

# AFGHANISTAN DEVELOPMENT UPDATE

APRIL 2022

## TOWARDS ECONOMIC STABILIZATION AND RECOVERY



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## Preface:

The Afghanistan Development Update provides a comprehensive report of the state of the Afghan economy. It covers recent economic developments and the medium-term outlook for Afghanistan. Each edition includes Special Focus sections providing in-depth analysis on specific topics.

The Afghanistan Development Update is intended for a wide audience, including policy makers, the donor community, the private sector, and the community of analysts and professionals engaged in Afghanistan's economy.

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# AFGHANISTAN DEVELOPMENT UPDATE APRIL 2022

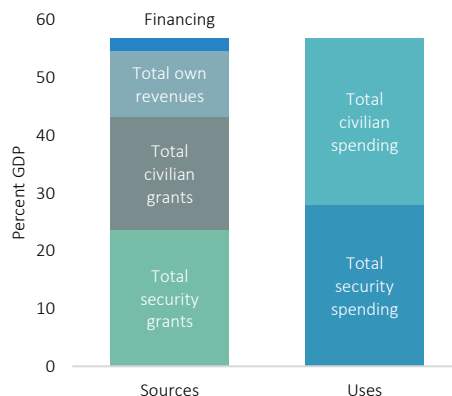
## KEY MESSAGES AT A GLANCE

**AFGHANISTAN RECEIVED VERY HIGH LEVELS OF AID SUPPORT FROM 2001-2020**  
High levels of international support drove rapid human development gains. However, grant inflows also left the economy aid-dependent, with benefits narrowly shared.

### Improvements in development outcomes

- The proportion of secondary-age children enrolled in secondary school increased from 13% to 54% between 2003 and 2017
- Between 2007 and 2018, the number of children surviving to the age of five increased by 142 for every 1,000 births
- The youth literacy rate increased from 47 percent in 2011 to 67 percent in 2018
- The fertility rate declined from 7.3 births per woman in 2002 to 4.3 births per woman in 2019

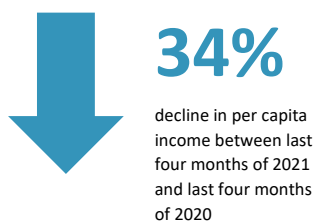
### Public finances - sources and uses (2019)



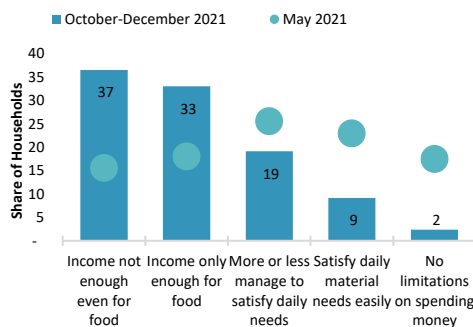
### AFGHANISTAN'S ECONOMY FELL INTO CRISIS FOLLOWING THE POLITICAL EVENTS OF AUGUST 15, 2021

Cessation of grant inflows, loss of access to overseas central bank assets, and breakdown of international banking relationships caused economic output over the last months of 2021 to decline by one-third. This has driven major increases in hardship.

### Estimated economic output per capita



### Household capacity to cover food and non-food expenses



### THE CURRENT TRAJECTORY BRINGS MAJOR RISKS TO AFGHANISTAN, THE REGION, AND THE WORLD

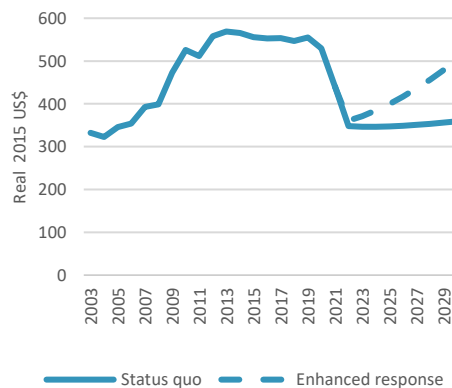
Under current conditions, growth will remain stagnant. Widespread poverty will pose important displacement, extremism, and fragility risks. Major changes in domestic and international policy settings would be required to allow Afghanistan to move towards a path of economic stabilization and recovery.

### Recovery Requirements

To unlock international assistance and advice, the Interim Taliban Administration must adhere to basic standards for the treatment of women and girls, respect for human and democratic rights, and basic principles of sound economic management.

The international community should, under any circumstances, ensure the continued provision of support to basic humanitarian needs. If policies of the Interim Taliban Administration allow, a broader program of economic assistance could be provided to macroeconomic management, broader public services, infrastructure, and the private sector, allowing much faster recovery.

### GDP per capita by scenarios



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## EXECUTIVE SUMMARY

Afghanistan's current economic crisis risks erasing development gains achieved over the past two decades. Emerging economic conditions pose grave poverty, displacement, and fragility risks to Afghanistan, the region, and the world. Economic stabilization and recovery will require decisive action by the Interim Taliban Administration (ITA) and the international community. This Afghanistan Development Update provides an overview of the drivers and impacts of the recent crisis and a set of broad recommendations for moving Afghanistan's economy back towards sustainable growth.

### Afghanistan's Economic Development from 2001-2021

Afghanistan received enormous international support over the past two decades. International support underpinned economic growth, the development of core government service delivery capacities, and rapid improvement against critical development indicators. Many of Afghanistan's development indicators moved from amongst the worst in the world to around the average for a country at its level of income. Major progress was achieved in improving women's access to services, rights, and representation, but critical gaps remained.

Due to a range of historical and political factors, development gains and broad macroeconomic stability did not translate into peace or the emergence of an effective and accountable state. Amid pervasive weaknesses in governance and institutions, growth was highly concentrated in the aid-driven service economy. Rapidly increasing demand in the context of limited productive capacities and weak competitiveness led to import dependence and a structural trade deficit. Informal and illicit sectors continued to account for a large proportion of economic activity. Financial sector development remained heavily constrained, with banks playing a limited intermediation role and firms facing constrained access to credit. Afghanistan's economic vulnerabilities became increasingly apparent in the period up to 2021. Economic growth slowed while progress against development indicators stagnated in the context of significant grant declines, poor governance, endemic corruption, sustained political instability, and the impacts of the COVID-19 crisis.

### The August 15 Crisis and Subsequent Economic Developments

The political events of August 15, 2021, triggered a complex economic crisis. This crisis involved the following overlapping drivers: i) a sharp fiscal contraction impacting the very large public sector and aid-driven economy, leading to collapsing demand (total public spending is expected to have declined by around 60 percent); ii) major disruption to basic services (including basic health and education), which had previously depended on international aid support; iii) a loss of hard-currency aid inflows, which had previously financed a very large trade deficit (equal to around 30 percent of gross domestic product (GDP)); iv) loss of access to the overseas assets of the central bank (around US\$9.2 billion); v) the cessation of international payments by correspondent banks, due to anti-money laundering and countering the financing of terrorism (AML/CFT) concerns, undermining the capacity of firms to pay for imports or receive payment for exports, disrupting remittance flows, and leaving international humanitarian and non-government organizations (NGOs) unable to pay salaries or contractors within Afghanistan; vi) loss of

central bank access to supplies of Afghani and USD cash notes ceased, creating a liquidity crisis in the banking system, constraining firms' and households' access to working capital and savings held in commercial banks; vii) rapid declines in investment confidence, given pervasive uncertainty and fear; and viii) loss of human capital, as tens of thousands of highly-skilled Afghans fled the country and new restrictions were imposed on women's participation in the private and public sector.

Output over the last four months of 2021 is expected to have declined by more than one-third relative to the same period in 2020. Contraction was concentrated in the urban service economy, which was heavily dependent on donor and government spending. Agricultural output is estimated to have declined by around five percent over the year, reflecting drought impacts and higher prices for key inputs (such as fuel, fertilizer, and seeds), partly offset by improved security conditions. Despite declining demand, headline year-on-year (y-o-y) inflation reached 12.7 percent in December, with food price inflation reaching 17.7 percent reflecting depreciation, increasing international prices, and import constraints arising from disruptions to international transactions (imports declined by 47 percent over the second half of 2021, relative to the same period in 2020).

The combination of declining incomes and increasing prices has driven a severe deterioration in household living standards. At the time of the latest Afghanistan Welfare Monitoring Survey (AWMS) conducted by the World Bank over October-December 2021, 70 percent of Afghan households had insufficient income to meet basic food and non-food needs. Extreme hardship has led to the widespread adoption of harmful coping mechanisms such as borrowing at high interest rates, the sale or consumption of assets, and reduced investment in human capital. This will have long-term consequences given Afghanistan's very young population.

Large inflows of in-kind humanitarian supplies and USD cash through humanitarian channels over late 2021 and early 2022 have supported some economic stabilization. Cash inflows have had important impacts in i) increasing supply of USD within the economy, driving appreciation of the exchange rate; ii) providing impetus to demand through local payment to humanitarian workers and suppliers; and iii) increasing supply of basic household goods, leading to lower prices. Following initial disruptions, access to some services has now recovered due to i) efforts by the international community to resume financing of health facilities through United Nations (UN) agencies; ii) effective use of cash shipments to bypass financial sector constraints; and iii) improved security across much of the country.

The financial sector remains in crisis, with the core functions of the central bank and banking sector unfulfilled. A World Bank rapid private sector survey conducted in late 2021 showed 81 percent of respondent firms reporting difficulty in sending or receiving payments domestically and 95 percent facing difficulties dealing with international payments. Around 85 percent of NGOs report that inability to transfer funds from overseas and limited access to cash are major constraints to their operations. The difficulties Afghan businesses face in making and receiving payments has forced enterprises to make increasing use of informal financial services, including through the hawala system.<sup>1</sup>

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<sup>1</sup> The hawala system is an informal remittance system used extensively by households and firms to transfer funds into, out of, and within Afghanistan.

The ITA moved quickly to restore revenue collection, and revenue performance has steadily improved. Monthly collections reached Afs 13 billion on average during January-March, slightly exceeding the monthly average of the first quarter in 2020. In the absence of on-budget grants, however, budget spending has sharply declined. The ITA's interim budget approved in January 2022, includes total recurrent allocations 34 percent lower than 2019 levels, mainly due to cuts to the defense (50 percent) and public order and safety (34 percent) budgets while those for education and health were maintained. Most development expenditures – including allocations for contracted basic health services – were eliminated. Actual expenditures are expected to have fallen significantly short of planned levels due to revenue shortfalls and an unfinanced deficit.

### Outlook and Priorities

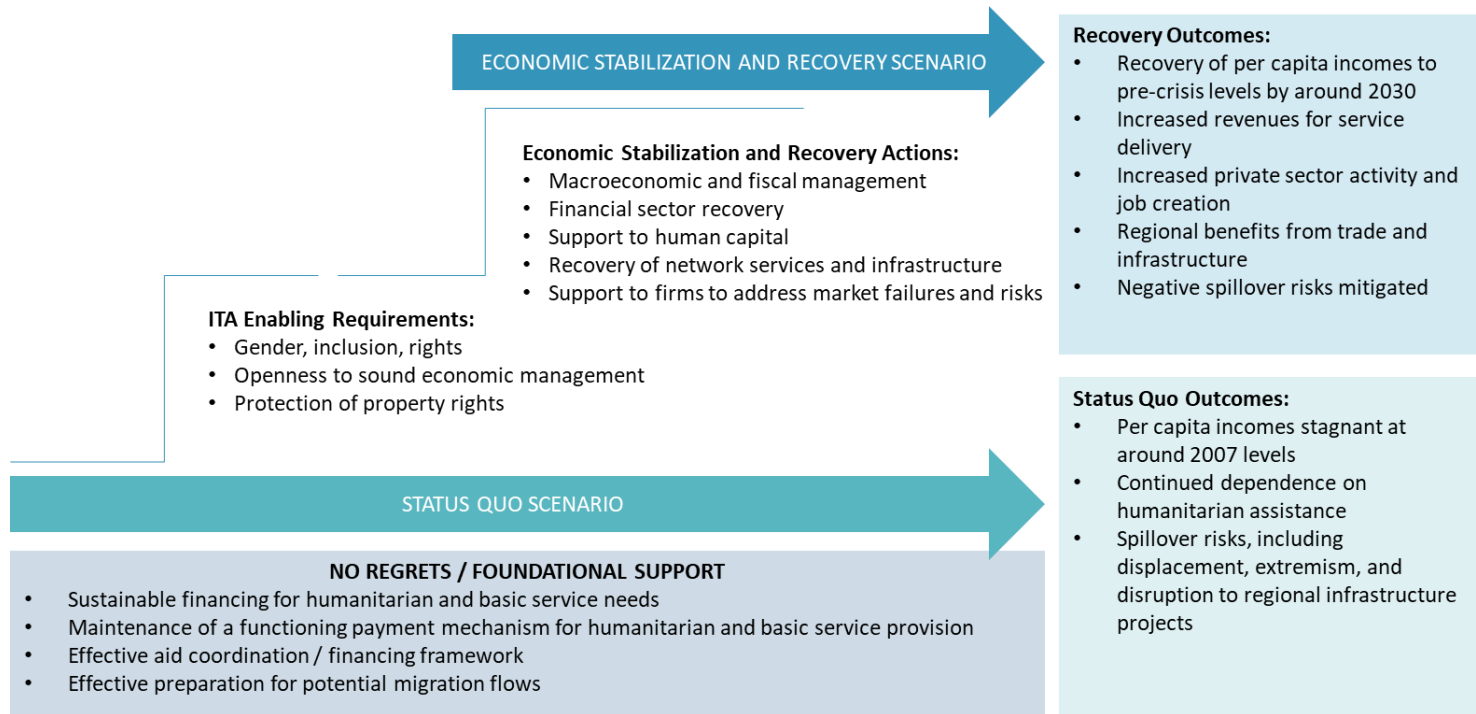
The recent crisis has left Afghanistan with a smaller and poorer economy. Per capita incomes at the end of 2022 are expected to be around one-third lower than at end-2020, reversing all progress since 2007. Under a baseline status quo scenario, per capita incomes will remain static in the context of slow growth and a rapidly growing population. The combined impacts of increased poverty, rapid population growth, and climate change present substantial risks to Afghans, the region, and world. These risks include: i) further poverty and humanitarian crises, necessitating regular, high-cost humanitarian interventions to support basic needs; ii) internal and external displacement risks driven by absence of economic opportunities and increased vulnerability to natural disasters; iii) increased risks of conflict, fragility, and extremism arising from increased contestation over natural resources, unemployment, and deteriorating access to services driving perceptions of exclusion.

Under an economic stabilization and recovery scenario, however, Afghanistan could achieve private sector led recovery in output over the medium-term through leveraging economic endowments and improvements in security and corruption (Afghanistan has substantial growth potential in agriculture over the short-term and extractives over the medium-term). This would involve i) international support across areas beyond basic human needs, supporting increased public investment; ii) easing of current financial sector constraints, including improvements in international payment flows and strengthened banking sector confidence and liquidity; iii) improvements in political confidence and associated increases in private investment; and iv) eased constraints to women's economic participation.

Given current widespread hardship, the international community must take no-regrets action for the effective and coordinated provision of critical basic needs. Moving towards the economic stabilization and recovery scenario will require further action by both the ITA and the international community. The ITA must meet minimum enabling requirements to both provide confidence to the international community and establish the core policy and institutional conditions for economic growth. If the ITA meets these requirements, a range of additional economic stabilization and recovery actions could be implemented (with international support) to facilitate sustainable, private sector led economic development. This framework for economic stabilization and recovery is shown in Figure 1.



**Figure 1: Framework for economic stabilization and recovery**



Source: World Bank

## 1. AFGHANISTAN'S ECONOMIC DEVELOPMENT FROM 2001 TO 2021

**Afghanistan received enormous international support over the past two decades.** International assistance to Afghanistan was provided through a range of channels including i) direct military and counter-terrorism activity by international partners; ii) grant and technical assistance support to Afghanistan security agencies; and iii) civilian aid for development and reconstruction. Grant support reached exceptional levels, with grant flows equivalent to around 60 percent of GDP on average between 2001 and 2020 and peaking at around 100 percent of GDP in 2009 (Figure 2). Grant support was divided roughly evenly between security and civilian support over the period. By 2020, grants had declined to around 45 percent of GDP, but still financed around half of the government budget, 75 percent of total public expenditure, and 90 percent of security expenditures. While overall aid levels remained exceptionally high, this largely reflected high security grants, with per capita civilian grant levels comparable to other low-income countries.

**International support underpinned rapid improvement against critical development indicators.** International support facilitated the development of critical state institutions while aid inflows drove aggregate demand and economic growth. Capacity and financing support to the Ministry of Finance, the central bank, and key line ministries underpinned i) rapid expansions in public spending; ii) sound macroeconomic management and rapid improvements in revenue collection; and iii) expansion of services through major national programs in health, education, and community development. As a result, economic and human development indicators improved. Afghanistan's economy grew by more than seven percent per year on average over 2001-2020, with GDP increasing by 180 percent between 2001 and 2020. Real per capita incomes increased by 75 percent between 2002 and 2018, with income per capita increasing from around 70 percent of the low-income country average to 107 percent of the low-income country average. Improved health services led to a rapid decline in maternal, infant and child mortality, with 142 more children surviving to the age of five for every 1,000 births between 2007 and 2018. Expansion in access to education saw rapid improvement in literacy rates, for both adults and youth, with youth literacy rates increasing from 47 percent in 2011 to 67 percent in 2018. Access to basic infrastructure expanded, as the number of connections to the electricity grid increased from 230,000 to nearly 1.5 million and the proportion of Afghans with access to sanitation increased from 25 to 43 percent.<sup>2</sup>

**While outcomes improved for women major challenges remained.** Girls' access to education expanded rapidly with important improvements in attendance rates and narrowing of gender disparities. Improved access to healthcare led to improved health outcomes for women, with the maternal mortality ratio falling from 1,600 to 638 deaths per 100,000 live births during 2002–2017 and the fertility rate declining sharply from 7.3 births per woman in 2002 to 4.3 births per woman in 2019. A quarter of the seats in Parliament were reserved for women, and women occupied some prominent positions within the executive, civil society, and private sector. Women, however, remained underrepresented in politics, private sector leadership, and the civil service. Women's labor force participation remained among the lowest in the world, at around 27 percent.

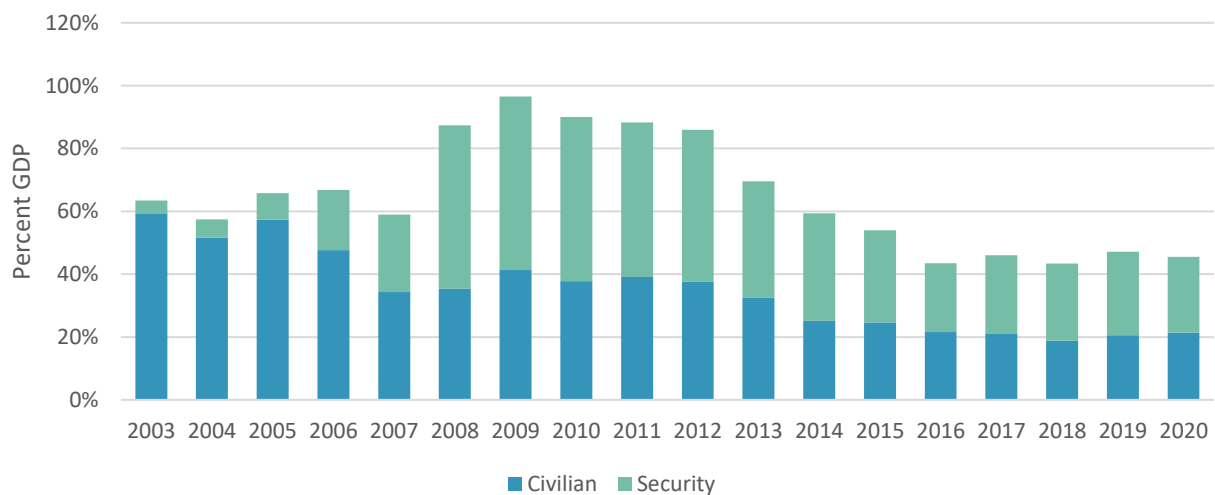
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<sup>2</sup> See World Bank (2020) Afghanistan's Development Gains, World Bank, Washington DC.

**Macroeconomic management was largely sound.** Following various debt relief and cancellation initiatives, government debt remained low and stable (around 7.5 percent of GDP in 2020). Reflecting limited access to financing sources, deficits remained tightly constrained. Efforts to improve revenue administration saw revenue collections increase from negligible levels in 2002 to reach around 14 percent of GDP in 2019 – close to the average for low-income countries. Inflation remained low and stable. The market-determined exchange rate remained relatively stable and foreign exchange reserves remained at very comfortable levels, reflecting continued large grant inflows (around 14 months of import cover at end-2020).

**Figure 2: International grants to Afghanistan have consistently remained at very high levels**

Grants as percentage of GDP



Source: World Bank staff estimates

**Due to a range of historical and political factors, development gains and broad macroeconomic stability did not translate into peace or the emergence of an effective and accountable state.** Property rights remained weak, with politically connected elites able to expropriate public and private resources with impunity. Security and justice institutions remained widely perceived as predatory and extractive. The state faced serious constraints to its capacity to effectively develop and implement policy and accountability of the state to the public remained weak, reflected in very low participation in elections, limited channels for public influence over sub-national government, and widespread and frequent political violence. International grant assistance, often mobilized in support of short-term security objectives, contributed to problems of governance by i) strengthening regional strongmen in relation to government, driving fragmentation; ii) fueling corruption and thereby undermining state legitimacy and fueling insurgency (Afghanistan ranked 165<sup>th</sup> out of 180 countries in the 2020 Perceptions of Corruption Index); and iii) reducing state reliance on tax revenues and thereby weakening state-society accountability relationships. In 2020, Afghanistan was ranked in the lowest ten percent of countries against five of the six indices reported in the World Governance Indicators. The weakness of state institutions was manifest in widespread violence, with local level disputes frequently spilling over into armed conflict, while organized crime became an increasing concern. Benefiting from external support, the Taliban

insurgency gradually gained momentum, increasing control over territory and intensifying attacks on Afghan security forces and civilians (an average 8,000 civilians were killed or wounded per year between 2014 and 2020).<sup>3</sup>

**The combination of large aid inflows and weak institutions had important implications for patterns of economic development and sustainability.** A very difficult business environment, limited infrastructure, insecurity, and high levels of political uncertainty undermined competitiveness. As a result:

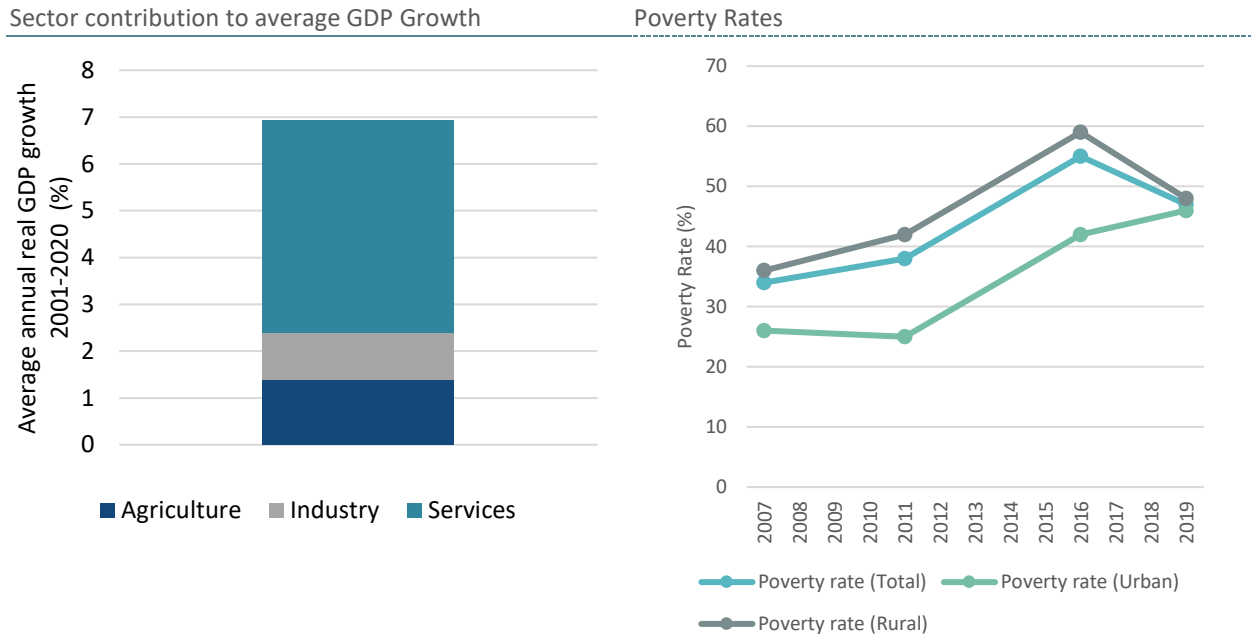
- **Growth was highly concentrated in the aid-driven service economy.** Rapid growth in public spending (which consistently exceeded 50 percent of GDP) drove expansion of the urban public sector and the associated contracting and services economy. The service sector grew by around 3.6 percent per year on average, accounting for nearly 65 percent of total growth over the period. By contrast, growth in industry averaged only 0.8 percent, concentrated in construction (Figure 3). By 2020, the service sector accounted for 58 percent of GDP (up from 40 percent in 2001). The construction and services sectors accounted for 77 percent of urban employment. Because the benefits of growth were not widely shared, Afghanistan experienced increasing poverty alongside high average growth rates between 2006/07 and 2015/16.
- **Imports grew rapidly, driving a structural trade deficit.** With limited domestic productive capacities and high costs, increasing public spending drove an explosion in imports. Over the past decade, imports averaged around US\$9 billion or 45 percent of GDP, reflecting heavy dependence on imports for critical goods such as food (around US\$2 billion per year), fuel (nearly US\$1 billion), and electricity (around US\$280 million). In comparison, exports over the period were equal to around US\$1.5 billion, including significant service exports to international installations on Afghan soil. This structural trade imbalance was financed almost entirely by grant inflows.
- **Informal and illicit sectors continued to account for a large proportion of economic activity.** With growth concentrated in urban services, rural areas remained heavily dependent on low-productivity subsistence agriculture (44 percent of the total workforce worked in agriculture and 60 percent of households derived some income from agriculture). Despite various eradication efforts, the opium economy continued to expand, driven by weak rule of law, easy access to key trade routes, and the absence of alternative livelihood generating activities. By 2020, the illicit economy accounted for a significant share of production, exports, and employment, including opium production, smuggling, and illegal mining. The major role of illicit activity in the Afghan economy weakened overall governance and deprived government of much-needed domestic revenues.
- **Financial sector development remained heavily constrained.** Limited investment opportunities and high governance and institutional risks weakened the intermediation function of the financial sector and constrained monetary policy transmission mechanisms. Banking sector deposits were largely held in overseas deposits by the central bank, rather than being recycled into domestic credit. As a result, total credit to the private sector remained equal to only around three percent of GDP in 2020, while the loan-to-deposit ratio

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<sup>3</sup> World Bank (2021) Risk and Resilience Assessment for Afghanistan, World Bank, Washington DC.

hovered around 15 percent. The banking sector remained highly liquid and highly dollarized, with over 60 percent of bank deposits held in USD.

**Figure 3: Growth has been concentrated in urban services, with benefits narrowly shared**



Source: NSIA, household surveys, World Bank staff analysis,

**Afghanistan’s economic vulnerabilities were increasingly apparent by the start of 2021.** Growth had slowed since 2015 leading to declining per capital incomes, reflecting decreasing grant inflows, political instability following the disputed 2014 and 2019 elections, increasing insecurity, and severe droughts in 2018 and 2021. Weak governance and widespread corruption sapped confidence, weakened trust in government, and further constrained investment. Wheat production declined by 20 percent in 2021, relative to the previous 5-year average. Intensified fighting and forced return of refugees from neighboring countries were driving an ongoing displacement crisis, with large numbers of internally displaced people arriving in major urban centers. The COVID-19 crisis had major impacts, with the economy contracting by 2.4 percent due to border closures, lockdowns, and reduced remittances. Poverty decreased between 2016/17 and 2019/20 – partly due to an increase in land being used for opium cultivation – but remained widespread, with 47 percent of the population living below the poverty line. Government revenues had fallen to 11.4 percent of GDP in 2020 due to weakening compliance and slowing economic activity. Reflecting weakening economic conditions and shortcomings in credit origination practices, asset quality on banks’ small portfolio of private sector lending showed signs of deterioration. The proportion of non-performing loans to gross loans reached nearly 22 percent by end-2020.

## 2. IMPACTS OF THE AUGUST 15 CRISIS

**The security situation deteriorated rapidly through 2021, with the Taliban insurgency gaining control over increased territory and intensifying attacks on military and civilian targets.** As United States (US) and North Atlantic Treaty Organization (NATO) security forces prepared for withdrawal, the Taliban insurgency gained pace. From mid-July, the Taliban began to take control of major cities and border crossings. Collapsing government revenues necessitated sweeping expenditure cuts. Broad public uncertainty led to a run on the banks, driving a large outflow of USD and AFN notes from the banking sector, necessitating the imposition of withdrawal limits. Large internally displaced populations, fleeing active fighting and the Taliban advance, established temporary settlements around Kabul. On August 15, Taliban forces moved into Kabul and established an interim administration (the ITA). Tens of thousands of Afghans sought to escape Afghanistan by air and land. The international community moved to quickly close off development and security assistance, while international sanctions came into force due to the representation of sanctioned individuals and groups within the ITA.

**Afghanistan fell into a complex economic crisis.** This crisis involved the following overlapping drivers:

- **A sharp fiscal contraction leading to declining demand and disruption to basic services.** The sudden stop of security and development grant inflows (previously equal to around US\$9 billion per year) saw immediate disruption to salary and contractor payments. Pay was paused for roughly 420,000 civilian civil servants, which accounted for eight percent of total formal employment. An additional 300,000 members of the formal security sector also went unpaid, while security sector contracting activities immediately ceased. Disruption to public sector spending led to a rapid slowing of the urban services and construction economy, which employed around 2.5 million Afghans and accounted for 77 percent of urban employment. Funding and technical support ceased to aid-supported national programs, which had previously played a critical role in providing basic education, health, and community development services, leading to major service delivery disruptions across the country (according to the World Health Organization, by September only 17 percent of health facilities were fully functional).
- **External and financial sector disruptions.** With the freezing of grant inflows, Afghanistan lost access to the primary source of hard currency that had been financing the very large trade deficit. Due to international sanctions, Afghanistan also lost access to overseas assets of the central bank, equal to around US\$9.2 billion. Reflecting sanction and AML/CFT concerns, international banks ceased processing almost all payments into and out of Afghanistan, undermining the capacity of firms to pay for imports or receive payment for exports, disrupting remittance flows, and leaving international humanitarian and NGOs unable to pay salaries or contractors within Afghanistan. The central bank's access to Afghani and USD cash notes ceased, creating a liquidity crisis in the banking system and preventing firms and households from accessing working capital and savings (USD notes had previously been provided by the United States Government (USG) from foreign exchange reserves held at the

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New York Federal Reserve, while local current notes were provided by contracted printers in Europe).

- **Loss of confidence and human capital.** Pervasive uncertainty and fear undermined investment confidence. The outflow of Afghans through air and land routes saw the loss of significant human capital, including a substantial proportion of the highly educated civil servants and technical specialists that had occupied key positions in the public and private sector, and supported economic development gains over the past 20 years. Reduced female participation in both the public and private sectors imposed further losses of productivity.

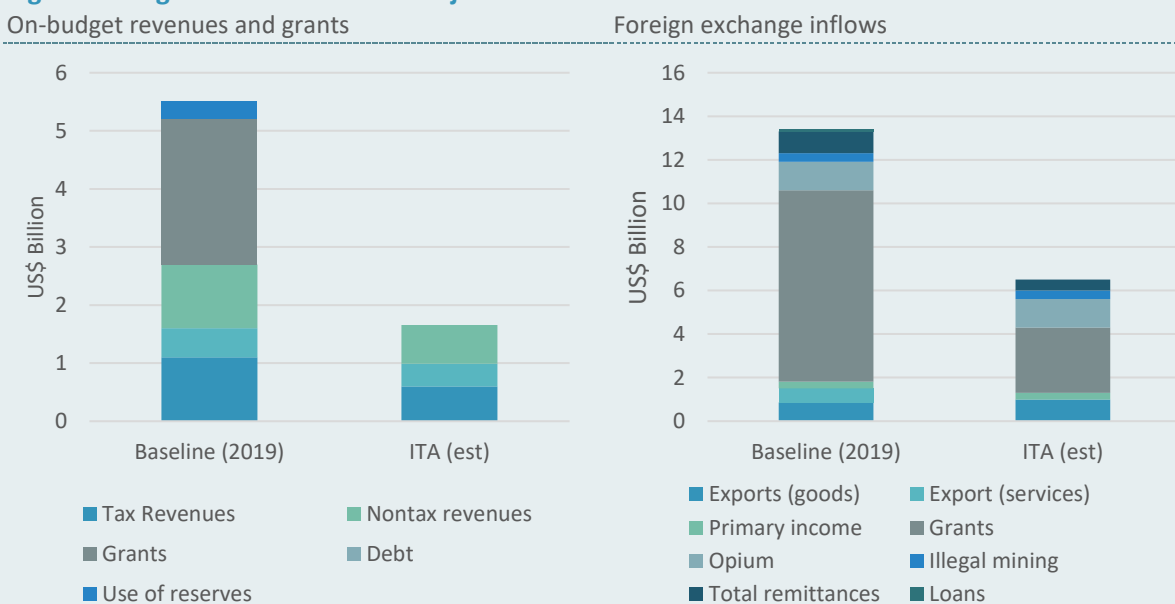
### Box 1: Quantifying the likely fiscal and external adjustment

The World Bank has undertaken basic analysis to quantify the likely scale of required fiscal and external adjustment.

The estimated adjustment of on-budget flows is in the range of US\$4 billion, with budget spending expected to decline to around 15 percent of GDP relative to 29 percent in 2019. Cessation of international on-budget security and civilian grants has led to an immediate reduction of roughly US\$2.5 billion of on-budget support. Based on current trends, ITA domestic revenues are estimated to be around 40 percent lower compared to earlier years, reaching roughly US\$1.7 billion in 2022. The ITA does currently not have access to deficit financing, leaving their on-budget flows restricted to domestic revenue mobilization. The very large contraction in sources of budget revenues and financing will drive equivalent reductions in expenditure, with important consequences for service delivery and economic activity.

Taking account of informal flows not included in official statistics, the reduction in foreign exchange inflows is estimated at close to US\$7 billion, with total balance of payments inflows declining to around US\$6.2 billion from around US\$13.5 billion in 2019. This adjustment is predominantly driven by the collapse in international on- and off-budget civilian and security grant support – which equaled roughly US\$8.8 billion or 46 percent of GDP in 2019 – with limited off-budget grants remaining (estimated at roughly US\$3 billion). Service exports are assumed to fall back to almost zero, as are external loans. Remittances are estimated to fall by 50 percent, to US\$500 million. Illicit exports (including informal mining and opium) are assumed to remain constant. The very large contraction in balance of payments inflows will drive large reductions in imports, including for critical items such as food, fuel, and other basic household goods.

**Figure 4: Large fiscal and external adjustments are inevitable**



Source: World Bank staff estimates



### 3. SUBSEQUENT ECONOMIC DEVELOPMENTS

#### Political and Security Developments

**Since August 15, 2021, the ITA has achieved territorial control and maintained basic government structures and functions.** The ITA immediately appointed an interim cabinet composed almost entirely of ethnic Pashtun men from within the Taliban ranks. Over the following months, the cabinet was expanded with an additional 27 members, including ministers, deputy ministers, heads of independent department, and senior military positions. Policy-making processes remain opaque and policy positions have often appeared contradictory and subject to reversal. The ITA has largely maintained inherited government structures but dissolved, created, or restructured several government ministries. The interim administration has removed women from senior positions within the civil service and issued several policy decisions curtailing women's rights and restricting press freedom. The ITA has also issued a series of decision regarding economic management, including banning the use of foreign currency for transactions, approving an interim budget in January, and announcing the realignment of the fiscal year to the Solar Hijri year (21<sup>st</sup> March – 20<sup>th</sup> March). The ITA recently announced a complete ban on opium production, but it is unclear how or if this decision will be enforced. Despite the establishment of various resistance movements, the ITA has moved quickly and successfully to consolidate territorial control, with Taliban units undertaking policing and military functions. Security conditions have improved significantly across the country, with a near complete end to active combat. Various extremist groups have reportedly increased their memberships and mounted several high-profile terrorist attacks against civilian targets, but none currently hold significant territory.

**The events of August drove an immediate humanitarian crisis.** Economic disruptions arising from the crisis exacerbated humanitarian needs in the context of ongoing drought and large-scale displacement. Between January and November 2021, 736,000 Afghans were internally displaced due to conflict and insecurity. More than half were displaced during July and August. The UN launched a flash appeal in September, seeking US\$606 million to provide urgent assistance to 18.4 million Afghans, including 12.2 million people facing emergency levels of food insecurity (IPC3+). The United Nations Office for the Coordination of Humanitarian Affairs (UNOCHA) subsequently prepared a humanitarian response plan to reach 24.4 million Afghans, at an estimated cost of US\$4.4 billion over CY2022 (the UN's largest ever country appeal). A pledging event was held in late March which mobilized US\$2.4 billion. While the ITA has been successful in providing broad territorial access to humanitarian agencies, the response has been hindered by financial sector dysfunctions. The inability to move funds through and withdraw cash from the banking system has led UN agencies to establish a program of physical cash shipments, whereby USD notes are flown into Kabul for use in meeting salaries and other domestic payment needs. Such shipments have now reached substantial volumes, with up to US\$150 million being flown into Afghanistan every month (equal to around 14 percent of 2021 estimated GDP per year).<sup>4</sup>

**Additional support beyond humanitarian assistance is now being mobilized.** Since August, the international community has progressively moved to expand support to the people of

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<sup>4</sup> The UN oversees physical cash shipments, with funds distributed in USD to recipients through the Afghanistan International Bank (AIB). Funds bypass the central bank, due to AML / CFT concerns.

Afghanistan. The US Treasury Office of Foreign Assets Control (OFAC) has issued a series of General Licenses, aimed at clarifying the scope of sanctions and thereby allowing the resumption of a broader range of commercial and aid transactions and activities. At the same time, the World Bank, Asian Development Bank (ADB), the United Nations Development Program (UNDP), and the Islamic Development Bank (IsDB) are mobilizing resources for basic service delivery activities through off-budget delivery mechanisms, including engagements to support primary health, education, food security, and community resilience. The expanded approach aims to support the delivery of essential basic services, protect vulnerable Afghans, and help preserve human capital and key social services. The international community is now also considering options for mobilizing support to the economy, including efforts towards restoring key financial sector and central bank functions.

### **Box 2: General Licenses for Afghanistan**

Recent developments have included General Licenses issued by the Office of Foreign Assets Control (OFAC). OFAC administers and enforces economic and trade sanctions in support of US national security and foreign policy objectives).

OFAC has issued a total of seven GLs.

- GL 14 covers humanitarian activities, GL 15 is applicable to the import of agricultural commodities, medicines, and medical devices (issued in September 2021), and GL 16 (from December 2021) allows for the processing of personal remittances.
- A further three licenses (GL 17, GL 18, GL 19), issued in December 2021, allow for transfers that are associated with the conduct of business of, respectively, the US government, international organizations, as nongovernmental organizations (NGOs). With respect to the latter, the license expanded the scope of permissible transactions beyond basic humanitarian aid—the list of activities covered by GL 19 includes “humanitarian projects to meet basic human needs; activities to support rule of law, citizen participation, government accountability and transparency, human rights and fundamental freedoms, access to information, and civil society development projects; education; non-commercial development projects directly benefitting the Afghan people; and environmental and natural resource protection”.
- GL 20, that was adopted in February 2022, clarifies that transactions with Public Entities and Ministries currently under control by individuals sanctioned by OFAC (many ministers are currently on the OFAC sanction’s list) are not covered by the sanctions and are thus permitted.

## Real Sector

**Output over the last four months of 2021 is estimated to have declined by more than one-third relative to the same period in 2020.** Declining output was driven by a sudden stop of very large public spending (impacting public sector salaries and contracted goods and services), flowing into lower household incomes, and reduced consumption. Public investment ceased with the loss of both government and donor funding for development projects, while deterioration in confidence is expected to have led to precipitous reductions in private investment. On the supply side, financial sector constraints to international transactions drove disruptions to import supply chains, infrastructure disruptions increased production costs, while ongoing drought conditions continued to weaken agricultural production. Contraction was concentrated in the urban service

economy, which was heavily dependent on donor and government spending, with service sector output declining by an estimated 60 percent over the last four months of 2021 relative to the same period in 2020. The very small industry sector is expected to have contracted by 50 percent, reflecting dependence of the manufacturing sector on agricultural production, and large drops in construction activity. Agricultural output is estimated to have declined by around five percent over the year, reflecting drought impacts and higher prices for key inputs (such as fuel, fertilizer, and seeds), partly offset by improved security conditions. Despite ITA announcements proscribing opium production and sale, illicit economic activity is expected to have expanded in the context of widespread hardship and deteriorating alternative livelihood opportunities.

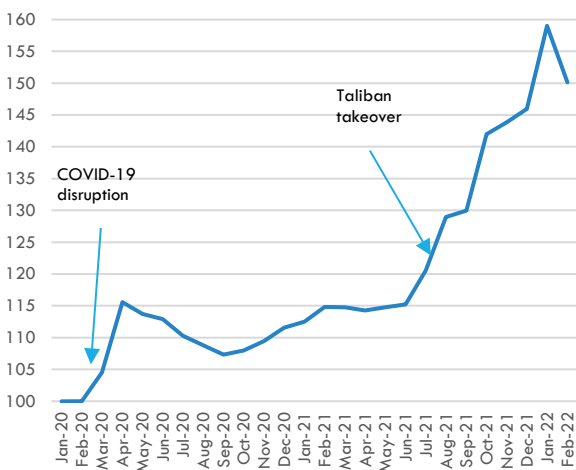
**Recent firm survey data confirmed the extent of the economic contraction.** The World Bank undertook a rapid survey of 100 private-sector firms during October/November 2021. This survey confirmed major negative impacts on private sector activity. Nearly all firms reported declines in demand, including three-quarters of large firms. One-quarter of respondent firms had at least temporarily closed operations. Surveyed firms had laid off nearly two-thirds of their staff on average. Among respondent firms, small and women-owned firms were more likely to have temporarily or permanently closed operations in response to reduced demand. Firms in the agribusiness and wholesale and retail trade reported relatively smaller reductions in demand (and in some cases increased demand), likely reflecting their critical role in the provision of basic household goods (including to humanitarian agencies), but still reported laying off a large proportion of staff (around half and two-fifths respectively).

**Deteriorating economic conditions drove sharp declines in household incomes.** Close to 90 percent of employed household heads interviewed for the World Bank's Afghanistan Welfare Monitoring Survey (AWMS) over October-December 2021 reported a decline in their labor earnings in the last 30 days. Those who were self-employed or in casual work saw the largest decline, with 88 percent of respondents reporting a drop in earnings. Those employed in salaried jobs also experienced a decline in income, with 80 percent of salaried workers in the public sector and 82 percent of salaried workers in the private sector reporting a drop in labor earnings. In rural areas, household earnings from agricultural sources were also negatively affected by economic and climate conditions, with 85 percent of households reporting diminishing yields and lower revenue due to drought conditions.

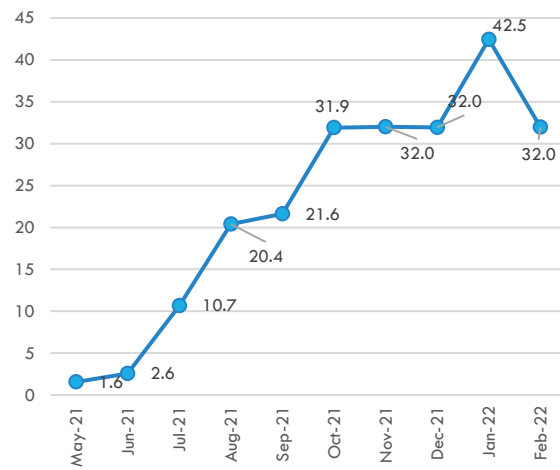
**Prices increased sharply through late 2021 and early 2022.** Prices were on a sharply increasing trend even before the political events of August 15 reflecting depreciation and supply constraints amid border closures and intensified conflict. Despite softening demand, prices continued to increase throughout late 2021 and early 2022 reflecting depreciation, increasing international prices, and import constraints arising from disruptions to international transactions. Official data shows that headline y-o-y inflation reached 12.7 percent in December, with food price inflation reaching 17.7 percent. More recent data collected by the World Food Program (WFP) shows inflation for a basket of basic household goods peaking at 42 percent in January 2022 (Figure 5).

**Figure 5: Prices have increased significantly**

Y-o-Y inflation, NSIA data



Y-o-Y inflation, basic household goods



Source: NSIA, WFP, World Bank staff calculations.

**The combination of declining incomes and increasing prices has driven a severe deterioration in household living standards.** 47 percent of Afghans were already living below the poverty line at the time of the 2019/20 household survey, with an additional 45 percent of Afghans living on less than 1.5 times the poverty line and therefore at risk of falling into poverty. By late 2021, the AWMS shows that 70 percent of Afghan households had insufficient income to meet basic food and non-food needs (Figure 6). The proportion of households unable to meet basic food needs increased from 16 percent in May 2021 to 37 percent in October-December 2021, while the share of the households with sufficient income for food needs but not other basic needs increased from 18 percent to 33 percent.

**To cope with deteriorating living conditions, more Afghan households are becoming active in the labor market, taking less remunerative jobs, and adopting harmful coping mechanisms.** Self-employment has increased between October-December 2019 and October-December 2021, both in urban and rural areas, compensating for the destruction of salaried employment and leading to a net increase in employment levels in rural areas (Figure 6). The share of people actively looking for work but unable to find it (i.e., unemployment) has also increased in this same period, especially in urban areas. Meanwhile, the share of people not participating in the labor market has declined considerably in both urban and rural areas. Extreme hardship has led to the widespread adoption of harmful coping mechanisms such as borrowing at high interest rates, the sale or consumption of assets, early child marriages, and reduced investment in human capital. This will have long-term consequences given Afghanistan's very young population.

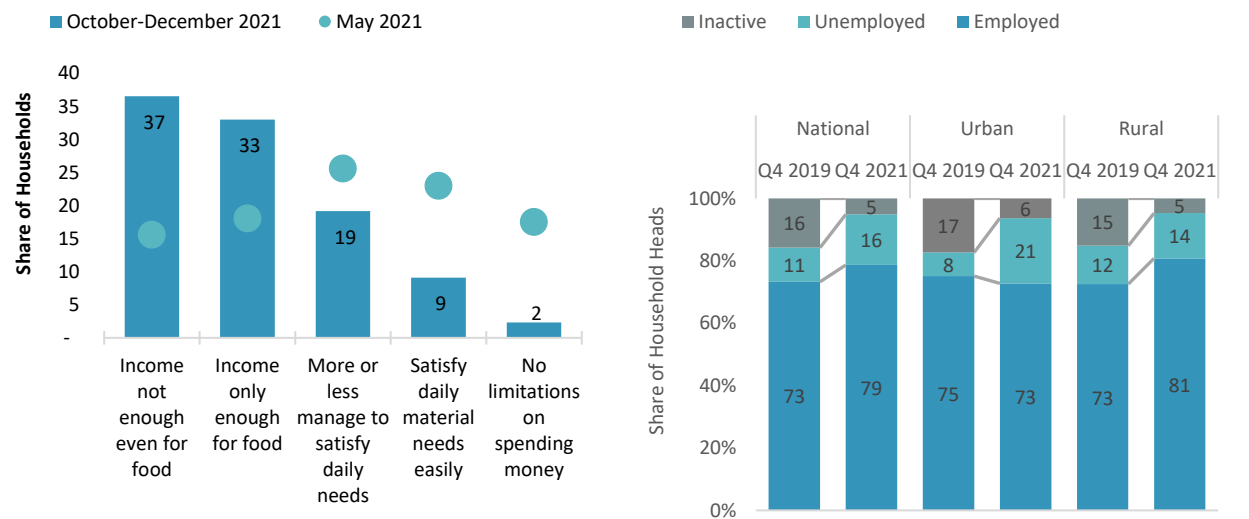
**Increased humanitarian aid support and supply chain adjustments may have helped stabilize output and prices over recent months.** Large inflows of in-kind humanitarian supplies and USD cash over late 2021 and early 2022 have had important impacts in: i) increasing supply of USD within the economy, driving appreciation of the exchange rate; ii) providing impetus demand through local payment to humanitarian workers and suppliers; and iii) increased supply of basic

household goods, leading to lower prices. Supply side constraints may also be easing as private firms adjust supply chains in response to formal financial sector constraints, potentially including through the increased use of informal money transfer systems. Y-o-Y inflation for basic household goods declined by around 10 percentage points over the month of February, while survey data suggests an increased demand for casual labor for the first time since August.

**Access to services has partially recovered due to improved security and international support, but the future of girls’ secondary education remains in question.** Following initial disruptions, access to some services has now recovered due to i) efforts by the international community to resume financing of health facilities through UN agencies; ii) effective use of cash shipments to bypass financial sector constraints; and iii) improved security across much of the country. Nearly all primary healthcare facilities are now fully operational. The recent AWMS confirmed continued access to healthcare with 94 percent of those needing healthcare able to access a local public or private health facility. This survey also showed an increase in the proportion of households sending both girls and boys to primary school, and an increase in the number of households sending boys to secondary school. The future of girls’ access to education remains unclear given recent ITA policy announcements delaying the opening of girls middle and high schools for the new school year.

**Figure 6: Living conditions have deteriorated significantly, pushing more Afghan households to become active in the labor market and take less remunerative jobs**

Household capacity to cover food and non-food expenses (May 2021 and October-December 2021)      Labor market status (Household heads, 15-65 years old)



Source: AWMS 2021

Source: IE-LFS 2019–20 for 2019; AWMS for 2021

## Monetary and Financial Sector

**Afghanistan’s financial sector remains in crisis.** With the departure of key personnel, the central bank has lost capacity to undertake key functions, including banking supervision, monitoring of illicit financial flows, and performing AML/CFT functions. Confidence in the banking sector has

been eroded following the bank run during the lead-up to the August 15 crisis and the subsequent imposition of withdrawal limits. The central banks' foreign exchange reserves remain frozen.<sup>5</sup> Correspondent bank relationships have been severely disrupted due to sanctions and AML/CFT concerns. While sanctions concerned have been eased by OFAC's recent issuance of General License 20 (which authorizes transactions involving Afghanistan and its institutions under certain conditions), AML/CFT concerns remain elevated. As a result, transfers between local and international banks are extremely limited and subject to delays.

**The core functions of the formal financial sector are not being fulfilled.** With the freezing of foreign exchange reserves, supply of USD notes (previously overseen by the United States Government) has ceased. Because of sanctions concerns, new AFN bank notes (printed overseas) are no longer being supplied. With limited AFN and USD notes within the banking system, households and firms are unable to withdraw funds even up to DAB's regulated limits, further eroding confidence. With the breakdown of correspondent bank relationships, stakeholders face major constraints moving funds into or out of Afghanistan. In limited instances where funds can be wired into Afghanistan, recipients are mostly unable to withdraw cash because banks are unable to convert USD into AFN, and – even when they can do so – are unable to access ANF notes. With limited access to AFN notes, the central bank (Da Afghanistan Bank – DAB) cannot control the domestic money supply. Without access to foreign exchange reserves, DAB cannot provide a currency exchange service to the banking sector. In the absence of recent and reliable data it is not possible to fully assess the impact of the crisis on the banking sector.

**Firms and NGOs report major issues with accessing cash and making transactions.** In the World Bank firm survey conducted over October-November 2021, financial sector issues were reported as the top constraint for business activity, with 81 percent of firms reporting difficulty in sending or receiving payments domestically and 95 percent facing difficulties dealing with international payments. Around 85 percent of NGOs report that inability to transfer funds from overseas and limited access to cash are major constraints to their operations.<sup>6</sup> Most businesses will accept cash only or impose a surcharge on other (less liquid) forms of payment.

**Informal financial flows are expected to have grown significantly.** The difficulties Afghan businesses face in making and receiving payments has forced enterprises to make increasing use of cash and informal financial services, including through the Hawala system. In the World Bank private sector survey nearly two-thirds of large businesses reported using the Hawala system for financial transactions. Around 75 percent of NGOs similarly report using the hawala system to transfer funds to Afghanistan since August 2021.<sup>7</sup> Increasing demand for hawala services are

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<sup>5</sup> Under a recent Executive Order, the Biden administration formally blocked all DAB access to approximately US\$7 billion of these assets and ordered them to be transferred to a consolidated custody account at the FRBNY. The administration has announced that it is seeking to use US\$3.5 billion of these assets for the benefit of the Afghan people, while the remaining assets will remain locked pending the resolution of legal claims on the assets by families of the victims of the September 11, 2001, terrorist attacks on New York.

<sup>6</sup> Moret, E. (2022) 'Life and Death: NGO access to financial services in Afghanistan', Norwegian Refugee Council, Oslo.

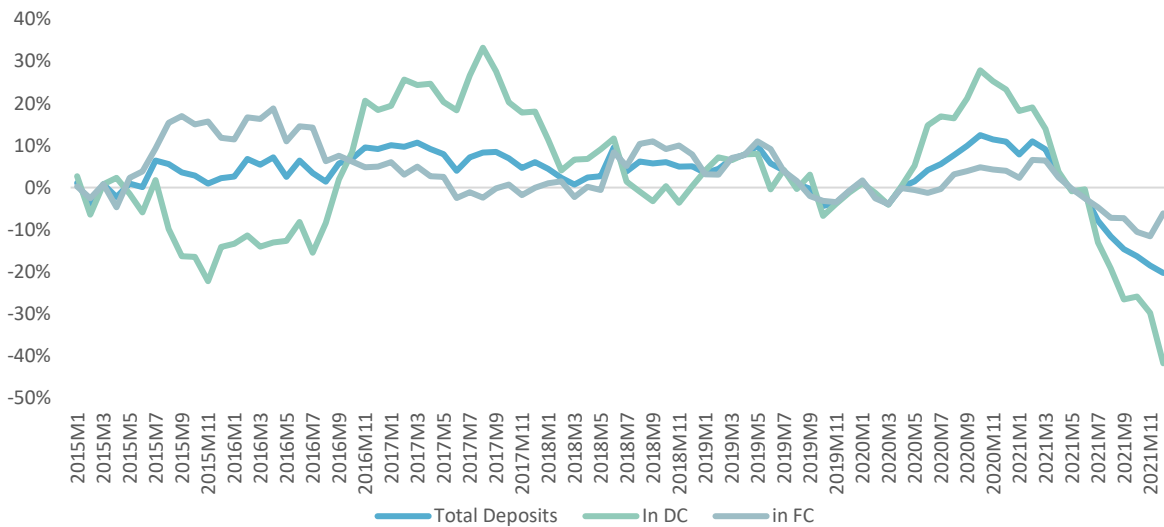
<sup>7</sup> Ibid.

reflected in current high fees, which have increased from around one percent of transaction volume prior to the August crisis to between 10-20 percent today.

**Monetary indicators reflect the lack of confidence in the financial sector and deteriorating economic conditions.** Reflecting weak confidence in the banking system, and despite withdrawal limits, total deposits in the banking sector dropped by 12.9 percent in the second half of 2021 from Afs 267.7 billion in June to 233.2 billion in December (Figure 7). Without access to new AFN currency notes, the central bank moved to meet commercial bank liquidity needs through existing vault reserves and the re-use of expired currency notes. As a result, currency in circulation rose by 8.5 percent from 283.2 billion to Afs 307.4 billion in the second half of the year. Reflecting difficult economic conditions and weak confidence, credit to the private sector declined. Local and foreign currency credit to the private sector fell by 9.8 percent and 6.1 percent respectively between July-December 2021. With the volume of decline in deposits outstripping declines in lending, liquidity of the banking sector significantly contracted, with the banking sector’s local and foreign currency holdings and reserves at DAB falling by 38.8 percent and 20.8 percent respectively in the second half of 2021. Cash hoarding by firms and households and reduced private sector credit has driven a reduction in the money multiplier, causing a contraction in the money supply and exacerbating liquidity shortages in the banking sector. As of the end December 2021, broad money and reserve money decreased by 6.1 percent y-o-y and 1.4 percent y-o-y, respectively (Figure 8).

**Figure 7: Deposits contracted amid declining confidence in the banking sector**

Total deposit growth

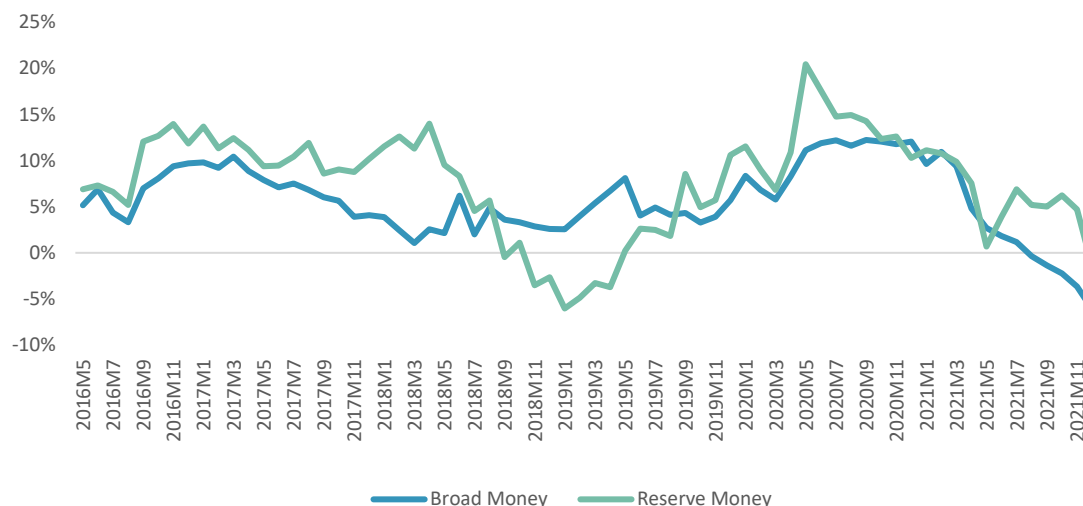


Source: Da Afghanistan Bank

Note: Change in foreign currency deposits is calculated in USD terms using the end-period monthly exchange rate.

**Figure 8: Money supply contracted**

Monetary aggregate growth



Source: Da Afghanistan Bank

## External Sector

**Afghanistan is facing a large and sudden external adjustment with severe impacts on the economy.** Due to the sudden stop in grant inflows, the ingrained structural trade deficit is estimated to have narrowed sharply. Most of the adjustment has been absorbed through reduced imports. Exchange rate adjustment has been curtailed by the authorities' lack of control over the domestic money supply, given limited access to new AFN currency notes. A broader macroeconomic policy response to smooth the adjustment has been undermined by the authorities' lack of access to foreign exchange reserves.

**Imports collapsed over the second half of 2021 reflecting the combined impacts of reduced demand and financial sector disruptions.** According to official data, goods imports declined by around 47 percent over the second half of 2021 relative to the same period in 2020, in line with contracting domestic demand and disruptions to international payments. Import contraction was broad-based, reflecting lower imports for all categories of goods (Figure 9). Import of foodstuffs fell by 48 percent y-o-y (US\$629.5 million), minerals and fuels by 16.1 percent y-o-y (US\$88.5 million), chemicals and plastic by 46.2 percent y-o-y (US\$178.5 million), base metal by 76.4 percent y-o-y (US\$181.1 million), machinery by 48.7 percent y-o-y (US\$90.6 million), and textiles by 44.1 percent y-o-y (US\$148.8 million). Recent data from the Pakistan authorities suggest that imports continue to slow, with imports from Pakistan in January 2022 equal to only around one-third of January 2021 levels.

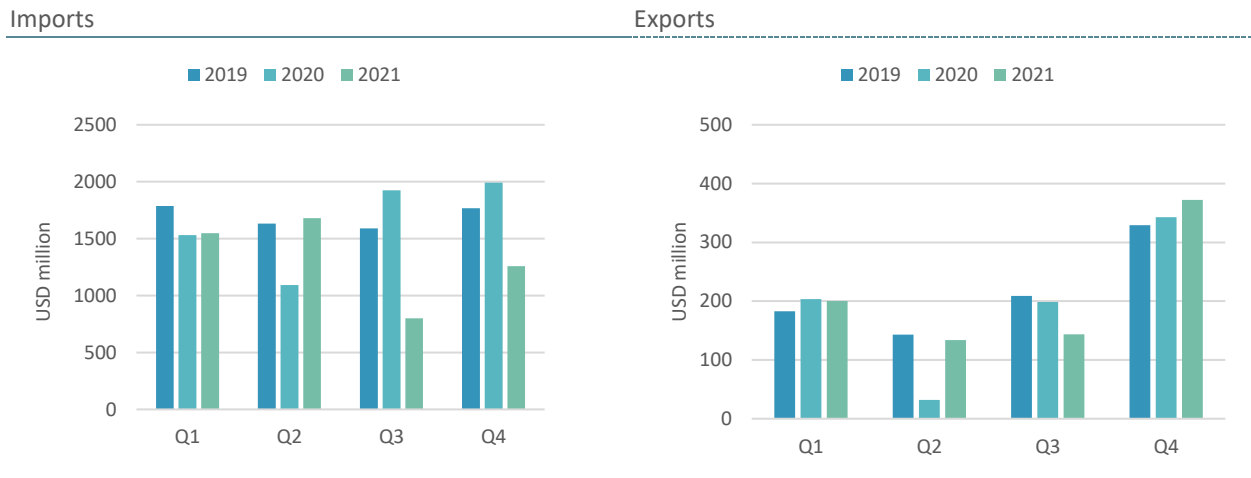
**Goods exports, on the other hand, declined only moderately.** Goods exports over the second half of 2021 fell by 4.7 percent relative to the same period in 2020, with contraction explained entirely by a 20 percent reduction in exports of vegetables and dried fruit (Afghanistan's primary export item). Export performance was buoyed by improved security and increased competitiveness due to depreciation. These positive impacts were offset, however, by financial



sector disruptions to receipt of overseas payments and supply chain disruptions arising from the closure of aid-subsidized air corridors for agricultural exports to India and China.

**Services trade is expected to have significantly declined.** While official data is not available, service imports (previously equal to around 6.4 percent of GDP) are expected to have fallen sharply, reflecting overall declines in economic activity and financial sector disruptions to external payments. Service exports (equal to around three percent of GDP) were previously dominated by services provided to foreign security and diplomatic installations in Afghanistan and are expected to have sharply declined following the cessation of international security support.

**Figure 9: Imports have contracted sharply, while exports have quickly recovered**



Source: NSIA

Source: NSIA

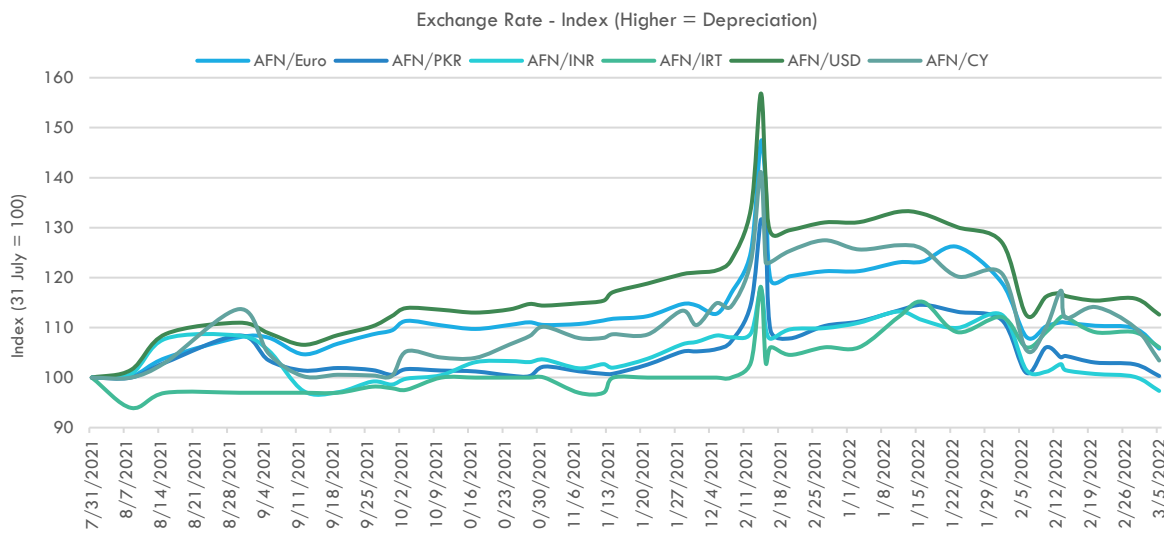
**Available data suggest a sharp drop in remittance inflows.** Official statistics show that the net inflow of remittances fell by 47.8 percent y-o-y to only US\$87.9 million in the year's third quarter, driven by difficulties in processing international transactions. More recent remittance data is not available but results from the AWMS show the proportion of households receiving income from remittances has declined to five percent in October-December 2021, down from 10 percent at the time of the previous household survey in 2019.

**The value of the Afghani depreciated over the period of political instability and exhibited significant volatility.** The Afghani depreciated moderately against all trading currencies through to early 2022, reflecting net hard currency outflows driven by the sustained trade deficit (Figure 10). Exchange rate movements since August have reflected substantial frictions and distortions. However, shortages of AFN notes and continued demand for Afghanis as a store of value and to conduct domestic transactions have buoyed the value of the local currency. Informal foreign exchange operators play a key role in determining rates, dominating the market for international transactions. Anecdotal reports suggest exchange rate movements may also reflect efforts by the ITA to influence rates in currency markets. A sudden drop in the value of the AFN during mid-December was arrested and quickly reversed through ITA efforts to address alleged hoarding of USD by currency traders.

**The exchange rate has recently stabilized, reflecting humanitarian USD inflows.** Between February 1 and March 5, 2022, the AFN appreciated by 12.9 percent against the US Dollar, 16.7 percent against the Chinese Yuan, 12.5 percent against the Euro, 5.7 against the Iranian Toman, and 11.2 percent against the Pakistani Rupee. Following recent appreciation, the AFN is now trading at around 11 percent below its value at end-July 2021 relative to the USD. Appreciation is thought to have been driven by the large inflows of USD cash through humanitarian channels (averaging around US\$150 million per month) combined with ITA attempts to stem illicit outflows of USD. Increased availability of USD within the economy has also allowed the central bank to resume USD auctions, with around US\$26 million auctioned since mid-February.

**Figure 10: The exchange rate depreciated following the crisis, but has recently recovered**

Exchange rate – Index (Higher = Depreciation)



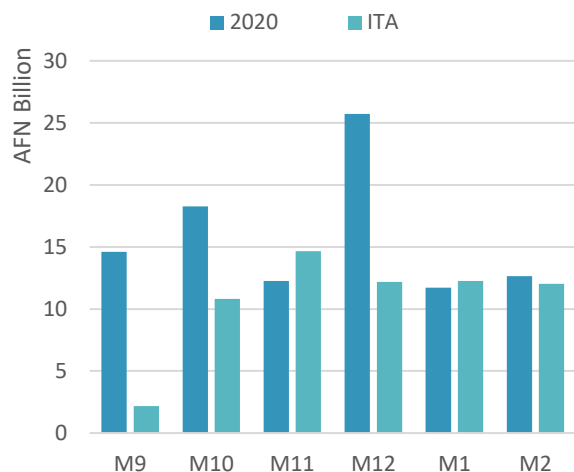
Source: Da Afghanistan Bank

## Fiscal Sector

**The ITA moved quickly to restore revenue collection, and revenue performance has steadily improved.** Total revenue collected during September–December 2021 reached Afs 39.8 billion, a little more than half of the past 4-year average over the same period. While total collections in September reached only Afs 2.2 billion, revenues increased to Afs 14.7 billion in November and plateaued at around Afs 12.2 billion in December. Revenue performance relied relatively heavily on collections at the border supported by rapid exchange rate depreciation and reduced corruption and leakage in customs collection, while inland revenue collection significantly lagged. Collections by the customs department accounted for 49 percent of total collections in the fourth quarter of 2021, relative to 43 percent over the same period in 2020. Strong revenue collection continued into 2022 with monthly collections reaching Afs 13 billion on average during January–March, slightly exceeding the monthly average of the first quarter in 2020 (Figure 11).

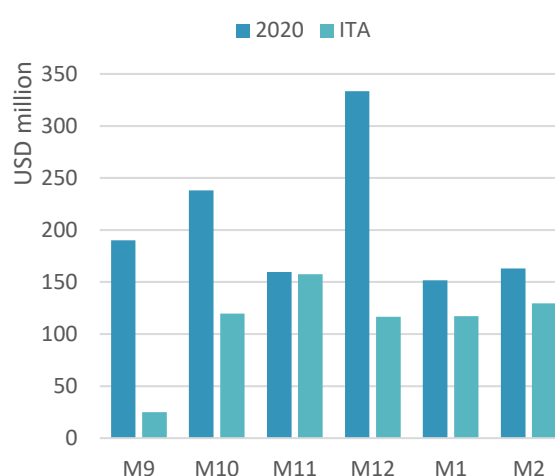
**Figure 11: ITA revenues have grown rapidly**

Monthly revenues in AFN



Source: Ministry of Finance

Monthly revenues in USD



Source: Ministry of Finance

**The ITA approved a quarterly interim budget in January (covering the period December 22, 2021-March 20, 2022), which signaled intent to finance basic services but also demonstrated the extent of required fiscal adjustment.** The content of the budget is rudimentary but includes basic ministerial allocations and aggregates. Total recurrent allocations were reduced by 34 percent compared to 2019 mainly through cuts to defense (50 percent) and public order and safety (34 percent) while those for education and health were maintained. Development expenditures were drastically reduced, budgeted at Afs 4.7 billion compared to Afs 34.6 billion in 2019. Proportional allocations by economic classification were largely consistent with previous budgets. Salaries and wages continued to account for around 70 percent of total recurrent expenditures, while goods and services accounted for around 18 percent of recurrent expenditures. Budgeted expenditures totaled Afs 53.9 billion for the quarter. The ITA expected to raise revenues of Afs 47.5 billion for the quarter, close to the average quarterly revenue performance in 1398 (Afs 51.8 billion). These projections appear optimistic as revenue performance in the first quarter of 2022 fell 17.5 percent short of the interim budget revenue target, at Afs 39.2 billion. The interim budget also included a total unfinanced deficit of Afs 6.4 billion (Figure 12).

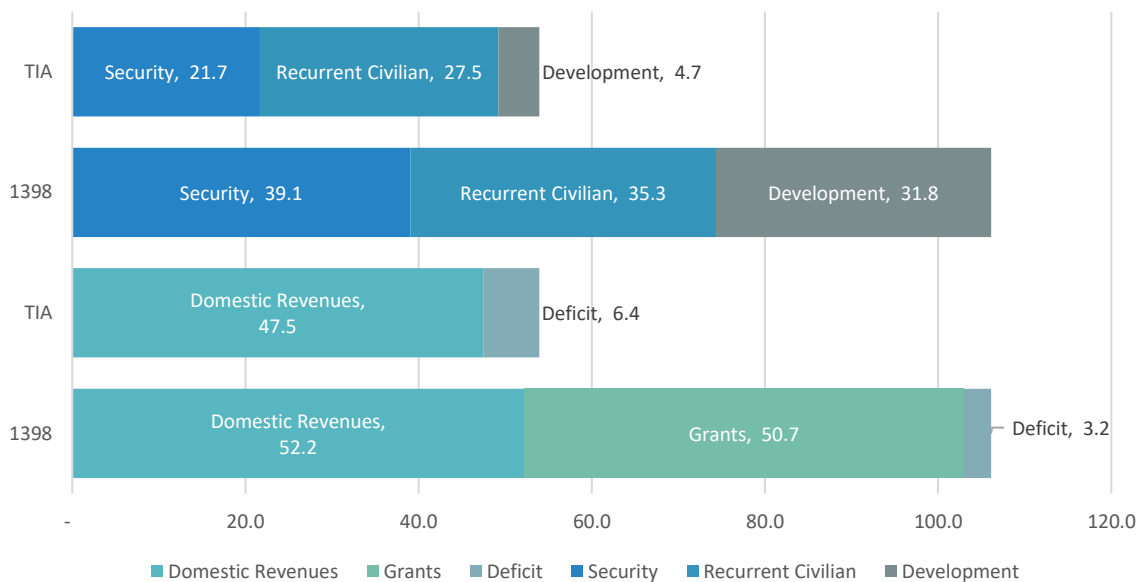
**Limited information is currently available regarding actual expenditures or future budget plans.** Given likely revenue shortfalls and lack of financing options, expenditures are expected to have fallen significantly short of budgeted levels. While pay was initially paused for roughly 420,000 civilian civil servants, World Bank survey data based on a non-representative sample of 267 civil servants suggests that by early March, more than 93 percent of respondents had received salary

payments in the last six months. Payments have not been made consistently, however.<sup>8</sup> The ITA is currently preparing an annual budget for the Solar Hijri year beginning March 21, 2022.

**Afghanistan has ceased servicing its external debt.** Official debt data is not being produced. Afghanistan’s total external debt is estimated at around US\$1.7 billion, consisting almost entirely of concessional loans from multilateral creditors. The external debt-to-GDP ratio is expected to have deteriorated due to recent contractions in output but remain at modest levels. Assuming a 30 percent reduction in GDP, the external debt-to-GDP ratio will increase from around 7.5 percent at end-2020 to around 10 percent. Several debt repayments due to multilateral creditors were missed over late 2021 and early 2022, leading to the accumulation of arrears and creating obstacles for future disbursements.

**Figure 12: The interim budget includes large expenditure cuts and an unfinanced deficit**

Basic Fiscal Aggregates for the ITA Interim Budget vs. Pro-Rate 1398 Budget

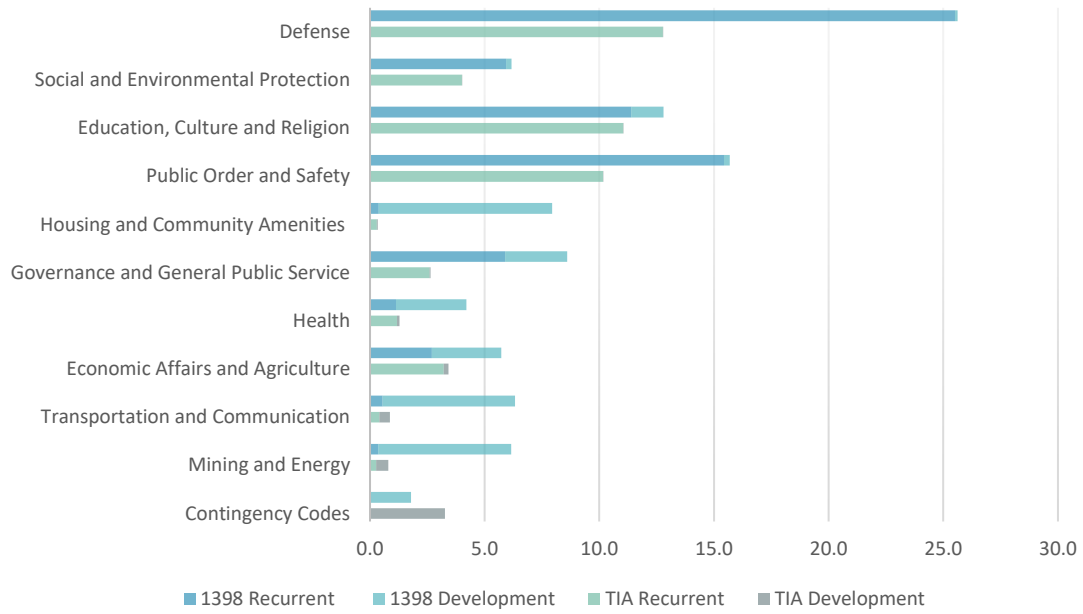


Source: Ministry of Finance

<sup>8</sup> The ITA announced a new civil servant salary pay scale in December 2021. 71 percent of the respondents to the World Bank survey who were aware of these changes indicated that their salaries had decreased.

**Figure 13: The budget sustains recurrent allocations to basic services while cutting security expenditures**

Sectoral Allocations - ITA Interim Budget vs. Pro-Rate 1398 Budget



Source: Ministry of Finance

## 4. OUTLOOK AND MEDIUM-TERM PROSPECTS

### Medium-Term Outlook

**Afghanistan's economic development is subject to enormous uncertainty.** Major sources of uncertainty include: i) the extent and nature of ongoing aid and other forms of international support; ii) policy decisions of the interim administration which may both directly impact economic conditions and confidence, and also influence the space for and direction of international assistance; iii) domestic political and security conditions; iv) domestic weather conditions, which will continue to heavily influence domestic agricultural production; and v) international economic conditions, including prices for key imported goods, which may be heavily impacted by the Russian invasion of Ukraine, war, and associated sanctions.

#### Baseline Scenario

**Under a baseline scenario, current conditions and approaches to international engagement will be retained.** Afghanistan will face: i) international support limited to humanitarian activities and basic core services (health, education, food security, and limited community-based livelihood support); ii) no resolution of current financial sector constraints, including limitations on international payments and limited banking sector confidence and liquidity; iii) continued reliance on cash shipments to meet payment needs of UN agencies; iv) maintenance of current ITA economic policies; and v) no change to the security environment.

**Output is expected to further decline in the short-term.** Under this scenario, the economy is expected to contract further throughout 2022, with real GDP per capita declining by around 34 percent between end-2020 and end-2022, reversing all progress since 2007. Firms will face continued suppressed demand and financial sector constraints to international trade and payments. Financial sector constraints will especially impact formal sector firms subject to AML/CFT controls that cannot meet international payment requirements through informal exchange providers. A significant number of firms that have so far maintained operations through utilizing cash reserves and inventories are likely to exit the market, with further impacts on employment and demand.<sup>9</sup> On the other hand, improved recent weather conditions are expected to support increased agricultural production while continued inflows of USD through humanitarian channels may provide some support to demand and consumption (conversely, any cessation in USD shipments would likely place additional pressure on the exchange rate and dampen overall demand and consumption). Over the medium-term, the economy is expected to return to positive economic growth on a low growth path, reflecting i) low public and private investment; ii) productivity loss through financial sector constraints and associated supply disruptions; and iii) reduced human capital through deteriorating access to and quality of services, and the further curtailment of women's access to private and public sector employment.

**Poverty is expected to worsen, although impacts on rural households may be ameliorated by improved weather conditions.** Urban poverty is expected to worsen over 2022 as i) private sector

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<sup>9</sup> In the recent World Bank private sector survey 40 percent of firms reported they would need loans from banks for working capital in the next six months, while 39 percent of large firms and 59 percent of small firms expected to reduce investment.

activity in main urban centers continues to decline leading to further unemployment; and ii) urban households exhaust savings. Rural poverty conditions will be impacted by the overall economic contraction and continued increased prices for imported inputs such as fertilizer and fuel. However, rural living conditions may be buoyed in the short-term by easing of recent drought conditions, increasing demand for agricultural products from humanitarian agencies, and improved trade access due to reduced security constraints. The recent increase in wheat prices due to the Russian invasion of Ukraine will negatively impact all households, as wheat flour is the most important food staple, accounting for around 12 percent of households' monthly cash expenditures (this share is slightly higher in rural areas and among households in the bottom deciles of the welfare distribution). Households will be forced to either reduce food consumption or switch to lower quality alternatives, increasing food insecurity.<sup>10</sup> Over the medium-term, slow economic growth combined with rapid population growth will lead to a stagnation of economic conditions and continued widespread poverty.

**The financial sector is likely to experience growing pressures.** Private sector credit is likely to further decline, reflecting difficult economic conditions and weaknesses in the funding and broader financial position of banks. Funding pressures are likely to remain elevated as account holders will seek to withdraw available balances. The central bank's capacity to supply liquidity to the banking sector will remain constrained in the absence of access to AFN and USD cash notes. In the context of continuing economic contraction and crippling cash shortages, borrowers' repayment capacity remains under pressure, while non-performing loans are expected to further increase from already high levels (around 20 percent before the August crisis), potentially posing solvency concerns for some institutions. Without further policy measures and reflecting growing pressures on funding and borrowers' repayment capacity, the medium-term outlook for the stability and solvency of the financial sector is grim.

**Fiscal pressures are expected to continue, curtailing service delivery.** The ITA are expected to raise revenues of around US\$1.7 billion (Afs 150 billion) over the coming fiscal year, subject to economic conditions and exchange rate developments (this compares to US\$2.7 billion or Afs 208 billion in 2019 – the most recent year of strong collections prior to the COVID-19 crisis of 2020 and Taliban advances of 2021). In the absence of on-budget donor support or financing sources, budget expenditures are expected to decline by around US\$4 billion or 70 percent from pre-crisis levels (see Box 1). Off-budget spending on humanitarian support or off-budget basic services is expected to reach around US\$3 billion, with total public spending reaching just over 40 percent of pre-crisis levels (including security and off-budget spending). Over the medium-term, public expenditures are expected to contract further with further deterioration in economic conditions, lower humanitarian inflows among donor fatigue and competing global priorities, deterioration of IT systems that have supported revenue collections to date, and the likely reemergence of substantial corruption and leakage in the revenue system.

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<sup>10</sup> Rural households may see windfall gains from the increase in wheat prices, as wheat is the most important crop for a third of rural households (40 percent among households in the bottom decile) and the upcoming winter wheat cropping season will coincide with the price spike. However, outcomes for wheat-producing households will depend on how gains will be distributed among the different agents along the wheat production and distribution supply chain (e.g., wholesale traders, intermediaries, lenders, landowners, and retail traders).

**The baseline ‘status quo’ scenario is associated with substantial development and spillover risks.** 40 percent of Afghanistan’s population is under the age of 15. Afghanistan’s population was expected to reach 48 million by 2030 before the recent crisis, and fertility rates may now increase in the context of worsening economic conditions and potential deteriorations in health and education access. Rapid economic contraction followed by sluggish growth will lead to very low and stagnant incomes in the context of rapid population growth. Afghanistan also remains heavily exposed to climate and natural disaster risks, including expected increased frequency of droughts, floods, and extreme heat and cold. The combined impacts of increased poverty, rapid population growth, and climate change and natural disasters will present substantial risks of: i) further poverty and humanitarian crises, necessitating regular, high-cost humanitarian interventions to support basic needs; ii) internal and external displacement risks driven by absence of economic opportunities and increased vulnerability to natural disasters; iii) increased risks of conflict, fragility, and extremism arising from increased contestation over natural resources and deteriorating access to services driving perceptions of exclusion.

### **Economic Stabilization and Recovery Scenario**

**As discussed in previous World Bank analytical work, Afghanistan continues to possess important economic endowments that – under the right conditions – could support strong future growth.**<sup>11</sup> These endowments include: i) a young population and declining dependency ratios; ii) strong agricultural and extractives industry potential; and iii) a geographical location in a dynamic region, with significant potential to benefit from regional trade and infrastructure investments. Afghanistan faces new opportunities to realize its growth and development potential, arising from:

- **Improved security.** The end of active combat (if sustained) may address a previous binding constraint to growth and support future private sector investment. Nearly half of surveyed entrepreneurs reported an overall improvement in the security environment compared to pre-August. These benefits are heavily gendered, however, with only nine percent of female entrepreneurs reporting that security conditions had improved while 66 percent reported deterioration.
- **Reduced corruption.** As above, survey data suggests dramatic reductions in corruption, with more than four fifths of firms that deal with the customs administration reporting that they were no longer required to pay bribes (while being required to do so in the past). If such changes can be sustained, reduced corruption may reduce business costs and increase certainty, addressing another previous major constraint to investment.

**Under a best-case economic stabilization and recovery scenario, Afghanistan would attract international support to mobilize growth sources.** Realizing this scenario would require fundamental changes to current domestic and international policy settings (as discussed below), including: i) international support across areas beyond basic human needs, supporting increased public investment; ii) easing of current financial sector constraints, including improvements in international payment flows and strengthened banking sector confidence and liquidity; iii)

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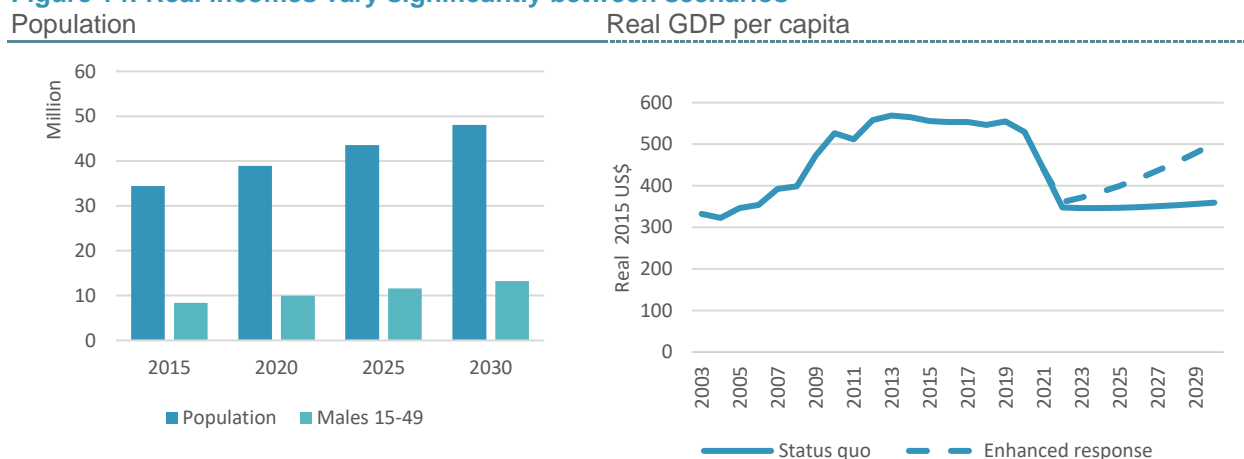
<sup>11</sup> World Bank (2018) Afghanistan to 2030: Priorities for Economic Development Under Fragility, World Bank, Washington DC.



improvements in political confidence; iv) associated increases in private investment; iv) eased constraints to women’s economic participation; and v) no change to the security environment.

**Under this scenario, the medium-term economic outlook is significantly improved.** Through the quick implementation of actions to foster economic recovery and growth, the short-term reduction in GDP per capita would be slightly moderated (per capita incomes would decline by around 26 percent). More importantly, with major changes to domestic policy settings and much broader international support, Afghanistan would move towards significantly faster growth over the medium-term, mobilizing agriculture and extractive sectors to achieve annual growth of around six percent. This would drive a relatively strong recovery in per capita incomes, with GDP per capita returning to close to 2020 levels by 2031. Faster rates of economic growth would be associated with rapid employment creation and the generation of fiscal resources to support service delivery, mitigating spillover and fragility risks.

**Figure 14: Real incomes vary significantly between scenarios<sup>12</sup>**



Source: UN Department of Economic and Social Affairs

Source: World Bank staff calculations

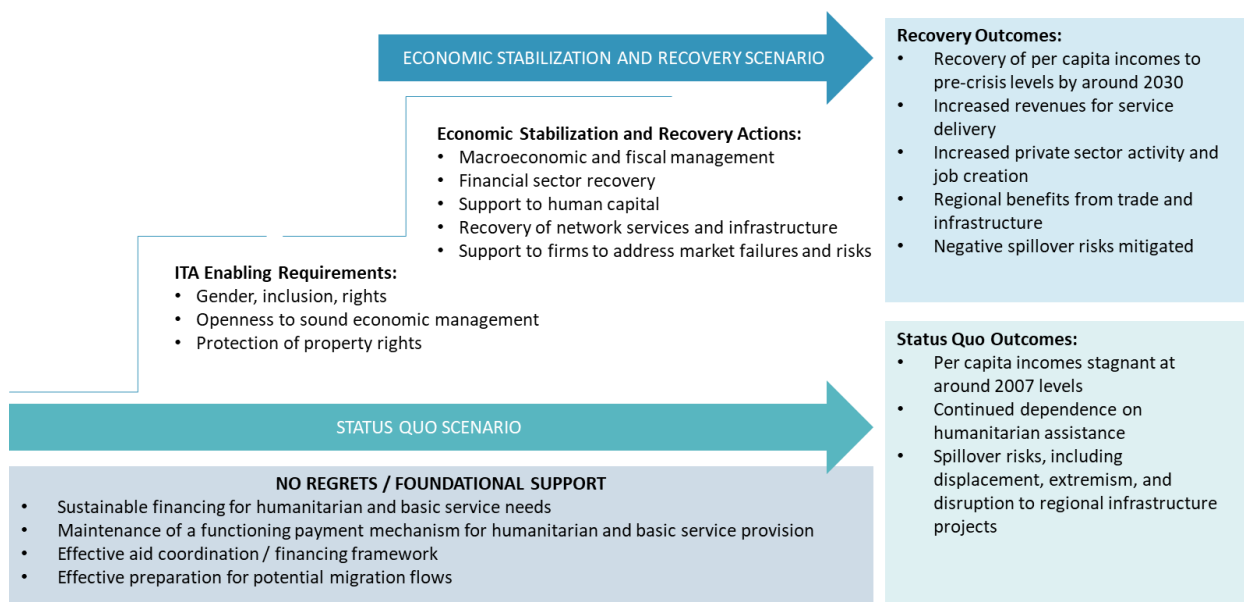
## Implications for Policy

**A framework for economic stabilization and recovery is shown in Figure 15.** The international community must take no-regrets action for the effective and coordinated provision of support to critical basic needs. Moving towards the economic stabilization and recovery scenario will require additional action by both the ITA and the international community. The ITA must meet minimum

<sup>12</sup> The economic recovery and stabilization scenario includes much faster rates of economic growth based on the following modeled assumptions: i) higher combined public and private investment (by around 10 percent of GDP) reflecting increasing business confidence and an improved investment environment, combined with slightly increased aid grant inflows; ii) increased labor force participation reflecting eased constraints to women’s economic participation (three percentage points higher than the baseline by 2030); iii) total factor productivity growth of around 0.6 percent per year, relative to negligible growth under the baseline scenario, reflecting investment in human capital and infrastructure and an improved business environment.

enabling requirements to both provide confidence to the international community and establish the core policy and institutional conditions for economic growth. If the ITA meets these requirements, a range of additional economic stabilization and recovery actions could be implemented (with the support of the international community) to facilitate sustainable, private sector led economic development.

**Figure 15: Framework for economic stabilization and recovery**



Source: World Bank

### No regrets support from the international community

#### **Under any circumstances, international assistance will be required to meet basic human needs.**

Given the scale of the current economic crisis, international assistance will be required to support basic needs for a sustained period (even under an optimistic scenario, per capita incomes are unlikely to recover to 2020 levels until at least 2031). Basic support from the international community should be provided as efficiently and effectively as possible. This should involve:

- **Provision of medium-term financing commitments for basic human needs at adequate but sustainable levels.** Commitment of financing on a medium-term basis may allow progress beyond short-term emergency appeals, facilitating certainty for planning and implementation.
- **Maintaining or establishing new mechanisms for funds transfer for humanitarian and basic service activities.** Financing for basic needs must be able to be effectively transferred to and utilized within Afghanistan. This could be achieved through the maintenance or scaling up of the existing cash shipment program, or the implementation of the planned Humanitarian Exchange Facility, which would support both humanitarian agencies and selected private sector firms needing to make overseas payments (see Box 4).

- **Development of new aid coordination mechanisms and a financing framework for basic needs.** Afghanistan's recent history illustrates that aid inflows can have serious and long-term negative economic and political impacts if not adequately planned, managed, and coordinated. To avoid mistakes of the past, mechanisms need to be established to ensure effective alignment of increasing aid inflows with country priorities. This should involve: i) agency-level coordination of activities across all 180+ agencies currently delivering support within Afghanistan; ii) mechanisms for coordination between existing and new multilateral or bilateral funding streams, including the World Bank ARTF, the ADB, the IsDB, the UNDP Afghanistan Special Trust Fund, the European Union and other bilateral mechanisms; iii) mechanisms for frequent technical dialogue on economic recovery issues between the international community and the ITA; and iv) development of a joint financing framework, specifying the respective financing responsibilities of the international community and the ITA, in order to address overlaps and gaps and prevent the inadvertent generation of fiscal space for low-priority ITA spending.

**The international community should also take measures to support management of potential migrant flows.** Afghans have a long history of migration in response to changing country conditions. Current economic conditions may drive further outflows of primarily young, rural, and male migrants seeking new economic opportunities abroad. The international community can work with regional partners to support economic integration of migrants into receiving countries, mitigating long-term costs and maximizing potential benefits.

**Box 3: Challenges and risks associated with increasing international support**

Afghanistan currently faces important constraints to efficient and coordinated international support. Assistance is being provided in a context where i) pre-August 15 aid coordination mechanisms are no longer operational or fit-for-purpose, given the current status of the ITA; ii) international assistance is being channeled entirely through multiple off-budget channels, precluding the typical role played by the annual budget and national programs in supporting coordination; iii) many international partners have limited engagement with the ITA to support alignment and coordination of expenditures; and iv) limited mechanisms are in place for citizen voice and accountability in setting assistance priorities and monitoring implementation and results.

The combination of rapidly increasing assistance in the context of limited institutional mechanisms for effective aid coordination and management poses significant risks. These risks include i) the generation of economic distortions, including within the labor market and markets for other critical inputs; ii) negative political and fragility impacts, including capture and contestation over aid resources; iii) inefficiency, waste, and corruption including through duplication, overlaps, and inadequate monitoring mechanisms; iv) creation of perverse incentives and moral hazard for the ITA, with international assistance resources creating fiscal space for security or other low priority expenditures financed from the ITA's substantial own-source revenues.

#### **Box 4: The Humanitarian Exchange Facility**

The United Nations agencies, UNAMA, UN-OCHA and the World Bank Group have been working together in close coordination with other development partners to address the financial sector constraints to humanitarian delivery. The World Bank Group has worked in tandem with international partners to design and establish the Humanitarian Exchange Facility (HEF) as a temporary measure to facilitate payments and to complement USD cash shipments until a more permanent solution is found. The design of the HEF was part of this collaborative effort which started in October 2021, the results of which were summarized in a joint seminar in mid-December 2021.

The HEF will provide a matching mechanism between private businesses in need of USD abroad and humanitarian/development agencies requiring AFN liquidity in Afghanistan. The HEF will aim to mobilize Afghani cash holdings of local businesses and make them available to international agencies for humanitarian purposes in Afghanistan, in exchange, international agencies will provide USD for payments of goods and services abroad on behalf of participating Afghan businesses.

The HEF will provide a clearing house mechanism to take receipt of USD funds from humanitarian actors, before sourcing equivalent AFN liquidity from eligible Afghan entities. The local currency cash deposited into the HEF on-shore account(s) will be considered as a "fresh deposit", and then processed onwards to UN agencies based on a priority schedule determined by the Humanitarian Country Team under leadership of the Humanitarian Coordinator for in-country expenditure. In return, the USD received by the HEF from Humanitarian actors into its offshore account will be used to pay for import invoices of the same Afghan entities, allowing them to settle their outstanding trade payables and to continue to import goods and services. The HEF will be managed by UNOPS who will manage the HEF workflow. The Facility Manager will open and manage the HEF accounts (one off-shore and one/multiple on-shore) and manage the facility.

#### **Enabling requirements to be met by the ITA**

**The ITA should implement measures to open space for increased international engagement and sustainable economic growth.** Firstly, the ITA should adhere to basic standards for the treatment of women and girls and respect for human and democratic rights. Without adherence to basic standards on gender and rights, increased international support for economic recovery and stabilization is unlikely to be forthcoming. Secondly, the ITA should signal clear commitment to broadly sound macroeconomic management, including in relation to monetary, exchange rate, and fiscal policies. Finally, the ITA should establish an adequate legal and institutional framework for the protection of private property rights. Without openness to sound overall economic management measures, any international support to economic stabilization and recovery is unlikely to be effective.

#### **Economic stabilization and recovery actions**

**Once required actions were undertaken by the ITA, a range of additional actions would be required to move from the status quo to the economic stabilization and recovery scenario.** Required measures would include:

- **Reestablishing sound macroeconomic and fiscal management.** Sustainable economic recovery, private investment, and the restoration of confidence will depend upon a stable macroeconomic environment. Progress in this direction could involve the development and

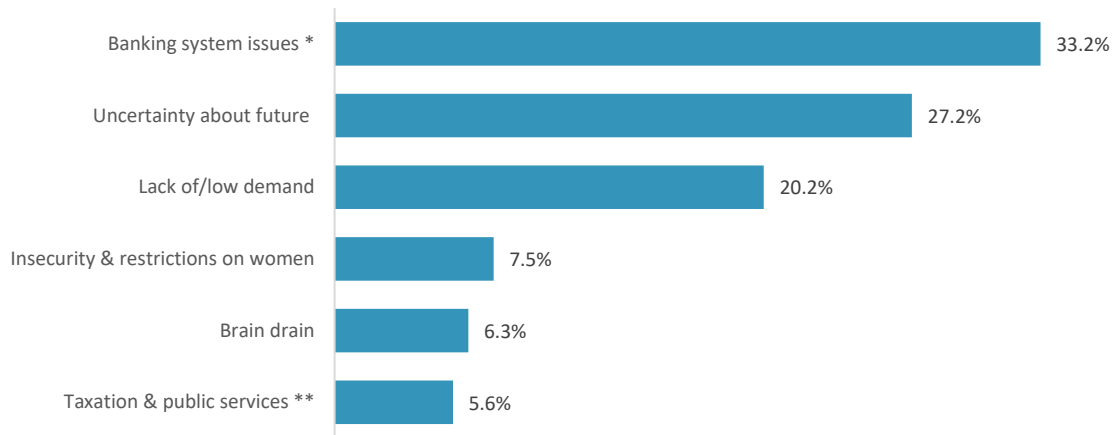
- implementation of a credible macroeconomic adjustment plan, and the provision of technical assistance and advisory support to central agencies to fill existing major capacity gaps. This could include: i) technical advisory support for monetary, exchange rate, and fiscal policies; ii) technical support for collection, analysis, and publication of economic statistics; and iii) advisory and system support for revenue policy and administration and expenditure management.
- **Restoring broader functions of the financial sector.** Financial sector dysfunctions currently represent a binding constraint for many formal businesses and threaten to drive further business closures (Figure 16). Efforts to restore financial sector functioning could include: i) restoring the central bank's access to AFN note supply through resumption of supply contracts; ii) technical assistance and system support to the central bank to restore functionality of the domestic payment system (including support the national payment switch); iii) technical assistance to the central bank to restore AML/CFT functions<sup>13</sup>; iv) efforts to encourage international banks to resume international correspondent banking relationships; and v) restoration of the central bank's USD funds and note supply. This package of support could be conditioned upon articulation and implementation by the TIA of an internationally accepted plan for: i) adequate governance (including independence) and management of the central bank and operational autonomy of financial sector supervisory authorities; ii) implementation of agreed steps towards effective macroeconomic and financial sector management; and iii) implementation of required AML/CFT measures.
  - **Support to human capital beyond basic services.** Afghanistan's long-term development will depend on efforts to address human capital deficits. Efforts to support human capital acquisition could involve broadened technical, institutional, policy, and financing support to secondary and tertiary health (beyond current support to primary healthcare through outsourced NGO contracting models). Support to education could be broadened to include policy and institutional capacity support, including emphasis on improving education outcomes. If necessary, assistance could be channeled through UN agencies or other off-budget providers.
  - **Recovery of network services and infrastructure.** Sustainable provision and expansion of infrastructure access will be critical to support both human and private sector development. Firms currently report disruptions to electricity access, while the financial and technical sustainability of energy and water utilities and telecommunications infrastructure is unclear given difficult current economic conditions and the loss of skilled staff during the August crisis. Such efforts could be complemented by support to regional infrastructure initiatives, including in transport, energy, and telecommunications. If necessary, such support could be provided directly to the state-owned enterprises and independent agencies that operate and regulate infrastructure, or delivered through other of-budget channels, bypassing direct influence of the ITA.
  - **Support to SMEs to help manage market failures and risks.** Under any future scenario, Afghan firms are likely to face major political risks and experience limited access to finance. Additional international support could be provided to firms to i) address credit market failures

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<sup>13</sup> Restoration of AML/CFT functions and capacities could potentially allow for central bank auctions of USD supplied through UN shipments.

and provide access to finance; ii) help mitigate or manage political risks; iii) access procurement and other opportunities arising from scaled up international humanitarian support; and iv) build capacity in critical areas, including for women entrepreneurs and business-owners.

**Figure 16: Top constraints faced by businesses (% of respondents)**



Source: World Bank Afghanistan Rapid Private Sector Survey

\* "Banking system issues" includes (i) limited functionality of banking system, (ii) lack of liquidity/cash, (iii) issues with access to bank loans or additional funding, (iv) limited functionality of hawala system, and v) issues with formal payments for imports and exports

\*\* "Taxation & public services" includes (i) higher tax rates, (ii) higher unofficial payments, and (iii) low capacity of authorities.

## SPECIAL FOCUS – COSTS OF PROVIDING BASIC SERVICES

This special focus section examines the cost of providing basic services in Afghanistan. To inform ongoing discussions regarding the cost and sustainability of international financial support to basic service delivery, we present indicative estimates of 2019 costs of providing various packages of services. We then compare these estimated costs against expected available ITA resources to derive a notional funding gap. This funding gap would need to be filled from grant resources to restore spending to 2019 levels.

Adjusting for inflation and exchange rate movements, the funding gap to restore spending on health and education to 2019 is calculated at between US\$823 million and US\$1.0 billion.<sup>14</sup> The funding gap to restore services across all civilian sectors is calculated at between US\$3.1 billion and US\$3.9 billion. The relatively modest size of estimated financing gaps relative to recent humanitarian needs estimates reflects the efficiency of previous approaches under which services were delivered through national programs. National program approaches provided economies of scale, allowed heavy use of local staff and inputs, and leveraged established institutional delivery mechanisms.

It is important to note that restoring spending to 2019 levels may not be sufficient to meet basic human needs. Certain public services were likely underfunded in 2019. Service delivery needs may also have recently increased given sharp deteriorations in living conditions. Delivering basic services through humanitarian and other off-budget channels will also inevitably increase costs. A key takeaway from this analysis is that the costs of providing basic services are likely to be reduced over time if progress can be made towards restoring the use of country systems and national program approaches.

### Expenditures for basic service delivery using national systems

We begin with ITA annualized budgeted expenditures as laid out in the interim budget.<sup>15</sup> We adjust these annualized budgeted expenditures by sector downward by 27.3 percent to account for the expected shortfall in ITA revenues (compared to budgeted levels) and the unfinanced deficit.<sup>16</sup> We assume that security expenditures will be fully covered as per the ITA annualized budget, and that required spending reductions are then proportionally allocated across all civilian expenditures.

We then estimate the funding gap between ITA adjusted planned expenditures and 2019 expenditure levels. We calculate the funding gap using three different service delivery packages. For the first package (“health and education”), we calculate the funding gap between ITA allocations and 2019 expenditures only on health and education. For the second package (“core

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<sup>14</sup> 2019 expenses in AFN are converted into USD using the average exchange rate for 2019 (1 USD @ AFN76.18). For the ITA annualized budget, an exchange rate of 1 USD @ 94.58 AFN is used. Further adjustments are made for inflation and depreciation, with these impacts roughly equivalent.

<sup>15</sup> Annual ITA estimates are based on annualization of the ITA quarterly budget, covering the first quarter of the 1401 fiscal year.

<sup>16</sup> 17.5 percent shortfall in revenue and 9.8 percent unfinanced deficit.

services”) we calculate the funding gap between ITA allocations and 2019 expenditures on health, education, agriculture, food security, and community development. For the third package (“sustained services”) we calculate the funding gap between ITA allocations and 2019 expenditures across all civilian sectors (security spending is assumed to be reduced to ITA budgeted levels).

Our estimates of 2019 expenditure levels include 2019 off-budget spending on health, education, agriculture, food security, and community development, but exclude off-budget spending in other sectors.

The ITA has already made downward adjustments to civil service salaries and pension payments. Some anecdotal and survey evidence also suggests reductions in corruption and leakage within the public sector. To account for potential savings that could be achieved under the ITA we include a ‘savings’ scenario for each package, which includes: i) 25 percent savings on wage-bill expenditures across all sectors; ii) pension payments at ITA budgeted levels; and iii) a general 10 percent efficiency saving on all other on-budget expenditure items.

The modeled service delivery packages are summarized in Figure 17.

**Figure 17: Summary of service delivery packages and assumptions**

	<b>Package 1: Health and Education</b>	<b>Package 2: Core Services</b>	<b>Package 3: Sustained Services</b>
<b>ITA allocations:</b>	<ul style="list-style-type: none"> <li>General government expenditures as per the annualized ITA interim budget, adjusted for estimated revenue shortfall and unfinanced deficit</li> </ul>		
<b>Funding gap:</b>	<ul style="list-style-type: none"> <li>Gap between adjusted ITA allocations and 2019 on- and off-budget expenditure for health and education.</li> </ul>	<ul style="list-style-type: none"> <li>Gap between adjusted ITA allocations and 2019 on- and off-budget expenditure for health, education, agriculture, food security, and community development.</li> </ul>	<ul style="list-style-type: none"> <li>Gap between adjusted ITA allocations and 2019 on- and off-budget expenditure across all civilian sectors.</li> </ul>
<b>Savings:</b>	<ul style="list-style-type: none"> <li>25 percent savings on wage bill</li> <li>Pensions at ITA budgeted levels</li> <li>10 percent general efficiency savings (on-budget)</li> </ul>		

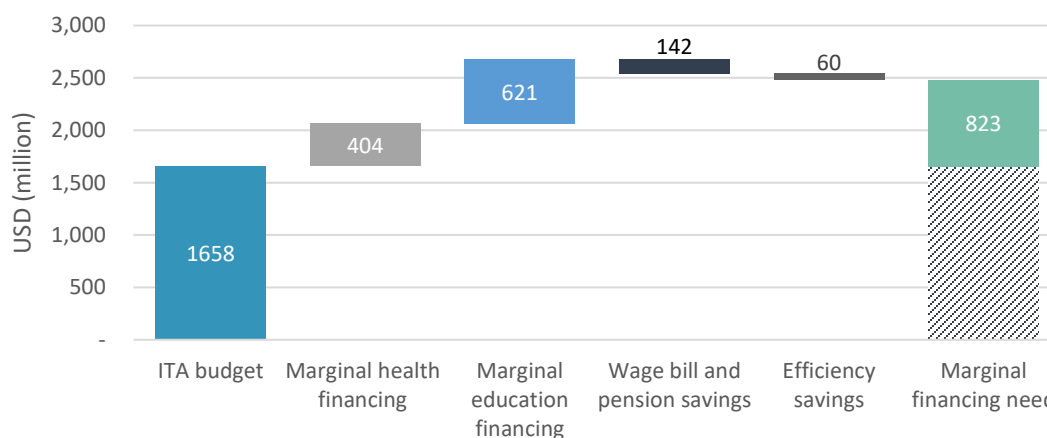
Source: World Bank



## Estimates

Under the first package – health and education – total expenditure needs are US\$2.5 billion, including savings of US\$202 million. US\$1.7 billion of expenditure needs are assumed to be covered by the ITA through domestic revenues. The funding gap to match 2019 expenditure levels (which included sector expenditures financed by on- and off-budget grants), beyond the ITA annualized budget, is US\$823 million (Figure 18).

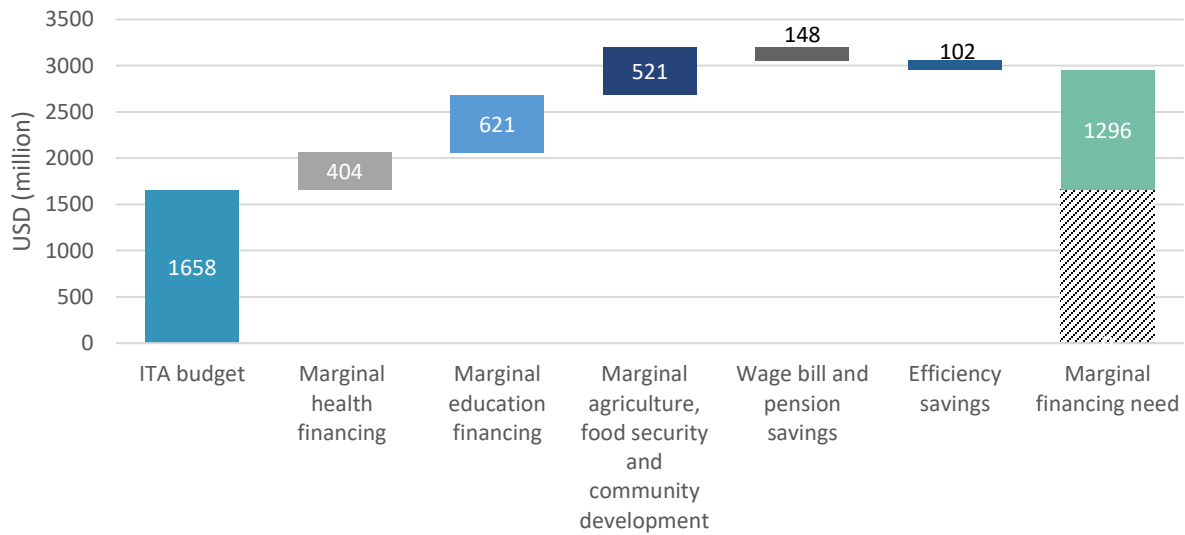
**Figure 18: Spending needs and funding gap under first package (health and education)**



Source: World Bank staff calculations

Under the second package – core services, including health, education, agriculture, food security and community development – total expenditure needs are US\$3.0 billion, including savings of US\$250 million. US\$1.7 billion of expenditure needs are assumed to be covered by the ITA through domestic revenues. The funding gap to match 2019 expenditure levels (which included sector expenditures financed by on- and off-budget grants), beyond the ITA annualized budget, is US\$1.3 billion (Figure 19).

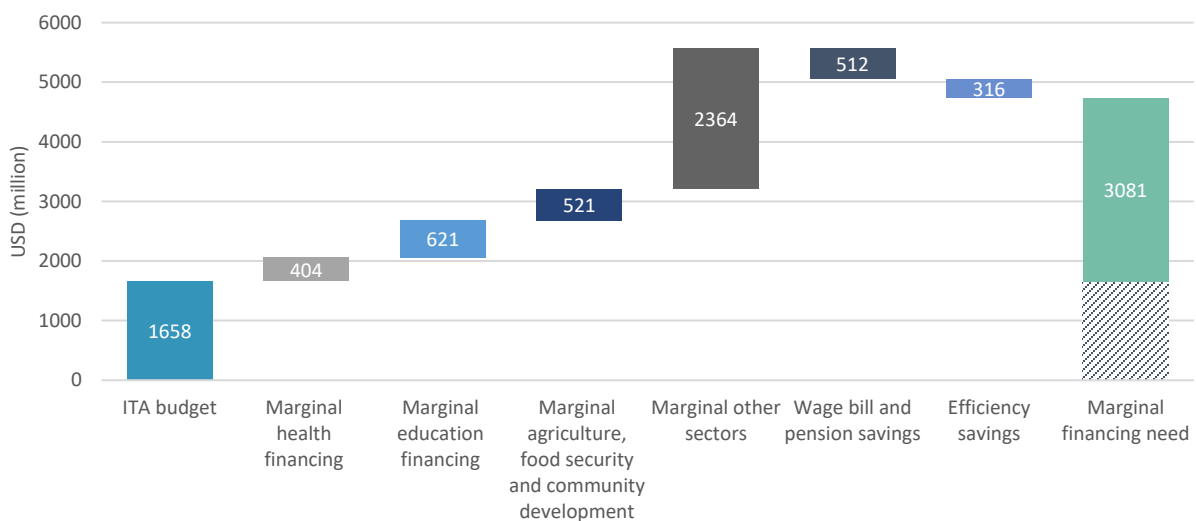
**Figure 19: Spending needs and funding gap under second package (core services)**



Source: World Bank staff calculations

Under the third package – sustaining services levels across all civilian sectors – total expenditure needs are US\$4.7 billion, including savings of US\$828 million. US\$1.7 billion of expenditure needs are assumed to be covered by the ITA through domestic revenues. The funding gap to match 2019 expenditure levels (which included expenditures financed by on- and off-budget grants), beyond the ITA annualized budget, is US\$3.1 billion (Figure 20).

**Figure 20: Spending needs and funding gap under third package (sustained services)**



Source: World Bank staff calculations

## Discussion

The funding gap to restore spending on basic services to adjusted 2019 levels ranges between US\$823 million (package one with savings) and US\$3.9 billion (package three without savings) depending on scenarios and savings. These costs appear relatively modest in relation to current estimated costs for meeting basic human needs through humanitarian channels.

Recent higher cost estimates partially reflect greater needs in the context of economic crisis, and the fact that substantial shortfalls in public funding for basic services already existed in 2019 (for example, the Afghanistan health system has remained heavily reliant on out-of-pocket expenditures, imposing an important burden on poor households). However, these costings also illustrate that the previous model of delivery through large-scale national programs using country systems was highly efficient. Efficiency arose from economies of scale, heavy use of local staff and inputs, and leveraging established institutional and planning structures.

As the international community considers options for future support to basic service needs, it may be useful to consider what interim steps could be taken to move over time towards large-scale, harmonized, national program approaches. In the interim, important measures could be taken to avoid inefficiencies and the creation of unsustainable dependencies in the long run. Such measures could include: i) ensuring salaries do not vary drastically across aid providers and are at levels commensurate with local labor market conditions; ii) maximizing the use of local staff and supplies; and iii) ensuring effective coordination to avoid segmentation, overlap and inefficiencies.





