

- **National accounts data**, with the exception of merchandise trade data, should be reported annually and no later than eight weeks after the end of the year. Merchandise trade data should be reported quarterly and no later than eight weeks after the end of the quarter.
- **Consumer price indexes (CPIs)** for the city of Kabul and for Kabul and five other major cities (“national” CPI) should be reported monthly and no later than four weeks after the end of the month.

24. The government of Afghanistan and DAB will prepare and send to the IMF reports explaining progress made in implementing structural reforms, in particular regarding those included as structural performance criteria and benchmarks in the program. These reports will include appropriate documentation to substantiate progress achieved, and will explain any deviations relative to the initial reform plans or timetable, specifying expected revised completion date.

25. Other details on major economic and social measures taken by the government that are expected to have an impact on program sequencing (such as changes in legislation, regulations, or any other pertinent document) will be sent in a timely manner to IMF staff, for consultation or information.

26. The Technical Committee of Coordination (TCC) will provide Division A of MCD with any other information that may be required by the staff of the IMF for the effective monitoring of the program. For program monitoring purposes, working meetings are planned, at least biweekly, with the participation of representatives of the designated members of the TCC, including any party that could facilitate monitoring implementation of the program.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF AFGHANISTAN

**Staff Report for the 2007 Article IV Consultation and Third Review Under the  
Three-Year Arrangement Under the Poverty Reduction and Growth Facility, and  
Request for a Waiver of Performance Criterion**

**Informational Annex**

Prepared by Middle East and Central Asia Department  
(In consultation with other Departments)

January 28, 2008

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**ANNEX I. ISLAMIC REPUBLIC OF AFGHANISTAN—RELATIONS WITH THE FUND**

(As of December 31, 2007)

I. **Membership Status:** Joined July 14, 1955; Article XIV.

II. <b>General Resources Account</b>	<u>SDR Million</u>	<u>% Quota</u>
Quota	161.90	100.00
Fund holdings of currency	161.92	100.01
Reserve position in Fund	0.00	0.00
Holdings Exchange Rate		

III. <b>SDR Department</b>	<u>SDR Million</u>	<u>% Allocation</u>
Net cumulative allocation	26.70	100.00
Holdings	0.20	0.77

IV. <b>Outstanding Purchases and Loans</b>	<u>SDR Million</u>	<u>% Quota</u>
PRGF Arrangements	35.80	22.11

V. **Latest Financial Arrangements:**

<u>Type</u>	<u>Date of Arrangement</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
PRGF	June 26, 2006	June 25, 2009	81.00	35.80

VI. **Projected Payments to Fund**

(SDR million; based on existing use of resources and present holdings of SDRs)

	<u>Forthcoming</u>				
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Principal					2.45
Charges/Interest	<u>1.11</u>	<u>1.11</u>	<u>1.11</u>	<u>1.11</u>	<u>1.11</u>
Total	<u>1.11</u>	<u>1.11</u>	<u>1.11</u>	<u>1.11</u>	<u>3.56</u>

VII. **Implementation of HIPC Initiative:**

Commitment of HIPC assistance	<u>Enhanced Framework</u>
Decision point date	July 2007

Assistance committed (NPV terms) <sup>1</sup> by all creditors (US\$ million)	571.40
<i>Of which:</i> Fund assistance (US\$ million)	--
(SDR equivalent in million)	--
Completion point date	Floating

**VIII. Implementation of MDRI Assistance:** Not Applicable

**Nonfinancial Relations**

**IX. Exchange Arrangement**

Afghanistan is an Article XIV member country. The authorities are implementing a liberal exchange system. Based on information currently available to the staff, no exchange restrictions and multiple currency practices are currently in place. The authorities have provided documents to IMF staff related to laws and regulations on the exchange regime and have requested technical assistance from the Fund to formalize the current liberal regime. They have been implementing a managed float system with no predetermined path for the exchange rate. On January 16, 2008, the average of the buying and selling exchange rates in cash transactions on the Kabul money exchange market was Af 49.47 per \$1.

To conduct monetary policy, the authorities rely on foreign exchange auctions since May 2002, and on short-term capital note auctions since September 2004. The foreign exchange auctions were initially open only to licensed money changers, but since June 2005 they are also open to commercial banks. The capital note auctions are open to commercial banks. Auctions are linked to the overall monetary program and are held on a regular basis (biweekly for foreign exchange auctions, daily for capital note auctions).

**X. Article IV Consultation**

The last Article IV consultation with Afghanistan was discussed by the Executive Board on March 6, 2006. Consultations with Afghanistan are on the standard 12-month cycle.

**XI. Safeguards Assessment**

Under the Fund's safeguards assessment policy, Da Afghanistan Bank (DAB) is subject to a safeguards assessment with respect to PRGF arrangement approved on June 26, 2006. A safeguards assessment of DAB completed on June 12, 2006 revealed serious vulnerabilities in DAB's external and internal audit mechanisms, as well as in its financial

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<sup>1</sup> Net Present Value (NPV) at the decision point under the enhanced framework.

reporting framework and system of internal controls. Capacity constraints, however, hampered the effective implementation of measures recommended by the assessment, and a follow-up staff visit conducted in November 2007 found that while external audit arrangements have been strengthened, financial reporting and internal controls were insufficient to ensure the accuracy of monetary data, and the accounting system remained unreliable. To provide some assurances ahead of the next review of the PRGF arrangement, the mission recommended that a special audit of reserve assets be conducted as a prior action for the completion of the review.

## XII. Technical Assistance, 2005–07

Department	Date	Purpose
FAD	March 2004–July 2006	Resident treasury expert
	May 19–25, 2005	Seminar on reorganization of the MOF
	October 18–25, 2005	Tax policy
	February 21–March 04, 2006	Public financial management
	April 30–May 09, 2006	Tax policy
	November 15–23, 2006	Tax and customs administration
	August 18–30, 2007	Program budgeting
	August 28–September 12, 2007	GFS
	October 2007–September 2008	Resident Treasury Advisor
FIN	April 2–11, 2006	Safeguards assessment
	November 9–12, 2007	Safeguards assessment
LEG	January 29–February 12, 2005	Income tax law
LEG/MCM	May 2–10, 2006	Legal framework of DAB's monetary and payment system policies
MCM	September 2004–April, 2006	Training coordinator
	April 2006–June 2007	Training coordinator (peripatetic)
	February 2–15, 2005	Implementation of DAB balance sheet reconstruction and capital adequacy recommendations
	May 16–25, 2005	Monetary policy and financial markets
	October 11–20, 2005	Monetary policy
	November 20–29, 2005	Financial markets
	January 22–February 5, 2006	Monetary policy
	January 22–February 5, 2006	Monetary policy
	May 2–10, 2006	Monetary policy, foreign reserve management, money markets and insurance
	November 28–December 10, 2006	Monetary policy formulation and implementation

<b>Department</b>	<b>Date</b>	<b>Purpose</b>
MCM	March 19–April 16, 2007	Central bank capacity building
	March 24–29, 2007	Banking supervision
	April 17–30, 2007	Monetary policy formulation and implementation
STA	January 15–February 15, 2005	Multisector statistics
	March 23–June 11, 2005	Multisector statistics
	July 20–August 31, 2005	Multisector statistics
	October 31, 2005–January 12, 2006	Multisector statistics
	March 6–15, 2006	Balance of payments statistics
	March 8–May 2, 2006	Multisector statistics
	March 13–April 1, 2006	Monetary and financial statistics
	May 24–July 18, 2006	Multisector Statistics
	August 2–16, 2006	Balance of payments statistics
	August 8–October 3, 2006	Multisector statistics
	September 22–October 4, 2006	Government finance statistics
	November 1–December 26, 2006	Multisector statistics
	November 5–19, 2006	Monetary and financial statistics
	April 22–May 4, 2007	Monetary and financial statistics
	July 7–30, 2007	National accounts
August 29–September 25, 2007	National accounts	
MCD	April 16–20, 2005	Basic macroeconomic accounting and financial programming
METAC	November 15–20, 2005	Tax policy and administration
	June 2006	Budget integration
	November–December 2006	Budget integration
	December 2006	Cash management
	March 2007	Cash management
	May 19–25, 2007	Balance of payments statistics
	June 6–19, 2007	Accounting
	July 1–10, 2007	Banking supervision
	August 2007	Cash management and program budgeting
	September 2–17, 2007	Central bank accounting
	November 13–December 4, 2007	Central bank accounting
	November 4–8, 2007	Banking supervision
November 6–15, 2007	Banking supervision	

Afghanistan is a participant in the Middle East Technical Assistance Center.

With financial support from the Sweden Technical Assistance Subaccount, the Fund sponsored a number of training activities aimed at DAB officials. A long-term resident training advisor, Mr. Khan, was posted at DAB from September 2004–April 2006 and is

now conducting peripatetic technical assistance missions. Finally, Sweden has financed a monetary policy peripatetic advisor (a position currently shared by Mr. Coats and Mr. Gray) to assist DAB in developing the strategy and instruments for improving the implementation of monetary policy.

### **XIII. Resident Representatives**

During the first half of 2002, the Fund's resident representative in Pakistan, Mr. Ghesquière, assisted in maintaining relations with the Afghan authorities. A resident representative, Mr. de Schaetzen, took up his post in Kabul on August 24, 2002. Mr. Charap succeeded him on June 13, 2005.

**ANNEX II. ISLAMIC REPUBLIC OF AFGHANISTAN—RELATIONS WITH THE WORLD BANK**

(As of January 9, 2008)

1. The Interim Strategy Note (ISN) discussed by the IDA Board of Executive Directors on May 25, 2006 follows the two Transitional Support Strategies (TSS) that covered the 2002-06 periods. It is guiding IDA's engagement in Afghanistan over the period of 2006–08 and is expected to be followed by a full Country Assistance Strategy (CAS) once the Government has finalized its full PRSP–Afghanistan National Development Strategy which is expected to be completed in March 2008. The government promulgated its Interim Afghanistan National Development Strategy (I-ANDS) in January 2006. As the government had submitted the I-ANDS to the IMF and the World Bank as its Interim Poverty Reduction Strategy (I-PRSP), Bank and Fund staff prepared a Joint Staff Advisory Note (JSAN) which was also discussed by the Bank Board on May 25, 2006. The ISN focus shifts slightly from the previous TSS, notably to provide greater emphasis on the development of the rural economy. Its pillars are: (i) build the capacity of the state and its accountability to its citizens to ensure the provision of services that are accountable, accessible, and of adequate quality; (ii) promote growth of the rural economy and improve rural livelihoods; and (iii) support growth of a formal, modern, and competitive private sector.
2. As of January 9, 2008 the World Bank had committed an aggregate of US\$1.6 billion in IDA assistance to Afghanistan, financing more than 30 projects covering public administration, infrastructure, education, health, customs, transport, and rural development. Three IDA projects closed in FY 2007 (i.e. July 2006–June 2007) and two have closed thus far in FY08. Most recently, the Board approved, in January 2008, a US\$30 million IDA investment in microfinance. Together with the HIV/AIDS project and the National Rural Access Program this takes FY08's commitments to date to US\$152 million with three more planned for board approval, including projects for skills development, educational improvement and Kabul urban waste.
3. As of December 31, 2007, the IDA's active portfolio comprised 21 investment projects with combined net commitments of US\$1,016 million of which 48 percent had been disbursed. In terms of sectoral composition of the overall portfolio, rural and transport sectors continue to represent the two largest shares, with respect to both commitments and disbursements. This is largely due to the successful implementation of the two nation-wide programs: National Solidarity Program (NSP) that supports development of community demand-driven rural infrastructure and community level governance, and the National Emergency Employment Program (NEEP) that provides short-term employment opportunities to the vulnerable segments of rural population through rural roads rehabilitation and reconstruction.
4. The World Bank also administers the Afghanistan Reconstruction Trust Fund (ARTF), on behalf of 27 donors, which became effective in May 2002. The ARTF is the main mechanism for providing coordinated funding support to Afghanistan's recurrent

budget, as well as investments through the Core Development Budget in line with agreed budget priorities of the Government. In the previous Solar Year 1386 (2005/06), the ARTF mobilized over US\$450 million, while cumulative disbursements reached US\$468 million. This Solar Year through November 2007, contributions have reached US\$455 million and disbursements US\$297 million.

5. As of 21 November, 2007, paid-in donor contributions to the ARTF reached US\$ 2.4 billion. As of 21 November, 2007 the ARTF investment window financing comprised 11 active projects with combined commitments of US\$394 million, of which US\$263 million had been disbursed. The National Solidarity Program II and the Microfinance are the two fast-disbursing programs in the ARTF current investment portfolio. The new Management Capacity Program was added to the ARTF active portfolio in FY 2007. The Bank also administers a special window for Afghanistan for the Japanese Social Development Fund of US\$50 million. ARTF is increasing its financing of investments and has the potential to support better donor coordination, simplified processes, and fast results.

6. The World Bank is also actively engaged in providing analytical and advisory services to the government. Current and recent analytical work has focused on civil service reform, urban development and land management, education policy reform, labor market and pensions, oil/gas infrastructure development, and the drug economy, as well as broader regional trade work encompassing issues with Afghanistan's neighbors. A Gender Assessment was released in January 2006. The World Bank completed a major Public Finance Management (PFM) review in 2006, which incorporates an assessment of civilian public expenditures and fiduciary aspects, including procurement and financial management, as well as revenue and security sector expenditures. Fund staff contributed to the PFM review, including by providing an analysis of domestic revenue prospects. Technical assistance on pensions and three major analytical tasks, on Public Administration Reform, on Fighting Corruption, and on Sub-National Administration are underway in response to government requests. Looking ahead, the pipeline for FY09 includes work on financial sector reform and rural enterprise development.

### ANNEX III. ISLAMIC REPUBLIC OF AFGHANISTAN: STATISTICAL ISSUES

#### General

1. Data are broadly adequate for surveillance and program monitoring, although statistical weaknesses remain. The statistical system has improved since 2002; nonetheless, organizational weaknesses, poor staffing, and lack of equipment continue to hamper the compilation process. Due to security reasons and limited central government influence outside Kabul, setting up a nationwide statistical system has been a difficult undertaking. While the Central Statistics Office (CSO) has regional offices, staffing and communication are poor. Staffing in most agencies is inadequate both in number and expertise, and salaries remain low. Strengthening statistical capacity is an ongoing process and greater efforts and significant institutional support will be required if further substantial improvements are to be made. STA continues to provide technical assistance through peripatetic statistical advisors as well as short-term topical missions.
2. The authorities have restructured the CSO, but many key donors involved in preparing the statistical master plan (SMP) have expressed concern over the independence of the CSO, which now reports to the Ministry of National Economy, and the integrity of the statistical system. Progress on the implementation of the SMP has been delayed, as the authorities have been slow in undertaking the required institutional changes and strengthening the management structure of the CSO.
3. The authorities have been participating in the General Data Dissemination System (GDSS) since June 2006.

#### Real Sector

4. The national accounts compilation process is hampered by the general lack of source data. The Asian Development Bank (AsDB) provided funding for two major surveys that could supply critical source data for the national accounts; however, the survey fieldwork has been delayed. The AsDB has suspended funding of TA projects in Afghanistan and the future of these surveys is uncertain.
5. The CSO now compiles a nationwide CPI covering Kabul and the five major cities. Nonetheless, the inexperience of price collectors has posed some early challenges to the compilation process. There is also the need to update the expenditure weights as the current CPI basket was derived from a 1987 household income and expenditure survey. In 2003, the CSO conducted a limited exercise to update the weights based on household expenditure in Kabul; however, a comprehensive exercise to obtain representative weights is required, and is predicated on the completion of an integrated living standard survey.
6. Customs coverage of overland foreign trade—which is most of foreign trade—is limited at best. The CSO currently records trade at only seven of the 14 customs posts. Monthly trade data are updated manually, thereby causing delays in dissemination. Accordingly, there is an urgent need for improved computer hardware.

## Government Finance Statistics

7. An STA expert has been assisting the Ministry of Finance (MOF) in compiling government finance statistics, achieving considerable progress. The tables reported for publication in the *Government Finance Statistics Yearbook 2006* incorporate for the first time data on extra-budgetary agencies, donor expenditure made on behalf of the government, and the operations of municipalities. Nevertheless a number of weaknesses remain, including a very limited technical capacity of the MOF's staff, inadequate classification systems in use by municipalities, deficiencies in the functional classification of government expenditure, and a lack of consistency and comprehensiveness in the data compiled.

## Money and Banking Statistics

8. The banking sector has developed steadily over the last several years. In addition to three state-owned banks in the process of restructuring, twelve commercial banks are now in operation. While there was some improvement in the scope and quality of data reporting by the central bank, there are still weaknesses in many areas. Da Afghanistan Bank (DAB) has installed a new accounting software, which allows DAB to produce its balance sheet at least on a monthly basis. The very limited accounting capacity of DAB, especially outside Kabul has hindered efforts to produce a complete and reliable balance sheet. Regarding the commercial banks, DAB has developed new reporting formats to provide data for bank supervision and monetary statistics compilation, and the banks are now reporting data to DAB regularly according to these formats. STA has assisted DAB (four expert visits took place between March 2006 and November 2007) in bringing the data reporting of DAB and the commercial banks in compliance with the methodology in the IMF's *Monetary and Financial Statistics Manual*.

9. The authorities have expressed interest in reintroducing a country page for Afghanistan in *International Financial Statistics (IFS)*. A STA expert has assisted DAB in drafting a country note and initiating data reporting for publication in *IFS*. Provided that DAB is able to compile and report data (Standardized Report Forms 1SR, 2SR, and 5SR) to STA on a regular monthly basis, an *IFS* page for Afghanistan could be introduced in early 2008.

## Balance of Payments

10. Like the national accounts, compilation of balance of payments statistics suffers from a paucity of source data. There are no estimates of unrecorded border trade, which constitutes a significant proportion of foreign trade. No reliable source data exist to estimate services, income, transfers, and foreign direct investment. A balance of payments statistics mission (May 19–25, 2007) found that source data are extremely weak and that survey initiatives have not materialized in any significant data output due to poor responses, sampling problems, and a lack of human, financial, and technological resources. The mission found that limited progress had been made on the work program initiated in August 2006. Outstanding issues include:

- Adopt legal measures that give DAB the authority to collect data from other sectors, other than banks, and ensure the confidentiality of reported data.
- Estimate exports and imports based on CSO data with adjustment for illegal trade and duty free imports. The CSO should start including duty free imports according to international classifications.
- Adjust freight and insurance at 12 and 3 percent, respectively, of c.i.f. imports from overseas to calculate imports f.o.b.
- Introduce questionnaire to hotels and guesthouses to collect data on expenses of nonresidents to estimate travel receipts.
- Conduct sample surveys of residents returning from travel abroad and use immigration data to estimate travel expenses.
- Introduce a questionnaire for collecting data from foreign embassies and other foreign organizations to estimate government receipts and compensation of employees.
- Improve the questionnaire on foreign direct investment (FDI) to collect relevant data from major FDI enterprises.
- Introduce reporting forms for foreign exchange transactions between residents and nonresidents to commercial banks, following discussions with the Banking Supervision Department of the DAB.
- Introduce a questionnaire for money changers and money transfer service providers.
- Enhance the collection of quarterly data from the Ministry of Economy on NGOs' receipts of donations and grants.
- Compile preliminary balance of payments statistics on the basis of various estimation procedures discussed with and documented by the Balance of Payments Section.

A follow-up STA mission in October/November 2007 noted some improvements in the area of source data and in the cooperation between agencies. The mission's main recommendations were to: (1) review the reporting forms in the area of services as provided by the mission and implement these as needed; (2) compile the financial account related transactions for the commercial banks based on the forms as agreed with the Banking Supervision Department; (3) compile DAB related transactions using the reporting form provided by the mission; (4) continue compiling international reserves data consistent with the fifth edition of the Balance of Payments Manual (BPM5) as compiled during the mission and provide these to the IMF for publication in the *International Financial Statistics (IFS)*; and (5) agree with Afghan Investment Support Agency to conduct an FDI survey. An action plan was agreed upon with the authorities, with targeted dates for implementation. Furthermore, DAB will report on a monthly basis to STA the progress regarding processing and compiling balance of payments statistics. The mission will continue to provide remote TA. Future TA missions will depend on DAB completing specified benchmarks three months after the end of the mission.

**External Debt**

Many records were destroyed during the war and the authorities are slowly rebuilding their database. Nevertheless, significant progress in terms of reconciliation has been made in the context of the July 2006 Paris Club rescheduling. Progress is also being made in reconciling debts to non-Paris Club creditors.