3

Fiscal Framework and the Budget

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Very limited information is available on Afghanistan's fiscal situation before the Afghan Interim Administration (AIA) took office in December 2001. The last time fiscal developments in Afghanistan were analyzed was during the 1991 Article IV consultations between Afghanistan and the IMF, which covered the 1987/88–90/91 fiscal years and provided preliminary projections for the 1991 budget. There is no comprehensive source for fiscal data in the subsequent periods, including the civil war (1992–96) and the Taliban regime (1996–2001).

A Slow Descent into Chaos

Partial information and empirical evidence confirm, however, that after two decades of conflict, fiscal policy and public finance management had disintegrated. With continuous fighting and deteriorating economic conditions, traditional domestic revenues steadily declined, together with inflows of external assistance, and were progressively replaced by illegal off-budget revenues, collected both by the central government and by local warlords. Actual revenue performance continually fell short of budget requirements and the central bank provided the government with unlimited overdraft facilities to cover the resulting budget deficits.[1] Monetization of the budget deficits resulted in high inflation and a rapid depreciation of the Afghani.[2] For most of this period, budget spending was focused on security expenditures and government salaries, with very limited amounts allocated to reconstruction and development. In sum, the national budget became a residual instrument in public policies, which were mainly conducted—and illegally financed—by warring local leaders according to their own factional interests.

The collapse of fiscal management and policy over the past 20 years took place in three stages. Traditionally, before the period of conflict began, government revenues were derived from three main sources: (1) extraction and exportation of mineral resources, particularly gas; (2) income transfers by state-owned enterprises (SOEs), whose production mostly focused on cement, fabric (especially wool), fertilizer, and agricultural goods; and (3) customs duties; taxes levied on agricultural land, hotels, and residential dwellings; and sales tax on real estate and cars. These domestic revenues were substantially supplemented by grants and external borrowing from diverse sources.

With the communist coup in April 1978, the new government sought to impose unpopular reforms, including land redistribution, and there was widespread unrest. This led to the invasion by the former Soviet Union in December 1979, and with the 10

[1]At the end of 2001, the government's accumulated overdraft with Da Afghanistan Bank (DAB) was estimated by DAB to have reached almost (old) Af 15 trillion, equivalent to $300 million at mid-2003 exchange rates.

[2]The Central Statistics Office released a report in 1996 showing that the prices of basic goods—such as flour, sugar, and cooking oil—rose on average about 162 times between 1991 and 1995 in Kabul.

years of conflict that followed, the government's traditional revenue sources began to dry up. Fiscal management by the Soviet-supported communist government in Afghanistan relied heavily on the printing press and on Soviet financing.

Following the retreat of the Soviet troops, and the subsequent fragmentation of political authority and civil war between opposing military factions, provincial warlords gained control of the mineral and productive resources in their territories, diverting the associated revenues from the central government to themselves, and started collecting large amounts of off-budget taxes and fees. Natural gas exports stopped, foreign assistance inflows substantially decreased, and the income of SOEs declined sharply because of large-scale armed confrontations in industrial areas, resulting in a severe loss of revenue for the central government.[3] Despite this fall in revenue, expenditures increased significantly, reflecting rising defense spending, successive pay increases for government employees, and subsidies, mainly on food and utilities. The resulting deficits were covered entirely by printing money.

After the Taliban regime took power in 1996, it is reported to have initially succeeded in collecting sizable revenues from import duties on trade, agricultural taxes, municipality surcharges, and various fees on transportation. The tax revenue base was also broadened to include some Islamic taxes, such as *zakat* (wealth tax) and *ushr* (tax on agricultural products). In the first years of their administration, the Taliban also received foreign assistance from Pakistan (about $10 million in 1998) and Saudi Arabia, the latter providing subsidized fuel and direct grants.[4] In addition to these official revenues and grants, the regime benefited substantially from unofficial off-budget revenues from taxes on poppy cultivation and duties on opium exports, and on smuggling of consumer goods from the United Arab Emirates to Pakistan. In northeast Afghanistan, controlled by opposition movements to the Taliban, the main source of income came from the gem trade (lapis lazuli and emeralds) through collection of *ushr* on mine owners and *zakat* on traders. By the end of the 1990s, however, the misrule and increased isolation of the Taliban regime, together with four years of drought and continued fighting, had seriously hampered the collection of official domestic revenues, and the government increasingly returned to monetary financing of the budget deficit.

Dismal Situation but Resilient Structures

In December 2001, when the AIA took office, the Ministry of Finance (MoF) at the center and its provincial offices (Mustufiats) had, for most intents and purposes, ceased to function.

- Most of the skilled and qualified staff of the MoF had emigrated during the war. Except for a limited number of senior staff who returned to Kabul after the conflict, the vast majority of MoF personnel still in situ lacked the basic qualifications to conduct even rudimentary fiscal functions. Tasks still being performed in the MoF were mostly of a clerical nature and carried out by the different MoF divisions in complete isolation from each other.
- The MoF's infrastructure had been devastated by years of war and neglect. This was especially true of a number of MoF regional offices and customs houses in the provinces, whose buildings were literally falling into ruins.
- Basic telecommunication facilities had failed, and most of the primary road network was impassable, resulting in the breakdown of fiscal relationships between the center and provinces. There was no office automation—in early 2002, there was only one calculator available for the whole Revenue Department—and key government offices lacked regular access to electricity.[5]

Budget policy was limited to the payment of salaries, and even these were subject to considerable delays and arrears.[6] Budget preparation consisted of adding a large central reserve to the previous year's appropriations, which was drawn down during the

[3]In 1991, the ratio of revenues to estimated net material product fell to 3 percent, according to IMF staff estimates.

[4]This aid was stopped in the summer of 1998 to protest the Taliban's refusal to expel Osama Bin Laden (Rubin, 2002).

[5]This was the situation in the entire country. The December 2001 World Bank, Asian Development Bank (AsDB), and United Nations Development Program (UNDP) preliminary needs assessment estimated that only 6 percent of Afghans had access to electricity in 1993 and Afghanistan had only 2 telephones per 1,000 people, compared with 24 in Pakistan, 35 in Tajikistan, and 68 in Uzbekistan.

[6]It is estimated that, in December 2001, about $20 million of salary arrears corresponded to wages incurred during the Taliban period.

Box 3.1. Public Sector and The Relationship Between the Center and Provinces

According to the 1964 Constitution and the 1966 Organic Budget Law, the public sector in Afghanistan is composed of ministries, provinces, districts, municipalities (provincial and rural), more than 170 nonfinancial public institutions, and several public financial institutions.

Under the law, provincial and district governments are deconcentrated offices of the central government rather than subnational levels of government. They comprise the provincial offices of the different central ministries and are administered by a governor, who is a civil servant directly appointed by the center. These provincial offices report both to the governor and to the corresponding line-ministries.[1] Provinces neither have a distinct budget nor do they collect their own revenues. At the request of the local office of each line-ministry, provincial expenditures are made by Mustufiat against the ministry's annual budget appropriations. Similarly, the revenues collected by the provinces are receipts of the national budget and can only be used by the provinces to finance the expenditures included in the line-ministries' budget; any surplus between centrally budgeted expenditures and locally collected revenues must be transferred to the center. The only exception to these rules concerns certain provincial and rural municipalities, which have very limited expenditure and revenue assignments, such as trash collection and park services, directly financed through the proceeds of local service charges.

[1]For instance, there is a Mustufiat in each province (provincial office of the MoF), placed under the authority of both the governor and the central MoF—and reporting to both.

year, depending upon the political pressures exerted by line-ministries. In violation of the budget law, line-ministries and provincial Mustufiats had opened a number of bank accounts in the regional branches of the central bank and state-owned banks, which were operated outside the purview of the MoF.[7] No reconciliation was performed between the government's accounts in the central bank and the treasury in the MoF. The reporting system between the center and the Mustufiats had broken down completely. The last annual government accounts prepared by the MoF accounting department related to 1989/90 and no government accounts had been put together since then. Most files and fiscal data were missing, including all records of the government's external debt.

The fiscal institutional framework featured a sharp contrast between the constitutional and legislative setup—providing for a highly centralized state with very limited deconcentration—and the reality on the ground was characterized by de facto fiscal autonomy of the provinces (see Box 3.1). For most of the 1990s, the central government had very limited control over the provinces, especially in the fiscal area. The revenues collected by provincial governors were neither reported nor remitted to the center and were spent off-budget, on expenditure items that were decided on the basis of local and factional interests. The Taliban regime apparently had some success in bringing the provinces under the rule of the center in the territories that they controlled. But, at the end of 2001, the provincial governors were, at the outset, very reluctant to comply with the country's centralized institutional framework.

Notwithstanding the dissolution of the system, a workable national fiscal process dating from before the conflict remained nominally in place, contrary to many other postconflict situations, where preexisting fiscal arrangements were either very weak or nonexistent (e.g., Kosovo and Timor-Leste). The existing fiscal laws and regulations, although imperfect and ignored for many years, provided a starting point for the reconstruction effort. There was no need to discard all past arrangements and invent completely new ones; the immediate challenge was rather to reactivate and reform a basically sound system, which had not been applied for many years.

The 1966 Organic Budget Law, for example, provided elements of good practice, such as the requirement that all revenues and grants be collected and spent through the government treasury, and the obligation that the full cost of government projects be reflected in the national budget. The entire public expenditure management system was comprehensively documented in the Organic Budget Law, the Accounting Regulations, and the Treasury Manual, and a number of senior officers in the MoF were still familiar with the procedures. Although often complex, obsolete, cumbersome, and in need of re-

[7]It has even been reported that the real Taliban treasury and central bank consisted of a couple of tin trunks in the house of Mohammad Omar, the leader of the Taliban regime, outside Kandahar (Ewans, 2002).

view, these procedures provided the legal and administrative basis for the delivery of basic financial functions, including payment and recording of fiscal transactions, reporting, control, and rudimentary accounting.[8] The Control and Audit Law also established a supreme audit authority responsible for the external audit of the whole government.

In spite of major weaknesses (see Chapter 4) and an urgent need for overhaul, a comprehensive tax system had also survived, based on the 1965 Income Tax Law and 1974 Customs Law, which includes individual and corporate income taxes, a form of sales tax (business receipt tax), fixed presumptive taxes, and indirect taxes on trade (Table A4.1).

Finally, the underlying arrangements for government employment stemmed from basically sound legislation providing for a system of centralized recruitment, and job classification and grading.[9]

Reconstruction Strategy

With the support of the international community, the AIA and its successor, the Afghan Transitional Administration (ATA), progressively outlined a government-led development agenda to address the humanitarian and reconstruction challenges facing the country. This process involved a number of different steps.

First, donor governments and international organizations helped the Afghan authorities to assess the external and technical assistance required to support the country's economic and social recovery over the short and medium term. In this context, in late 2001, the AsDB, the UNDP, and the World Bank conducted a preliminary assessment of the funding requirements for the Afghanistan reconstruction program, covering horizons of one, two and a half, five, and ten years.[10] These projections, presented at the International Conference on Reconstruction Assistance to Afghanistan in Tokyo on January 21–22, 2002, concluded that $14.6 billion would be needed over a period of 10 years to fund Afghanistan's recovery, excluding humanitarian assistance.[11] This assessment led to donor countries pledging $1.8 billion in grants for the first year and $4.5 billion mostly over the first two and a half years for Afghanistan's reconstruction (see Chapter 2). Also, international agencies, including the IMF and the World Bank, sent a number of diagnostic missions to the country to take stock of the existing situation—administrative structures, laws and regulations, suitability of staff, availability of facilities and equipment—and to develop appropriate technical assistance action plans.

In the meantime, donors focused on providing immediate humanitarian relief to vulnerable Afghan people and ensuring regular payment of civil service salaries. In the first few months of the AIA, the international community, especially the UN system, was closely involved in these efforts because the machinery of government had not yet recovered enough to fully lead the recovery process. During this intermediate stage, the UN's Immediate and Transitional Assistance Programs (ITAPs)—covering October 2001 to December 2002—were the main instruments through which UN institutions addressed the most urgent humanitarian needs of the Afghan population. These programs mainly focused on (1) the return and reintegration of refugees and internally displaced people; (2) food assistance; (3) rehabilitation of crop production; (4) child immunization; and (5) improvement of school enrollment, with estimated spending of $1 billion[12] (Box 3.2). Similarly, in the first six months of the AIA (January to June 2002), the payrolls of the civil service both at the center and in the provinces were processed, controlled, recorded, and financed through a specific fund, the Afghan Interim Administration Fund (AIAF), set up and administered by the UNDP. However, from the outset, the payroll was prepared and the salaries paid by the line-ministries and the MoF's treasury.

The Afghan authorities progressively took the lead in formulating the reconstruction strategy and put forward their vision for the country's future. The adoption of the 2002/03 operating budget and the presentation of the National Development Framework (NDF) in April 2002 were turning points in this regard: they marked the government taking a full leadership role in the development agenda and an increased focus on reconstruction over humani-

[8]For instance, the different stages usually found in most public expenditure management systems (appropriations, apportionment of appropriation, commitments, payment orders, and payments process) are satisfactorily defined in the Accounting Regulations and Treasury Manual.

[9]See World Bank (2002).

[10]The horizon of two and a half years corresponds to the combined expected terms of the AIA and the ATA.

[11]The financing required for the first year was estimated at $1.7 billion and for the first two and a half years at $4.9 billion.

[12]Excluding the civil service payments made by the Afghan Interim Administration Fund.

Box 3.2. UN Immediate and Transitional Assistance Programs, 2001–02

On the basis of the AsDB, the World Bank, and the UNDP January 2002 preliminary needs assessments, the United Nations developed a set of emergency programs—Immediate and Transitional Assistance Programs (ITAPs) for the Afghan People—to deal with the ongoing humanitarian crisis facing Afghanistan. These programs, covering October 2001–December 2002, were financed by $1.1 billion from donor countries and achieved the following main results.[1]

1. *Return and reintegration of refugees and internally displaced persons (United Nations High Commission for Refugees)*. Nearly 1.8 million refugees and 400,000 internally displaced persons were assisted in returning home, in part under the government's voluntary repatriation program. Some 48,000 million tons (MTs) of food aid, 310,000 return packages, and $35 million in travel grants were provided to returning families. About 40,000 shelters were constructed in areas of return all over the country.

2. *Food assistance (World Food Program)*. By December 2002, 250,000 MTs of food commodities had reached over 8 million people, and school feeding programs had reached 150,000 children; 1.8 million people had benefited from food aid provided through "Food-for-Asset-Creation" and over 250,000 received assistance through "Food-for-Work."

3. *Rehabilitation of crop production and food security (Food and Agriculture Organization)*. During spring 2002, 1,500 MTs of wheat seed and an equivalent amount of fertilizer were distributed to 40,000 farmers. During autumn 2002, 3,800 MTs of wheat seed and 6,500 MTs of fertilizer were distributed to 80,000 farmers.

4. *Health*. Six million people were vaccinated against polio, preparing for total polio eradication by 2003. Nine million children were vaccinated against measles.

5. *Public administration*. Some $50 million worth of civil servant salary payments were made with the support of the AIAF.

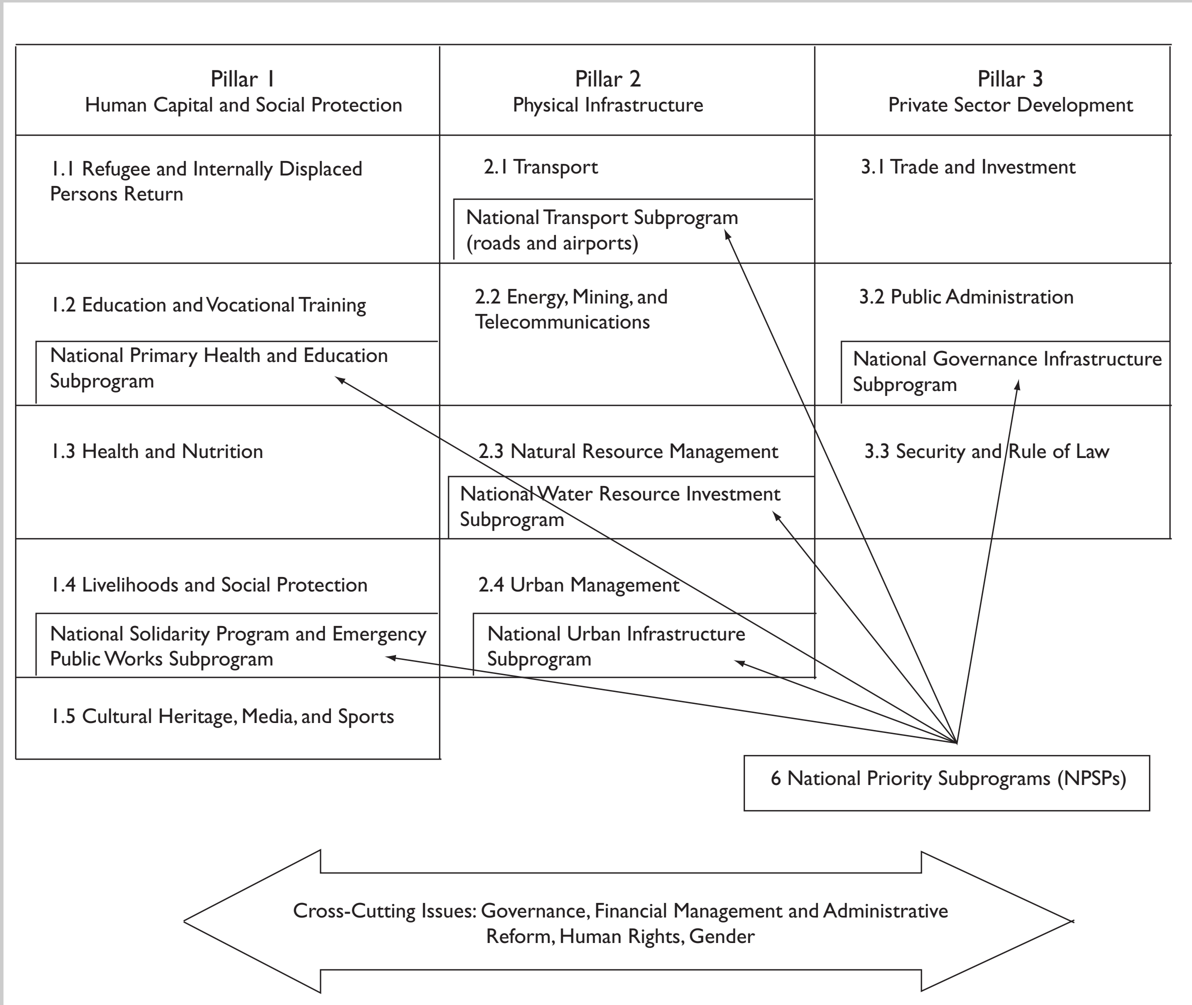
6. *Education*. The Ministry of Education, with UN and NGO support, launched a back-to-school campaign in March 2002, providing basic educational supplies, such as student kits, teacher kits, and blackboards, to 1.8 million children and 70,000 teachers at 4,500 schools.

[1]This list is incomplete and includes only the most salient features.

tarian assistance. In particular, the first operating budget adopted on April 6, 2002, by the AIA was an important step in establishing the government's macroeconomic credibility, by prioritizing operating expenditures under the constraint of limited external assistance and setting up clear benchmarks for domestic revenue collection. In addition, the NDF, through extensive consultations between the MoF, line-ministries, and the government, outlined the key principles underpinning the government's strategy. It was also a significant step taken by the government to move away from the mostly donor-driven strategy underpinning the UN ITAPs to a truly government-led reconstruction process. The NDF focuses on three pillars of development: (1) human capital and social protection; (2) physical infrastructure; and (3) private sector development. Under these pillars, the government developed 12 National Programs, of which six National Priority Subprograms have been identified to receive priority attention from donors and implementation agencies (Figure 3.1). In the NDF, the government has committed to five main principles in the formulation and implementation of the development framework:

- *Government leadership in the formulation of the development strategy*. The authorities have progressively succeeded in making the budget the central instrument for policymaking. Although the government acknowledged from the outset that a number of reconstruction projects would be directly *implemented* by donors and NGOs, without the corresponding funds being channeled through the MoF, the authorities insisted that all development projects, including those independently implemented by donors, should be *approved* in the budget, as determined by the cabinet. In parallel, the authorities obtained the donors' agreement that all available resources, whatever their sources, be reflected in the budget. This principle sought to avoid the emergence of parallel budgets, thereby ensuring a proper prioritization of expenditures and putting the government in the driver's seat in the reconstruction process.

Figure 3.1. National Development Framework: Relationship Between Pillars, National Development Programs, and National Priority Subprograms



- *Reliance on market mechanisms and private sector–led growth rather than state intervention*. The authorities have always made it clear that the state should not be involved in the production of goods and services, or directly manage the economy. They see the private sector as the main engine of growth and consider that the role of the state should be limited to providing security, investing in human capital, offering assistance to the most vulnerable, and enabling a suitable environment for the development of the private sector.
- *Programmatic approach to policymaking and resource allocation*. Underlying the NDF, there is a strong belief, confirmed by international experience, that investment projects would not be sustainable unless anchored in coherent programs. This strategy also aims at aligning donor support with the national priorities identified by the government and avoiding duplication of donor efforts.
- *Government's transparency and accountability*. Recognizing that accountable and transparent public expenditure management is critical for securing donor funding, the government publicly reiterated its commitment to fiscal transparency several times. It contracted three reputable international companies through competitive bidding

to provide interim management and build government capacity in the key areas of fiscal reporting and accounting, and procurement and audit (see Chapter 4).

- *Priority on investing in security and human capital*. Without security, development efforts have little chance of taking hold. In this regard, the authorities' priorities included the development of a national police force and army, reintegration of excombatants, and revival of the judicial system. The authorities also put strong emphasis on immediate enhancement of the education system and school enrollment, especially of girls, given that quality education is the foundation for economic development. One of the major achievements of the government in this area over the past year included getting three million children back to school.

This process culminated with the adoption by the cabinet, in March 2003, of the 2003/04 National Development Budget (NDB), translating the high-level architecture of the NDF into detailed development projects, with precise identification of funding sources for each project:

- The 2003/04 NDB marked full ownership by the government of the development agenda and made the budget the focal point for decision making on government policy and the allocation of domestic and external resources. In particular, the NDB combined in a single document the 2003/04 operating and development budgets, which comprised most of the projects financed by the donor community, including the 2003/04 UN Transitional Assistance Programs (these projects, worth $815 million, succeeded the 2002/03 ITAPs). This represented a significant improvement over 2002/03, when most of the development projects (including ITAPs) were carried out by donors outside the budget. This document was prepared by the MoF and approved by the cabinet after extensive consultation and negotiation with line-ministries, including information compilation, strategy formulation, prioritization, and cutoffs to observe resource constraints.
- The adoption of the first NDB was accompanied by a significant reform of coordination between the government and donors, aimed at enhancing the effectiveness of government-donor interaction. Twelve Consultative Groups (CGs), covering the 12 major programs of the NDF, were established and charged with the tasks of (1) preparing budget bids for MoF consideration during the preparation of the NDB; (2) monitoring the implementation of the operating budget; (3) reporting on the progress of the reconstruction strategy; and (4) offering a forum for general policy dialogue in the various sectors. Each CG is chaired by a lead line-ministry and includes all the UN agencies, donor countries, and NGOs that are the most active in the program area. In addition to the CG structure, an Afghanistan Development Forum is convened every year in March, with the participation of all the cooperation partners to the NDB, to review priority areas and policy objectives, assess progress made in the previous year, and firm up external assistance pledges.

Fiscal Policy Framework: Postconflict Budgeting

During the first fiscal year of the new government (2002/03), the authorities succeeded in maintaining fiscal discipline and providing basic services to the population despite the very difficult circumstances, including the continued lack of a satisfactory fiscal relationship between the center and the provinces, and a very low base for domestic revenues. Availability of external assistance during the year was a key factor in achieving this positive outcome.

In fiscal year 2003/04, the authorities sought to increase the operating and development budgets, especially in the areas of security, education, health, and humanitarian assistance. Ensuring that this fiscal strategy remained compatible with the authorities' commitment to fiscal discipline required that (1) the strong support pledged by the international community materialized; (2) domestic revenue collection increased to the ambitious level set out in the budget; and (3) significant progress could be made toward the fiscal unification of the country.

Budget for 2002/03: A Positive Outcome

The operating budget for 2002/03 (March 21, 2002–March 20, 2003) was prepared with the assistance of the IMF and the World Bank staff, and adopted by the cabinet on April 6, 2002.[13] The passage of this first budget was both a difficult challenge and a significant achievement, given the total absence of reliable fiscal data from previous periods. This operating budget, covering the entire state's fiscal transactions for both the center and the provinces, relied heavily on donor financing, and aimed primarily at ensuring the payment of civil service and military wages.[14]

Expenditures were budgeted at (new) Af 15.7 billion, plus an additional Af 750 million to clear wage arrears accumulated prior to the new government's tenure. This corresponded to a dollar amount of $483 million, including clearance of wage arrears, using the exchange rate prevailing at that time of Af 34 per U.S. dollar as an accounting rate. This budget included a modest revenue target—$83 million or 17 percent of total spending—reflecting the narrow tax base and the low domestic revenue collection observed in the first three months of the AIA. This left a gap of $400 million—83 percent of the budget—to be financed by donor assistance (Table 3.1), because the authorities precluded domestic financing of the budget. This budget also included a 240,000 cap on civil employees, of which 60 percent were in the provinces and 40 percent at the center, broken down by ministry. This allowed, in theory, all employees that were on the payroll prior to the Taliban regime to continue working.

In terms of composition of expenditures (Table 3.1), civil service wages, excluding the police and army but including the SOEs, were projected at $120 million and military salaries were estimated at $99 million, for a total estimated wage bill representing a little less than 48 percent of total spending.[15] Together with the police, security-related spending amounted to about 45 percent of total spending, a proportion considered justified given the need to reestablish security throughout the country. The low share of spending on health and education, 20 percent of the total envelope, resulted from anticipated capacity constraints in the recruitment of new teachers in the first year, and the assumption that most development spending in the social sectors would be carried out by donors outside the operating budget.

Comparing Afghanistan's 2002/03 operating budget with the operating budgets of a sample of low-income countries (Appendix 3.1) shows that, in 2002/03, budgeted current expenditure was, in percentage of GDP, much lower in Afghanistan than the sample average (11 percent compared with 18 percent). Similarly, the civil employment caps included in the 2002/03 budget placed Afghanistan at the low end of public civil employment relative to population.

The budget decree for 2002/03 included a strong commitment to fiscal discipline by explicitly prohibiting the government from taking recourse to central bank financing (no-overdraft rule) and by limiting ministerial allotments to the amount of resources actually available in the government's accounts.[16] Other elements of sound public expenditure management included the introduction of binding headcount ceilings for each ministry's civil service staff, provision that all state operating expenditures should be explicitly authorized in the budget, and the establishment of specific funding for wage and pension reforms. The decree also separated SOEs from the rest of the civil service, by removing the compensation due to SOE employees from the budgeted wage appropriations, making this instead part of the government's transfers and subsidies to SOEs. The authorities also publicly stated that they intended to restrict, to the extent possible, external borrowing to the financing of the development budget, that is, the operating budget would mainly rely on external grants.

According to preliminary estimates, actual spending in 2002/03, including estimated nonwage provincial expenditures, reached 95 percent of budgeted amounts in Afghani terms (Table 3.2). In U.S. dollar terms, expenditures amounted to an estimated $349 million, much less than the $460 million initially envisaged, due to the depreciation of the Afghani during the year (the annual average exchange rate was Af 44.5 per U.S. dollar whereas the

[13] Although preliminary development expenditure numbers were submitted to the international community in October 2002, there was no development budget as such in 2002/03 and development expenditures were directly carried out by donors. The authorities made progress toward better integration of the operating and development budgets in the preparation of the 2003/04 NDB by presenting both budgets together.

[14] In a break from past practice, under the new budget, the wages of the provincial civil service were henceforth to be paid by the center.

[15] Sum of the rows "wages and salaries" and "subsidies to SOEs wages" and half of the total appropriations for defense, interior, and national security in Table 3.1 (excluding the clearance of wage arrears).

[16] In the absence of a parliament, presidential decrees signed by the head of the AIA and ATA have the force of law.

TABLE 3.1
General Government Current Budget, 2002/03
(In millions of U. S. dollars)

	2002/03
1. Wages and salaries (excluding defense, interior, national security, and SOEs)	104.3
Of which: allocation for wage reform	24.1
2. Goods and services (excluding defense, interior, and national security)	60.7
3. Capital expenditure (excluding defense, interior, and national security)	14.4
4. Defense, interior, and national security	198.8
Defense	96.6
Interior	83.4
National security	18.9
5. Subsidies to SOEs	34.1
Wages	15.9
Other	18.3
6. Social transfers	18.8
Of which: allocation for pension reform	15.5
7. Interest	6.6
8. Contingency	22.5
9. Total	460.3
10. Wage arrears clearance	22.5
11. Revenues	83.0
12. Financing need	399.8
13. Foreign grants	399.8

Sources: Afghan authorities; and IMF staff estimates.

budget accounting rate was Af 34 per U.S. dollar).[17] In the first half of the year, budget spending was very low, reflecting limited administrative capacity, a lack of financing, and a shortage of banknotes in the central bank before the currency conversion. Expenditures, however, picked up sharply in the second half of the year, especially in the fourth quarter, as donor disbursements accelerated and administrative capacity improved, and there was no longer a shortage of banknotes. Figures 3.2 and 3.3 show that budget execution at the center during the last five months of the year focused mostly on salary payments (74 percent of total spending, significantly more than the budgeted 48 percent) and on three priority sectors: security (43 percent), education (19 percent), and health (8 percent).[18] Accordingly, the ministries that accounted for the highest shares of spending were defense, interior, education, health, and the president's office, which dispenses presidential discretionary funds that were reallocated to diverse expenditure items during the year.

Domestic revenue as reported to the center reached about $132 million, significantly higher than the budgeted $83 million. More than 80 percent of the reported revenues were collected in the provinces, with the remainder coming from the line-ministries at the center. About 60 percent of the locally collected revenues were customs revenues (a breakdown of noncustoms revenues into the different categories of revenues is not available). But only a small proportion of the reported provincial revenues were actually transferred to the central government's accounts.

These combined factors have limited the financing requirement to an estimated $232 million (66 percent of total spending), considerably less than the initially planned $400 million. This gap was mainly met through (1) donor-assistance grants ($184 million), including support ($125 million) from the Afghanistan Reconstruction Trust Fund (ARTF; see

[17]Expenditures excluding the clearance of wage arrears.

[18]No comprehensive information on the composition of expenditures is available for the first seven months of the year, nor in the provinces. Sixteen percent of spending also related to "economic affairs," but this category lumps together highly different items.

TABLE 3.2
Budget Execution, Center and Provinces, 2002/03
(In millions of U.S. dollars)

	Q1	Q2	Q3	Q4	Comp. Period	2002/03 Budget[7]	2002/03 Adj.[8]	2002/03 Act.[7, 8]
Domestic revenue	18.0	26.9	41.0	46.1	. . .	83.0	64.0	131.9
Customs revenue[1]	9.9	14.3	21.2	22.3	. . .	. . .	. . .	67.8
Central ministries	0.6	2.3	13.4	7.1	. . .	. . .	. . .	23.3
Noncustoms provincial[1]	7.5	10.3	6.3	16.7	. . .	. . .	. . .	40.8
Expenditure	36.0	69.3	102.1	131.7	9.8	482.8	369.2	348.9
Center	18.0	34.1	68.0	67.7	5.7	. . .	. . .	193.1
Provinces (payroll only)[2]	3.0	11.0	14.8	33.6	4.1	. . .	. . .	66.5
Net presumptive provincial expenditures[3]	15.0	24.2	19.8	30.3	. . .	. . .	. . .	89.3
Balance (MoF)	–18.0	–42.4	–61.1	–85.6	–9.8	–399.8	–305.7	–217.0
Float and adjustment[4]	0.4	–0.7	–0.9	–6.4	–7.1	. . .	. . .	–14.8
Balance (DAB)	–17.7	–43.1	–62.1	–92.0	–16.9	–399.8	–305.7	–231.8
Donor assistance grants	26.3	39.0	37.9	60.8	19.9	. . .	. . .	183.5
Bilaterals	10.0	10.0	6.4	0.0	0.0	. . .	. . .	26.4
UNDP	16.3	10.0	0.0	0.0	0.0	. . .	. . .	26.3
ARTF	0.0	18.5	30.3	56.3	19.7	. . .	. . .	124.9
LOTFA	0.0	0.0	1.2	4.5	0.0	. . .	. . .	5.7
Others	0.0	0.0	0.0	0.0	0.2	. . .	. . .	0.2
Donor assistance loans	0.0	0.0	0.0	25.0	0.0	. . .	. . .	25.0
Other financing[5]	0.0	22.8	4.2	12.0	0.0	. . .	. . .	39.0
Exchange rate adjustment[6]	–6.4	–7.4	4.0	8.4	1.5	. . .	. . .	0.1
Surplus/deficit net	2.2	10.8	–16.0	14.2	4.5	. . .	. . .	15.8

Sources: Afghanistan's Ministry of Finance; DAB; and IMF staff estimates.
Note: All arrears to the World Bank, AsDB, and IMF were cleared in 2002/03 through grants ($51.2 million) and Afghanistan's reserve tranche with the IMF ($5.7 million).
[1]As reported to the MoF. However, a small part of this money is remitted to the center (transfers received by the MoF).
[2]Provincial salaries were paid by the center except for Herat province, which paid the salaries of its government staff out of the revenues it collected.
[3]Because no reliable data on nonwage provincial expenditures are available at the center at this date, these expenditures are assumed to equal the provincial revenues reported to the center plus net transfers from the center.
[4]Variation between the fiscal position recorded at MoF and DAB. This discrepancy is because of the difference ("float") between checks issued and cashed and the fact that the provinces' accounts in DAB branches were not consolidated into the government's central accounts at the end of the year.
[5]International Air Transport Association (IATA) accumulated overflight fees, sale of a telecommunications license, one-off transfer from the Ministry of Commerce, and transfer of previous year's provincial surpluses.
[6]This adjustment reflects the difference between the exchange rate used for donor grants (effective exchange rate at the time of deposit in the government's accounts) and the average exchange rate used to convert into U.S. dollars the other components of the table (Af 44.46 = $1).
[7]Including Af 750 million for the clearance of wage arrears related to payrolls incurred before the interim administration took over in January 2002.
[8]The approved budget was expressed in Afghanis and was converted into U.S. dollars at the time of its adoption (March 2002), using an accounting exchange rate of Af 34 = $1. The depreciation of this rate to an annual average exchange rate of Af 44.46 = $1 results arithmetically in a downward adjustment of the U.S. dollar amount of the budget.

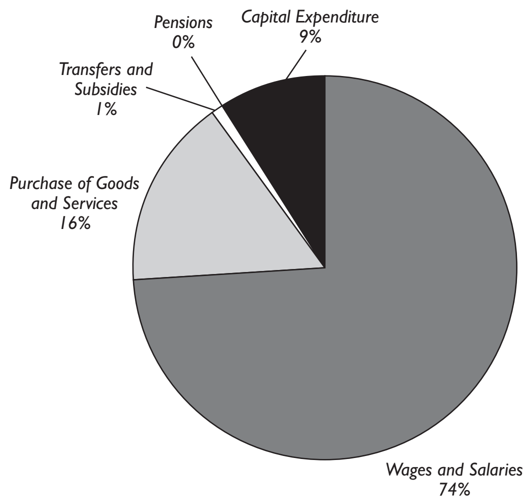
Box 3.3); (2) one-off receipts[19] ($39 million); and (3) partial use of an external loan extended by the Asian Development Bank ($25 million), leaving a positive balance of $16 million at the end of the year (Table 3.2).[20]

The execution of the first operating budget of the AIA/ATA included a number of positive features.

[19]Including $22 million from the International Air Transport Association in accumulated overflight rights; $5 million from the sale of a telecommunications license; $7 million of customs valuation fees accumulated in the past few years; $4 million of last year's provincial surpluses.

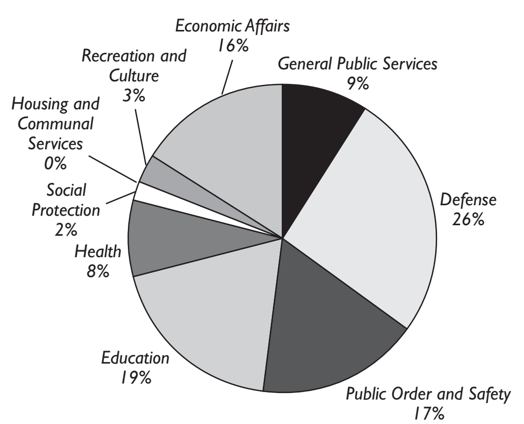
[20]This figure includes the external assistance deposited by donors in the central bank's account in the U.A.E. but not yet transferred to the government's accounts.

Figure 3.2. Budget Execution: Economic Classification, 2002/03
(Last five months of the fiscal year)



Sources: Afghanistan's Ministry of Finance; Afghanistan's Financial Management Information System.

Figure 3.3. Budget Execution: Functional Classification, 2002/03
(Last five months of the fiscal year)



Sources: Afghanistan's Ministry of Finance; Afghanistan's Financial Management Information System.

First, the authorities respected their commitment to fiscal discipline. The prohibition of monetary financing of the budget (no-overdraft rule) was observed, except in the third quarter, when the government's account went temporarily into overdraft because of time lags in donor disbursements and a lack of communication between the MoF and the central bank. Second, despite a slow start, most of the annual budget was spent, and the budget was truly national in scope since more than 45 percent of the estimated spending benefited the provinces.[21] Third, actual spending reflected the government's sectoral priorities for education, health and social protection, and security. Fourth, domestic revenue collection as reported to the MoF was much higher than envisaged in the budget. And, fifth, expenditures were fully financed from revenues, grants, and loans, and the government ended with a significant positive balance at the end of the year.

These achievements were all the more significant given that the execution of the 2002/03 operating budget—and its monitoring—was undertaken in the context of a number of obstacles. The main obstacle was the lack of unity of the fiscal system because of weak central control over the provinces. Although provinces collected the bulk of domestic revenues and reported these revenues to the center—albeit with considerable time lags—only very limited amounts of these revenues were actually transferred to the central government's accounts during 2002/03 (about 27 percent).[22] The reluctance of most provinces to transfer local revenues also led to the collapse of the equalization system between "rich" provinces (border provinces collecting large customs revenues) and "poor" provinces (inland provinces). In the absence of revenue remittances from the rich provinces, the government found itself unable to allocate to the provinces the transfers budgeted in the budget decree. In addition, contrary to the existing fiscal regulations, most provinces did not send to the MoF reliable reports on their nonwage expenditures, for which comprehensive information was therefore unavailable for 2002/03. This missing information seriously complicated the monitoring of the execution of the budget

[21]Including "presumptive nonwage provincial expenditure."
[22]It is also likely that revenues reported by the provinces were well below the revenues actually collected by the provinces. The 1964 Organic Budget Law requires that any positive balance between locally collected revenues and budgeted expenditure should be promptly sent to Kabul.

at both the center and the provinces. To compare actual spending with the budget, the authorities had to estimate the provinces' unknown nonwage expenditures by assuming that all revenues collected by each province were entirely spent by the same province.[23] Furthermore, it was only during the second half of the year that it became possible to get a clear and reliable picture of spending by ministry and by economic or functional categories, and this was only for the center, following the introduction of a computerized system of expenditure recording at the MoF.

There were also problems in estimating the number of permanent staff employed by the government in 2002/03 and enforcing the recruitment ceilings included in the budget decree. This was for the following reasons: (1) the preparation of a nominal roll of employees for the whole country was a long and resource-demanding process, which the authorities were not able to complete during 2002/03; (2) the executed provincial payroll could not be broken down by ministry in the first half of the year; (3) contrary to the provisions of the budget decree, a part of the staff working in the SOEs continued to be directly paid through the government payroll and not through transfers to the SOEs; and (4) a number of provinces apparently hired and paid a significant number of civil service staff directly out of their local revenues without informing the center.

Although the overall initial budget ceiling was respected, important reallocations between expenditure items were made during the fiscal year without the budget being revised accordingly: (1) government employees' food allowances were raised by 37 percent in May 2002 to increase government wages from their very low levels; (2) food in-kind distributed to civil service staff by the World Food Program was replaced in September 2002 by a new monetary allowance; (3) civil servants received in November 2002 a salary bonus corresponding to one-month salary ("Ramadan bonus") to ease the social tension stemming from the depreciation of the Afghani during the currency conversion (see Chapter 5); and (4) a number of line-ministries, including the Ministry of Education, apparently hired more staff than authorized in the budget decree. These slippages in the execution of the budget were financed within the overall budget ceiling through the use of the substantial 2002/03 presidential reserve fund and the wage and pension reform reserves. (No such reforms took place in 2002/03.)

No detailed information is available on expenditures directly spent by donors on development projects in 2002/03 because the Afghanistan Aid Coordination Agency (AACA) has not yet received comprehensive information on donors' project financing. It is estimated, however, that total disbursements of external assistance reached about $1.4 billion, excluding support for the operating budget. Less than 40 percent of these funds, which were channeled outside the government's budget, went to reconstruction; the remaining were allocated to humanitarian relief.[24]

Box 3.3. Afghanistan Reconstruction Trust Fund

The main source of funding for the 2002/03 operating budget was the Afghanistan Reconstruction Trust Fund (ARTF), which covered 54 percent of the funding requirement. Established in April 2002, the ARTF is a coordinated funding mechanism administered by the World Bank, which provides financial grant support to the Afghan government in three main areas of expenditures: recurrent civil costs of the government (excluding the army and national security), priority investments, and benefits granted to returning expatriate Afghan professionals. In 2002/03, ARTF disbursements focused almost entirely on the first component; under the second component, only four investment projects were approved (on a commitment basis) in late 2002; and no disbursement had yet taken place under the third component (return of Afghan expatriates). The ARTF is governed by a management committee, which consists of representatives of the Asian Development Bank, Islamic Development Bank, UNDP, and World Bank, with day-to-day administration of the fund performed by the World Bank. A monitoring agent has been appointed by the World Bank to ensure proper fiduciary management; a donor committee supervises the management and administration of ARTF and provides policy guidance.

[23]Nonwage provincial expenditures are thus estimated as equal to provincial revenues reported to the center plus net transfers received from the center.

[24]ATA and AACA (2003).

Budget for 2003/04: Increasing Domestic Revenues

The authorities presented both the 2003/04 operating and development budgets—for a total of $2.3 billion—to the donor community during the first Afghanistan High-Level Strategic Forum (AHSF) held in Brussels in March 2003.

The budget decree for 2003/04 reiterated the authorities' strong commitment to fiscal discipline. The decree explicitly reaffirmed the government's commitment to the principle of no government overdraft with the central bank. It also included, as in the previous year, ceilings for total staff by ministry but, unlike before, the authorities had the capacity to meaningfully monitor, and effectively enforce, these ceilings.[25] The budget decree furthermore restricted external borrowing to $300 million for the entire fiscal year and limited its use to the funding of development projects and meeting temporary cash flow requirements for the operating budget. The decree specifically mentioned the passage of a customs reform package and ranked the centralization of revenues as one of the government's priority tasks for the year. A Civil Service Reform Fund ($20 million) was established to accommodate the much-needed reforms of the civil service (see Chapter 4). The reserve funds of the operating budget were reduced and were subject to tighter controls.[26]

The 2003/04 operating budget envisaged expenditures equivalent to $550 million, an increase of 58 percent compared with the previous year's outcome, reflecting the fact that in 2002/03 government spending was constrained by limited absorptive capacity. Almost 40 percent of planned spending was allocated to defense, public order, and safety; 24 percent to education; and about 10 percent to health and social protection (Table 3.3). Wage and salary payments accounted for 50 percent of the budget, which represented a significant reduction in the weight of wages in the operating budget, compared to actual spending in 2002/03 (74 percent).

Domestic revenues were budgeted to reach $200 million. This ambitious revenue target—52 percent more than domestic revenues collected in 2002/03—was based on the assumptions of (1) strong economic growth (see Chapter 2); (2) an increase in revenue collection expected from the planned customs reform (see Chapter 4); and (3) the effective centralization of locally collected revenues.

This revenue assumption left a $350 million financing gap to be covered by foreign assistance, of which $250 million was projected to be financed through the ARTF. Military and other security expenditures, which are not eligible for financing through the ARTF, were expected to be financed through domestic revenues and by $100 million in donor assistance channeled through the Law and Order Trust Fund for Afghanistan (LOTFA) and the Army Trust Fund. (These two trust funds, managed by the UN, were established in 2002 to channel donor assistance to support military and security recurrent expenditures.) The authorized headcount ceiling for civilian employees was set at 356,000, which represented a 50 percent increase over the previous year's budget (whose civil employment cap was low by international standards, see Appendix 3.1), mainly concentrated in the Ministry of Education, growing from an authorized level of 72,000 in 2002/03 to 166,000 in 2003/04. Only 60,000 new staff (mainly teachers) would actually be hired; the remainder of the increase would result from the recording of staff who were already paid by the provinces in 2002/03 from local revenues, but whose payroll was not reported to the center.

The 2003/04 development budget, which was the first real development budget prepared by the ATA, amounted to $1.8 billion (Table 3.4),[27] to be fully financed by external assistance. Over one-third of the development budget was to be spent on the rehabilitation of infrastructure; another one-third on health, social protection, and humanitarian assistance; and 14 percent on education. All donor projects were supposed to be reflected in the budget, especially most of the Transitional Assistance Programs for Afghanistan (TAPAs; successors to ITAPs) carried out by UN agencies—$750 million of the $815 million envisaged for TAPAs in 2003/04 was included in the development budget. However, full comprehensiveness was not yet achieved because the budget envelopes did not include the development costs for

[25]This is because the budget decree included an obligation for each ministry to break down its headcount ceilings into "subceilings" for the center and each province, which was not the case in 2002/03.

[26] "Unallocated items" in the economic and functional classification of expenditures in Table 3.3.

[27]Actual disbursements during the year, however, were expected to be less, reflecting the disbursement pace of the various multiyear projects.

TABLE 3.3
Operating Budget, 2003/04
(In millions of U.S. dollars)

	Budget	Outturn (Estimates) Q1	Q2	Q3	Q4	2003/04
Domestic revenue[1]	200	44	47	42	75	207
Center	. . .	3	7	12	26	49
Provinces	. . .	41	40	30	49	159
Expenditure[2]	550	80	91	114	167	451
Central government[3]	. . .	35	58	61	90	244
Provinces[4]	. . .	45	33	53	77	208
Economic classification	550	80	91	114	165	451
Wages and salaries	277	33	63	83	120	299
Purchase of goods and services[4]	178	39	16	16	23	94
Transfers and subsidies	25	3	4	3	2	12
Pensions	. . .	0	3	0	1	4
Capital expenditure	39	5	5	12	19	41
Unallocated	31					
Functional classification	200	80	91	114	167	451
General public services	49	7	10	9	16	41
Defense	128	18	20	31	53	123
Public order and safety	82	13	23	30	39	105
Education	133	5	18	23	31	77
Health	28	3	5	7	7	22
Social protection	25	0	3	1	4	8
Housing and communal services[4]	1	26	0	0	1	27
Recreation and culture	13	1	2	3	4	10
Economic affairs	41	6	9	10	14	38
Unallocated	52					
Balance (MoF)	–350	–36	–44	–72	–92	–244
Float and adjustment[5]	. . .	18	–25	14	27	35
Balance (DAB)	–350	–18	–68	–58	–65	–209
Donor assistance grants	350	50	27	60	77	214
ARTF	250	46	11	50	69	175
LOTFA and Army Trust Fund	100	4	16	10	9	39
Bank balance	. . .	–32	41	–2	–11	–4

Sources: Afghanistan's Ministry of Finance; DAB; and IMF staff estimates.
[1]As reported to the MoF. However, a small part of this money is remitted to the center (transfers received by the MoF).
[2]Checks issued by the MoF.
[3]Provincial salaries are paid by the center except for Herat province, which pays the salaries of its government staff out of the revenues it collected.
[4]Including $25.2 million paid in the first month by the Ministry of Reconstruction in Herat province for the purchase of services (advance payments to contractors).
[5]Variation between the fiscal position recorded at MoF and DAB. This discrepancy is because of the difference (float) between checks issued and cashed, and the fact that the provinces' accounts in DAB branches are not yet consolidated into the government's central accounts at DAB.

the Afghan National Army, the Counter-Narcotics Program, and the preparation of the national elections to be held in 2004.[28]

Preliminary budget execution data indicate that the authorities adhered to their commitment to fiscal discipline and effectively enhanced domestic revenue mobilization (Table 3.3). Revenue performance reached an estimated $207 million—higher than the targeted $200 million and most of these reported revenues, still mainly collected in the provinces, were transferred to the government's central accounts. Included in this were transfers by the provinces of their

[28]The Afghan National Army and Counter-Narcotics Program development expenditures were kept outside the budget for confidentiality reasons and because they were planned and executed directly by specific bilateral donors. The cost of the national elections was not included in the 2003/04 budget because it was not known at the time the budget was prepared.

TABLE 3.4
Development Budget, 2003/04

	2003/04	
	In millions of Afghanis	In percent
Pillar I: Human and social protection	858.3	48.2
Refugee return	162.6	9.1
Education	244.0	13.7
Health and nutrition	173.5	9.7
Rural livelihoods and social protection	248.0	13.9
Culture/media/sports	30.2	1.7
Pillar II: Physical infrastructure	637.2	35.8
Transport and telecommunications	253.6	14.2
Energy, mining	162.4	9.1
Natural resources	146.1	8.2
Urban management	75.2	4.2
Pillar III: Private sector development	284.8	16.0
Trade and investment	5.5	0.3
Public administration	87.9	4.9
Justice	27.0	1.5
Interior	98.4	5.5
Mine action	66.1	3.7
Total	1,780.4	100.0

Source: Afghan authorities.
Note: Items not included in the development budget: Mine Action Program, Afghan National Army development costs, Counter Narcotics Program, and MIGA Investment Guarantee Trust Fund.

2002/03 surplus revenues to the center. Spending got off to a slow start in 2003/04—because of delays in budget allotments and procurement difficulties—and amounted to an estimated $450 million for the year as a whole, substantially lower than envisaged in the budget. The no-overdraft rule was observed throughout the year. While donor grant disbursements were lower than had been envisaged in the budget, they were more than sufficient to finance the budget deficit, allowing some carryover of available financing for the 2004/05 budget. Donor commitments for 2003/04 covered about 70 percent of the requirements expressed in the NDB. As a result, the government was able to implement high-priority projects in infrastructure, education, and other critical areas.

During 2003 the authorities made important progress toward addressing the serious weaknesses that hampered the execution of the 2002/03 budget. The most significant step in this regard was an agreement concluded between the central government and provincial governors to enforce effective centralization of provincial revenues. In May 2003, the National Security Council chaired by President Karzai issued an instruction cosigned by the major provincial governors, ordering that (1) all provincial tax and customs revenues be recorded and transmitted to the center on a regular and timely basis; (2) provincial authorities refrain from meeting their expenditures directly out of their local revenues; and (3) provincial expenditures be limited to budget allotments received from the center. A major challenge was to ensure that provincial governors complied with their signed agreement. In parallel with this initiative, 40 newly trained fiscal experts were sent to the provinces—including six foreign consultants stationed in the largest provinces—to enhance financial reporting from the provinces on their revenues and expenditures, and to follow up locally on the agreement on revenue centralization (see Chapter 4).

Appendix 3.1. Programs of the National Development Framework

The following provides a summary of the 12 national programs of the government's National Program for Reconstruction.[29] Information has been

[29]See World Bank (2003).

taken from government documents including the National Development Framework and the National Development Budget.

Refugee return: With an unprecedented number of refugees returning to Afghanistan and settling in urban centers, facilities and services—already severely pressed to serve current residents—have been stretched beyond capacity. This program aims to improve information, registration, and documentation of refugees, and provide support to the neediest and their host communities. Specific measures are designed to cater to the needs of the most vulnerable during the cold winter months. The program will also address policy and institutional issues and develop the capacity of government agencies charged with assisting refugees and coordinating their reintegration.

Education: Given the appalling conditions of the education system in the country, evidenced by the population's education indicators—among the worst in the world—and the destruction of many of the country's educational institutions, development of the education system is a vital need for future growth and development in Afghanistan. The education program covers a range of essential areas, including improving education infrastructure, teacher development, increased primary and secondary school enrollment with a particular focus on female enrollment, as well as vocational training and early childhood development.

Health and nutrition: Infant, child, and maternal mortality rates in Afghanistan are very high and there is widespread prevalence of communicable diseases and poor nutrition. The health and nutrition program will therefore focus on decreasing mortality rates through the provision of basic packages of health services, increasing the capacity of government to develop necessary systems and policies, as well as implementing a number of specific interventions, including safe motherhood and nutrition programs. The expected results are quantifiable improvements in health indicators as well as improvements in health infrastructure and institutional capacity within relevant agencies.

Livelihoods and social protection: Aimed to address the risk and deprivation experienced by large parts of the rural Afghan population, this program will focus on five areas: institutional strengthening, macroeconomic regeneration, community-based development, protection of lives and livelihoods, and income generation. It is hoped that communities will be empowered by being directly involved in designing and implementing reconstruction efforts in their communities. This program will also address issues of the disabled, who comprise nearly 4 percent of the population.

Cultural heritage, media, and sports: Recognized as a key element in consolidating a common Afghan identity, particularly during the transitional period, this program will promote a number of activities, including the preservation of Afghan cultural heritage, rehabilitation of sports infrastructure, and rehabilitation of the media, with participation of women encouraged in all areas.

Transport and telecommunications: The vital role of good communication and transport networks in economic development and national integration form the basis of this program. Having suffered significant destruction and neglect through years of war, large investments are planned in these networks. In addition to building physical infrastructure for both national and secondary roads, this program will also create a regulatory environment to promote private sector participation in the transport sector and address other policy and institutional issues. In the areas of telecommunications, telephone, information technology, Internet, and postal service, improvements will be addressed, as will the regulatory environment for private sector involvement and the development of the technology for distance education in priority areas.

Urban management: With Afghanistan's urban population estimated at about 30 percent of the total population, this program aims to create cities as viable economic hubs around the country. The program will address rebuilding in cities that have been destroyed during the war, the provision of services to housing areas, wastewater and sanitation services, new land acquisition for housing as well as attention to policy issues such as town planning and management and standards, procedures, and legislation.

Energy and mining: As in other areas, the power and mining sectors have suffered severe neglect after years of war. The energy and mining program, which recognizes the significant role of the private sector in this area, aims to secure cost-effective power supplies to urban areas and the expansion of these power supplies to rural areas where it is cost-effective and practical. The role of government will focus on regulation and development of a policy environment for private sector participation, rather than a directed operational approach.

Natural resource management: Focusing on community management of natural resources and

TABLE A3.1
Afghanistan's 2002/03 Budget Compared with Budgets of Selected Low-Income Countries

	Afghanistan 2002/03	Low-Income Countries[1] Average	Africa	Asia	Middle East	Eastern Europe	Latin America
General government employment (in percent of population)[2]	. . .	3.8	1.7	2.9	3.8	8.2	2.6
Civilian government employment[3]	1.1[4]	3.3	1.4	2.1	3.5	7.2	2.3
Armed forces	. . .	0.5	0.3	0.8	0.3	1.0	0.3
2002/03 budget (in percent of GDP)							
Total revenues	. . .	21.6	22.6	17.3	20.5	18.7	28.8
Revenues, excluding grants	2.1	18.7	16.8	14.2	18.5	18.0	25.8
Tax revenues	. . .	16.1	14.5	11.5	15.0	15.8	23.6
Nontax revenues	. . .	2.6	2.3	2.8	3.5	2.2	2.3
Grants	. . .	2.9	5.8	3.1	2.0	0.7	3.0
Total expenditures	. . .	27.2	26.7	20.5	30.5	23.4	35.1
Current expenditures	11.5[5]	18.5	16.1	10.9	22.0	19.6	23.8
Of which: wages	7.2	5.6	5.8	3.5	. . .	4.9	8.4
Capital expenditures	. . .	8.7	10.6	9.6	8.5	3.8	11.3
Memorandum items							
Population in 2002/03 (in millions)	22.0						
GDP for 2002/03 (in millions of U.S. dollars)	4,000.0						

Sources: Employment data: Schiavo-Campo, de Tommaso, and Mukherjee, 1997; budget data: Gupta and others, 2002.
[1]Based on a sample of 39 low-income countries in these regions (see list of countries in Table A3.2).
[2]Data from a 1997 World Bank Study, mostly based on 1995 and 1996 numbers. Excludes state-owned enterprises.
[3]Central and local governments excluding defense and state-owned enterprises.
[4]Including the police but excluding national security and army.
[5]Operating budget for 2002/03, excluding clearance of wage arrears.

improvements in livelihoods, this program will rehabilitate and enhance the development of sustainable agriculture, horticulture, and livestock production, including the identification of viable substitutes for poppy production. Resource protection measures will include sustainable water usage and protection of existing forests as well as new planting through agro-forestry programs. Additionally, environmental laws and policies will be developed and awareness campaigns conducted to reach out to the population.

Trade and private investment: Private sector development lies at the heart of the government's development plans, and the trade and investment program will lay the basis for developing an environment conducive to foreign and domestic investment. Activities will include assistance for small business development, efforts to improve governance, creation of laws in areas such as competition, direct and foreign investment, and standards and certification. The challenging issues of divestiture of state-owned enterprises will also be included.

Public administration: The public administration program focuses on three key areas: the establishment of an effective civil service system, the rehabilitation of the physical infrastructure of government, and the development of an organizational structure that permits the government to deliver the needed goods and services to the Afghan public in an effective manner. The program will also aim to rationalize the number of ministries, ensure that donor assistance is integrated into the budget process, and reduce the number of government corporations. Within this program, an important subprogram will focus on mainstreaming gender through public administration.

Security and rule of law: Specific activities relating to security remain under discussion. To address the rule of law, activities will improve the domestic justice system to ensure independence of the judiciary and will include efforts to rebuild the administration of juvenile justice, and prison and law enforcement systems. The activities to be carried out include establishing new courts and strengthening legal aid

Table A3.2
Sample of Low-Income Countries Used for Comparison

Africa	Asia	Middle East	Eastern Europe	Latin America
Benin	Cambodia	Yemen	Albania	Bolivia
Burkina-Faso	Lao P.D.R.		Armenia	Guyana
Cameroon	Vietnam		Georgia	Honduras
Central African Republic			Kyrgyz Republic	Nicaragua
Chad			Macedonia	
Djibouti			Moldova	
Ethiopia			Tajikistan	
Gambia, The				
Ghana				
Guinea				
Guinea-Bissau				
Kenya				
Lesotho				
Madagascar				
Malawi				
Mali				
Mauritania				
Mozambique				
Niger				
Rwanda				
São Tomé and Príncipe				
Senegal				
Tanzania				
Zimbabwe				

Sources: Employment data: Schiavo-Campo, de Tommaso, and Mukherjee, 1997; budget data: Gupta and others, 2002.

services within the organizational structure of the Supreme Court.

Appendix 3.2. Comparing Afghanistan's 2002/03 Operating Budget with Low-Income Countries' Budgets

This appendix compares the operating budget of Afghanistan for fiscal year 2002/03 with the budgets of 39 low-income countries—24 in Africa, three in Asia, one in the Middle East, seven in Eastern Europe, and four in Latin America—supported by an IMF Poverty Reduction and Growth Facility (PRGF) arrangement (Table A3.1).[30] Budget numbers are expressed in percentage of GDP and separately show revenue, grants, current expenditure (with identification of the wage bill), and capital expenditure.

Table A3.1 also shows the size of the general civilian government in Afghanistan (in percentage of the population) and compares it with those of other countries in the sample. Consistent with international standards, the general government concept used in this analysis includes both central and local governments, and extrabudgetary funds, such as pension schemes, but excludes state-owned enterprises. For all the countries in the sample, except for Afghanistan, for which reliable data on the military are not available, civil and military employments are identified separately.

Data on Afghanistan's operating budget and employment levels are drawn from the 2002/03 operating budget as approved on April 6, 2002. For the other countries, the employment data come from a 1997 World Bank Study and the budget numbers are based on an IMF working paper.[31] The main findings are the following:

General Government Employment

- The civil government employment ratio in Afghanistan (1.1 percent of the population), ex-

[30]Appendix prepared by Thierry Kalfon. See Table A3.2 for a list of these countries.

[31]See Schiavo-Campo, de Tommaso, and Mukherjee (1997); and Gupta and others (2002).

cluding the army and national security, is comparable to that of low-income African countries (1.4 percent), but lower than the average for the countries in the sample, excluding Eastern European countries (2.3 percent).[32]

- Data on the size of Afghanistan's national army and national security are not available. However, for the other low-income countries in the sample, the weight of armed forces in percentage of the population is shown as reference.

Budget Expenditure and Revenues

- Current expenditure in percentage of GDP is much lower in Afghanistan than the sample's average (11.5 percent compared with 18.5 percent). However, the weight of wages in GDP is larger in Afghanistan (7.2 percent).
- Regarding budget revenue, Afghanistan's budget is characterized by a very low level of domestic revenues, which, in percent of GDP (2.1 percent), is about one-tenth of the average of the selected countries (18.7 percent).

[32]Including the police.

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