9	21.2	20.8	21.9	25.0	25.0	26.3
Operating balance (excluding grants) 3/	-4.4	-3.6	-3.8	-5.5	-4.2	-3.7	-5.3	-8.1	-8.0	-11.0
Overall balance (including grants)	-1.0	0.6	-2.5	-3.9	-1.8	0.9	-0.6	0.2	-0.6	-2.2
Public debt 4/	205.9	24.1	20.4	16.9	15.4	6.8	6.2	5.9	6.3	6.5
	(Annual percentage change, end of period, unless otherwise indicated)									
Monetary sector										
Reserve money	19.5	16.6	24.5	38.5	26.4	26.1	21.9	3.9	12.4	13.3
Currency in circulation	18.2	10.5	23.5	24.4	23.4	36.7	20.8	1.1	12.5	16.7
Broad money	...	...	42.4	31.4	33.0	26.9	21.3	8.8	9.4	5.8
	(In percent of GDP, unless otherwise indicated)									
External sector 1/										
Exports of goods (in billions of U.S. dollars)	0.24	0.24	0.35	0.49	0.46	0.55	0.51	0.64	0.73	0.83
Imports of goods (in billions of U.S. dollars)	2.93	3.66	4.67	5.65	6.59	8.53	10.16	10.05	9.24	8.53
Merchandise trade balance	-43.6	-49.4	-50.5	-50.2	-50.8	-52.1	-53.9	-46.4	-42.3	-37.9
Current account balance										
Excluding official transfers	-39.7	-43.8	-42.8	-47.5	-46.5	-43.1	-44.6	-41.8	-35.5	-34.7
Including official transfers	17.5	2.0	40.5	2.7	13.1	8.3	6.4	6.3	7.5	6.9
Foreign direct investment	4.4	3.1	2.2	1.6	0.6	1.4	0.8	0.7	0.3	0.6
Total external debt 4/	205.9	24.1	20.4	16.9	15.4	6.8	6.2	5.9	6.3	6.5
Gross international reserves (in billions of U.S. dollars)	1.5	2.0	2.6	2.9	4.1	5.0	6.2	6.9	6.9	7.4
Import coverage of reserves 5/	4.2	4.3	4.8	4.4	4.9	5.0	6.0	7.3	7.9	7.6
Exchange rate (average, Afghanis per U.S. dollar)	49.4	49.9	50.0	50.3	50.3	46.4	46.7	50.9	55.4	57.4
Real exchange rate (average, percentage change) 6/	3.5	2.4	5.6	21.0	-6.6	8.9	7.7	-4.3	-2.7	0.9
Memorandum items 7/	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
Nominal GDP, incl. opium (in billions of Afghanis)	328	375	519	541	633	747	896	1,086	1,197	...
Of which: Opium (in billions of Afghanis)	16	23	83	8	18	17	40	25	35	
Real GDP, incl. opium (annual percentage change)	9.9	9.2	16.1	2.3	17.2	3.2	8.7	10.9	6.5	...
Price (in U.S. dollars per kilogram)	101	94	86	70	48	128	180	163	163	...

Sources: Afghan authorities; United Nations Office on Drugs and Crime; and Fund staff estimates and projections.

1/ Excluding the narcotics economy.

2/ For comparison, 2011 and 2012 are recalculated from data reported on the solar fiscal years basis (March 21–March 20). Since 2013, the fiscal year runs December 22–December 21 (in most years), which is closer aligned with the Gregorian calendar year.

3/ Defined as domestic revenues minus operating expenditures.

4/ Public sector only. Incorporates committed but not yet delivered debt relief.

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

6/ CPI-based, vis-a-vis the U.S. dollar.

7/ Items presented on the Afghan solar year's basis.

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Annex I. The Views of the Authorities[1]

The authorities welcomed the opportunity to comment on the lessons learned from the Fund's engagement in Afghanistan. They thought that the report provides an appropriate assessment of the IMF's engagement and agreed with the recommendations regarding a potential successor arrangement, in particular the need to maximize program ownership. They argued that the Fund occasionally envisioned faster reforms than feasible given Afghanistan's legal infrastructure and political environment and, moreover, that the Fund was inflexible when faced with either missed or delayed conditions. The authorities disagreed with the EPA assessment of the Kabul Bank crisis, arguing that it was mostly the result of Kabul Bank managers resorting to misreporting and difficult-to-detect fraud.

1. **Both Fund-supported programs helped to stabilize the economy and address urgent institution-building tasks in Afghanistan.** Past Fund support has been highly valued, in particular the role of a "trusted advisor" to the government. Fund-supported programs were essential in garnering donor support and attracting sustained aid inflows, although program interruptions negatively affected aid flows. In this context, the coordinating role of Fund staff vis-à-vis the donor community during the time the ECF arrangement was off track was much appreciated.

2. **Fast-paced reforms created the necessary legal infrastructure and institutions, and contributed to impressive economic growth, allowing improvements in many human development indicators.** With fundamentals in place, the gains made to date should be sustainable. The fast pace of reforms brought about a number of challenges, however. The Fund occasionally overestimated the implementation capacity of a post-conflict country, in particular with regard to legal matters and capacity building. It was occasionally challenging to find a balance between the elevated expectations of the donor community, which sought a speedy resolution of issues, and demands from the domestic audience, which favored a more gradual approach to lawmaking. Greater flexibility with respect to program conditions would have prevented some of the program interruptions.

3. **The success of a future Fund-supported arrangement depends on improved ownership of the reform program.** The changes to the 2010 ECF-supported program were rushed, with insufficient consultation of key stakeholders beyond the ministry of finance and the central bank. Going forward, greater and early consultation with authorities on program design and conditionality

[1] Mr. Bulíř and Ms. Khandelwal met on April 16, 2015 with Messrs. Gul Maqsood Sabit (Deputy Finance Minister), Mr. Khan Afzal Hadawal (Acting Governor, Da Afghanistan Bank); Khalid Payenda (Senior Advisor, Ministry of Finance), and Mr. Samiullah Ibrahimi (Advisor to the Executive Director, World Bank). The authorities also provided written comments.

could help improve ownership. Coordination with and between donors will remain an essential element of aid predictability.

Specific comments on the ex post assessment report

4. The Kabul Bank crisis happened mainly due to extensive fraud, nondisclosures, and malefactions of shareholders and management. The crisis revealed institutional weaknesses and banking supervision challenges. However, there is no evidence that inaction on the side of banking supervision allowed unsound practices such as connected lending, loans to shareholders to buy equity stakes, and offshore speculative real estate investments. On the contrary, onsite examinations conducted by Da Afghanistan Bank uncovered serious regulatory violations and Kabul Bank management resorted to extensive fraud and misreporting in order to avoid further regulatory actions.

5. The recovery of Kabul Bank assets is an ongoing process. The total loan portfolio of the bank was US$987 million when it defaulted, however, to date more than US$330 million has been recovered, and the list of borrowers who owe the remaining US$660 million has been finalized (20 borrowers owe almost the entire remaining amount). Recently, some borrowers promised to pay US$90 million and therefore their loans have been rescheduled. The two major shareholders owe around US$530 million and Kabul Bank Receivership, in coordination with other legal authorities, works to recover the amount. Some of the assets are located in foreign jurisdictions and are being pursued through legal and diplomatic channels.

Annex II. The Views of Stakeholders

1. Overview. The IMF-supported programs provided a useful macroeconomic framework that facilitated international aid disbursements needed for rebuilding institutions and infrastructure. IMF funding played a minor role as compared to the large-scale bilateral aid.

2. Program design and conditionality.

- Most stakeholders viewed the IMF program design and conditionality as appropriate and sufficiently flexible. Many stakeholders considered that the limited progress in specific areas was a reflection of a lack of program ownership and moral hazard rather than due to missing conditionality. The need to meet donor conference timelines adversely affected the strength of program conditionality, program ownership, and performance.

- In hindsight, some stakeholders considered that the PRGF arrangement had placed insufficient emphasis on banking sector issues, and this omission contributed to inadequate surveillance and conditionality in this area. In the aftermath of the Kabul Bank crisis key shareholders demanded strong conditions linked to Kabul Bank assets recovery and money laundering issues. Progress in these areas remained disappointing, however, despite much stronger conditionality.

- Data weaknesses with respect to the magnitude of donor assistance, most of which remained off-budget, hampered an understanding of aid's macroeconomic impact. Improved data availability could have facilitated greater analysis of the macroeconomic impact of donor assistance and policy options associated with declining aid.

3. Coordination among stakeholders. International aid helped to secure the country and meet development needs, but also contributed to waste, corruption, and challenges for macroeconomic management. Various stakeholders—the authorities, the World Bank, the Fund, and the international donor community—argued for their own spending priorities. Ensuring that aid inflows were in line with absorptive capacity and macroeconomic sustainability proved difficult in this over-politicized environment. Following the 2012 Tokyo Mutual Accountability Framework (TMAF) coordination improved at the political level, however, structured policy dialogue and coordination on the technical level between the donors and Afghan authorities remained weak.

4. Capacity building.

- Many stakeholders felt that capacity-building efforts generally targeted the right institutions. These efforts were neither sufficiently coordinated across the donors providing technical assistance nor comprehensive enough in support of program priorities. In the areas with multiple technical assistance providers, the quality thereof was assessed to be poor (Sud, 2013). Effectiveness of capacity building was further hampered by the weak security conditions and undermined by vested interests.

- Several of those interviewed noted that capacity-building efforts focused on measureable outputs—as opposed to hard-to-assess outcomes—created a parallel civil service, financed off-budget and paid significantly higher salaries than the regular civil service. Meanwhile, the regular civil service remained neglected. The ad hoc salary structures contributed to distorted wages in the local labor market.

5. Engagement and outreach. The gradual deterioration in security made it difficult for the Fund staff to engage with a broad set of stakeholders, outside of the ministry of finance and the central bank. Missions since September 2013 have occurred in third-country locations, limiting both interactions with the civil service and outreach opportunities that could help to improve coordination and build ownership of reforms among the broader government and civil society.

6. Challenges for future Fund-supported programs.

- Although a Fund-supported program can help maintain macroeconomic stability, achieving sustainable economic growth in Afghanistan was seen as difficult. The security situation and corruption presented binding constraints to the delivery of public services and galvanizing private sector-led investment and growth. Most of the interviewed officials acknowledged that these areas fall outside the Fund's remit.

- All stakeholders thought it desirable for the Fund to boost its local presence in Afghanistan to strengthen capacity building through improved coordination among donors and authorities. A stronger local presence could support authorities' reform efforts through improved dialogue and monitoring. They were cognizant, however, of the challenges posed by the deteriorating security situation.

- Stakeholders see the reduction in aid inflows as inevitable and would like to see it handled in a predictable manner, given high aid dependency and the need to ensure fiscal sustainability. These inflows remained the subject of intensive negotiations among the authorities and various donors, however, making it difficult to address this task in a credible and transparent way.

- With high salaries and skills concentrated in the parallel civil service and a large stock of public capital, the stakeholders thought that the authorities may find it difficult to deliver services and maintain roads and schools in the face of declining donor funds.

Annex III. Structural Conditionality

Afghanistan: Structural Conditionality Under the PRGF Arrangement 2006–10

Description	Type	Status
Fiscal		
Collect the business receipt tax and nontax liabilities due by airlines	PA	Canceled
Submit to parliament legislation to eliminate nuisance taxes and introduce an excise tax	SB	Not met
Clarify the tax policy framework and system including separating the legislation of the business receipts tax and income taxes	SB	Met
Withdraw trader concessions on filing and paying taxes	SB	Canceled
Notify traders of the expiration of exemption from the general income tax regime	SB	Met
Introduce Business Receipts Tax on imports	SB	Not met
Issue an instruction to ensure timely updates of reference prices for petroleum products	PA	Met
Sign a memorandum of understanding between MOF and MoCI to clarify working arrangements with the Fuel and liquid gas enterprise	PA	Met
Prepare monthly report on the volume and value of fuel imported and amount of taxes and customs duties levied and collected	PA	Met
Adopt and implement the business model of border controls with internationally accepted best practices	SB	Canceled
Implement the automated system for customs data	SB	Met with delay
Establish appeals process for customs and tax administrations	SB	Met
Roll out the large taxpayer office to Herat, Jalalabad, and Mazar-e-Sharif	SB	Met
Set up post-clearance audit units in the customs directorates of Jalalabad and Mazar-e-Sharif	SB	Met
Issue first monthly report by the revenue department verifying the collection of business receipt tax on imports	SB	Met
Submission of DABM's (electric company) financial statements for 2006/07-2007/08	SPC	Not met
Fiscal Transparency		
Publish external audit report of Fuel and Liquid Gas Enterprise	SB	Met with delay
Electric company publish bimonthly report on financial flows and other key variables	SB	Canceled
Submit to parliament the core budget's audited financial statements for 2005/06	SPC	Met
Submit to parliament the core budget's audited financial statement for 2006/07	SPC	Not met
Submit to parliament the core budget's audited financial statement for 2007/08	SPC	Met
Submit core budget to parliament according to the PFEM Law and accompanied by a MTFF	SB	Met
Submit to parliament the core budget's audited financial statement for 2007/08	SB	Canceled
Monetary		
Implement an integrated accounting system at Da Afghanistan Bank headquarters	SB	Delayed
Expand the automated integrated accounting system to six regional hubs	SB	Met
Reconcile Da Afghanistan Bank's accounting records and the monthly reports on operations for 2007/08	SB	Met with delay
Produce a Monetary Survey for 2007/08 using a consistent time frame for the entire banking system	SB	Not met

Afghanistan: Structural Conditionality Under PRGF Arrangement 2006–10 (continued)

Description	Type	Status
Develop an action plan to address the gaps in the Da Afghanistan Bank's framework	SB	Met
Create an electronic registry of capital notes	SB	Met
Process gold held in the palace vaults into a form that qualifies as a reserve asset	SB	Not met
Develop a monthly monetary survey in line with international standards	SB	Met with delay
Ensure that the accounting system at six regional hubs is automatically monitorable from headquarters	SB	Met
Complete a special audit of the central bank's reserve assets in accordance with International Standards on Auditing	PA	Met
Appoint a reputable international audit firm to audit the bank's annual financial statements for financial year 2007/2008	PA	Met
Submit to parliament the 2004/05 and 2005/06 external audits of Da Afghanistan Bank	SB	Met with delay
Financial sector		
Issue regulations on credit-granting standards and credit monitoring processes	SB	Met with delay
Issue regulations setting limits on sectoral loan concentration	SB	Met with delay
Issue a circular informing banks that the requirement to invest 80 percent of bank deposits in domestic economy has been repealed	SB	Met
Appoint a new board of directors at Bank Pashtany	SB	Not met
Make a public statement announcing the liquidation of the Export Promotion bank or its merger with another licensed commercial bank	SB	Met with delay
Submit to Cabinet a restructuring plan for bank Millie	SB	Met
Prepare, and submit to Cabinet a restructuring plan for Bank Pashtany	SB	Delayed
Privatization/Public Enterprises		
Publish a schedule of fees charged by the Fuel and Liquid Gas Enterprise for its services	SB	Met
Conclude a comprehensive agreement with the electricity public enterprise on a medium-term plan to reduce subsidies	SB	Met with delay
Submission of the state-owned electricity company audited financial statements for 2006/07–2007/08	PA	Met
Transfer the directorate responsible for monitoring and managing public enterprises in the Ministry of Finance	SB	Canceled
Adopt a comprehensive restructuring plan for the public entities and government agencies engaged in commercial activities but not covered by the state-owned enterprises law	SB	Delayed
Conclude an agreement with the electricity public enterprise on quarterly reform benchmarks throughout 2008/09 in exchange for the subsidy disbursements	SB	Not met
Review the fiscal relations between the government and public enterprises (Afghan Telecom, Ariana, DABM/DABS, and FLGE)	SB	Modified
Implement the ASYCUDA Transit and Declaration Processing Module in Nangarhar and Herat, and at Kabul Airport inland clearing depots	SB	Met
Finalize a comprehensive review of the financial situation of public enterprise companies	SB	Canceled

Afghanistan: Structural Conditionality Under the PRGF Arrangement 2006–10 (concluded)

Description	Type	Status
Trade		
Reduce tariff rate on soft drinks established by Presidential Decree Nr. 96	SPC	Canceled
Eliminate the discriminatory application of the 1 percent tariff rate on imports of raw materials and intermediate goods	PA	Met
Amendment of income tax legislation to introduce business receipts tax on imports	PA	Met
Other		
Request verification by the Control and Audit Office of the 2006 reviews of the Tashkeel at the Ministry of Interior and Ministry of Education and the related arrears from 2005/06	SB	Met
Establish a certified monthly payroll system	SB	Met

Sources: MONA database; IMF staff reports 2006–10.
Notes: PA-prior action, SB-structural benchmark, SPC-structural performance criteria.

Afghanistan: Structural Conditionality Under the ECF Arrangement 2011–12

Description	Type	Status
Financial		
Submit to Parliament legislation introducing marketable debt instruments	SB	Met
Issue detailed public statement about the events leading to the collapse of Kabul Bank and the actions taken to deal with the crisis	PA	Met
Finalize legally binding agreements with cooperating Kabul Bank shareholders for the repayment of the full amounts	PA	Met
Formulate and announce strategy to enforce Afghan laws in relation to any financial crimes committed at Kabul Bank.	PA	Met
Complete inception report for audits of Kabul Bank and Azizi Bank	PA	Met
Issue an enforcement letter for Azizi Bank based on a recent onsite examination listing key actions to be undertaken, a timetable, and penalties and sanctions for noncompliance	PA	Met
Issue supervisory orders to selected banks with timetables for compliance and sanctions for failure to comply with key corrective actions previously recommended	PA	Met
Enforce in full conflict-of-interest regulations and circulars in the banking sector by removing shareholders from serving as Chairman and CEO of the bank they own	PA	Met
Finalize an 18-month business plan for the bridge bank	PA	Not met
Establish a senior official-led interagency steering committee (Economic Crimes Task Force) to oversee the passage and implementation of the new banking law, the anti-money laundering and terrorist financing laws and their provisions, and to function as a coordinating body for the implementation of the Economic Crimes Strategy and its action items	SB	**Completed as scheduled***
Submit to Parliament the amended or new banking law, prepared in consultation with the Fund that will strengthen provisions on corporate governance, capital, large exposures, related parties, consolidated supervision, early intervention, enforcement, and bank resolution, where appropriate in line with the Basel Core Principles	SB	**Completed with delay***
Strengthen the AML/CFT regime by implementing an action plan based on the recommendations of the February 2011 assessment	SB	**Completed with delay***
The Supreme Council of Da Afghanistan Bank to approve strategies for banks that fall short of the minimum paid-up capital to be merged or closed	SB	Met with delay
Produce a roadmap with a strategy to build capacity and improve the institutional framework to respond promptly to economic crime	SB	**Completed with delay***
Conduct an in-depth public inquiry to examine the events leading to the Kabul Bank crisis by the independent monitoring and evaluation commission	SB	Met
Put Kabul Bank under receivership and revoke its banking license. Extinguish all shareholder ownership and related rights and interests. Split assets and liabilities into a good bank (bridge bank) and the remaining Kabul Bank estate	PA	Met
Reduce number of branches at bridge bank (New Kabul Bank) by 20 according to the updated business plan	SB	Modified
Approve the privatization plan for new Kabul Bank prepared by the privatization advisor in consultation with Fund staff	SB	**Completed as scheduled***
Fiscal		
Submit to the ministry of justice amendments to the income tax law, minerals law, hydrocarbons law and customs code	SB	**Completed with delay***
Submit draft law on VAT to the parliament	SB	**Completed with delay***

Afghanistan: Structural Conditionality Under ECF Arrangement 2011–12 (concluded)

Description	Type	Status
Submit VAT law to the Ministry of Justice for review	SB	Met
Identify taxpayers in the medium taxpayer office and the small taxpayer office whose turnover exceeds the large taxpayer office threshold and revisit the thresholds for the large taxpayer office and the medium taxpayer office with a view to having an efficient allocation of taxpayers across the three offices	SB	**Completed as scheduled***
Roll out to at least two additional Border Crossing points the new border management model piloted at Hairatan border crossing point	SB	Met
Submit to the ministry of justice legislation bringing state-owned corporations under effective monitoring and oversight of the ministry of finance, including financial reporting to the ministry of finance and ministry of finance approving financial plans on an annual basis	SB	**Completed as scheduled***
Submit to the Ministry of Justice legislation bringing public enterprises under effective monitoring and oversight of the Ministry of Finance.	SB	Not met
Ministry of Finance to issue 8-year bond to capitalize the central bank to cover the cost of Kabul Banks resolution ($825 million) and obtain parliamentary approval for a budget appropriation to service the bond	PA	Met
Sign a memorandum of understanding between Financial Transactions and Reports Analysis Center of Afghanistan, the Financial Supervision Department of DAB, and competent law enforcement authorities on information sharing	SB	**Completed with delay***
Monetary		
Submit to parliament amendments to the central bank legislation that aligns the provisions on the netting and allocation of net income with international good practice	SB	Not met
Revise central bank regulations and prepare and issue informational circulars to ensure consistency with the revised banking law	SB	Met
Approval by the Supreme Council of Da Afghanistan Bank of the new organizational structure of the Financial Supervision Department	SB	Met
Issue a memorandum of understanding between the Ministry of Finance and the central bank on the central bank capitalization needs and a schedule for recapitalization	SB	Met with delay

Sources: MONA database; IMF staff reports 2010–14.
Notes: PA-prior action, SB-structural benchmark, SPC-structural performance criteria.

***** Conditions, the status of which is denoted in bold and with an asterisk (*), were assessed by the staff outside of the program review.